52nd Heckerling Institute on Estate Planning-Wrap Up

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A KEY ESTATE PLANNING GUIDE

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5 Topics

- 1-Planning for increased temporary exemption.
- 2-Large estate planning during the current window of opportunity.
- 3-Trusts – new planning/drafting approaches.
- 4-199A – some additional thoughts.
- 5-Miscellaneous planning ideas post TCJA.

1-Increased Temporary Exemption

- Incredible planning opportunity.
- Use it or lose it – must explain this to clients (2025 sunset; legislative change before).
- Wealth - Look at client's current and future wealth. Net Worth $5M might be $10M+ in 2026.
- Complex/inconsistent goals for "moderate" wealth clients: access, income tax issues, completed gift challenges.
- UHNW clients: business as usual, augment existing plans.

1-Common Plans to Use Doubled Exemptions

- SLATs: Non-reciprocal spousal lifetime access trusts ("SLATs") to use exemption but preserve access.
  - Avoiding reciprocal trust status.
  - Power to loan to permit access to assets.
- DAPTs: (variants - power to add settlor as beneficiary, or distributions to settlor in discretion of non-fiduciary).
- Basis: Consider 2038 power and other mechanisms to include in estate.

1-Asset Protection and Irrevocable Trust Planning

- Large use it or lose it exemptions will encourage gifting larger portions of wealth to secure temporary exemptions.
- Loosen old rules of thumb on percentage of wealth that can be transferred?
- Solvency affidavits and other due diligence - use more with greater portions of wealth transferred?
- Access to transferred assets if more of wealth transferred is critical. Reconsider: long term care and life insurance to protect transferors.

2-Large Estate Ideas – Sale to <u>Non</u>-Grantor Trust

- Sales to non-grantor trusts.
- Assets stepped up on spouse’s death so no gain.
- Fractionalize sale between sale to grantor and non-grantor trusts.
- If pass on 1st spouse’s death to QTIP need right to distribute. HEMS standard – will it work?
- Defined value clause must be two tier as there could be both income and gift tax audits.

2-Large Estate Ideas – Collateral Swap idea

- Sales to existing irrevocable trusts.
- Trust has grown substantially and has significant assets.
- Typical note sale transaction sell stock to irrevocable trust for note and secure with stock sold.
- Consider using different assets of the old trust as collateral for the note and not the asset sold.
- Does that reduce the link for challenge?

3-Asset Protection Planning-Are Non-Grantor Trusts Needed?

- Physician wants asset protection planning. Net worth $14 million. Under prior law would have had large estate tax. Creating and funding an irrevocable trust provided valuable tax as well as asset protection benefits. Under current law there is no tax benefit. Does that taint planning as solely for asset protection purposes?
- If use a non-grantor trust plan that provides immediate income tax benefit does that again provide a tax cover for the asset protection plan?

3-Trusts Structuring- SALTy SLATs

- Might these clients be able to structure completed gift (unlike the ING trusts), non-grantor (like the ING trusts) trusts to achieve multiple goals use temporary exemptions, access assets, and save SALT?
- Trust may distribute income to the client/settlor’s spouse, or accumulate for future distribution to the settlor’s spouse, all subject to the required consent of adverse party, and not be characterized as a grantor trust. IRC Sec. 672(a).
- An adverse party is a person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power. This might include trust beneficiaries, such as an adult child (Consideration must be given, of course, to whether an adverse party consenting to the gift would be making a gift.). 2514 default remainder beneficiary is an adverse party. ING strategy provides concepts.

3-SALTy SLATs Owning your Homes

- Use non-grantor trusts to multiply property tax deductions in high tax states to minimize SALT limitation impact.
- Transfer house and/or vacation home to an LLC. Election out of partnership status.
- Gift LLC interests to non-grantor trusts - SALTy SLATs.
- Each trust should qualify for a separate $10,000 property tax deduction.
- Be certain SALTy SLAT has enough income to offset property tax.
- Loss of Sec. 121 home sale exclusion. Convert back to grantor trust if SALT rules modified in future or if planning to sell house and want to start home sale 2 out of 5 ownership period.
- IRC Sec. 643(f): "…under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if— (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person…" SIIH Partners, 150 TC No. 3 (if no regulations issued the provision has no teeth).

3-SALTy SLATs – Drafting Tips

- Start with a form for a BDT.
- Trust should intentionally omit the swap power and other powers that might make it grantor as to the settlor.
- Delete the Crummey power included to make the trust grantor as to the beneficiary.
- Add requirement for approval or provide veto to non-adverse party on distributions to spouse.
- Form in trust friendly jurisdiction.

3-Trusts Structuring- Traditional INGs Post TCJA

- UHNW clients used incomplete non-grantor trusts to shift income out of the reach of state tax authorities. These trusts were funded with incomplete gift transfers and were structured to avoid grantor trust status. Large capital gain on the sale of stock earned inside ING avoids high SALT in a high tax state.
- NY Legislated against INGs – incomplete gift deemed grantor trust.
- Pending New York legislation, real estate tax could be deducted without limit and even if the taxpayer took a standard deduction on the federal return. Thus, using an ING in New York: non-grantor trust would be treated as a separate entity for federal purposes; and it would be treated as a grantor trust for New York purposes, which would result in the real estate tax deduction flowing through to the grantor's return for New York purposes (without limit).
- Post TCJA the ING is a great tool for ultra-wealthy clients that have used all of their exemptions and do not need to access assets in irrevocable trusts. For a large swath of clients it will not be the optimal trust structure.

3-Trusts Structuring- The Completed Gift "ING"

- Another variation in planning may occur because of the SALT changes and the doubled estate tax exemption.
- Clients with moderate (relative to the new high exemption amounts) wealth, who reside in high tax states, a different variation of all the above planning might be preferable if feasible to achieve. These clients, perhaps in a wealth strata of $5-$40 million may be sufficiently wealthy that estate tax planning should continue because the higher doubled exemptions may be rolled back in the future.
- These taxpayers are not be so wealthy that they can afford to give up access to those trusts.
- With the SALT deduction restrictions or elimination it may be prudent to shift investment income to a different no tax jurisdiction.
- Strip out powers given to grantor in ING trust that make it incomplete. Article forthcoming to describe which and why.

3-Trusts Structuring- BDITs

- Variation of the Beneficiary Defective Trust (“BDT”) to address the SALT restrictions of the TCJA?
- In the traditional BDT (BDIT) the parent may create a BDT for a wealthy child with a $5,000 initial gift, so that the child could sell assets to the trust without triggering capital gain because the BDT would be grantor as to the child. A good plan, but how can this be spun for the Act?
- If the parent lives in a high tax state and the child in a no tax state, might a variation of the typical BDIT approach be used by the parent to shift income to a lower SALT environment to save SALT when they are no longer deductible?
- Mom gifts $5,000 to a BDIT that is grantor to son in a low tax state. Mom then directs business opportunity to the trust which has no discernable gift tax value. Bross Trucking. The income generated will be reported by son in the no tax state. The value of the business opportunity would be grown outside the parent and child’s estate in contemplation of the sunset of the estate tax repeal.

3-Charity, Tithing and New Standard Deduction Regime

- Most taxpayers won't beat the standard deduction threshold thereby losing tax benefits of charitable giving.
- Form simple local non-grantor trust with a non-compensated family member trustee. Include 642(c) language.
- Donate enough investment assets to generate sufficient income to pay intended contributions.
- Name heirs as well as charities as beneficiaries and give trustee power to allocate.
- Can donate to charities and get full deduction, or direct to heirs in a given year.

4-199A Is it an SSB? Dividing SSB and Non-SSB Income

- **Example:** A physician operates a practice.
- An FLP, separate from the practice entity, owns the buildings where the practice operates and leases the facilities to the practice entity.
- Another FLP, independent from the practice and the real estate entity, was created by various family trusts and hired a graphics designer and marketing firm. Those contractors created a practice name, logo, slogan, consumer facing website (i.e., one without client data), and related marketing materials that were licensed to the practice. The practice operates under the licensed name, uses the licensed logo and marketing materials on all letterhead, advertisements, signage, website and more.
- Equipment was purchased and held in a third FLP. The equipment FLP leased equipment to the practice.
- These ancillary entities would all seem to be non-SSB's independent of the medical practice. Further, so long as the prices are arm's length for the rents and license fees the earnings in those entities should qualify for the IRC Sec. 199A deduction.
- Consider gifting ownership interests to irrevocable trusts non-grantor trusts each of which has its own threshold amount.

4-199A and 704(e)

- Client wants to maximize 199A deduction but has high taxable income. So gifts business interests to heir in lower income tax bracket below the threshold amount.
- Does it work?
- For a partnership (LLC taxed as partnership, GP or FLP) will IRC Sec. 704(e) and the requirement that capital be a material income producing factor impede the effectiveness of the gift?

4-199A and Real Estate Developers or Fund Managers

- Client wants to maximize 199A deduction but all employees for real estate empire (or investment fund group) are housed in separate management company.
- Can the property LLCs (separate fund entities) contract with the management entity and pursuant to the terms of that contract characterize the management entity as an agent for each property entity (can the management entity opt to be a disregarded entity) and each property entity report a pro-rata (or other appropriate) share of payments for employees and treat those as W2 wages?

4-199A and Large Law and CPA Firms

- Form a REIT with leasehold interests.
- Smaller firms might band together and do the same.
- Leasehold interests are intangibles and cannot qualify for 2.5% calculation (that only applies to tangible property).
- REITs automatically qualify for 20% deduction.

4-199A Restructuring

- As clients restructure business entities to capitalize on 199A consider impact on buy sell agreements, estate plans (what if certain interests/entities are owned by a trust and others are not), etc. The ripple affects to address could be significant.

5-C Corporations and Accumulated Earnings Tax

- Might C corporations that are accumulating earnings in the 21% C corporation solution use permanent life insurance to justify the funds?
- Consider revising buy sell agreements funded with term insurance instead with high cash value insurance.

5-Kiddie Tax and the NIIT

- Is there a change to the implications of this to the Net Investment Income Tax ("NIIT")? "The provision simplifies the "kiddie tax" by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child... Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates…"
- It would seem that the Conference report suggests the application of a trust tax construct such that the threshold amount for NIIT purposes would be the $12,500 figure at which trusts reach the highest tax bracket.
- However, the threshold amount in IRC Sec. 1411 does not appear to have changed so that a child would appear to still qualify for the $200,000 threshold amount.
- So trust distributions to a child beneficiary might still facilitate avoiding NIIT.

5-Tax Preparation Costs No Longer Deductible - 1

- The Act repealed the deduction for tax preparation expenses. Under the provision, an individual would not be allowed an itemized deduction for tax preparation expenses. The provision would be effective for tax years beginning after 2017. Under current law, these expenses are miscellaneous itemized deductions only deductible in excess of 2% of AGI, so many taxpayers may not have received significant benefit in any event.
- **Planning Consideration**: This will likely result in taxpayers revisiting allocation of tax preparation fees as between business endeavors and personal returns preparation. Practitioners should be alert to possible ethical considerations if they bill the incorrect taxpayer (e.g. the client's business instead of the client for personal non-business services).

5-Tax Preparation Costs No Longer Deductible - 2

- Practitioners might protect themselves by cautioning clients in retainer agreements or a footer on bills, concerning the improper payment or allocation of fees.
- **Sample Provision**: “How you allocate legal fees, to various persons, entities or trusts could affect whether the payment is tax deductible. It is important that you use checks drawn on the appropriate accounts for the appropriate entities or persons when paying legal fees. Paying personal expenses from a business entity could be argued by a claimant or tax authority as evidence of your disregarding the independence and legal integrity of the entity. If you personally, or another entity, pays for legal fees for the services rendered to that person, entity or trust inappropriately, the IRS might argue that the payment is equivalent to an impermissible additional gift and that the tax position of the trust should not be respected.”

5-Matrimonial Provisions

- Non-deductibility of alimony on divorces after 2018 is a major issue, but there are other minor ones of importance.
- Personal exemptions for children were commonly negotiated now they are gone.
- 529 plans can be used for elementary and secondary school. Parties may have contemplated only college. Now what?

5-Existing Durable Powers of Attorney

- Revisit gift provisions. Are they useful or necessary considering the exemption doubling? For many clients, the gift provision might warrant elimination by revoking the old power of attorney (“POA”) and executing a new one that expressly prohibits gifts.
- For wealthy clients, they might wish to permit transfers of the exemption amounts but only to specified trusts. This might be appropriate if the clients are wary of using the new exemption amounts but want to facilitate further planning in the event they become incapacitated.

5-Charitable Giving Generally

- Fund donor advised funds ("DAFs").
- Bunch deductions.
- Using IRAs after 70.5.

5-What and how to inform clients, dormant clients and others?

- Differs by practice. Planner with 100 clients can and will respond differently then a planner with 5,000 existing clients.
- Does email work? Older clients often don’t have. Will that suffice?
- Consider a post-card. Extract data from electronic rolodex and email to printing/mailing firm to send.