Martin M. Shenkman's Meeting Notes from Heckerling 2018: Day 1 Morning/Afternoon Notes

These notes are prepared and published quickly without proofreading or review so be cautions that there will be typographical errors, citation omission and mistakes.

Over the course of many years, **LISI** has been delighted to provide members with **Marty Shenkman**'s notes from the proceedings at the **Heckerling Institute on Estate Planning**. Heckerling, as it is affectionately known, is the nation's leading conference for estate planners, attorneys, trust officers, accountants, insurance advisors and wealth management professionals. 2018 is the 52nd installment of Heckerling, and for those not fortunate enough to be in sunny Orlando, the meeting this year runs from Monday, January 22nd through Friday, January 26th.

These materials have been published with specific permission from the **Heckerling Institute on Estate Planning** and **LISI** very much appreciates the courtesy! Because of the length of Marty's commentary, **LISI** has made his notes from the sessions on Monday Morning January 22, 2018 available to members through the following link:

Related LISI Webinars: on February 2, 2018 2pm EST Marty will be joined by Jonathan G. Blattmachr and Joy E. Matak to present a webinar on creative trust planning strategies after the Tax Cut and Jobs Act of 2017 which will reflect ideas gleaned at Heckerling. Click here to register: **[LINK].** On February 8, 2018 1pm EST Marty will present a webinar on planning nuggets gleaned from the week long Heckerling proceedings, the highlights from the extensive notes LISI will publish. Click here to register: **[LINK].**

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in Fort Lee, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and more than 1,000 articles. Marty's latest book, **Estate Planning After the Tax Cut and Jobs**

Act of 2017, is available as an e-book on www.Amazon.com or as a PDF download on www.etateplaning2018.com.

Steve Leimberg recently noted that:

> Every tax professional in the country will (or should be) reading this book! This is the most complex and far reaching tax law passed in the over 50 years I've been studying, teaching, and writing about tax law and this resource arms you not only with the necessary and vital information you need to know but also the thinking and planning concepts of three of the brightest minds in the tax world!

Marty is the Recipient of the 1994 Probate and Property Excellence in Writing Award, the Alfred C. Clapp Award presented by the 2007 New Jersey Bar Association and the Institute for Continuing Legal Education; Worth Magazine's Top 100 Attorneys (2008); CPA Magazine Top 50 IRS Tax Practitioners, CPA Magazine, (April/May 2008). His article "Estate Planning for Clients with Parkinson's," received "Editors' Choice Award." In 2008 from Practical Estate Planning Magazine his "Integrating Religious Considerations into Estate and Real Estate Planning," was awarded the 2008 "The Best Articles Published by the ABA," award; he was named to New Jersey Super Lawyers (2010-15); his book "Estate Planning for People with a Chronic Condition or Disability," was nominated for the 2009 Foreword Magazine Book of the Year Award; he was the 2012 recipient of the AICPA Sidney Kess Award for Excellence in Continuing Education; he was a 2012 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Counsels; and he was named Financial Planning Magazine 2012 Pro-Bono Financial Planner of the Year for his efforts on behalf of those living with chronic illness and disability. In June of 2015 he delivered the Hess Memorial Lecture for the New York City Bar Association. His firm's website is www.shenkmanlaw.com where he posts a regular blog and where you can subscribe to his free quarterly newsletter Practical Planner. His website www.shenkmanlaw.com has information of interest to advisers and you can register for his quarterly planning newsletter Practical Planner.

Heckerling Institute 2018: Monday Morning, January 22

Fundamentals: Starting Off - Issues at the Formation of Closely-Held Business.
Stephanie Loomis-Price, Samuel A. Donaldson and Ivan Taback.

a. TCJA changes.
    i. Effective 2018 and later.
    ii. No special rate for persona service corporations which use to pay flat 25% rate now all C corporation have 21% rate, no special rate for personal services corporations.
    iii. 10 years estimated revenue loss $1.35 trillion.
    iv. Preferential tax rate on dividends continue to apply as before Act There is still a double tax on C corporations but instead of 35% followed by dividend and NIIT tax of 3.8% that double tax bite has been mitigated by 21% rate. $100 income, pays $21 tax = $79 to distribute and if shareholders pay 20% net $63 net of all tax.
    v. Contrast in S corporation $100 earned. 37% maximum tax rate. After pay $37 left with $63.
    vi. But with C corporation may be able to defer tax above 21%. Should you have all income funneled through a C corporation instead of as a pass-through entity to defer second tax cost? Be careful as there may be tax consequences when unwind the C corporation.
        1. Accumulated earnings tax.
        2. Personal holding company tax.
    vii. Despite the issues C corporations cannot be dismissed as they may have been in the past.

b. 199A.
    i. Shelf-life is short. Be careful taking irrevocable steps that may not prove worthwhile in the long term. The law itself is temporary and that period might be shortened by the next administration. How difficult will it be to unwind a structure you create now.
    ii. New deduction for pass-through entities.
    iii. Who qualifies for 199A deduction?
        1. Partners in partnership. 3.46 million returns filed.
        2. Shareholders in S corporations.
        3. Sole proprietor. 24 million returns filed. The term pass-through entity is defined to include a sole proprietorship.
        4. These pass-through entities substantially out number C corporations.
    iv. Who does not qualify?
        1. C corporation and shareholders.
        2. Employees. If working as employee no 199A deduction. If were instead an independent contractor may qualify.
    v. 3- Taxable income zones.
        1. Taxable income does not exceed 157,500 ($315,000 for MFJ) you get full deduction. This figure is inflation adjusted.
        2. If taxable income above 157,500 ($315,000) but by not more than $50,000 ($100,000) for MJF you will be subject to additional limitations depending on wages and depreciable property.

3. For taxable income more than 207,500 ($415,000 for MFJ) certain businesses are just disqualified and wage and basis calculation comes into full effect.

vi. Specified Service Business ("SSB").
1. Deduction phases out.
2. If taxable income above $415,000 phased out.
3. Definition: Health, law, accounting, financial services, actuarial science, performing arts, consulting, athletics or brokerage services are SSBs. Investing services investment management, trading or dealing in partnership interests, securities or commodities are also an SSB.
4. Principal asset of business is reputation or skill of one or more of its employees or owners.
5. See IRC Sec. 1202 and AMT for similar definitions. However, two professions are not included in the definition of SSB, architects and engineers.
6. SSBs do not qualify.
7. Consider spinning off separate assets such as building in which the business operates. If that spun off operation constitutes a trade or business income from that might qualify.

vii. Must be engaged in the conduct of a U.S. trade or business.
1. Foreign businesses will not qualify.
2. Do not get deduction for personal use property.
3. Distinction between trade or business and investment activities.
4. Profit motive, devotion of time and effort to activity to constitute a business and not an investment.
5. Must be able to support that the activity arises to a level of a trade or business to take advantage of the deduction.

viii. Deduction amount.
1. Under TI threshold 20% of QBI. Full deduction.
2. Phase-out range: 20% of QBI, reduced if 50% of wage basis limit is less. Reduction/phase-out over the $50,000/$100,000 range.
3. Above TI threshold 20% of QBI or if less, 50% of the wage-basis limit.
4. If client has multipole lines of business must do this separate from each separate lien of business. You cannot combine separate businesses for calculation.

ix. What is qualified business income ("QBI")?
1. 199A(c) the net amount of income items, gain, loss and deduction from an eligible trade or business except for items of capital gain and law and certain divides from REITs, cooperatives and publicly traded partnerships.
2. What if you have a loss? If net amount from all businesses is a net loss, the statute provides net loss carries over to the next year as if it were a separate trade or business, i.e., separate for calculation purposes in the subsequent year. There seems to be no limit on

how long such losses are carried forward, no cap on number of years (perhaps other than the sunset of the provision itself).

3. Compensation paid to taxpayer, and guaranteed payments paid to the taxpayer are not QBI.

x. Wage-Basis limit.

1. W-2 wages and adjusted basis. 199A(b)(2) defines this alternative as the greater of 50% of the w-2 wages paid by the business to all employees including the taxpayer; or if greater 25% of w-2 wages and the unadjusted basis immediately after acquisition of all deprecation property used in the business still at hand at year end. It is not 2.5% of adjusted basis but of UN-adjusted basis = initial cost basis. If you buy a $10M building and even if you are depreciating it you can use the full $10M cost basis of the building in the calculation so long as building is still on hand and you have not exhausted the recovery period for that property. And that recovery period of the assets is given a minimum 10-year period.
2. The concept of the 2.5% prong is to accommodate real estate which does not typically have significant wages.
3. This calculation might affect when to acquire depreciable property.
4. This gives basis a different function that it has not served before.

xi. Trusts and estates.

1. Estates and trusts with interests in partnership and S corporation are eligible for the deduction under 199A as well.
2. The Act instructs the Treasury to issue regulations to explain how the deduction will be apportioned between fiduciaries and beneficiaries.

xii. Sunset.

1. QBI deduction expires at the end of 2025.
2. Deductions applies in tax years beginning after 2017 and before 2026.

c. Transition from S corporation to C corporation.

i. Is the client better off to just transform into a C corporation?
ii. Not clear.
iii. It will depend.
iv. It is generally a tax-free event to lose a Subchapter S election.
v. But may lose ability to use cash method of accounting and may have to use accrual method of accounting. The Act did create a significant exception for this. IRC Sec. 481 requires permission of IRS to change accounting methods.
vi. If you have to make a Section 481 adjustment you may have to recapture certain income. New IRC Sec. 481(d) prorates the adjustment over the first six taxable years starting with the year of conversion for conversions occurring on or before December 21, 2019.

d. What type of business entity should be used.

i. Menu of choices.

e. Sole proprietorships.

i. Tax considerations.
   1. None.
   2. Disregarded for income tax purposes and all income and deductions picked up on Schedule C Form 1040.
   3. IRC Sec. 6166 permits estate tax deferral for a sole proprietorship.

ii. Business issues.
   1. Succession planning.
   2. Successor can be given by gift the business or by purchase. This would include going concern value and direct transfer of assets.
   3. If multiple successors may be better to create entity, drop assets into entity and then do a transfer to the successors.
   4. Goodwill needs to be addressed in the planning.
   5. Consider Bross Trucking case. How to set up succession of business where goodwill is a component. Have later generations create/establish their own business and they grow their businesses and the initial business eventually ceases.

iii. Family considerations.
   1. Succession and family issues need to be addressed.
   2. In a community property state, the spouse may own ½ of the interest in the sole proprietorship.
   3. Filing a joint return might transform a "sole" proprietorship into both having an interest.

iv. State law issues.
   1. No step (may have to file DBA).
   2. No state requirements or filings required.
   3. No documentation required to form.
   4. See comments above about community property.

v. Litigation issues.
   1. No limited liability wrapper.
   2. Must have adequate insurance coverage.
   3. Debts of proprietorship are personal assets.

f. C Corporation.

i. Tax considerations.
   1. Tax free formation.
   2. Sec. 1202 qualified small business stock. Cannot get this in S corporation, only C corporation. Can now exclude 100% of gain. This is a significant advantage.
   3. If looking for angel investors if want to cash out after 5 years.
   4. Act does not affect IRC Sec. 1045 like kind exchange of qualified business stock in one entity for qualified business stock in another entity.
   5. 21% tax rate.
   6. Traditionally paid larger wages which were deductible by the C corporation so even though shareholder had ordinary income and employment taxes were incurred it was an advantage. Now, with a 21% rate it may still be better to pay compensation, but a 21% rate

followed by dividend tax may be better net of tax then compensation since avoid the employment taxes. May need to reconsider.

7. If shareholder is a creditor better to pay generous interest. Even though Act has limitation on interest it only begins at high levels.
8. Shareholder landlord paying rent has and remains way to mitigate against corporate tax since rental income may be a QBI under 199A.
9. So, only "general" rules of thumb are not so clear.
10. Accumulated earnings tax ("AET") is a penalty tax when IRS determines that the corporation has too much retained earnings. Hording earnings to avoid second layer of tax. Tax is 15% of accumulated earnings beyond what is reasonable. Have corporate resolutions documenting why the corporation is accumulating earnings.
11. Act eliminated corporate alternative minimum tax ("AMT") and this change is permanent.
12. Buy sell agreements often supported by life insurance. Company will by corporate owned life insurance to cover this. In the past the AMT affected this. But corporate owned life insurance may increase value of entity for estate tax purposes.

ii. Business issues.
   1. Directors and officers are responsible for management of the entity, not the shareholders. They may or may not be the same people.
   2. Should have a shareholders' agreement:
      a. Buy-sell provisions.
         i. Most important aspect of a succession plan.
         ii. Cross purchase agreement wherein other shareholders acquire transferring shareholders' interest.
         iii. Redemption – the corporation acquires the shareholders' interests.
         iv. What formula is used to determine purchase price?
         v. IRC Sec. 2703 – whether or not terms of shareholders agreement buyout will be respected when family members are involved.
      b. Rights of shareholders.
      c. Restrictions on transferability of shares. This might provide discount for estate planning purposes.
      d. Provide method to transfer shareholders interest in the event of retirement, death, or disability.
      e. Update provisions.
   3. If will later elect S status consider at inception and perhaps not create multiple classes of stock.

iii. State law issues.

1. Surpluses and solvency requirements under state law may be implicated by life insurance. See above.
2. Create entity by filing with state. If operate in other states must file certificate to do business in that state. Each state has its own unique laws governing formation and operation of corporations.
3. Bylaws should set forth how many directors and officers, how elected, when removed, when and where are meetings and more. When are special meetings called and who calls them.
4. Too many clients put corporate kit on the shelf and forget about it. Practitioners should remind clients to have meetings, minutes, etc. With risks of piercing corporate veil this should be taken seriously and addressed regularly. May benefit from showing challengers that you have acted like a corporation, not merely formed one. Respecting the corporate formalities is the key to having successful liability protection.

iv. Litigation issues.

1. Creditor of the company may try to pierce the corporate veil and pursue the shareholder personally.
2. Annual minutes, bylaws up to date, documenting decisions, who is making decisions, etc.
3. Shareholder, directors and officers should follow the rules of the corporate structure.

g. S corporations.

i. Tax considerations.

1. If lose S-election must wait or submit ruling request to get relief from inadvertent termination.
2. Eligibility requirements.
    a. Only domestic corporations can be S corporation. If a corporation is organized both abroad and in US it is treated as a US corporation for this purpose.
    b. Not more than 100 shareholders. The law had been years ago not more than 15, then 35 so not up to 100. All members of a family are treated as one shareholder. Use any common ancestor and go down six generations of lineal descendants. All spouses and ex-spouses are included.
    c. No non-resident alien. Watch risk of shareholder marrying a non-citizen. Consider addressing in prenuptial agreement. State law determines nature of property and then federal law as to how taxed. IRC Sec. 1361(b)(1)(C).
    d. Only single class of stock. Can differ only in ownership or distribution rights.
    e. Corporations, partnerships, limited liability companies and other business entities are not eligible S corporation shareholders.
3. Must affirmatively elect S status.

a. All shareholders must sign off on election and provide tax ID numbers. IRC Sec. 1362(a).
b. Must be done by 15th day of third month, March 15 for calendar year taxpayer. Elective retroactively.
c. IRS provides relief for late election.

4. Operation.
    a. Income, deductions etc. flow through to shareholders pro-rata. Character of each item is determined at the entity level.
    b. Loan proceeds if used in trade or business interest can be deducted as business interest. New 163(j) impose limitation on deduction of business interest but only if average annual gross receipts are in excess of $25 million. Below that can deduct business interest in full. If borrow money to buy S corporation stock that would be investment interest but there is a look through rule for S corporation and you are deemed to buy underlying assets not stock in corporation. This would thus be deductible business interest. That look through rule does not apply to partnerships or C corporations.
    c. Employment tax loophole. In an S corporation all S corporation income flows through to shareholder but distributions are tax free. Distributions are better than compensation so higher profits for entity but distribution is not taxed and no employment tax. But the IRS is aware of this and may challenge underpayment of compensation and may convert distributions to compensation. In sole or single shareholder S corporation context Treasury studies indicate that about 41% of profits paid out as salary and balance as distributions. The better answer may be to pay a salary what an unrelated employer might pay them.
    d. Partnerships have a tracing rule. Income from a particular contributed law basis asset must be allocated to contributing partners on pre-contribution gain under IRC Sec. 704(c). But in an S corporation context when S corporation sells the same asset the profit will be split pro-rata. This can be used to shift or assign a proportion of income on pre-contribution gain to lower bracket family member.
    e. Manufacturing basis to claim net loss. Can only claim loss if have stock or debt basis (contributed capital or made loans).
    f. Key employee becomes 2% shareholder. Defined as someone who owns more than 2% of the corporation. Lose health insurance premiums and they become taxable.

g. Basis credit for entity debt. If the S corporation borrows money there is no impact on basis. In many cases the shareholders must execute personal guarantees. Refinance the loan so that the shareholders borrow the money and contribute to S corporation capital.
h. 1374 may have less impact after the 2017 Act. 1374 may still apply but those converting from C corporation to S corporation under new rate structure will not have as great an incentive under

5. Trust S corporation shareholders.
    a. Qualified Subchapter S Trusts ("QSST"). IRC Sec. 1361(d).
    b. Grantor trust.
    c. Electing small business trust ("ESBT")
    d. Estates for limited period of time.
6. IRC Sec. 6166 may permit deferral of estate tax.

ii. Business issues.
1. Succession planning issues similar to C corporation but watch special S corporation tax rules. These will make planning more complex and restrictive.
2. Succession planning only can use voting versus non-voting stock classes. Shareholders agreement cannot have terms that create second class of stock, restrictions on type and number of shareholders. These restrictions make succession planning more difficult.
3. Might recapitalize into two classes of stock, voting and non-voting. Then a small percentage of voting stock. Transfer after recapitalization non-voting stock to descendants or trusts for them.
4. Discounts to be availed of in estate planning. Transferring non-voting shares may maximize discounts.

iii. Family considerations.
1. What if want to treat children economically equally but some are in business and others not? Recapitalization to voting and non-voting can facilitate that type of planning.

iv. State law issues.
1. See corporations above.
2. Create by filing certificate.
3. Have bylaws, minutes and "all the other niceties are clients don't follow but should."

v. Litigation issues.
1. Run entity properly to minimize risks of piercing entity veil.
2. Maintain updated corporate book.
3. Have a shareholders' agreement.

h. Partnerships.

i. Types.
1. General partnership.

a. All share in management and control but all have unlimited liability.
b. No filings required (consider certificate of general partnership filling).
c. Some states permit conversion filing into LLC.
d. Personal liability is a significant downside.
e. Too often GPs have no written agreement and that often becomes a major problem.

2. Limited partnership.
    i. One or more general partnerships who share in control and have unlimited liability.
    ii. One or more limited partners who cannot manage and generally their liability is limited to capital contributed.
    iii. GPs have burden to run business and have unlimited liability. That liability could be mitigated by that GP being a limited liability entity like an LLC or corporation.
    iv. In addition to documentation required to file with the state, e.g. certificate of limited partnership, should take steps to document formalities and adherence to such formalities.
    v. Issues can arise in that LPs may have views on how entity should run but they have no authority to participate in management. That can result in friction but that friction can be excessive leading to problems. Solution is to have a complete FLP partnership agreement addressing: management, succession, etc.
    vi. Entity of choice for private investment funds.

b. LLP.
    i. Typically used for law firms or CPA firms. All partners have some liability protection.
    ii. Offer less liability protection then corporations or LLC but some states are not allowed to form in those other formats under some state laws.
    iii. LLPs tend to differ from state to state and one state may not recognize an LLC formed in another state.

c. LLCs.
    i. Can allocate since treated as partnership for income tax purposes but have all around limited liability like a corporation.
    ii. Form by filing a certificate.
    iii. Member managed or manager managed.
    iv. Manager managed LLC usually one or more persons designated as managers with substantial

control subject to perhaps restrictions on specific items that are subject to member control or vote.

v. Manager can be third party and does not have to even be a member.

vi. Multi-member LLCs can choose to be taxed as a corporation rather than a partnership.

vii. Single member LLC provides liability protection under statute but piercing entity veil may be riskier, e.g., commingling.

viii. Operating agreement governs buy sell, governance, percentage of ownership, treatment of contributions of property, distributions, management powers and duties of members to extent members have any, restrictions on transfers, permissible transfers to family or trusts, etc.

ii. Tax considerations.

1. LLCs in some states subject to franchise taxes when partnerships might not be.
2. LLCs not subject to TEFRA reporting requirements.
3. Contrast to S corporation which passes every item through to owners. In partnership can meet with partners and after year had ended can look back and determine how to divide on tax returns. So long as there is substantial economic effect to the allocation it may be respected, i.e., must adjust to reflect allocations. Partnerships are less regimented.
4. Partnerships are preferred to S corporations since partnerships can make a IRC Sec. 754 adjustment. In an S corporation shares get step up but the corporation cannot adjust the basis in its assets. In partnership if make 754 adjustment can make 743 adjustment partnership inside assets also get a proportionate step up. 743 adjustment only takes place with respect to persons inheriting deceased partners interests.
5. At death IRS will look at IRC Sec. 2036. Case law suggests pro-rata for 2036 bona fide sale exception to apply. So, the partnership allocation flexibility does not apply here.

i. **Comments**:

i. Post-TCJA practitioners must be alert for changes in entity structure, modification or creation of new economic arrangements and more that all the ancillary planning is also updated. As indicated in the overview of the IRC Sec. 199A deduction above if a firm spins off real estate into a separate entity so that some portion of income because QBI, what else must be addressed? The buy sell for the main entity and the new real estate entity must be reviewed or created. If a new real estate entity is created will its ownership mirror the existing entity from which it was spun off? How will rent be determined? If the primary or pre-existing entity was an SSB not qualifying for the 20% 199A deduction, the incentive may be to charge as high a rent as appropriate to maximize the 199A deduction. But what impact will that have on planning for both entities? Will any partners or others receiving bonus or incentive compensation be adversely affected? The ripple effects of such changes could be many.

ii. The panel stressed on numerous occasions the critical importance of clients adhering to the formalities of entities and corroborating the entities adherence to entity formalities with annual minutes or consents, appropriate governing documentation and the like.

iii. A comment was also made, one that every practitioner has heard too many times, that clients do not wish to incur costs of professional fees to address this. The reality is that most clients meeting with professional advisers can in fact afford the costs to do the work right. What they really cannot afford is the damage from what work done wrong. Everyone on the advisory team should support the efforts of the other advisers to do their component of the planning properly. The best asset allocation will be of little use if the client's business entity is pierced and those personal investment assets seized. If the collective of the planning team speaks with the same voice of caution the static of objecting to fees will more often give way to better planning.

iv. 2017, may primarily be remembered for TCJA, there were many new developments in 2017. In the asset protection arena, the caveat the speakers in this session stressed, adherence to formalities arose in many cases. While practitioners might not need yet another reminder that creating entity structures (LLC, corporation, partnership, trust) to protect assets will not succeed if the debtor himself does not respect the integrity of those entities, there were many. Transfirst was one of the cases that provided that reminder. The debtor asserted that the only remedy against an LLC was a charging order, but the creditors argued that the entities were shams, and endeavored to pierce the LLC to reach underlying assets. The creditor similarly asserted the right to pierce a trust and the debtor claimed that such an action against a trust was inappropriate. If entities of any type, or even trusts, are used to defraud creditors, courts may well craft a means to disregard or pierce them. Further, optics can be important in creditor cases. When the debtor lives a lavish lifestyle while claiming no access to assets, the result will more likely be less favorable to the debtor. While Transfirst is another bad-fact case, it should nonetheless serve as a reminder that clients with complex structures must meet regularly, not less frequently than annually, to review the maintenance and operation of those structures with their entire advisor team and assure they are operated with all appropriate formality. Clients with legitimate business purposes for entity and trust structures should corroborate them. Transfirst Group, Inc. v. Magliarditi, 2017 WL 2294288 (D. Nev., May 25, 2017).

v. Part of the answer for this dilemma is for all practitioners to support the efforts of others on the financial and estate planning team to encourage and guide clients to properly operate entities, trusts and plans. No planner on the team will be immune to the fallout of a plan that fails from proper maintenance. Accountants and wealth advisers should push clients for proper documentation for their respective files. When that occurs, the voice of the attorney recommending annual meetings or reviews, or updating documents, will be echoed across the team. If the response the accountant or wealth manager receives is presentation from the client of a governing document that has clearly outlived its relevance, they too should stress to the client the problems and need for update.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Marty Shenkman

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Recent Developments 2017. Carol A. Harrington, Steve R. Akers, Jeffrey N. Pennell.

a. 2704 Regulations.

        i. Treasury identified in October 2017 as unworkable and they were withdrawn.
        ii. The regs were never temporary.
        iii. Panelists do not anticipate seeing another iteration of the 2704 regs.
        iv. **<u>Comment</u>**: Proposed Regulations under section 2704 on Restrictions on Liquidation of an Interest for Estate, Gift and Generation-Skipping Transfer Taxes (REG-16311302; 81 F.R. 51413). "…Treasury and the IRS currently believe that these proposed regulations should be withdrawn in their entirety. Treasury and the IRS plan to publish a withdrawal of the proposed regulations shortly in the Federal Register." See "Second Report to the President on Identifying and Reducing Tax Regulatory Burdens," Executive Order 13789, Steven T. Mnuchin, Secretary of the Treasury October 2, 2017, page 3.

b. Consistent basis rules.
    i. IRC Secs. 1014(f) and 6035. The proposed regs on this were viewed as very burdensome.
    ii. Criticism of providing valuation to beneficiaries in 30 days long before personal representative could know which asset would be distributed. This often results in disclosing data on all assets to some or even all beneficiaries. This is a statutory requirement so it would take a technical corrections act to change it.
    iii. Each person would have to report if transferred property in a carryover basis situation. This requirement was unsupported by statute that applied to regulations.
    iv. Zero basis rule that penalizes beneficiaries of asset that were not reported with having a zero basis in those assets.

c. 2642(g) Regulations.
    i. Extension to allocate GST exemption or to elect out of automatic allocations.
    ii. Requirements to act in good faith and not to have prejudiced the IRS.

d. HO 7 Basis of Grantor Trust assets on death.
    i. Basis of assets under IRC Sec. 1014 held in trust when trust assets are not included in estate.
    ii. IRS stated no rulings would be issued while it studied this issue. Rev Proc. 2015-37.
    iii. Foreign trust assets not included in estate but obtained basis step up. PLR 201544002.
    iv. IRS representatives view this as a much broader issue then just one concerning foreign trusts. The IRS is considering the basis of assets held in grantor trust, if held in trust and there is a self-cancelling installment note ("SCIN"), the trust property was held in a trust subject to the elective community property rules of a few states (AK, SD, TN) that permit residents of non-community property states to secure a step-up in tax basis as if they were community property state residents, swap powers, and more.

e. Anti-Kohler Regulations.

i. Taxpayers had endeavored to restructure assets, e.g. consummating a reorganization after the taxpayer's death but before the six-month alternate valuation date ("AVD") in order to reduce the value of assets for AVD valuation purposes. The IRS view was rejected by the court in the Kohler. The IRS had argued that only market forces could impact using AVD.

ii. Creating a discount entity post-death should not be permitted as a change in value to be respected for AVD purposes. Regs were issued after the Kohler case restricting the ability to use transactions to lower the value post death. REG 112196-07. Distributions, changes to capital structure and other changes will not suffice. Prop. Reg. Sec. 20.2032-1(c)(1)(i).

iii. **Comment**: Example 7 of the above reg provides as follows: "Example 7. D died owning 100% of Blackacre. D's will directs that an undivided 70% interest in Blackacre is to pass to Trust A for the benefit of D's surviving spouse, and an undivided 30% interest is to pass to Trust B for the benefit of D's surviving child. Three months after D's death (Date 1), the executor of D's estate distributed a 70% interest in Blackacre to Trust A. Four months after D's death (Date 2), the executor of D's estate distributed a 30% interest in Blackacre to Trust B. The following values are includible in D's gross estate pursuant to paragraphs (c)(1)(i)(E) and (c)(1)(iv): the fair market value of the 70% interest in Blackacre, determined by calculating 70% of the fair market value of all (100%) of Blackacre as of Date 1; and the fair market value of the 30% interest in Blackacre, determined by calculating 30% of the fair market value of all (100%) of Blackacre as of Date 2."

f. Graegin Loan.

i. IRC Sec. 2053.

ii. Provides a deduction for administration not paid at death but paid years in future but deduction is based "as if" paying on date of death."

iii. Regs may discount using PV connects such payments. Not clear what will be done.

iv. **Comment**: Graegin loans have been a popular planning tool to reduce the value of an estate. While legitimate reasons for the loan on which interest deducted seems necessary to support a Graegin transaction, application of present value techniques will reduce or destroy the benefits.

g. Valuation of Promissory notes.

i. Prop. Reg. Sec. 20.7872-1 provides that a gift term loan is valued for estate tax purposes at the present value of all future payments or the face plus accrued interest. These regs were proposed in 1985 and have still not been finalized.

ii. Is an installment note a gift term loan?

iii. Until the regs are finalized "…most estate planners have seen no reason why the estate tax value should not be fair market value…."

h. Purchase of GRAT remainder.

i. CCA 201745012 – dealt with the purchase of GRAT remainder a day before the settlor's death, the settlor purchased the remainder interest in the GRAT with promissory note.

ii. CCA says the IRS will disregard remainders as consideration for these purchases since the property would have been included in decedent's estate in any event, so issuance of the notes was for "nothing" and notes were a gift.
iii. Also held that notes were not deductible. This results in more assets being subject to tax then the decedent had to start with.

i. Koons.
   i. Koons v. Commr, 686 Fed Appx 779 (11th Cir. April 27, 2017), aff'g TC Memo 2013-94.
   ii. Children signed redemption agreement 4 days prior to death. Redemption was completed leaving estate owning 70% of voting stock. Tax Court valued as a holding company that held $322M of cash and $30M of other assets and valued it as asset value at no less than amount estate could demand. Looked to redemption agreement and found it was binding. IRS experts discount 7.5%. Also had a Graegin issue in the Koons case. The estate borrowed $10M from an entity for a 25 year note at 9% that resulted in $71M in interest to be paid and a commensurate $71M deduction. Court held no as estate could have forced LLC to distribute cash to pay the IRS so it was really equivalent to a delayed distributed out of the LLC.
   iii. Taxpayer argued purpose of business was to invest in other business and court did not agree. To be respected the borrowing should be necessary to prevent a forced sale and business must have reasonable prospects of repaying the borrowing.
   iv. **Comments**: Decedent's revocable trust comprised the majority of his estate's assets, and the trust's primary assets was interests in an LLC. The estate's remaining liquid assets were insufficient to pay its tax liability. The trust held 70.42% voting control over the LLC, and because the LLC had over $200,000,000 in liquid assets, the trust could have ordered a pro rata distribution to obtain these funds and pay its tax liability. But the trustees of the trust declined to direct a distribution of the trust's interest in the LLC to pay the estate tax liability, stating that immediate payment would hinder the LLC's plan to invest funds in operating businesses. So, the trustees obtained a loan from the LLC in exchange for a promissory note bearing an annual interest rate of 9.5%. No payment was due for 18 years and principal and interest were scheduled to be repaid in 14 installments. Prepayments were not permitted and the projected interest payments would total $71,419,497. The Estate filed its tax return in June 2006, claiming a $71,419,497 deduction for interest on the loan as an administrative expense. The IRS denied the deduction. Reality check. Does a 32-year period for repayment of a loan constitute a reasonable period? With a Graegin loan the longer the loan term the greater the interest charge, the larger the interest deduction and the less the tax. How far can a taxpayer push the concept before a court would find it unreasonable?

j. Powell case.
   i. Estate of Powell, v. Comr., 148 TC No. 18 (May 18, 2017).

ii. Biggest tax court case of the year. Fully reviewed Tax Court case.
iii. Taxpayer tried to settle.
iv. Two substantive items:
   1. 2036(a)(2) caused estate inclusion of all assets in FLP even though decedent only owned an LP interest. Never had case with only LP interest only held by transferor included under 2036(a)(2).
   2. Judge went through analysis suggesting client could be hit with a double inclusion analysis. Discussed below.
v. Facts.
   1. Son under power of attorney ("POA") transferred $10M assets into FLP for 99% LP interest.
   2. Sons gave notes in exchange for GP interests.
   3. Son under POA transferred all of mother's 99% FLP interests into a CLAT with payments to charity at end of each year and whatever left at mother's death passes to sons. There was a gift element to the CLAT plan.
   4. POA only authorized gifts to issue and only up to the annual exclusion amounts.
   5. Court held transfer to CLAT was void or voidable.
   6. Mother died 7 days later. Note that the case does not explain all facts mother actually died unexpectedly from sepsis. This is an appealable point.
vi. Case was not tried but was decided on summary judgement motions.
vii. 2036(a)(1) is the classic IRS argument because of an attack using the implied agreement doctrine. The IRS does not have to show express retention of income using this attack. Taxpayer's brief did not mention 2036(a)(2) and perhaps court chose that path.
viii. Intention in Powell was that mother was not going to have any interest whatsoever in the assets which is perhaps why the IRS focused the case on 2036(a)(2) to disallow discount. Court argued under (a)(2) that decedent alone or "in conjunction with" any other person can designate who can benefit from the property. This never occurred under a situation in which the decedent only owned an LP interest.
ix. IRC Sec. 2036(a)(2) arguments "have been addressed in only four prior cases: Kimbell and Mirowski both of which were taxpayer victories. In Strangi and Turner IRS won but those involved general partnership interest (50% of GP). The general partner, the ability to control distributions and who can enjoy, but in Powell this was not the case. The court seized on the "in conjunction with" language. The court reasoned that the decent in conjunction with all the other partners could have dissolved the partnership. This is problematic as co-owners might always do this. There are cases that put limits on how far this could go. 1935 case Helmholz (sp?) involved transfer to a revocable trust that settlor in conjunction with other should modify so predecessor of IRC Sec. 2038 applies. Court said there were limitations on the in conjunction with concept. Some cases have put limits on how far can go in terms of finding

that the settlor could "in conjunction with others" modify a trust. These arguments not made in Powell.

x. Son was general partner and agent for mother so through his actions he may have authority to designate who could enjoy the property.

xi. Court said in Powell that full consideration exception did not apply.

xii. How did court conclude 2036(a)(2) applied?

  1. Partners could have under LP partnership agreement could agree to liquidate. "alone or in conjunction with any other person." If TP joins with anyone doing anything (e.g. joins together to buy real estate) does that mean 2036(a)(2) apply?
  2. If they had eliminated the provision from the partnership agreement it would not seem to have changed the result (i.e., that draft around may not suffice to avoid a Powell challenge). That is because the GP and majority of LPs could dissolve under state law, so that would not resolve unless state law default rules did not provide a similar right.
  3. Son was mother's agent through son and duties son owed mother. So, avoid this by not having mother's agent as the person holding GP interest.

xiii. Double inclusion analysis.

  1. IRC Sec. 2043 should prevent double inclusion of assets in the decedent's estate.
  2. If make transfer with retained interests but without adequate consideration. Taxpayer transfers assets to entity and gets back interests in entity. If assets included in estate government has traditionally ignored the interests in the entity that were received back. What this means is we include assets transferred as if you never did the deal, and we also include the consideration you did receive. That results in double taxation and IRC Sec. 2043 is designed to ameliorate this result. But what if a decade passed and the value of the interest in the entity increased. Problem with consideration offset rule is you include assets as if never did deal and the ownership interests, but the consideration offset is only for consideration received at the date of the transaction, not at the date of death, which could be much larger. This results in all the appreciation in both assets (i.e., in the underlying assets, and in entity value that is included in the estate) being included.
  3. Judge Halperin on his own raised this issue/result. The 2043 issue was not briefed by either party.
  4. In footnote he stated that could have double taxation if there was appreciation post-transfer.
  5. Note that the concurring opinion of 7 judges felt that the partnership was merely the alter ego of those same assets so it should not also be included in the estate, i.e. no double counting.

xiv. Powell is a terrible facts case but the question/worry is whether the holding will be limited to such bad fact cases? What is worrisome is the reasoning of the Tax Court in this case. Planners should try to differentiate their planning from this case.

xv. Where are we now?

1. Qualification for the bona fide sale exception for full consideration is very important. Most cases TP have won are on this basis.
2. Is it better to not give partners right to unanimously dissolve partnership? That could be an important factual distinction.
3. Might this suggest change in thinking about FLPs? If Powell is correct 2036(a)(2) may apply. Consider 2035 if transfer within 3 years of death 2036 may still bring into estate.
4. Is the double inclusion really a concern?
5. Some commentators believe that this is merely a bad fact case, 99% LP owning securities transferred before death, and may not have significant impact.
6. Has the emphasis many planners made to not have transferor's hold GP interests not the same concern considering Powell?
7. For many clients below exemption amounts we might argue the "in conjunction with" argument could be applied to obtain a basis step up.

xvi. **Comments**: Several practical planning lessons practitioner can be gleaned from Powell, including the following:

1. Practitioners should review all client powers of attorney and tailor the gift provisions to what might be appropriate for the particular client's circumstances. For clients of significant means, the gift provisions should be tailored to permit whatever type of gift or other transfers that might be appropriate to planning, but constrained to minimize the risk of abuse. Where gift powers are inappropriate they should be expressly limited or excluded. Too often practitioners have relied on boilerplate annual gift provisions for durable powers when fine tuning in one direction, or the other, might be preferable for the client.
2. Clients should be educated as to the importance of periodic reviews to endeavor to avoid the compressed planning time frame used in Powell. Rushed planning will almost assuredly increase the risks to the plan. Ongoing planning is the key to avoiding that.
3. Practitioners should review governing documents to confirm they support the intended transactions. If not, alternate arrangements should be evaluated.
4. Non-tax purposes should be evaluated and corroborated for most planning. Document non-estate tax motives for estate tax transactions. Even as planning shifts from estate tax minimization to income tax planning and asset protection planning, documenting business purposes for any transactions will remain important. This is not a new consideration in FLP and other discount planning, but perhaps Powell can be viewed as a reminder of the importance of crafting transactions to demonstrate non-tax business purposes.

5. Every client has a "story to tell." Document that story to corroborate why the client wants the entity established. Stone and other cases have very long opinions in part because they discuss in detail the contemporaneous discussions, the estate planning attorney's notes, and more.
6. Family partnership/operating agreements should be reviewed in light of the Powell case. Consider amending all governing documents to assure that a senior generation (e.g. a parent) has no right to vote on liquidations, distributions or partnership agreement amendments associated with liquidations or distributions. An alternative is to liquidate these entities but that would eliminate the control and asset protection and other benefits. Action should be taken at least 3 years before death.
7. For clients with active operating businesses, as contrasted with a mere FLP holding passive security investments, the section 2036 exception argument seems strong and the client and planner may feel comfortable relying on that. The case law, especially when passive security holding entities are involved, differs as to whether the facts meet the "legitimate and significant nontax reason" test, so practitioners should consider what can be done to corroborate the non-tax reasons.
8. Another consideration might be to amend FLP and LLC governing documents more than three years before death to give a special "termination and liquidation" right to someone other than the client, so that the client has not ability to force a liquidation or distribution without such consent.
9. The right to consent should be given to someone not serving as agent for the client under the client's durable power of attorney (and perhaps also not serving as a successor trustee under a revocable trust for the client). In the wake of the Strangi case some practitioners had the termination right held by the trustee of a family trust who could be replaced with an unrelated party by the Grantor.
10. But under the Powell analysis, if all of the partners could together act to amend the partnership agreement to delete the restrictive saving provisions as a matter of state partnership law, would the reasoning of the Powell majority still apply?

k. Sommers v. Commr. 149 TC No. 8 (2017).

   i. Net gift agreement. Mr. Sommers died within 3 years of completing the transaction and the gift tax is phantom asset included in his estate under IRC Sec. 2035. The gift agreement did not make donees include estate tax.
   ii. Net gift agreement – the reimbursement is a right of the estate.
   iii. **<u>Comments</u>**: There was another interesting issue in the Sommers case as to whether the gifts of the art LLC were completed gifts. In accordance with the art/LLC/gift plan, the taxpayer transferred artwork to the LLC, Sommers Art Investors, LLC, and executed two sets of gift and acceptance

agreements with his nieces, the first dated December 27, 2001, and the second dated January 4, 2002. When decedent and his nieces initially executed the agreements, they left blanks for the number of units included in each transfer, pending completion of an appraisal of the artwork. The commissioned appraisal, when completed in March 2002, assigned a value to the artwork that led decedent's counsel to conclude that dividing the transfers of units across the end of 2001 would not allow for the complete avoidance of gift tax. After the nieces agreed to pay any gift tax resulting from the 2002 transfers, the gift and acceptance agreements were completed by filling in the blanks for the number of units covered by each transfer. Note that this was perhaps three months after the initial transfer, and after a material change in terms of the agreement initially executed in 2001. The Petitioner requested the court rule that the decedent did not make completed gifts of the units until April 11, 2002, when the gift documents were completed by filling in the number of units covered by each agreement, with the consequence that the units were includible in the value of decedent's gross estate under sections 2035 and 2038. Respondent's motion asked us to rule that decedent had made completed gifts of units to his nieces on December 27, 2001, and January 4, 2002. We granted respondent's motion and denied petitioner's motion regarding the timing of decedent's gifts. Thus, the court recognized as effective a gift made of LLC interests with the number of interests unknown, as effective when signed, and was not determined by a material re-negotiation or change in the agreement by adding the net gift component months later. This portion of these cases was not mentioned in the literature but might be useful to advisers in both tax and other circumstances if the effectiveness of a gift with blank components, or waiting for a later appraisal, is made.

l. Reforming General Power of Appointment ("GPOA").
    i. PLR 201737001 and 201737008.
    ii. The governing instrument had inadvisable language permitting the appointment to such persons or charities as the holder appointed by will.
    iii. Common law is you cannot appoint to estate unless it is specifically authorized. That would have seemed to have saved the problem of the intended LPOA being a GPOA. However, the language used may also be interpreted as including appointing to creditors which would make it a GPOA which was not the intent (i.e., it was supposed to be an LPOA not included in the estate).
    iv. The IRS accepted reformation limiting the power as intended.

m. PLR 201721006 Renunciation of QTIP Interest.
    i. **Comment**: The PLR discusses division of a QTIP followed by a renunciation of interest on one part of the post-division QTIP to trigger a gift under IRC Sec. 2519. While this has been a useful planning technique for a number or reasons, the large doubled estate tax exemptions make it more intriguing to consider as moderate wealth clients seek to identify assets that can be transferred in a manner to use exemption. This will be

such a powerful tool for some clients that practitioners might want to include this idea in communications to clients. 2044. After the surviving spouse renounced his interests in Marital Trust One, no part of Marital Trust One deemed transferred under IRC Sec. 2519 will be includible in Spouse's gross estate under IRC Sec. 2044(b)(2).

ii. Doubling of basic exclusion amount and will end in 2025 and revert. Last time we saw this was 2012 when the exemption might decline from $5M to $1M in 2013.

iii. Issue for many people want to make gift but do not want to lose access to enjoyment of the asset. Useful way to accomplish planning if client is surviving spouse and beneficiary of a QTIP. Facts included QTIP and proposed dividing into two portions and surviving spouse/beneficiary renouncing interests in one portion. Renunciation triggers IRC Sec. 2519 as to renounced portion but not as to the other.

iv. IRC Sec. 2519 is triggered if you renounce even a modest amount of QITP trust income interest.

v. Use this renunciation of a small portion of income interest and intentionally trigger 2519. That will cause the use of otherwise unusable exclusion amount. You could renounce 1% of income interest and the 99% will be subject to 2519 tax but that income will continue to flow to taxpayer spouse for life.

n. Adequate Disclosure.

i. Need to apprise the IRS of sufficient information.

ii. 20152201F IRS held did not meet requirements for adequate disclosure. No employer ID number was power. Did not clarify if general or limited partnership interest. No description of discount. Did not identify restrictions that might impact value, just said it was farmland.

iii. LAFA 20172801F. Did not describe property or provide description of method used to value property. So, this insufficient disclosure did not trigger adequate disclosure rules.

iv. Be careful about disclosing and if anything over disclose.

o. Inadvertent Payment.

i. Beneficiary inadvertently paid tax of trust. PLR 201735005. Beneficiary was reimbursed and no problem with reimbursing – no tax consequence.

ii. **Comment**: In this PLR the beneficiary of a trust inadvertently made state and federal tax payments that should have been paid by the trust. The IRS held that this would not result in estate or gift tax issues. Specifically, the IRS held that these inadvertent payments would not constitute a constructive addition by the beneficiary to the trust. The beneficiary had a right to recover as against the trust. The taxes which were inadvertently paid by the beneficiary were reimbursed by the trust to the beneficiary, along with interest and legal fees.

p. Portability, DSUE, and the Sower Case.

i. Overreported amount of DSUE available to spouse in 2003-5. Estate of Sower v. Commr. 149 TC No. 11. Gifts made before portability but nonetheless should have reduced the exemption available to surviving spouse. The IRS had issued a closing letter. Wife later died and claimed DSUE reported on husband's return which was incorrect.

   ii. A gift a $1M not reflected on face of return.
   iii. On audit IRS reviewed prior deceased spouse's = husband's return. Under IRC Sec. 6501 the IRS can examine the return.
   iv. Estate argued that IRS should be estopped from opening the estate. Poor argument. A closing letter is not a closing agreement.
   v. **Comments**: The IRS can and in fact will audit estate tax returns filed solely to secure the deceased spouse's DSUE. While practitioners expected this result, the Sower case confirms it. A key take-away from Sower is that the race to the bottom to prepare quick and inexpensive estate tax returns since "its' only for portability, there's no tax due," is a risky gambit for practitioners pursuing that type of work. Sower demonstrates the importance of care (and maintenance of backup) in the preparation of the first to die 706 filed to preserve DSUE and the potential chilling effect of reliance on an incomplete or inaccurate return. Since the IRS can revisit the first return in the assessment of tax due on the second, a significant change in value could place the second return in a significant understatement penalty position. Portability is relatively new – what about second to die spouse returns filed decades from now which rely upon timely filed the first to die returns intended to provide portability of DSUE? In Sower, the surviving spouse's DSUE was reduced following an examination of her deceased husband's estate tax return. The opinion included several arguments and issues concerning portability that will provide additional clarity to practitioners.

q. Estate of Hake v. US, 234 F. Supp. 3d 626 (2017).
   i. Fighting heirs. Executors hired counsel to file return and intended to do so.
   ii. Late filing penalties. Court held that it was reasonable to rely on advice of counsel.

r. Estate tax closing letters.
   i. Notice 2017-12, 2017-5 IR 742.
   ii. IRS indicated that will not issue closing letter but you can ask if you wait four months after filling.
   iii. Can also ask for transcript and if it has "Code 421" that indicated filing was made. Form 4506-T can be used to get transcript.
   iv. Priority statutes place liability on fiduciary if debt is due federal government. These are part of general US Code. Closing letter is signal to fiduciary that it is reasonable to make distributions.

s. Liability issues of recipients.
   i. 6324(a)(2) recipients of non-probate assets have personal liability.
   ii. 6901 Transferee liability must be assessment within 4 years.
   iii. 6502 says under general collections statute that IRS has 10 years.
   iv. US v. Johnson, 224 F. Supp. 3d 1220. Elected IRC Sec. 6166 estate tax deferral for hotel in estate, and furnished lien under 6324A. Hotel went bankrupt and IRS pursued executors for past due tax. Court found no liability for assets in revocable trust included in the estate under IRC Sec.

2033, personal liability only extends to assets included in estate under 2036 or 2038.

t. Swap powers.
   i. Schinazi v. Eden, 792 SE 2d 94.
   ii. Case involved settlor endeavoring to exercise a swap provision. IRC Sec. 675(4)(C).
   iii. Settlor of trust was doctor who discovered lucrative aids medication that was held in an LLC inside trust. He wanted to swap that highly appreciated LLC interest out of the trust for a note. His ex-wife was named as trustee and she would not accept his note. Court agreed as LLC that held patent for drug had restrictions and physician/settlor failed to comply.

u. BDOT = Beneficiary Deemed Owner Trust.
   i. This could be a useful planning tool but at present there is little guidance.
   ii. Two trusts and one trust deemed the owner of the other trust for income tax purposes under the grantor trust rules. PLR 201633021.
   iii. This opens up transfers between new parties, e.g. beneficiary and testamentary trust deemed grantor under IRC 678(a)(1).
   iv. Contrast the BDOT with the different technique of a BDIT. BDITs use a Crummey power to create grantor status as to beneficiary.
   v. The BDOT under IRC Sec. 678(a)(1): "A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself…"
   vi. Must give beneficiary right to withdraw ordinary income and capital gains. Under 678 beneficiary is deemed owner of the trust. See Rev. Rul. 85-13.
   vii. Campbell v. Commr. TC Memo 1979-495. This was a situation in which the 678(a) power caused the beneficiaries to be taxable and deemed owners of the capital gains income. They held the power to cause the trustee to distribute capital gains to themselves. Even though they never asked for the capital gains, and they were never distributed, deemed ownership nonetheless occurred.
   viii. Wrinkle HO78para d --- Here a significant amount can be transferred in and withdrawal is only over income. Do we have a 5/5 issue and an excess transfer? Not certain.
   ix. 1970 Fisch (sp?) case from 9th Circuit 2514 5/5 power is it measured by 5% of corpus or 5% of income?
   x. Very few cases have addressed the "or income" provision.
   xi. Spendthrift issues. Lapses of withdrawal right if within 5/5 amount does not open to creditors' claims.
   xii. Cannot be grantor trust as to grantor.
   xiii. When might this be used?
      1. This could be used to make surviving spouse as deemed owner of an irrevocable testamentary trust.

2. Perhaps it is a grantor trust during life and after death the beneficiary can have right to withdraw to make it grantor as to beneficiary.
3. If it is a grantor trust as to the beneficiary perhaps can avoid filing a trust 1041 and use a skeleton return and report on beneficiaries return.

xiv. **<u>Comment</u>**: As planning for ultra-high net worth taxpayers proceeds apace while we have no 2704 Regs and the temporary increase in the exemption, clients with large non-GST exempt trusts might create new GST exempt trusts that are designed by their terms to be grantor as to the old non-GST exempt trust. Then old non-GST exempt trust could then sell assets in a note sale transaction to the new GST exempt trust thereby freezing the value in the non-GST exempt trust. Another interesting technique for large clients pursuing aggressive planning is the melting GRAT. See Gooen, Snow and Harris, "The Estate "Melt": GRATs Are Only the Tip of the Iceberg," Estate Planning Nov. 2017.

v. Green case.
   i. Green, (CA 10 1/12/2018) 121 AFTR 2d ¶ 2018-343
   ii. January 12, 2017 reversed and deduction for trust donation to charity is limited to basis. This ties back to the IRC Sec. 642(c) gross income requirement.
   iii. Several recent rulings addressed issue of "paid pursuant to governing instrument."
   iv. Limited power to appoint to charity. Not contrary to grantor's intention so not ultra vires, etc. IRS in CCA held not sufficient, must be under initial instrument.
   v. **<u>Comment</u>**: See discussion of TCJA ESBT changes below.

w. Fakiris v. Commr.
   i. Bargain sale case. Seller kept ability to transfer so it was not a completed charitable gift at the time of the transfer so no contribution deduction. Applied accuracy penalties. Did they get deduction in the next year when donation was actually made?
   ii. **<u>Comments</u>**: Because the donor did not part with dominion and control over the donation of a building no deduction was permitted. The Fakiris case addressed whether a charitable donation was complete. The taxpayer/donor failed to reduce the deduction at all for the sales price. Since the transaction was characterized as a bargain sale under the Regulations (a transfer of property which is in part a sale or exchange of the property and in part a charitable contribution, as defined in section 170(c), of the property) the taxpayer should have reduced the donation claimed by the proceeds. The sales contract for the theater to the charity prevented the donee charity from selling that property during the 5-year period after obtaining the deed, and the seller/donor had the right during that period to transfer the theater to another charity. These conditions survived the transfer of the deed to the donee. As a result, the donor/seller retained dominion and control over the theater property so that the

donation was an incomplete gift, and the charitable contribution deduction was disallowed. Reg. Sec. 1.170A-4(c)(2).

x. Conservation easements.
    i. **Comment**: Speaker noted that the IRS does not like conservation easements and that there have also been many abuses. So, caution is certainly in order.
    ii. RERI Holdings I, LLC. Disallowed deduction as taxpayer did not note on Form 8283 basis for the assets. Taxpayers probably intentionally failed to report since they purchased the property for $3M and donated for $33M and they knew they would be audited based on those numbers.
    iii. Syndicated conservation easements. Listed transactions – higher penalties.
    iv. BC Ranch, II, LP – 5th circuit ruled in favor of taxpayers.
    v. RP Golf failed to subordinate.
    vi. 310 Retail, LLC and Big River Development, LP issue was contemporaneous written acknowledgement. Deed of transfer qualified as statement required from the charity.

y. 2017-73 Donor Advised Funds ("DAFs").
    i. IRS has raised questions as to how DAFs are being administered.
    ii. If DAF pays for dinner ticket what should happen? As an individual taxpayer you would be allowed to deduct the difference from what you as a donor paid (total gift) and what you receive back in value (e.g., value of actual meal). However, if paid out of DAF the new IRS proposal is that this is a benefit that is more than just the FMV of the meal. This is incidental benefit would disqualify donation.

z. DAF can satisfy a pledge.
    i. But cannot state that it is paying pledge.
    ii. If charity chooses to treat as satisfaction of pledge it is OK.
    iii. Part of this it is difficult for DAF to determine if pledge is binding or not.

aa. State death taxes.
    i. Delaware sunsets estate tax 2018.
    ii. New Jersey repealed its estate tax 2018 but retained its inheritance tax, no tax on close relatives, higher tax 11-16% for more remote recipients.
    iii. Will states keyed to federal exclusion back off from high exclusion amounts?

bb. Ackerlery.
    i. Washington state estate tax was held properly assessed on gift taxed paid within three years of death subject to 2035(b) gross up rule.

cc. QTIP and state estate tax.
    i. Estate of Bracken, 290 P. 3d 99.
    ii. Estate of Brooks v. Commr. of Revenue Services, 159 A.3d 1149.
        1. Surviving spouse moved from FL to CT and as beneficiary of QTIP.
        2. CT follows federal.
        3. Even though no marital deduction on first spouse's death CT court held that the QTIP was included in surviving spouse's estate.

        4. What if facts were reversed and CT surviving spouse moved to a state without an estate tax? States don't have long arm statute.

dd. Fielding v. Commr. of Revenue.
   i. 2017 WL 2484593 (Minn. Tax Ct.)
   ii. No sufficient nexus for MN to assess income tax.
   iii. If trust had been a testamentary trust of a decedent subject to probate in MN might have given sufficient nexus to tax trust in future even if no MN source income, no MN beneficiaries and no trustee.
   iv. Lesson is to create inter-vivos trust. **<u>Comment</u>**: See case above concerning benefit of revocable trust and federal tax lien wherein executors avoided personal liability.
   v. Case in on appeal to MN Supreme Court.
   vi. Trend of cases suggest constitutional problems and MN income tax should not apply.

ee. State non-tax cases.
   i. A general issue is that clients may die in different states and how might terms and concepts be construed?
   ii. In re estate of Watkins, 2017 WL 3149610 (Tenn. Ct. App.).
      1. Anti-lapse statute designed to fill in blank if leave property to beneficiary who predeceases. Does bequest go to estate of beneficiary or fail? Most states have anti-lapse statute that addresses this issue.
      2. An anti-lapse statute may only apply if the beneficiary is a descendent of the decedent. In that case property will pass to deceased beneficiary's descendants.
      3. TN anti-lapse statute also applied to spouse of decedent.
      4. The last will was 21 years old and not updated even after beneficiary who was decedent's spouse died 16 years earlier. TN statute sent property to his descendants who were not her descendants. So, assets passed to the descendant's step-children not her children. And this is not what average person would intend.
      5. Do you turn statute off? If 2603 of Uniform Probate Code – difficult to turn off. If say "To my wife if she survives me" is not enough. Must say "To my wife if she survives me and if not to…."
   iii. Removal of trustee.
      1. Lower court permitted modification of trust to remove and replace the trustee. However, the PA court said must use Sec. 706 and if do not comply with the statute, you cannot be permitted to do an end run around the statute by amending the trust document.
   iv. Per stirpes.
      1. A commonly used phrase but what does it mean? What does "per stirpes" mean? What does" by right of representation" mean?
      2. More than one interpretation, especially if an entire generation is deceased.
      3. Modern per stirpes says look to highest generation that has living people. If no children then divide equally among grandchildren.

4. Intestacy law might suggest each grandchild gets 1/10th if ten. Consider in trust where if child died their child may have received 1/3rd of income if 3 children but then if when third child died it would completely change disposition and result in 1/10th of principal to that same child.
5. See Schwerin v. Bessemer Trust Co., 2017 WL 1017792.

v. Financial abuse of elderly.
   1. Right to information.
   2. Right to bring action.
   3. Strong policy issues on all sides.
   4. The plaintiff would use information to go after mother's money versus no one keeping an eye on the fox in the hen house.
   5. Sec. 813 of UTC discusses duty of providing information. There is no duty to provide information while settlor of revocable trust is alive.
   6. If issues happen with revocable trust while settlor is alive there is no opportunity to question while settlor is alive versus defer until after settlor is alive.
   7. Cases have tended to be egregious cases in which court is trying to identify some theory.
   8. Hauser v. Hauser, 796 S.E. 2d 391 (NC Ct. App. 2017) court held neither action could be pursued while parent/settlor was alive as only she could bring suit.
   9. What should we do? Ask the client. Autonomy versus protection.
   10. Compare provisions under the Uniform power of attorney act. Provides ability to obtain information. Section 116 of Uniform Power of attorney Act.

vi. Domestic Asset protection trusts ("DAPTs").
   1. Klabacka v. Nelson.
   2. Both plaintiff and defendant were both Nevada residents.
   3. Chronology is important. Married couple that divorces.
   4. 10 years into marriage executed agreement to transmute property into separate property. 8 years later each created identical asset protection trusts. They did this together. Another 8 years transpire before the divorce. Nevada legislation authorizing DAPTs does not protect spouse or child support.
   5. This does not per the speaker advance the asset protection trusts case.
   6. **Comment**: Not all practitioners agree. In fact, the use of asset protection trusts remains an issue that draws emotional and strong opinions across the spectrum of practitioners and planning options. The Klabacka holding, according to many practitioners, is a positive development for domestic asset protection trusts ("DAPTs") and suggests that the very protective statute in Nevada, that excludes a divorcing spouse as an exception creditor, will be respected. However, the Klabacka decision does not address the

most worrisome DAPT issue, which is whether a resident of a non-DAPT jurisdiction, who creates a trust in a DAPT jurisdiction such as Nevada, will have that trust respected, i.e. will achieve the hoped-for asset protection goals. But the number of DAPT jurisdictions has grown with the addition of Michigan as the 17th state to enact such legislation, a rather significant number.

vii. Can disclaimer avoid claim?
    1. Federal claims – no.
    2. Some states will allow you to disclaim and defeat creditors, others do not.

viii. Portability.
    1. Vose case. Can the executor be forced to make a portability election?
    2. Oklahoma case.
    3. Wife and husband had conflict before she died. Her son was administrator and surviving husband wanted portability election made. A prenuptial agreement had been signed and waived all rights. Does that prenuptial agreement waive surviving husbands right to portability?
    4. Court pointed out that DSUE and portability did not exist when the prenuptial agreement was signed. So, the prenup could not waive what no one knew about.
    5. Is there a fiduciary duty to file to secure the DSUE? **Comment**: Might the answer depend on whether the surviving spouse is a beneficiary? On whether there was an agreement to port the DSUE?
    6. Husband was not a direct beneficiary of the estate.
    7. DSUE would be lost forever to anyone if estate tax return would not be filed. Did not say it was an estate asset, but it got pretty close. Surviving husband agreed to pay all costs of filing and this may have been an important factor.
    8. **Comment**: Carefully draft an agreement with the surviving spouse. Will she pay cost of return preparation plus the cost for the personal administrator to provide data? What if there is an audit of that information on the surviving spouse's estate which is permitted. The indemnification for costs should include that as well. What if the surviving spouse obtains her own appraisal that differs from the estates appraisal? What happens? What if the estate did not obtain appraisals but objects to the appraisals the surviving spouse obtains as they impact how assets may have been distributed under the estate or are lower thereby providing a lower basis adjustment?

ix. Digital Assets.
    1. Uniform Access to Digital Assets Act.
    2. Privacy issue. Can provider turn over without violating Stored Communications Act?

3. Exception if there is lawful consent and vendor can then disclose.
4. What about a personal representative after the account owner has died? Is that lawful consent.
5. Interpretation of stored communications act.
6. TOSA = terms of service agreement, could have provided something different. TOSA may be unenforceable if unconscionable.
7. Estate of Serrano – NY case. Wanted to get access to contacts and calendar. Court ruled that Act provides generally that personal representative can get access to catalogue but not content. Catalogue is the contacts. For calendar entering something on a calendar is not a communication caught by the Act.
8. Fiduciary access to catalogue but content can only be accessed if decedent had signed something unless an online tool provides to the contrary.
9. Some sites access about privacy whether you wish to give access.
10. Should clients sign consent to access digital assets?

ff. Professional adviser is in a principal agent relationship.

i. Model Rules adopted in 49 states are the law of agency as they apply to lawyers.
ii. If a fiduciary you are held to a higher standard than a principal agent relationship.
iii. NPR Foundation v. Dimeff, 2017 WL 1406817 case.
    1. Attorney sole beneficiary of plan.
    2. Attorney sanctioned.

gg. Decanting and Modification of Trusts.

i. Matter of Hoppenstein, NYLJ 1202783016744, Sur Ct, NY County 2017. The New York County Surrogates Court approved the transfer of a life insurance policy from an old trust to a new trust which effectively removed certain beneficiaries of the old trust. The Court found that the action was an acceptable exercise of the trustee's discretionary power to distribute principal under the old trust agreement. That old trust gave the independent trustee discretion to distribute principal to one or more beneficiaries in the trustee's discretion. That discretion could be exercised even if it resulted in the exclusion of some of the beneficiaries. Written notice, however, had to be given to the beneficiaries. The court determined that a decanting may be accomplished under the terms of the trust's governing instrument without regards to New York statutory requirements.
ii. Be mindful tax issues have not been resolved. Decanting a grandfathered GST is not resolved and may only decant if there is case law or provision in document. If under statute you may not be under safe harbor.

hh. Medicaid.

i. Tannler vs. Wisconsin Dept. of Health and Social Services, 564 NW 2d 735. If an individual is entitled to property and chooses not to take it, e.g. Elective share of surviving spouse, for Medicaid purposes that failure to take is treated as if you took the property and then made a disqualifying disposition.

ii. Forged power of attorney.
    i. Son forged mother's signature on POA. Yi v. Oh, 2017 WL 3393283.
    ii. Many issues. Want to protect defrauded principal, but want to also protect purchaser in due course.
    iii. Widespread use of powers. Third party may justifiably be concerned about acting under POA.
    iv. Statutes have strong language providing that third
    v. Section 119 of Uniform Powers of Attorney Act. Even acknowledges that rule applies to forgery.
    vi. Statutes generally require that POA be notarized.

jj. Tax Cut and Jobs Act of 2017.
    i. First major tax reform since 1986.
    ii. Generally effective after 2017 but some items start earlier.
    iii. Individual tax provisions and transfer tax provisions sunset after 2025 as a revenue provision with the Byrd rule.
    iv. Basic exclusion has been doubled to $10M but inflation adjusted with a new index is chained CPI. Estimates are that the exemption is $11.18 million.
    v. Estate tax was not repealed.
    vi. In 2025 exemption reverts to $5 million but chained CPI remains.
    vii. Clawback – same issue as in prior years $5 million exemption may have declined to $1 million. Does law bring back into your estate the additional $5 million you give before clawback? Speakers believe that clawback should not apply. In the TCJA it amends 2001(g) require the Secretary of the Treasury to issue regulations to carry out this section.
    viii. Advise clients to make gifts now even if clawback occurs as it would remove future appreciation from the estate tax base.
    ix. NRAs did not fare well under TCJA. Credit against estate tax has been $13,000 ($60,000 of assets) has been in place for decades. This puts increased pressure on planners to keep assets of NRAs out of US estate tax reach.

kk. Testamentary planning.
    1. Consider that only about 1,800 of 2018 decedents will have to pay estate tax in 2018 with exclusion amount of about $11M.
    2. Middle rich client – enough wealth to plan, but not enough to be taxable.
    3. What planning is most appropriate for moderate wealth or middle range planning? **<u>Comment</u>**: The answer is not simple, uniform, or assured.
    4. Disadvantages of disclaimers post mortem to engineer the amount going into credit shelter trust (size of estate, exclusion in year of death, etc.). Disclaimer planning is risky. Surviving spouse inadvertently accepts benefits, dies or become incompetent and

cannot disclaim. Disclaimers lose GST planning benefits and cannot grant powers of appointment.

5. One speaker prefers flexibility of a moderate wealth client if use QTIPs. Instead of a disclaimer required at 9 months the making of the QTIP election can be deferred for 15 months. The ability to make formula QTIP elections seems important. The ability to make a reverse QTIP election to preserve GST exemption could be valuable.
6. Consider drafting a QTIP-able trust with a mandatory income distribution. If that is problematic consider a Clayton QTIP so non-elected property passes to a discretionary income trust. **Comment**: The mandatory income payout if not required because of the size of the new exemption may create asset protection exposure and other issues. No simple answer.
7. In some cases, 100% QTIP election and portability election to get basis step up on second death. "There is no one size that fits all." **Comment**: The last comment seems to apply to so many aspects of post-TCJA planning – planning of all types needs to be selected more precisely for the client's circumstances, the options are greater, and the need for flexibility greater. Not an easy wish list.
8. Difficult to balance all of this. Do not know where beneficiaries will reside and may be in a state where income taxes are higher than estate taxes.
9. For different types of clients what steps might be appropriate?
10. Couple with under $5M do they want outright or trust planning and if do trust planning want to consider basis adjustment. **Comment**: When would trust planning not be appropriate? The loss of protection from creditors, the structure to protect a client as she ages, divorce protection, all the obvious things all practitioners know make the use of trusts the preferred default for all estates but the smallest. That being said, every practitioner equally well knows that a substantial proportion of clients loath the costs and complexity of trusts, even if they understand that it is advisable for them.
11. $5-11M should be concerned about taking steps to use exemption amount because of sunset. Use QTIP or portability. **Comment**: There are many more options to explore.
12. Client with more than $11M consider gift issues as well.
13. Basis adjustment planning at both deaths and particularly at second spouse's death should be considered:
    a. Distributions to beneficiary. Give independent trustee with broad discretion right to make
    b. Give someone LPOA in non-fiduciary capacity to make distributions to beneficiaries to get a basis step up.
    c. GPOA or power to grant GPOA (consider formula GPOA) drafting the formula can be difficult.

d. With GPOAs must be concerned about creditor impact. General trend in state law is if exercised creditors can reach it. Uniform Power of Appointment Act says even if exercisable creditors can reach assets.
e. Delaware tax trap. Grant LPOA and can be exercised in manner to spring the DE tax trap and have assets included in the estate. Caution -- so many states have repealed their rules against perpetuities. If you do not have a rule against perpetuities it may not work.

14. Transfer planning – window of opportunity as exemption may go down. Making a $5M gift is of no use need to make a gift of much more than $5M. Biggest impact of new large exclusion. Cushion effect will be significant. Could be helpful to making gifts. Defined value transfers not necessary for a $5M gift but still necessary for an $11M transfer.
15. Ways to use new gift exemption:
    a. Forgiveness of loans.
    b. Equalize prior gifts.
    c. To save state estate tax.
    d. Split-dollar loans can be unwound.
    e. Gifts to non-grantor trusts. Use separate taxpayer of non-grantor trust. With the $10,000 SALT limit get house into trusts for children or QBI because of $157,000 threshold.
    f. Trust sales can get bigger seed gift into trust.
    g. If have poor parents with lots of exemption create trust with GPOA to parents to get basis step up.
16. Considerations.
    a. If appoint assets from a SLAT back to donor spouse is it a creditor issue?
    b. Existing documents with credit shelter trusts have issues. Formulas may not work as desired.

ii. Income tax planning after TCJA.
1. Rate brackets have changed.
2. Indexing with chained CPI.
3. Standard deduction doubled $24,000 for a married couple filing a married filing joint income tax return ("MFJ.")
4. If give $10,000/year to charity may get no benefit. Consider funding a trust a DAF with a larger amount and drip out the donations over future years.
5. If states expand charitable contributions or payroll tax credited against income tax to circumvent SALT issue. Bills have been introduced to increase the $10,000. **<u>Comment</u>**: The $10,000 figure is not inflation adjusted.
6. PEAS limitation has been eliminated.
7. Home mortgage interest limited to $750,000 of debt.
8. 50% increased to 60% for cash contributions.

9. No deductions for home equity debt and no grandfathering for home equity lines.

iii. 67(e) deduction issues.

1. Change made to miscellaneous itemized deductions in new IRC Sec 67(g) which provides that no miscellaneous itemized deductions are permitted.
2. IRC Sec. 67(a) previously disallowed 2% loss of deductions which has been changed via the TCJA new Sec. 67(g) to be a 100% loss of deductions.
3. 67(b) defines miscellaneous itemized deductions. There are deductions set forth that are excluded from term "miscellaneous" deductions. Exceptions includes many that have been limited in other ways, e.g. the IRC Sec. 163 mortgage interest deduction.
4. IRC Sec. 67(e) covers expenses of trust administration that use to be excepted from 67(a). What Congress has done to deduction of administration expenses of trust and estates is to have suspended all miscellaneous itemized deductions subject to the 2% floor. IRC Sec. 67(e) said expenses unique to the administration of a trust or estate are not subject to 2% floor so that they should not be subject to IRC Sec. 67(g) disallowance. The IRC Sec. 67(e) regulations say all expense of fiduciary administration are permitted, except for investment advisory fees, as they are not unique to trust administration.
5. IRC Sec. 642(h) excess deductions only pass out to beneficiary in year of termination. These are deductions fiduciary cannot use. Are these subject to loss of deduction if not fiduciary expenditures? When they pass out they are not fiduciary expenses as they become deductions of the individual so they may be subject to loss of deduction.

iv. Life settlement new rules.

1. For life settlements not to family members not subject to transfer for value exceptions.

v. Divorce.

1. All divorces after 2018 alimony will not be deductible nor included to receiving spouse.
2. Alimony trust are repealed (not suspended).
3. Loss of IRC Sec. 215 is a real blow.
4. Loss of 682 is a major tax inconvenience for wealthy clients.
5. Consider impact of standard deduction. Recipient spouse with no earnings gets no benefit from standard deduction and standard deduction for earning spouse will be relatively smaller.
6. If trusts created during marriage tax costs will increase. Under current law if divorce Sec. 682 shifts tax liability to recipient spouse. But when IRC Sec. 682 no longer applies because 672(e) treats settlor spouse as subject to tax. Provisions in separation

agreement may require reimbursement to payor spouse for tax liability.

ll. Trusts.

i. IRC Sec. 691(c) deduction remains.

ii. Trusts exemptions of $100 for complex trusts remains.

iii. ESBTs.

1. Nonresident alien could not be current beneficiary of an ESBT. Act eliminates that prohibition. Trust pays tax on trust income even if distributed so no advantage to NRA being beneficiary of ESBT. Exception if a NRA owns stock in US corporation she will pay tax on divided income at 30% rate but now if held through ESBT may pay tax at 23.8% rate.
2. For ordinary trust to get deduction for charity must satisfy IRC Sec. 642(c). These rules are difficult. Payment must be pursuant to governing instrument and IRS position is amendment to governing instrument does not count. Payment must come from gross income of trust. This is difficult to show in some instances, e.g. if trust invests in pass-through entities. Prevents trusts from realizing deduction for unrealized appreciation. See Green decision above.
3. The Act changed this for ESBTs and they get charitable deduction under IRC Sec. 170 not under 642(c).

mm. IRC Sec. 199A.

i. 20% deduction of taxpayer's income if sufficient qualified business income ("QBI").

ii. 199A is a temporary provision until 2025. Drop in C corporation rate is however permanent.

iii. This provides meaningful tax relief to middle class other than being an employee.

iv. Most professionals or any trade or business in which skill or reputation of the individual is a key asset are not permitted the same benefit of 199A.

v. Limitations apply above threshold income amounts. $157,000 - $207,000 (single) so successful partner will get no relief and contractor that subcontracts much of the work will not get much benefit.

vi. QBI is calculated on a business by business basis. If have separate basis one with W2 income and one not, will aggregation minimize or prevent a deduction?

vii. What client has 20 real estate properties in separate LLCs. None have employees but rather a single-family business has employees and does work for each property. Might this client restructure to take better advantage of the new deduction?

viii. Complications of 199A may push some clients to switch to C corporation where looking to build business and not make earnings available to shareholders.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Marty Shenkman

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