BUILDING BASIS, BEYOND THE BASICS:

Effective and Efficient Basis Building
Strategies For Your Client

Ellen Harrison
McDermott Will & Emery
Washington, D.C.,

Turney P. Berry
Wyatt Tarrant & Combs
Louisville, KY

Paul S. Lee
The Northern Trust Company
New York, NY
Powers of Appointment & “Upstream” Planning
Powers of Appointment: How Restrictive?

- **Testamentary power**;
- Exercisable in favor of creditors of the estate of the powerholder;
- With the consent of a non-adverse party;
- To the extent of available exclusion amount; and
- Only over assets that benefit the most from a “step-up”

**“Limited Power of Appointment”**

- Inter-vivos or testamentary
- Exercisable in favor of:
  - Powerholder,
  - Estate of powerholder, and
  - Creditors of the estate of the powerholder
- Over all assets.

**“General Power of Appointment”**

Very Limited

Very Broad
Granting Powers of Appointment

Modify trust to grant testamentary general power to G2

Grantor (G1) → Irrevocable Trust → Lifetime Beneficiary (G2)
(Gross Estate of $1 MM) → Remainder Beneficiary G3
Powers and Multiplying the Applicable Exclusion

- Testamentary General Powers of Appointment
  - Formula clause: each beneficiary’s unused Applicable Exclusion Amount (estate and GST tax), specific to asset that would most benefit from “step-up” in basis, and in default in further trust.
  - Independent trustee/protector giving testamentary general power of appointment to beneficiary.
  - Modification of existing trusts or decanting.

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Grantor (G1) ➔ Grandfathered or GST Tax Exempt Trust (Dynasty Trust)

3 Children (+ Spouses?) (G2)
3 x Applicable Exclusion

10 Grandchildren (+ Spouses?) (G3)
10 x Applicable Exclusion

[#] Great Grandchildren (G4)
[#] x Applicable Exclusion
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Upstream Planning: “Accidentally Perfect” Grantor Trust

Older Generation

IDGT

“Zeroed-Out” Transfers

Younger Generation

Testamentary General Power of Appointment (Lapse/Failure of Exercise)

Available Applicable Exclusion?

Available GST Tax Exemption?

Income Tax Considerations

“Step-Up” in Basis § 1014(b)(9)

GST Tax Exempt Trust f/b/o Younger Generations

Grantor Trust § 1.671-2(e)(5)
What about Crummey gifts to the IDGT?

Older Generation

Guarantees Note

IDGT

Asset A
AB/FMV
$0/$10 Mil.

Promissory Note
($10 Mil.)

Younger Generation

Testamentary
General Power of Appointment

Available
Applicable
Exclusion
Amount?
Upstream GRAT Remainders?

End of GRAT Term

Older Generation

GRAT

Younger Generation

Testamentary
General Power of Appointment
Basis Planning with Foreign Trusts and Entities
U.S. Estate Tax of Non-U.S. Citizens and Domiciliaries

**U.S. Estate Tax: U.S. Situs Assets**

- Real and tangible property located in the U.S.
- Stock of U.S. corporations
- Debt obligations of U.S. persons, except:
  - U.S. bank deposits
  - Portfolio debt
- Interest in partnerships (possibly)
  - Holding U.S. situs assets
  - Organized in the U.S.
  - Doing business in the U.S.
- Trusts
  - Look through to underlying assets

**No U.S. Estate Tax: Non-U.S. Situs Assets**

- Real and tangible property located outside the U.S.
- Stock of foreign corporations
- Debt obligations of Non-U.S. persons
- Stock of a Non-U.S. corporation
- Life insurance on non-resident alien insureds
§ 672(f)—Foreign Grantor Trust if:

- “[P]ower to revest absolutely in the grantor title to the trust property… exerisable solely by the grantor without the approval or consent of any other person or without the consent of a related or subordinate party who is subservient to the grantor,” or
- “[O]nly amounts distributable…during the lifetime of the grantor are amounts distributable to the grantor or the spouse of the grantor.”
“Step-Up” in Basis

§ 1014(b)(2): Revocable and Retained Income Trusts

“Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust.”

§ 1014(b)(3): Retained Control Trusts

“Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent with the right reserved to the decedent at all times before his death to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.”

§ 1014(b)(4): Exercised Testamentary General Power of Appointment

“Property passing without full and adequate consideration under a general power of appointment exercised by the decedent by will.”
“Basing-Up” With Foreign Holding Companies

Non-Resident Alien (Deceased):
U.S. Beneficiary

Foreign Grantor Trust

Foreign Holding Company

U.S. Situs Assets

AB/FMV
$0x/$100x

“Step-Up” in Basis on Shares in Foreign Holding Company

Non-U.S. Situs Assets

AB/FMV
$0x/$100x

“Taxable” Liquidation of Foreign Holding Company
“Basing-Up” With Foreign Holding Companies

Non-Resident Alien (Deceased):
U.S. Beneficiary

Foreign Grantor Trust

U.S. Situs Assets

Non-U.S. Situs Assets

<table>
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<tr>
<th>AB/FMV</th>
<th>$100x/$100x</th>
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Check-the-Box, Timing, CFC, and PFIC Issues

Sec. 14215 of TCJA:
Section 951(a) is amended by striking “for an uninterrupted period of 30 days or more” and inserting “at any time”

Controlled Foreign Corporation & Passive Foreign Investment Company
U.S. shareholder subject to current income taxation and upon liquidation, causing U.S. shareholder to be taxed on the appreciated assets of the foreign holding company.

Check-the-Box Election
- If holding company qualifies for a CTB election, entity becomes either disregarded entity or a partnership.
- If classification of the entity was relevant for U.S. tax purposes, the election is treated as a deemed liquidation.

Foreign Grantor Trust

Non-Resident Alien (Deceased):
U.S. Beneficiary

Foreign Holding Company

U.S. Situs Assets

Non-U.S. Situs Assets
Possible Solution: Tiered Structure

Non-Resident Alien (Deceased):
U.S. Beneficiary

Foreign Grantor Trust

Foreign Corporation #1

Foreign Corporation #2

Foreign Corporation #3

CTB 1 day after DOD

CTB 1 day after DOD

CTB 1 day before DOD

U.S. Situs Assets

Non-U.S. Situs Assets

§ 951(a)(2)

Treas. Reg. § 1.951-1(b)(1)

§ 952(a)

Subpart F Income

Workaround Required?
Closing tax year?
Unlimited company?

§ 332(a)
Not applicable.

No common parent. [See § 1504(a)]

See § 1504(a)
Partnership Basis Stripping and Shifting Examples and Opportunities
Importance of Partnerships in Tax Basis Management

Assets either purchased by the partnership or contributed more than 7 years ago.

Low “Outside” Basis

Younger Partners

Partnership

Older Partners

Low “Inside” Basis

High “Inside” Basis

Assets either purchased by the partnership or contributed more than 7 years ago.
Ancient Alien Theory: 3 Lines of Evolution?

- "Mother Ship" 
  - All Asset (Ex. Assets) Partnership
  - Section 751 "Hot" Assets Partnership  
  - Marketable Securities Partnership

No § 754 Election

- "Mother Ship" 
  - All Asset (Ex. Assets) Partnership
  - Section 751 "Hot" Assets Partnership

§ 754 Election

- Isolated "Aliens"
- Isolated "Hot" Assets

7 Years: A Billion Years in Tax Time
Creating, Stripping, and Shifting Basis
(Even with Marketable Securities)
“Old and Cold” Investment Partnership

Investment Partnership under § 731(c)(3)(C) of the Code:

- Never engaged in a trade business.
- “Substantially all” (e.g., 90%) assets are (have been):
  - Money
  - Stock in a corporation (including pre-IPO shares)
  - Notes, bonds, debentures, or other debt
  - Derivative financial instruments (e.g., options, futures, short positions)
- All distributions to “eligible partners.”

“Mixing Bowl” and “Disguised Sale” Rules Do Not Apply

- All assets purchased by partnership or contributed more than 7-years ago
Debt to Exchange Concentrated for Diversified Position

G1 Partners

G2 Partners

investment Partnership

Stock A

AB/FMV

$0/$100x

OB/CA

$0/$10x

OB/CA

$0/$90x
1. Partnership borrows $90x.

2. Invests $90x in diversified portfolio.

3. G1 solely responsible for partnership liabilities.
Debt to Exchange Concentrated for Diversified Position

G1 Partners

OB/CA $90x/$10x

Liquidating Distribution

OB/CA $0/$90x

G2 Partners

Diversified

Stock A

AB/FMV $90x/$100x ($90x)

AB/FMV $90x/$90x

$754 Election & § 734(b) Adjustment

Debt

Diversified

AB/FMV $0x/$90x

§ 754 Election & § 734(b) Adjustment
1. Sells 90x of Stock A ($81x of AB).
2. Recognizes $9x of gain (+9x OB of G1=$99x).
3. Repays $90x to lender (-$90x OB of G1=$9x).
Basis Shifting With Grantors And Grantor Trusts
Grantors, Grantor Trusts, and Partnerships

- **Partnership**
  - IDGT
  - Asset A: AB/FMV $0/$100x
  - Asset in Need of Basis

- **S Corporation**
  - ~1%
Grantors, Grantor Trusts, and Partnerships

Partnership

Grantor

IDGT

OB/CA
$100x/$200x

Unitary Basis and Capital Account

S Corporation

~1%

Asset A
AB/FMV
$0/$100x

Asset B
AB/FMV
$100x/$100x
Loss of Grantor Trust Status Is a Deemed Transfer

Grantor

50% Interest

Non-Grantor Trust

OB/CA
$50x/$100x

Partnership

S Corporation

~1%

Asset A
AB/FMV
$0/$100x

Asset B
AB/FMV
$100x/$100x
Disguised Sale or Mixing Bowl Issues?

**Grantor**

**S Corporation**

**Partnership**

**Asset A**
- AB/FMV: $50x/$100x
- § 754 Election & § 734(b) Adjustment

**Asset B**
- OB/CA: $50x/$100x
- AB/CA: $50x/$100x
- OB/CA: $50x/$100x
- AB/CA: $50x/$100x

**Non-Grantor Trust**

- OB/CA: $50x/$100x
- AB/CA: $50x/$100x

- $0x of Gain as long as Asset A contributed at least 2 years ago

- ~1%
Making a Trust a “Grantor Trust” as to Another Trust?

- **PLR 201633021**
  - **Trust 1**
    - Grantor deceased.
    - F/B/O children, spouse, and issue.
    - Trustee proposes to transfer assets to Trust 2.
  - **Trust 2**
    - F/B/O children, spouse, and issue.
    - Trust 1 retains sole power to revest net income of Trust 2.
    - Lapses on the last day of the calendar year.
    - “Net income” includes income under § 643(b) and capital gain.
Sharing Basis Between Non-Grantor Trusts

Non-Grantor Trust (Former SPLAT)

Surviving Spouse QTIP Trust

Non-Grantor Trust 1

QTIP
“Grantor Trust” of Trust 1

Trust 1 Assets

AB/FMV
$0/$50x

S Corporation

~1%

Partner

 Partnership

QTIP Assets

AB/FMV
$50/$50x
Sharing Basis Between Non-Grantor Trusts

- **Non-Grantor Trust 1**
- **Unitary Basis and Capital Account**
- **QTIP “Grantor Trust” of Trust 1**

**OB/CA**

$50x/$100x

**S Corporation**

~1%

- **Partnership**

- **Trust 1 Assets**
  - AB/FMV: $0/$50x

- **QTIP Assets**
  - AB/FMV: $50/$50x
Sharing Basis Between Non-Grantor Trusts

- **Non-Grantor Trust 1**: OB/CA $25x/$50x
- **S Corporation**: ~1%
- **Partnership**: AB/FMV $50/$100x
- **Non-Grantor Trust**: QTIP OB/CA $25x/$50x

50% Interest connection between Non-Grantor Trust 1 and Non-Grantor Trust.
Sharing Basis Between Non-Grantor Trusts

Non-Grantor Trust 1

OB/CA $25x/$50x

Non-Grantor Trust

OB/CA $25x/$50x

Liquidate Partnership (at least 7 years later)

S Corporation

~1%

Partnership

Partnership Assets

AB/FMV
$50/$100x
Sharing Basis Between Non-Grantor Trusts

Non-Grantor Trust 1

Trust 1
Assets
AB/FMV
$25/$50x

QTIP
Non-Grantor Trust

QTIP
Assets
AB/FMV
$25/$50x
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