Martin M. Shenkman's Meeting Notes from Heckerling 2018: Wednesday January 24, 2018, Day 3, Morning and 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 January 24, 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].**

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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.

1. **<u>Long-Term Care (When I'm Sixty-Four)</u>**. Bernard A. Krooks.
    a. Aging.
        i. Growing number of aging clients.
    b. Alzheimer's disease.
        i. 5 million Americans with Alzheimer's disease ("AD").
        ii. 200,000 young under 65.
        iii. Costs are staggering.
    c. Elder law myths.
        i. It won't happen to me. I won't go into a nursing home.
            1. 70% of people will need long term care.
            2. 50% will require nursing care.
        ii. Medicare will pay costs of care.
            1. Medicare does not pay for long term care.
            2. Acute illness, e.g. stroke cost of care is covered, but Parkinson's disease and Alzheimer's disease are not covered.
        iii. I'll make my own decisions.
            1. You may not be able to make decisions:
                a. Client too often presume they will be able to make decisions but there is often no advance notice of an acute health issue and with chronic issues clients wait too long. It is important to plan in advance.
                b. Financial. Who pays for your care?
                c. Where to you want care? Home? Assisted living?
                d. Who can visit (e.g., new spouse and kids don't get along and results in litigation). Better to indicate in document in advance who has what rights.
        iv. I'll stay at home.
            1. 80% of care at home is by unpaid caregivers.
            2. Caregiver agreement if want to get paid.
            3. If want to qualify for government benefits pay obligation must be in writing and there are tax consequences as it is an employee/employer relationship.
            4. Reduce to writing to minimize risks of family litigation.
    d. Long term care.
        i. Activities of daily living.
        ii. US has no health insurance for long term care.
        iii. Costs are staggering and most families cannot afford it for even a year.
        iv. You are responsible for cost of care for spouse.
            1. Spousal protections.
            2. Marital entity is deemed one entity for these purposes.
                a. Signing a prenuptial agreement even expressly saying you are not liable for care is not binding on the government as government was not a party to the agreement.
            3. Divorce.

a. Still have to have equitable distribution of assets and those assets would be required to be spent on cost of care, but it might preserve part of estate.

e. Assisted living.
    i. Custodial care in apartment-like setting.
    ii. Not licensed to provide medical are.
    iii. No governing federal regulation.
        1. State laws, regulations, licensing standards.
    iv. Risk of trying to negotiate agreement – may not accept client as patient/tenant. Often the family wants the client to be in a particular facility so that it becomes almost irrelevant to them what is in the agreement, as they want that particular facility.
    v. Many want private pay.
    vi. Caution consider what an actual cost will be and what extra charges may be assessed.
    vii. Medical expense deduction in excess of 7.5% AGI so may be entitled to deduction for assisted living facilities.
        1. Get statement from facility as to what component is rent versus medical expenses that are deductible.
f. Nursing home.
    i. Cannot require as condition of admission or continued stay that someone is a responsible party (other than spouse).
    ii. Might indicate that someone is a sponsor and agreement might make sponsor responsible that patient's bills are paid and may constitute a breach making the sponsor personally liable. While that is a violation of federal law but if you negotiate the agreement, client may not be admitted.
    iii. Nursing homes are limited as to how much money they can ask for up front. If come from hospital none. If come from home it is three months security.
    iv. Binding arbitration – consumers would rather be in court. Nursing home industry prefers binding arbitration. CMS – federally agency has stated that binding arbitration provisions are not permitted (2016). Nursing home industry filed for injunction and one state approved. New administration 'took it off the books." So, this remains the law. Kindred case – mom appointed daughter as agent under POA. Daughter as agent signed nursing home admissions agreement which included binding arbitration provisions. Daughter sued the nursing home for poor care. Nursing home said daughter as agent signed binding arbitration agreement. KY trial court said ability to go to court is so sacrosanct an agent cannot waive this on behalf of a principal and permitted court case to proceed. Nursing home filed writ to Supreme Court which in a 4:3 decision reversed federal law preempts so motion to dismiss was granted.
g. Paying for long term care.
    i. Private pay. Bunch deductions.
    ii. Reverse mortgages.
    iii. Life insurance – accelerated benefit rider.

iv. Medicare.
v. Medicaid.
vi. Long term care insurance.
vii. VA benefits.

h. Medicare.
   i. Federal program administered by CMS.
   ii. Only pays for rehab if patient is improving. Had been cutting people off after 30 days stating patient plateaued. Statute does not say anything about 'improvement."
   iii. Class action suit filed and standard is now maintenance but many do not know of this.
   iv. Observational status – you can be in a hospital for days but not be formally admitted. If then go to nursing home no coverage since not coming from admission in hospital. Now hospitals are supposed to inform you if you are just in observation status.

i. Medicaid.
   i. Jointly funded federal and state program so there is wide variation from state to state. Must use local expert for advice.
   ii. Administered through state and county agencies.
   iii. Federal minimum standards.
   iv. Spend-down state versus income cap state.
   v. May affect quality of care.
   vi. Resource limits. Bare minimum of assets in some states $2,000. You can spend down or give away.
   vii. Look back period. If you give away assets there was a 2 year look back now 5 years and a bill was introduced in Congress to make it 10 years.
   viii. A few differences from tax law – disclaimers treated in Medicaid world as if you received funds and then gave away, vs. tax world treated as if you never got it. Joint account in Medicaid world treated as all owned by patient whereas in financial or tax world the treatment might be deemed ½ joint owner. Rules differ by state.
   ix. Exemptions include retirement accounts in some states but must be in payout status, e.g. taking out minimum distributions. In other states retirement accounts treated like all assets so would have to liquidate and pay income tax to begin planning. In some states a home is exempt and home equity limit is $560,000 to 840,000.
   x. Other exemptions exist.

j. Trusts.
   i. Exempt trusts.
      1. First party special needs trust.
      2. Pooled trust.
      3. Qualified income trust.
   ii. Third party trusts.
      1. SNT trust assets not available.
      2. Discretionary trust if deemed support trust it is reachable. A wholly discretionary trust should work.

            iii. Right of election.
        k. Long term care insurance.
            i. Insurance designed to cover cost of custodial care.
            ii. Difficult to obtain.
            iii. Rigorous physical and cognitive exam.
            iv. Benefits based on daily rates, e.g. $300/day.
            v. Inflation rider.
            vi. Eliminate period.
            vii. Assistance with activities of daily living.
            viii. More conservative underwriting.
            ix. Women file more claims.
        l. Tax deduction is insignificant.

2. **<u>U.S. Income Taxation of U.S. Grantors and Beneficiaries of Foreign Trusts</u>**. M. Read Moore.
    a. Introduction.
        i. All English-speaking countries and others have trusts.
        ii. Trust law is different in different countries.
        iii. If grantor is non-resident alien ("NRA") different rules.
        iv. Throwback rules apply to foreign trusts.
        v. Beneficiary reporting for foreign trust is different.
        vi. What should practitioners look out for?
    b. When is a trust foreign or domestic?
        i. A trust that is not domestic is foreign. Two tests:
            1. Court test – It is a foreign trust if no court in US can exercise primary supervision over it. Test can be uncertain so a safe harbor has been provided: If the trust is administered in the US, the instrument does not direct that it be administered outside the US and the trust is not subject to an automatic migration provisions. Reg. Sec. 301.7701-7(c)(1).
            2. Control test – if a substantial decision can be made for trust by someone who is not a US person. If trustee or power to remove or replace trustees is a nonresident/non-citizen trust is a foreign trust, e.g. a trust protector. One or more US persons must have the authority to control all substantial decisions of the trust. IRC Sec. 7701(a)(30)(E)(ii).
        ii. Reporting implications when trust was formed.
    c. Tax issues – US Beneficiaries of Foreign Grantor Trusts.
        i. Foreign grantor trust means NRA is owner of trust income, gain and loss for income tax purposes. If so characterized, then distributions to a US person are income tax free. The NRA as grantor is generally not paying US income tax.
        ii. Congress is aware that this is a 'good deal' so special rules were provided for when trust will be treated as grantor as to a NRA. Bias to treat trusts as non-grantor if created by NRA.
        iii. First issue is who is grantor?

1. Someone who makes gratuitous transfer to trust is grantor.
2. This is a transfer for other than FMV. It is not the equivalent definition as a gift. Treas. Reg. Sec. 1.671-2(e)(1).
3. Only applies to person who settles trust.
4. US people subject to IRC Sec. 678 to determine grantor. That rule does not apply to NRAs. Sec. 678 if NRA can withdraw trust property without consent of another person and not a grantor, that will leave the trust as a non-grantor trust as 678 only applies when person holding power is a US person.
5. NRA beneficiary is treated as a grantor if has GPOA and exercises it.

iv. Second issue is if you have a foreign grantor when is he/she taxable on income?

v. Rules are different for foreign trusts.

vi. Sec. 672(f) only two types of trusts will be NRA to be treated as grantor.
   1. Grantor or grantor spouse is exclusive beneficiary – sole benefit trust. IRC Sec. 672(f)(2)(A)(ii). Not useful to plan for US beneficiaries since they are not going to be beneficiaries.
   2. Revocable trust – NRA is treated as owner of trust if he or she can re-vest trust property in himself alone or with consent of related or subordinate party.

vii. US Beneficiaries of foreign trust must report income on Form 3520. Must demonstrate why trust is a foreign grantor trust and why not taxable to beneficiary. 35% penalty for failure to report even though not taxable. Form 8938 US person with interest in foreign trust must declare interest. Does not apply if a beneficiary of foreign grantor trust. Contrast with domestic grantor trust wherein beneficiary has no reporting obligation.

viii. Foreign trust might use different title, like deeds of settlement, by declaration of trust. May not list grantor's name.

ix. Offshore trust may have a nominal settlor. In Australia trusts are settled my nominal settlor, e.g. the attorney. Must go 'behind' that and determine actual settlor. A company may be listed as settlor. That company may be treated as grantor, e.g. company settling trust for business purposes. If not settled for business purpose of company then owners of the company are treated as owners.

x. Easier to identify grantor under FATCA as trustees have to get information on who real settlor is and report to their government.

xi. Does settlor have power to re-vest property as that is one of two ways NRA can be treated as owner of trust. In the US use a revocation power. But revocable trusts not used much outside US. Notion under UK law that all trusts are irrevocable. A US style revocable trust might be viewed as a mere will under foreign laws. You will therefore rarely see what we consider a revocable trust outside US (Canada has a limited use of revocable trusts). So, the term "re-vest" is different than "revoke." What you are looking for is whether NRA grantor have direct or indirect power to get the trust property back. IRC Sec. 672(f)(2)(A)(i).

d. Taxation.
    i. Foreign non-grantor trusts calculate income similar to a US individual except as otherwise provided. Subject to US tax on US source income. Limitations on deductions.
    ii. Compute DNI of foreign trust to determine when distribution is made how beneficiary is taxed. DNI is sum of worldwide income less deductions calculated as if trust was a US trust, but foreign trust is not subject to US income tax on foreign source income.
    iii. Foreign trusts include capital gains in DNI.
    iv. Add back any foreign tax paid.
    v. Include foreign source income.
    vi. Look at worldwide income.
    vii. DNI divided ratably to foreign and US beneficiaries.
    viii. Throwback tax applies. IRC Sec. 665(b).
        1. Use to have in US when tax on trusts was lower than tax on individuals creating incentive to accumulate income in trusts. This is still applicable to beneficiary of foreign trust.
        2. Separate tax when beneficiary of foreign non-grantor trust gets an accumulation distribution that is larger than DNI for year or fiduciary accounting income.
        3. UNI = undistributed net income. If has accumulated income in UNI then the base on throwback tax applies is on amount of UNI. Must add back foreign tax paid by trust and subtract other distributions. Tax base is basically income that was not distributed before calculated according to US principles. Interest charge is imposed based on years US person was a beneficiary. Federal underpayment rate compounded daily. IRC Sec. 668 says total cannot be more than 100%. Major issue on long term foreign trusts.
        4. What is a distribution from a foreign trust? If distributes cash it's a distribution. If a distribution of property if property has appreciated in value above trust basis distributes out DNI based on basis of property so many not trigger throwback tax but not beneficiary has low basis property. What if make a loan and argue it is not a distribution? But a loan is treated as a distribution unless it is a qualified obligation (promissory note, 5 years or less, disclosed to IRS, interest at AFR, and beneficiary agrees to extend statute of limitations). So quite restrictive as to what type of loan will not be treated as a distribution. Notice 97-34.
    ix. Additional reporting requirements apply.
    x. Foreign trust law issues might make this tricky.

3. **<u>Question and Answer Panel</u>**. Carol A. Harrington, Steve R. Akers, Jeffrey N. Pennell.
    a. BDOT.

i. Cause surviving spouse to be deemed owner of a testamentary trust.
ii. Campbell case and PLR in 2017 addressed.
iii. Grantor trust rules refer to taxable income with respect to right to withdraw. How can you withdraw taxable income if there is no accounting income?
iv. Different parts of trust (income, corpus, etc.) as portion subject to grantor trust rules.

b. Home interest deduction.
   i. Mortgages grandfathered if indebtedness incurred before 12/15/17. Can buy, build or improve up to $1M total on principal residence and second home.
   ii. Old rules permitted deduction of home equity indebtedness. No longer the case.
   iii. New rules $750,000 limit but applies to debt to both principal residence and vacation home.
   iv. You can refinance as long as you don't increase the debt.
   v. So only $750,000 and loss of home equity line have changed.
   vi. **Comment**: The JCTA is scary stuff. The legislation was formulated and finalized in an absurd amount of time. Positions changed from the House to the Senate, and again to the conference report. And if that wasn't confusion enough, there were three more changes made by the Parliamentarian. There are inconsistencies in several places in the Conference Report as compared to the statute enacted. The array of sunset provisions is disconcerting. And on top of all of that there many provisions that simply turn upside down traditional tax treatments we have all grown accustom to, not to mention joyfully simple new provisions like 199A. Good luck to us all.

c. Sunset.
   i. Joint committee lists sunsets versus permanent changes Report from Joint Committee on taxation JCX-1-18 2016-2027 list of tax provisions.

d. Clawback.
   i. Who pays estate tax on exemption given as a gift before 2026 before sunset of exclusion?
   ii. Does state law address question? Likely not.
   iii. Does document address question? Likely not.
   iv. Can donor impose this liability on the donee in the instrument of gift analogues to a net net gift which obligates the done to pay estate tax on gift tax (gross up rule). Need to add a provision to any agreement but then the question is whether that provision would be enforceable?

e. ESBTs and Charity.
   i. Charitable deduction rule for ESBTs IRC Sec. 170 applies get the deduction whether or not governing instrument allows charitable gifts (Regs had already permitted this). Deduction is limited to 60% of adjusted gross income for cash.
   ii. CLATs – is the change a bad thing for CLATs as now subject to AGI limitation on gifts to charity.

iii. Trust only gets deduction for gifts made by S corporation. Only ESBT deductions are those that flow through and a few others which is not a charitable deduction. So, change is unlikely to be determinantal.

f. ESBT 199A.

i. Can ESBT get deduction? 199A is not available because IRC Sec. 641(c)(2)(C) doesn't expressly allow it, and does not flow through under IRC Sec. 1366 to the ESBT. The 199A deduction is determined at the shareholder level. Language of 641 is conflict with 199A as it shall apply at shareholder level.

ii. Need guidance to be sure.

iii. **<u>Comment</u>**:

1. New IRC Sec. 199A(a) provides: "Sec. 199a. Qualified Business Income. ''(A) In General.—In the case of a taxpayer other than a corporation, there shall be allowed as a deduction for any taxable year an amount equal to…"
2. New IRC Sec. 199A further provides: ''(i) this section shall be applied at the partner or shareholder level,…"
3. The Conference Report clearly stated: "The conference agreement provides that trusts and estates are eligible for the 20-percent deduction under the provision." If the provision clearly was intended to apply to trusts is seems incongruous that an ESBT would be precluded from claiming the deduction. Further, the new statute itself states that it shall be applied at the shareholder level and the ESBT is the shareholder.
4. IRC Sec. 641(b) provides: "Computation and payment. The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary."
5. IRC Sec. 641(c) provides: "(C)The only items of income, loss, deduction, or credit to be taken into account are the following…."
6. IRC Sec. 641(c) flush language at the end of the provision provides: "No deduction or credit shall be allowed for any amount not described in this paragraph, and no item described in this paragraph shall be apportioned to any beneficiary."
7. Clearly Congress intended to permit trusts to avail themselves of the 199A deduction as evidenced by the Conference Report and statute. It appears that not amending IRC Sec. 641(c) to add the 199A deduction was an oversight.

g. Powell Case.

i. Powell does seem to be a "far out result."

ii. Issue is 'in conjunction with others' decedent could dissolve partnership and get back underlying assets. So even if governing documents so no dissolution for 50 years partners could still get together and change this.

iii. Under state law RULPA a GP and majority of LPs can dissolve partnership. So even if agreement is silent, state law permit dissolution.

Further, partnership agreement is just a contract so partners can get together and change.

iv. 2036 bona fide sale exception. 3 cases that have saying 2036 did not apply without relying on that exception including Mirowski and Kimbell. That will still be the big exception to continue to rely on.
v. John Porter indicated agents are raising 2036(a)(2) on audits. Co-ownership of land IRS has raised 2036(a)(2).
vi. SALT limitation distributing home to entities so each get SLAT limit is a form of co-ownership. Historically would take 15-20% discount for non-controlling interest so under Powell theory no discount.
vii. Can we use the 2036(a)(2) argument to negate discounts on an estate? Basis increase considerations.

h. Form 706.
   i. QTIP.
      1. Must file Form 706 no other means to accomplish this.
   ii. GST exemption.
      1. If testamentary trust and you want to allocate GST exemption must file 706. This may be a surprise for small estates but they have no choice if they intend to make a trust GST exempt.

i. IRC Sec. 67(g).
   i. Limits deductions.
   ii. Sec. 67(a) lists limits on itemized deductions. IRC Se. 67(g) converts that limit to a prohibition. They took the shortcut approach of making this change in IRC Sec. 67.
   iii. Full deductibility of expenses of administration of trust or estate will continue to be allowed. Look at structure of IRC Sec. 67. 67(b) defines which are subject to 67(a). 67(e) says those limitations in 67(a) do not apply to expenses in trust. If you have fiduciary administrative expenses 67(e) continues to allow full deductibility of those items previously not subject to 2% floor.
   iv. Legal fees – may require unbundling if wraps many fees together. Look at un-bundling Regs which require you separately identify legal and accounting fees not charged on an hourly basis. Since most fees are billed on an hourly basis those will be deducted. Do these fees relate to something unique to administration of trust or estate (Knight case). What is unique to fiduciary administration, would not have been incurred if not held in a fiduciary capacity. Look at initial proposed regulations for guidance. Fees to prepare tax returns for the fiduciary Form 1041 and decedents final 1040 are unique to administration of trust or estate and are deductible. State income tax should be subject to SALT limitation applicable to all. For attorney and legal fees what was the advice rendered related to? Key issue relates to investment fees and portion of fiduciary fees related to investment advisory fees since these are not unique to a trust. These may be a Sec. 212 deduction which were not excepted under IRC Sec. 67(b) so you lose them.

j. Decanting.

        i. Trust A distributes assets to Trust B. Trust A was a resident trust in CA. Trying to avoid CA income tax. Is Trust B a grantor trust with income taxable to Trust A. Rule under Regs is that a trust is not generally considered the grantor of another trust. The grantor is the creator or person who made the gratuitous transfer, so the initial grantor of Trust A would be deemed the grantor of Trust B. If Trust A can take back assets from Trust B, the perhaps Trust A would be treated as the owner of Trust B, then perhaps Trust A is grantor to trust B. Perhaps both Trust A and Trust B might be treated as one trust under the multiple trust provisions. Treasury has never prescribed regulations under the code provision.
        ii. Reporting question – see Regs 671-4. Does a grantor trust have to file its own 1041? Regs have complicated set of rules. Generally, a trustee must have EIN and file own return and attach schedule of income. Exception if trust is treated as owner and provided trustee with completed Form W9 and that TIN is provided to all payors. Must also provide schedule to grantor. These are the rules governing how to report a revocable trust.
    k. Rev. Rul. 73-142.
        i. Bosch does not apply to state court decision before event becomes final.
        ii. Look at context of the factual situation involved. There could be gift tax implications to court order. You are not required to litigate to ultimate degree. In business that is a business decision (e.g. legal costs of pursuing case make it uneconomical), but in a family context that presumption is gone and should document why not pursuing. Gift tax only applies to a voluntary transfer so want to avoid appearance that litigation was a fake.
    l. 162 Deduction for Investment fees.
        i. Lender Management v. Comr. Dec. 2017. 212 deduction limitations. Discussion as to how to structure investment management fees to be 162 trade or business deductible expenses. Case law says you cannot invest on your own behalf and take expenses (Higgins doctrine). But there are outside investment managers in a trade or business. Can you turn investment management for wealthy families into 162 deductions? May use carried interests earning a percentage of profits. By doing this if compensation is a percentage of investment results of a fund that fund takes this off the top. In Lender family only, a few family members were involved and they managed money for other families a well.
        ii. TCJA changes holding period for carried interests.
    m. 2519 and QTIP Planning.
        i. 2519 used to trigger taxable gift to use exception. 2519 taxes remainder interest in a QTIP.
        ii. Do we need to worry about surviving spouse's disclaimer? No if it is a 2518 qualified disclaimer.
        iii. Can trustee make distributions out of QTIP that would permit gifts to surviving spouse/beneficiary to use exclusion? If QTIP has HEMs standard likely not. Difficult to justify.
        iv. Trustee has fiduciary liability concerns if he/she makes distributions that exceed standards in trust.

v. What about using a non-qualified disclaimer that intentionally incurs gift tax which may be what client wants with a large exemption. In some states the disclaimer statutes were drafted in a manner to save taxpayers from themselves. So, for example, the state disclaimer statute might require that the disclaimer be made in 9 months. So, confirm what state law permits.
vi. Intentionally trigger 2519.
vii. IRS may attack inappropriate distributions intended to secure basis step up.
viii. Consider modification of the trust.
ix. Defective grantor trust. Buy the low basis assets back.

n. 199A.
   i. Should single member LLC change to S corporation? Probably no. Self-employment tax savings with S election but may be worse under 199A because of requirement to have reasonable compensation to shareholder.
      1. **Comment**: The Senate Report provided: "Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer." But if that wage was paid as wages it would in fact reduce QBIT but it would also count for the 50% (or 25% + 2.5%) test. So perhaps no, perhaps it depends and it may require calculations under different scenarios to determine which is better.
   ii. If business is in C corporation is there a requirement to pay minimum or reasonable compensation rather than take dividend? There has been no incentive to question this. Corporation earns $1M pays no salary and pays all income out as dividends. SH will have after tax income tax at 37%. She will get same amount under either approach but C corporation can deduct SALT. 269A power to allocate C corporation back to SH if personal service company that performs most services for one other entity.
   iii. Sole proprietorship no requirement to characterize income as compensation.
   iv. Language in 199A(c) is ambiguous – may give power to IRS to impute compensation income to reduce amount eligible for 199A deduction.
   v. SSB no 199A deduction available after certain income.
   vi. Is owner of sports team in an SSB? 448 has definition of field of performing arts and regs under that section say that it does not include provision of services by person who is not performing the arts so by that standard owner of sports team should get 199A deduction.
   vii. If partnership makes 754 election beneficiaries can start depreciation again. What is result under 199A? Rule relates to unadjusted basis and seems based on time property was placed in service, so 754 may not help.
   viii. S corporation employees doesn't' employ people but uses employee leasing company. Does that support W2 wages? Answer is likely no. Both the contracting firm and leasing company will both want 199A deduction.

o. IRC Sec. 645.
   i. How long can we keep 645 periods open when treat estate and revocable trust as one? Is there a fiduciary duty to close the period? Is there

guidance? What about fact that closing letters not issued in ordinary course?

ii. Period is 6 months after the final determination of estate tax liability. Defines final determination (e.g. if too small to file, etc.). If have to file a return the final determination is 6 months after closing letter is received, or several other items. Suggests 12 months after closing letter. So, it might be better to delay receiving the closing letter.

p. Joint settlor/revocable trust.
   i. Basis improvement? How does it work?
   ii. Common in community property jurisdictions.
   When one spouse dies how do you allocate basis adjustment? Do you trace assets going in? Is it an anti-tracing?
   iii. Trust may have provisions governing who can revoke what portions of the trust. On death of first spouse only part becomes irrevocable.
   iv. Is ½ the trust grantor and ½ complex? No certainty. Most treat as if 50% is fully grantor and 50% not grantor. A lot of complexity arises with joint inter-vivos grantor trusts.

q. DSUE.
   i. If spouse dies and get DSUE via portability what happens when exemption declines?
   ii. 2001(g) use rates at date of death. But doesn't say what gift exclusion amount should be used. Instructions say use date of gift. Instructions should be corrected.
   iii. This really pertains to portability.
   iv. H dies in 2018 and $8M of his exemption is ported to W and she dies in 202 after sunset. 20.2010-2(b) in defining DSUE several elements including BEA in effect in year of death of the decedent. So, you should get DSUE based on year of first spouse's death and should not matter that the exemption declines.
   v. If use up exclusion in part it comes off the bottom. So, if you make a gift now of $5M we have used $5M of exclusion. If later the exclusion drops to $5M you have used your exclusion. This means you need to give away $11M if worried about sunsetting.
      1. **<u>Comment</u>**: If husband and wife together will make a $10M gift to use some exemption (assuming no prior use of exemption) perhaps one spouse should make the $10M gift so if exemption sunsets the other spouse will still have $5M. If both gift $5M each and exception sunsets nothing will be left.

r. GST.
   i. What if there has been an automatic allocation you did not want made? The amount transferred into a trust is the allocation so if gift $10M to a GRAT with $1 current gift it appears $10M of GST would have to be allocated. An argument exists a $1 allocation is sufficient.
   ii. What if GST is allocated to trust with GPOA?
   iii. Automatic rules do not work well for many ILITs e.g. when you have survivorship trust, e.g. on death outright to children by age 35. This does

not fit well within many of the exceptions. Automatic rules not drafted to pick up two lives. If automatic rule has allocated GST exemption in this type of satiation? Can you decant to change terms to keep in trust for lifetime then to grandchildren? If you modify a trust you must worry what IRS will think about it. If you modify a grandfathered trust you have four safe-harbors for not losing GST exemption. The regs do not say that if you do not comply with safe-harbors you necessarily lose exemption. There is, however, an example in the regs saying if you extend term you lose exemption. But when is that status lost? IRS may say on transfer taxpayer may say when it terminates.

4. **<u>Special Sessions I-F: Structuring Philanthropy: What Works</u>**. Martin Hall, Erik Dryburgh, Michele McKinnon.
    a. Private Foundation ("PF").
        i. Some clients/donors believe the PF will bring children together. If family is dysfunction a PF won't provide a cure. May grant off dollars to donor advised funds ("DAF") to break it up.
        ii. You can convert PF to supporting organization or pass out to DAFs so that PFs provide flexibility. So, client could continue PF so long as family is able to do so but if not, exercise those options.
        iii. Certainty as PFs have been around a long time.
        iv. Mission creep.
            1. How do you make sure generations out the same mission is pursued?
                a. Describe purpose in detail in organizational documents.
                b. Use trust vehicle.
            2. How much does donor care if mission changes as community changes? Do they want flexibility built in?
        v. Compensation issue.
    b. Family business.
        i. Case Study: 30 years ago, started business and grown to $1B. Net worth of client is $400M. Not sure of future of business. Will it be sold or perhaps daughter will want to continue business after dad dies?
        ii. How deal with business? Will daughter continue to run business? Or is expectation that business will be sold? That means daughter will be out of a job. If it will be sold when will sale occur? Will it occur during lifetime or when John or brother dies?
        iii. Excess business holdings limit - PF can hold 20% of active trade or business but must consider ownership of all disqualified persons. So, if John=dad contributes to PF, the ownership interests held by the children must be considered. If dad's brother is involved and wants to support the foundation then he will also be a disqualified person if contributes or is on board.
        iv. If sell during lifetime:
            1. PF would have to pay 2% excess tax on gain of owns stock when sold.

2. Sale during lifetime will permit PF to begin charitable activities.
3. Daughter might choose to work for foundation if business sold.

v. If receive business interest in PF can hold for 5 years. Can sell back to company by corporate redemption exception. If brother not involved in the foundation he would not be a disqualified person so he could buy business interests back.

vi. Coordination around sale of business is key.

vii. If business will not be sold:
1. Does the company have resources to fund a redemption?
2. Transactions will have to be at FMV.

viii. If no sale until death of survivor of brother's issue is how long? Have 5 years under excess business holding rules.

ix. Figuring out family plan for business is key to charitable planning.

x. Newman's Own is 100% owned by foundation and got 5-year extension, which is not easy to do and requires PLR. They tried to get the law changed but did not succeed. Newman's Own 10-years ends this year.

xi. DAF.
1. Advisers can only advise when and how much.
2. If transfer business to a sponsoring organization you have to have a family comfortable that the charity will do the right thing when the business is sold. Most families don't want charity to stop a business deal. Charity (community foundation) has a fiduciary duty which can create tension with the family.
3. Type 1 Supporting organizations excess business holding rules do not apply. Can allow for subsequent generations to be on board. Insulates the supported charity from owning assets directly (in controlled subsidiary).
4. Other types of supporting Type III not functionally integrated and certain Type IIs are subject to the rule. So primarily, Type I organizations are used since they have the fewest restrictions.

xii. Charitable Remainder Trust planning.
1. If most of charitable giving testamentary might they put some into CRT and foundation could be remainder.
2. Get income tax advantages by funding now and securing an income tax deduction.
3. Split interest charitable vehicles, e.g. CRT and CLT.
4. Can these types of entities be funded with closely held business interests?
5. What type of entity is the business? CRT is not an eligible shareholder of an S corporation. If it is a C corporation or LLC or partnership can transfer. If it is a C corporation do the PF rules apply? Many of the rules are carried over from PF area to CRTs. But the excess business holdings rule does not apply during period annuity is paid to the CRT beneficiaries. So, you can use a CRT to generate an income tax deduction for interest without the excess business holdings rule.

6. What if entity is a partnership or LLC? This will create UBIT concerns. Tax rate on UBIT received by CRT is 100% tax. So, if it is a pass through and business income flows to a CRT, the tax is assessed at a confiscatory level.
7. What about a CLT? If client wants an income tax deduction 170(f)(2)(B) must be structured as a grantor trust or there is no income tax deduction. John=dad as owner/donor must remain owner of lead trust assets. Donor will remain taxable on income earned by business during lead trust term. CLTs are also subject to some of the rules. The excess business holdings rules apply to a lead trust if the value of the lead interest is worth 60% or more of the FMV of the funding assets.

c. Income tax considerations.
   i. What are some of the income tax deduction considerations on gifts into charitable vehicles.
   ii. Case Study: Client purchased rental real estate. No close family. $500M net worth. Some properties are held in his own name, some in single member LLCs, etc. Wants to start making charitable gifts. Will sell some real estate holdings. All are depreciated and many have negative or zero basis. So, he will have large tax bill when he cuts back.
   iii. Appraisal issues.
      1. Substantiation of the gift is important part of any planning.
      2. Appraisals must be done properly.
      3. If gift over $500,000 must give the entire appraisal to the IRS with the tax return.
   iv. Does he want full deduction?
      1. If ordinary income realized on sale of asset you lose FMV deduction. Limited to basis and if basis is -0- you are getting no deduction.
   v. DAF.
      1. How will he know that sponsoring organization will carry out his intent after he dies?
      2. Identify someone to be successor advisor on DAF.
      3. The sponsoring organization, e.g. a community foundation, may have a field of interest fund.
      4. Might set up a fund within the community foundation to benefit organizations he wants to support.
   vi. Supporting organization.
      1. Local or national community foundation or grant making organization.
      2. Type I organization might help. Since it is a public charity it will maximize his income tax benefits.
      3. Having an SO might help client crystalize philanthropy vision. Can fund it over time so can take "'baby steps" to see how it works.
   vii. PF.

            1. If can give up income tax benefits associated with public charity could do a PF.
      viii. Granting outside US.
            1. Possible through DAF. Some larger DAFs will grant overseas. CAF America and Give to Asia are examples.
      ix. CRT.
            1. Might gift partial interests.
            2. Could create one CRT that the remainder goes to the private foundation, and another CRT the remainder of which goes to a public charity, to create more options.
            3. Defers capital gains.
            4. Can be used to give more time for client in case study to determine what charitable goals are?
            5. Lead interest could be worth 90% (must have 10% remainder interest). Sell asset and have got rid of the problem.
            6. Could be valuable in planning for problematic assets.
d. Tech company
      i. Case Study: Sold tech company and interested in education. Want to be actively involved in philanthropic efforts. May hire staff to help. May have a family office. This charitable endeavor will be their new jobs now that they are selling.
      ii. Timing.
            1. Should have planned before sale. Too late.
      iii. DAF.
            1. Since want to conduct active charitable efforts DAF seems inappropriate since you merely advise and family is not actively involved and cannot carryout direct charitable programs.
            2. Cannot do scholarships from DAF since DAFs cannot make grants to private individuals.
      iv. SO=supporting organization may meet desire for control.
      v. Private operating foundation ("POF") or straight private foundation ("PF") seems to be right choice since they (clients in this case study) want to be involved.
            1. Private operating foundation is treated like a public charity may give greater donation but type of assets involved do not seem to subject them to rules limiting deduction to basis. Seems like assets are all marketable securities so only the percentage limitations are applicable.
            2. Excess business holdings is not an issue.
            3. What activities will be conducted? Private operating foundation must carry out activities and not just grants. Scholarships are not characterized as a direct activity so may need multiple planning options.
            4. Private operating foundation spending requirements can be lower.

5. Private regular foundation is not only just a grant making entity. A PF can undertake direct charitable activities. PF can have its own charitable activities.
6. 4942(g) paid to accomplish one or more purposes described. Focused on purposes. So, using charitable assets to fund direct charitable activities meets the requirements. PF does not only have to give to another charity. Running a school, which is of interest to these clients, a PF with prior authorization can set aside amounts for future charitable activities that cannot be accomplished in the current year. Example, they may want to build a school so may be able to set funds aside and spend over a 5-year period to build the school and that can meet the PF distribution requirement.
7. PF can make direct grants to individuals, including scholarships, so long as pre-approved.
8. So, most of the goals of the clients in the case study can be met with the PF.
9. You can flip in and out of PF and POF.
10. Note that they had outstanding charitable pledges. Cannot use PF or POF funds to pay a pledge as that is an act of self-dealing. Note that for DAFs they may be able to do so. Issue is what is a "binding" pledge. Many pledges are only an intent to give and not binding contracts. This is really a contract issue. Has charity issued consideration back (I want my name on the building), whether charity or other donors have relied on pledge (we broke ground on building). If not clear might get charity to acknowledge that it is not binding so then PF or POF can pay it. Best for clients to confirm before making a pledge which funds will be used to pay it before signing.
11. Scholarships are important goal for the clients in the case study how much involvement do they want to have in scholarship programs? Do they have staff in place? Can earmark scholarships for recipients. Usually are paid to school to assure used for what they are supposed to be used for. But PF must get advance IRS approval for grant making procedure, must be objective and non-discriminatory basis.
12. POF requires same procedure under taxable expenditure rules. POF must meet tests showing it is using assets towards charitable activity. Scholarships do not meet this requirement, they are merely a grant making activity. What will they do? Do they want to separate scholarship program into a separate PF? Maybe they just establish scholarships at particular universities. National scholarship organizations will run scholarship programs for the PF.

vi. Clients create PF and five years later they want to add lobbying activities. They want to invest in startup companies which is risky. They want to support social causes that are important to the community but don't come under definition of charitable. What can they do? Also, assume that they have substantial unused charitable contribution carry forward deductions. So, more deductions are not a driving force. Now can open new opportunities. Consider a 501(c)(4) organizations for promotion of social welfare, operated for civic betterment, etc. These C4's are much broader than merely charitable, etc.

1. 501(c)(4) no income tax deduction but PATH act confirmed that there is no gift tax issue on funding.
2. Note that there is no corollary in estate tax rules with exclusion for gift tax so if directing beneficial enjoyment, it is included in estate for estate tax purposes.
3. PATH added an exclusion. Did not bring C4, C5 and C6 under charitable definition, merely provided an exclusion.
4. C4 is not an eligible shareholder for S corporations.

5. **<u>Special Sessions II-A: Settlors, Beneficiaries and the Dynasty Trust</u>**. Diana S.C. Zeydel, Todd A. Flubacher, Barry F. Spivey.
   a. Revising estate planning documents in light of TCJA.
      i. Jurisdictions without rule against perpetuities. 20 states have perpetual trusts and 8 have very long-term trusts. 8 states have common law rules against perpetuities.
      ii. Wills and revocable trusts. Do they pour into long term trusts? Local jurisdiction until settlor's death? Matters of validity are determined at time of creation of the trust. If pours over into long term trust in a better jurisdiction? If so may be preferable to set up trust in more favorable jurisdiction from inception. Hansen v. Denkla concerned FL trust and FL did not recognize trust and trust was in DE was that valid when property was administered under DE trust? FL court held it hand no jurisdiction over DE trustee. Law of jurisdiction where trust was formed governs.
      iii. GRAT, QPRTs etc. for most clients who under prior law and smaller exemptions were bumping up against those exemption amounts, that planning will disappear. But traditional reasons for using trusts, such as minimizing the risks of dissipation of wealth, remain.
      iv. Case law is inconsistent as to whether former spouse can reach into trust created by ex-spouse parent. For example, in FL the Berlinger (sp?) case had an unfavorable result. Given that type of risk is the client ever completed protected? Not always, but using a trust still puts them a step ahead. Consider adding a clause to the trust that if the beneficiary does not have a prenuptial agreement or post-nuptial agreement satisfactory to the trustee to protect the trustee the distributions to that beneficiary are reduced solely to covering medical expenses. This will force heirs to get prenuptial agreements.
      v. Trusts are unique vehicle to preserve wealth. Ongoing reasons for trusts:
         1. Creditor protection.
         2. Son in law = divorce protection. See above.
         3. Preservation of wealth.
         4. Hold family business.

5. Restrict disclosure of information about wealth. Example - the use of a silent trust.
6. Confidentiality document generally does not pass through probate and remains private for as long as trust is operative.
7. Protect against future tax uncertainty. Consider with respect to dynasty trust plan. If can avoid estate tax inclusion for any heirs if exemptions are lowered or other changes in law those assets may remain protected.

b. Options to modify trusts.
   i. Reformation of old and cold trust (will not have decanting clause).
      1. Must have a valid trust before you can reform it. FL requires execution with formalities of a will and the trust only had one witness.
      2. UTC 415.
      3. Always a judicial proceeding.
      4. Not a modification. Trying to establish by clear and convincing evidence that there is a mistake you are trying to fix. You are trying to get the trust to say what it should have said.
      5. You don't need ambiguity as you would in a construction proceeding.
      6. Must prove mistake by clear and convincing evidence. Court found document unambiguous. Lesson is you must convince trial court. Appellate court will not re-weigh the evidence.
      7. Should be no tax consequences since correction is effective at inception.
   ii. Judicial modification.
      1. UTC 412.
      2. Anyone can bring an action to modify or terminate if it furthers the purposes of the trust. Extension of equitable deviation to modify inopportune details. Must modify in accord with settlor's probable intent and if terminated must distribute in accord with purposes of trust. Virtual representation may apply.
      3. Must have the right court with subject matter jurisdiction, etc.
      4. Who are parties?
      5. Who might collaterally attack because they were not involved (no due process)? Requires that interests of beneficiary and person representing them must be aligned and representation must be adequate.
      6. Someone may want court approval even if another method were permissible.
      7. Court may appoint guardian ad litem to represent unknown, unascertainable or minor beneficiaries.
   iii. Consent Modification UTC 411.
   iv. Decanting.
      1. Consider GST, gift and estate tax considerations.

2. If more than one jurisdiction was appropriate you should be able to proceed under either. You may have competing statutes and they are not all the same.
3. In decanting consider if clause addresses notices. If notice is required it can be difficult. FL case held that without notice decanting was invalid.
4. If trustee is preparing to so alter the beneficiary interests that there may not be an adequate remedy that you may have to give advance notice of that.
5. Consider complying with both state law and decanting clause in the trust document.
6. If power to decant is a fiduciary power how do you address the duty of impartiality? Document might waive that duty.
7. Must consider trustee's obligation to remainder beneficiaries. If do not have to notice beneficiaries of a distribution will a notice of a decanting be required?
8. If you get releases are their gift tax consequences?
9. IRS has not issued guidance and there are many unanswered questions.

v. Merger.

vi. Non-judicial settlement agreement – UTC 111.

1. Should you be concerned about using this? If dealing with UTC refers to any matter involving a trust which should seem to include modification. The comment includes non-adversarial matters. Most commentators have concluded that you can do a modification if everyone agrees and is represented.
2. But a corporate fiduciary may want court approval. Getting that seal of approval is certainly the most assured. See above.
3. Issues – has everyone been represented? Have you gone beyond authority? Might a beneficiary who was virtually represented claim there was a conflict tainting that?
4. A beneficiary might attack an agreement on the basis that it violates a material purpose of the trust.
5. PLR 201233008 all beneficiaries, grantor and trustee consented to modification pursuant to state statute and IRS held this did not trigger state inclusion. If modification changes beneficial interests, shifts interests or cuts out a beneficiary what are implications of settlor signing this? What about gift tax ramifications as to beneficiaries signing off?

vii. Administrative amendments.

c. Considerations.

1. Flexibility and longer-term trusts are more prone to conflicts.
2. Modification produces risk.
3. Decanting merger and administrative amendments are an exercise of discretion.

            4. Virtual representation. Limited circumstances because a non-party may be bound by judgement by someone representing them, interests are aligned (substantially identical), represented understands that they are representing others, trial court makes sure to protect interests that are not before the court. These findings are needed. Not proforma, you must offer evidence to prove these elements.
            5. Binding on all parties.
    d. Jurisdiction and representation of parties.
        i. Situs and choice of law.
            1. Bring action in primary place of administration, that is primary jurisdiction for bringing an action concerning a trust. It is where trustee is located.
            2. Must be jurisdiction substantially related to matter litigated. Fact specific. If trust has assets in multiple jurisdictions. Example trust administered in State A but action concerns realty in State B might bring in either. Which venue is best (forum)?
            3. Under UTC can specify tax situs or real property.
            4. Trustee submits to personal jurisdiction at place of administration so if you want to surcharge that is the location.
            5. If you are trying to get a beneficiary to contribute to tax apportionment may have to sue where beneficiary lives.
        ii. What venue is best or proper jurisdiction over the trust.
        iii. Jurisdiction over fiduciaries and beneficiaries.
        iv. Competing court jurisdiction.
    e. Tax issues.
        i. Longer term trusts are prone to more issues. Beneficiaries will change and their desires will change and there will be more conflict. Controlling these issues and dealing with beneficiary expectations while still addressing tax planning is not simple. More flexibility means less guidance and parameters for distribution.
    f. Drafting for flexibility.
        i. Long term trusts should be future proof.
        ii. Express modification provisions.
        iii. Powers of appointment.
        iv. Springing powers of appointment.
        v. Add and remove beneficiaries.
        vi. Two separate standards of liability.
            1. General standard.
            2. A second standard if all beneficiaries want something done, e.g. power to allocate, or administrative power to amend.
        vii. Bifurcate responsibilities.
        viii. Special trustee.
        ix. Use and enjoyment of assets, e.g. loan for business instead of distributions, real estate held in trust and permit beneficiaries to use it.
            1. Common question is loans.

    2. Common law does not strongly support this so perhaps it should be drafted to address.
    3. Lending versus distributing to avoid distribution committee process, but nonetheless you have taken the loan on as an asset of the trust.
    4. Consider dropping assets into LLC and permit LLC doing this.
    5. What types of lending powers should trustee have?

x. Silent trusts.
    1. What is consequence of a silent trust?
    2. What happens to fiduciary involved in a silent trust?
    3. Silent trusts have become very popular. Enables trustee to avoid conversations with beneficiaries. Clients like these but the panel and fiduciaries generally are not in favor of these.
    4. How can you have a silent trust with Crummey withdrawal right?
    5. DE as an example allows you to appoint someone to give notice to and to bind beneficiaries.
    6. In DE it is permissible for a period of time, e.g., for a person's life.
    7. Difference between "you have no duty" in which case the trustee might still give notice versus "thou shall not give notice."

xi. Precatory language.

xii. Special needs trust provision.

xiii. Avoid unnecessary limitations and restrictive definitions.

HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!

Marty Shenkman

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