Leimberg Information Services, Inc.

Steve Leimberg's Income Tax Planning Email Newsletter - Archive Message #163

Date: 03-Dec-18

From: Steve Leimberg's Income Tax Planning Newsletter

Subject: **Jonathan G. Blattmachr & Martin M. Shenkman: Trust and Related Planning Post 2017 Tax Act**

"In the wake of the Tax Cut Jobs Act of 2017 ('Act'), the focus of planning discussions has shifted to the use of non-grantor trusts to secure income tax deduction, and perhaps secondarily to the use of the larger but temporary estate tax exemptions. While these are important planning changes that practitioners need to address, the planning environment is much more complex. There have also been important other recent developments affecting planning for irrevocable trusts, including the following:

- *Irrevocable trust planning may benefit from using new planning and drafting techniques to optimize results in the unique post-Act environment. Practitioners should understand the new types of trusts and the pros and cons of using them.*
- *The Proposed Regulations under IRC Sec. 199A introduce new controversy and challenges for practitioners endeavoring to structure non-grantor trusts.*
- *The type of planning that needs to be addressed will vary significantly by the client's wealth level, income tax circumstances, and other factors. These differences may be more pronounced than pre-Act.*
- *The use of non-grantor trusts, while potentially advantageous, entails a level of detail and risk that deserves more consideration. There is a myriad of income tax considerations, and traps, to non-grantor trust planning, as well as other factors that should be evaluated. While much of the literature following the Act has extolled the benefits of non-grantor trust planning, and that can be true, now that more time has passed perhaps a more objective and holistic analysis will be useful to practitioners.*
- *The potential need to use self-settled domestic asset protection trusts ('DAPTs'), or variations of DAPTs, to provide clients access to the*

large wealth that must be transferred to secure some portion, or all of the current large exemptions has increased post-Act. At the same time, there seems to be concern among some practitioners about the efficacy of this technique. Practitioners need to understand the issues to guide clients to make informed decisions about the use of DAPTs and variants, but to also give clients the comfort level to proceed with planning that could prove valuable.

- *The ultra-high net worth ('UHNW') clients have become active in the current environment. Many have given up on any hope of estate tax repeal, and view the current environment (high exemptions, no 2704 Regulation restrictions, etc.), as the 'best it will ever be' to plan. While the Act has not itself changed the techniques available to these UHNW clients, what types of issues and considerations or new ideas might be integrated into planning for these clients? With substantial wealth transfers being undertaken by this client segment, the differences in opinions about various planning techniques used by for clients consummating large wealth transfers are fascinating to consider. These variations highlight the uncertainty of UHNW client planning, and perhaps opportunities to refine and improve planning techniques.*
- *New developments concerning split-dollar life insurance planning, for those clients that can still benefit from such techniques despite the high exemptions, should be considered in formulating such plans.*
- *New developments concerning self-settled domestic asset protection trusts should be considered in planning such transactions.*

Overall irrevocable trust planning is more complex than ever. Practitioners need a wider variety of trust planning techniques in their tool kits than ever before. All this occurs at a time when most even wealthy clients view the transfer tax system as irrelevant given the current high exemptions. That will likely prove a mistake for clients who do nothing and miss out on income tax, asset protection, and estate planning that may well prove with hindsight to have been advisable. Practitioners need to educate all clients as to appropriate planning to consider for their wealth levels in what is a new and different planning environment."

LISI is excited to be able to share with members a 50 page+ special report on trust planning authored by **Jonathan G. Blattmachr, Esq.** and **Martin M. Shenkman, Esq.** Their commentary addresses the new uses of non-grantor trusts, continued relevance of grantor trusts, how to craft a plan with the appropriate mix of grantor and non-grantor trusts, as well as some

of the unique trust planning considerations in the current environment for ultra-high net worth clients.

Jonathan G. Blattmachr is **Director of Estate Planning** for **Peak Trust Company** (formerly Alaska Trust Company), co-developer of Wealth Transfer Planning a computer system for lawyers, a director of Pioneer Wealth Partners, LLC, author or co-author of eight books and over 500 articles, and a retired member of Milbank, Tweed, Hadley & McCloy, LLP, and of the Alaska, California, and New York Bars.

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, more than 1,200 articles, and, is a Director for the National Association of Estate Planners & Councils.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jonathan Blattmachr

Martin Shenkman

CITE AS:

LISI Income Tax Planning Newsletter #163 (December 3, 2018) http://www.leimbergservices.com Copyright 2018 Leimberg Information Services, Inc. (LISI). Reproduction in Any Form or Forwarding to Any Person Prohibited – Without Express Permission.

Trust and Related Planning Post 2017 Tax ACT

By: Jonathan G. Blattmachr, Esq. and Martin M. Shenkman, Esq.

Contents

Contents

Trust and Related Planning Post 2017 Tax Act

By: Jonathan G. Blattmachr, Esq. and Martin M. Shenkman, Esq.

Introduction and Overview

In the wake of the Tax Cut Jobs Act of 2017 ("Act"), the focus of planning discussions has shifted to the use of non-grantor trusts to secure income tax deduction, and perhaps secondarily to the use of the larger but temporary estate tax exemptions. While these are important planning changes that practitioners need to address, the planning environment is much more complex.[1] There have also been important other recent developments affecting planning for irrevocable trusts.

- Irrevocable trust planning may benefit from using new planning and drafting techniques to optimize results in the unique post-Act environment. Practitioners should understand the new types of trusts and the pros and cons of using them.
- The Proposed Regulations under IRC Sec. 199A introduce new controversy and challenges for practitioners endeavoring to structure non-grantor trusts.[2]
- The type of planning that needs to be addressed will vary significantly by the client's wealth level, income tax circumstances, and other factors. These differences may be more pronounced than pre-Act.
- The use of non-grantor trusts, while potentially advantageous, entails a level of detail and risk that deserves more consideration. There is a myriad of income tax considerations, and traps, to non-grantor trust planning, as well as other factors that should be evaluated. While much of the literature following the Act has extolled the benefits of non-grantor trust planning, and that can be true, now that more time has passed perhaps a more objective and holistic analysis will be useful to practitioners.
- The potential need to use self-settled domestic asset protection trusts ("DAPTs"), or variations of DAPTs, to provide clients access to the large wealth that must be transferred to secure some portion, or all of the current large exemptions has increased post-Act. At the same time, there seems to be concern among some practitioners about the efficacy of this technique. Practitioners need to understand the issues to guide clients to make informed decisions about the use of DAPTs and variants, but to also give clients the comfort level to proceed with planning that could prove valuable.
- The ultra-high net worth ("UHNW") clients have become active in the current environment. Many have given up on any hope of estate tax repeal, and view the current environment (high exemptions, no 2704 Regulation restrictions, etc.), as the "best it will ever be" to plan. While the Act has not itself changed the techniques available to these UHNW clients, what types of issues and considerations or new ideas might be integrated into planning for these clients? With substantial wealth transfers being undertaken by this client segment, the differences in opinions about various planning techniques used by for clients consummating large wealth transfers are fascinating to consider. These variations

[111] See Shenkman and Blattmachr, "Trust Planning After the New Tax Law," Trusts and Estates, Feb. 2018, p. 13.
[2] Proposed Reg. Sec. 1.199A, REG-107892-18.

highlight the uncertainty of UHNW client planning, and perhaps opportunities to refine and improve planning techniques.

- New developments concerning split-dollar life insurance planning, for those clients that can still benefit from such techniques despite the high exemptions, should be considered in formulating such plans.
- New developments concerning self-settled domestic asset protection trusts ("DAPTs") should be considered in planning such transactions.

Overall irrevocable trust planning is more complex than ever. Practitioners need a wider variety of trust planning techniques in their tool kits than ever before. All this occurs at a time when most even wealthy clients view the transfer tax system as irrelevant given the current high exemptions. That will likely prove a mistake for clients who do nothing and miss out on income tax, asset protection, and estate planning that may well prove with hindsight to have been advisable. Practitioners need to educate all clients as to appropriate planning to consider for their wealth levels in what is a new and different planning environment.

Irrevocable Trust Planning by Wealth Strata

The following discussion delineates differences in planning for clients of different wealth levels. The wealth strata used are broad generalizations defined relative to the new exemption levels.

Lower wealth clients

Creative applications of non-grantor trusts may garner income tax deductions for these clients. For lower wealth clients, existing documents and planning will have to be reviewed. Many clients in this wealth strata will be inclined to unravel prior planning under the premise of "Why do I need this now?" Lower wealth clients are often inclined to merely terminate prior planning as irrelevant to them. Practitioners will have to educate these clients as to the value of retaining (whether modified or otherwise) existing planning from several perspectives. Many estate planning steps provide asset protection benefits and the transfer tax changes do not minimize the need for that. For some clients if the planning is already in place the modest cost of continuing to maintain that planning may be insignificant relative to the cost of unraveling the planning, and then having to reconstruct it in the future if the law changes yet again (e.g. a reduction in the exemption amount by a future administration). Practitioners should advise these clients as to the benefits of retaining prior planning, e.g. a life insurance trust to protect the proceeds for intended heirs, as well as the costs and potential problems of simply terminating existing planning.

Moderate wealth clients

"Moderate" wealth may be a wide range from perhaps $5M to as much as $40M (or more) relative to the new high exemption amounts. High temporary exemptions $22M+/couple, might suggest a "plan now" approach. These exemptions, as all are aware, are scheduled to be reduced by half in 2026. Exemptions and other planning could be adversely affected by changes enacted by a new administration before 2026. Income tax considerations and the state and local tax ("SALT") deductions change the face and goals of planning. Access to assets transferred is more critical than ever with the large dollars that have to be transferred to use exemption currently.

This is critical to avoid the so-called buyer's remorse that affected many 2012 last minute estate planning transactions. In many of those plans the transferor/donor made large wealth transfers in the rush of the December 31, 2012 anticipated deadline, and thereafter could not access those funds. While some clients might have regretted planning because the exemption did not decline to $1M as feared, rather it may have been the lack of access to assets transferred that was the primary complaint. In the current trust planning environment, assuring access to assets can prove much more difficult than in the 2012 environment for two reasons. First, in 2012 any transfer of more than $1M preserved exemption. In 2018 transfers might need to exceed the $5.6M estimate of what the current exemption may decline to in 2026 before any benefit of the temporary exemption is preserved. Second, in 2012 the most irrevocable trusts created to hold gifts and other transfers were structured as grantor trusts. This permitted the spouse to have access and the settlor to borrow trust funds without adequate security. In the current 2018 planning environment it will be advantageous to structure many of the trusts to receive gifts as non-grantor trusts, although this could be more challenging consider the proposed changes to the multiple trust rules.[3] This will require more complex planning to achieve goals that may be contradictory. This is explained at greater length below. Practitioners should consider having one spouse, not both use exemption thereby preserving more exemption.

Example: Husband and wife have a combined estate of $16 million and are willing to make an $8 million transfer to irrevocable trusts to secure a portion of the temporary exemption. If each of husband and wife transfer $4 million to a non-reciprocal spousal lifetime access trust ("SLAT") in 2026 when the exemption declines by half, to perhaps $6 million, each spouse will be left with $2 million of exemption, or a total of $4 million. If instead husband alone transferred $8 million to a trust for wife and descendants, wife would have left her entire $6 million exemption.[4] For taxpayers with estates of a size that there is no need to preserve the new GST exemption, it might be prudent to make late allocations of GST exemptions to existing trusts so that if a future administration rolls back the Act's benefits, those trusts will already be exempt.

UHNW clients

These clients appear to have given up on any hope of estate tax repeal and seem to be aggressively planning before a less favorable changes occur. UHNW clients are concerned that if a different administration exists in Washington after the 2020 or 2024 elections a reaction to the perceived favoritism the Act showed the wealthy may occur. Perhaps a new administration will propose legislative changes to implement the withdrawn 2704 Regulations may have brought about. Now may be prove to be the best time to plan that they will ever have. Estate planning for larger estates has not been dramatically affected by the Act since for UHNW clients the new large exemption may facilitate some planning but is might be modest relative to their net worth. There have been other developments and new planning ideas that practitioners might consider.

---

[3] Proposed Reg. Sec. 1.643(f)-1 "Anti-avoidance Rules for Multiple Trusts."

[4] The preamble to the Proposed Regulations provide: "Section 643(f) grants the Secretary authority to treat two or more trusts as a single trust for purposes of subchapter J if (1) the trusts have substantially the same grantors and substantially the same primary beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1 of the Code. Section 643(f) further provides that, for these purposes, spouses are treated as a single person." Using one spouse's exemption in a single non-grantor trust obviates the issues created by the Proposed Regulations.

This too should be part of planning in the new trust landscape. Some of the planning ideas, such as the use of non-grantor to salvage portions of an otherwise lost home property tax deduction may not be worth the bother for larger clients. For example, if a UHNW client's home property tax bill is $100,000, or a multiple of that, how many trusts is it worth creating to salvage a portion of that tax benefit, even if such planning remains after the final 199A Regulations become law. Non-grantor trust planning for the UHNW client is also be easier than for the moderate wealth client in that the UHNW client, in contrast to a moderate wealth client, may not need access to the assets transferred to the non-grantor trusts. That can avoid several complex tax issues on structuring a non-grantor trust to permit access, as discussed below.

Transfers to Irrevocable Trusts Post-Act May Change Evaluation of Grantor versus Non-Grantor Status

Asset protection considerations of non-grantor trusts deserve additional attention post-Act. With moderate wealth clients not facing any federal estate tax, unless they are domiciled in a decoupled state that could result in a state estate tax, there may be no transfer tax benefit to creating a grantor trust plan that affords asset protection, e.g. a DAPT or non-reciprocal SLATs for married couples. It may only be the income tax benefits afforded by a plan based on non-grantor trusts that offers a non-asset protective rationalization for the planning.

Example: Physician has a net worth of $12 million. Prior to the Act the couple faced a federal estate tax. Shifting assets to non-reciprocal spousal lifetime access trusts ("SLATs") would likely save estate tax, and that tax savings would likely grow as the estate grew. However, post-Act the same couple would realize no estate tax benefit from creating non-reciprocal SLATs. Perhaps, there is no other justification for the plan other than asset protection. However, if a non-grantor trust were instead created, and state income tax, SALT and other income tax savings are realized, those income tax savings might lend support to the non-assets protection motives for the trust.

Multiple Trust Rule May Impact Income Tax Savings from Non-Grantor Trusts

Code Section 643(f) provides: "Treatment of Multiple Trusts: For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if—
(1) such trusts have substantially the same grantor or grantors **and** substantially the same primary beneficiary or beneficiaries, **and** (2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.
For purposes of the preceding sentence, a husband and wife shall be treated as 1 person. [**highlights** added]." This appears to thus be a three-part test in which each component must be met.

While practitioners speculated about the use of multiple trusts to enhance Section 199A deductions, the Treasury clearly read the same articles and has incorporated Section 643 into the proposed regulations. Clearly, the mere use of non-grantor trusts will not provide the planning panacea some anticipated. Note the "and" requirements. The language in the Proposed Regulations might not facilitate using powers of appointment, different distribution standards,

and other differences that had been used to break the reciprocal trust doctrine, may not suffice to differentiate trusts as some may have done before. Thus, the reciprocal trust doctrine may be avoided for several trusts, but those trusts may still be ensnared by the provisions of the Proposed Regulations. This language may also ensnare using multiple trusts for SALT or property tax deduction and one SALT limitation may be applied.

The Preamble to the Proposed Regulations provides:

> "Section 643(f) grants the Secretary authority to treat two or more trusts as a single trust for purposes of subchapter J if (1) the trusts have substantially the same grantors and substantially the same primary beneficiaries and (2) a principal purpose of such trusts is the avoidance of the tax imposed by chapter 1 of the Code. Section 643(f) further provides that, for these purposes, spouses are treated as a single person.
>
> To address this and other concerns regarding the abusive use of multiple trusts, proposed §1.643(f)-1 confirms the applicability of section 643(f). As noted in part II of the Background, section 643(f) permits the Secretary to prescribe regulations to prevent taxpayers from establishing multiple non-grantor trusts or contributing additional capital to multiple existing non-grantor trusts in order to avoid Federal income tax. Proposed §1.643(f)-1 provides that, in the case in which two or more trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and a principal purpose for establishing such trusts or contributing additional cash or other property to such trusts is the avoidance of Federal income tax, then such trusts will be treated as a single trust for Federal income tax purposes.

This, as the statute, appears to incorporate three distinct requirements: (1) substantially the same grantor; (2) substantially the same primary beneficiaries; and (3) a principal purpose of avoidance of federal income tax. If a parent creates a trust for each child in which a specific child is named as primary beneficiary and other descendants as merely secondary beneficiaries, is that sufficient to circumvent the restriction proposed? A client might create two SALTy- "SLATs" (non-grantor trusts) with each "SLAT" created for a separate child. The spouse, however, would not be listed as a beneficiary of one of the trusts at inception (i.e., not even with the require of the approval of a non-adverse party for a distribution) but rather as a mere appointee. Would this suffice to differentiate the "primary" beneficiary of each such trust? Many clients might want Child A as primary, but all other descendants as secondary beneficiaries and the Regulations appear to subsume that arrangement under the "substantially similar" language.

It would have seemed that non-reciprocal spousal lifetime access trusts ("SLATs") should not run afoul of this requirement as they cannot have the same primary beneficiary but, see the following, as the Proposed Regulations also attack this common planning tool. If those non-reciprocal SLATs are to be non-grantor, then an adverse party would have to approve distributions to the spouse who is the intended primary beneficiary. Would that approval process negate the characterization of that spouse/beneficiary as the "primary" beneficiary under the

Proposed Regulations? Would the use of different adverse parties have any impact? It would appear not. What if different primary beneficiaries are provided for? For example, one spouse is a beneficiary of one SLANT subject to the approval of an adverse party. In a second trust the spouse is not named but a person is given the power of appointment that could result in appointing that spouse as a beneficiary. Might that constitute a sufficient difference in primary beneficiary yet still pass muster as a non-grantor trust?

Might it be possible for a corporation to serve as a grantor of one trust and thereby break one of the three requirements?[5] The trust was found to be a grantor trust. A business entity can be a grantor to a trust if the transfer to the trust serves a business purpose of the entity. An example of this is an entity transferring property to a trust to secure a legal obligation of the entity to an unrelated third party. In contrast, however, if an entity makes a gratuitous transfer to a trust that has no entity business purpose, but rather serves the personal purposes of the owners of the entity (e.g. shareholders of a corporate transferor), the transaction will be treated as a constructive distribution to the owners who will then be treated as the grantors of the trust.[6] A number of private revenue rulings have upheld transfers by corporations to trusts.[7]

Note that the Proposed Regulation includes the word "and" so that in addition to having "the same primary beneficiary or beneficiaries" the trust must also have as a principal purpose "avoidance of Federal income tax." However, the example near the end of the Proposed Regulations, appears to have negated this additional requirement exceeding the scope of the statute. Do the asset protection benefits and use of temporary exemptions outweigh or negate the possible tax benefits of additional Section 199A deductions being a principal purpose? Since the Section199A deductions are by law to sunset after 2025 that limiting factor may be relevant to the calculus of "principal purpose."

The Proposed Regulations provide: "(a) A principal purpose. A principal purpose for establishing or funding a trust will be presumed if it results in a significant income tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation of these separate trusts." A projection of maximum income tax savings from additional non-grantor trusts might be quite modest when compared to the asset protection benefits. What if the trusts were formed in different jurisdictions arguably enhancing the asset protection each afforded the client? What of the potential estate tax savings the trust might afford. Having different trusts each naming a different heir as both a primary beneficiary and holder, as an adverse party, to permit a spouse to receive a distribution might fulfill a significant non-tax purpose of lessening the spouse's dependence on just one beneficiary.

For purposes of applying this rule, spouses are treated as only one person and, accordingly, multiple trusts established for a principal purpose of avoiding Federal income tax may be treated as a single trust even in cases where separate trusts are established or funded independently by each spouse. The "principal purpose" test must still be met, but it would seem that Treasury's intent is to negate even SLAT (or the non-grantor SLANT or SALTY-SLAT variations).

[5] Service Medical Group, Inc. Employee Protective Trust v. Comr., 85 T.C. 1031 (1985).
[6] Treas. Reg. Sec. 1.671-2(e)(4).
[7] PLR 200644013; 200203034.

Proposed §1.643(f)-1 further provides examples to illustrate specific situations in which multiple trusts will or will not be treated as a single trust under this rule, including a situation where multiple trusts are created with a principal purpose of avoiding the limitations of section 199A. The application of proposed §1.643(f)-1, however, is not limited to avoidance of the limitations under section 199A and proposed §§1.199A-1 through 1.199A-6. The latter sentence may imply that the new 643(f) Regulations will also be used to attack the use of multiple non-grantor trusts to salvage SALT deductions.

Example 1. (i) A owns and operates a pizzeria and several gas stations. A's annual income from these businesses and other sources exceeds the threshold amount in section 199A(e)(2), and the W-2 wages properly allocable to these businesses are not sufficient for A to maximize the deduction allowable under section 199A. A reads an article in a magazine that suggests that taxpayers can avoid the W-2 wage limitation of section 199A by contributing portions of their family businesses to multiple identical trusts established for family members**.** Based on this advice, in 2018, A establishes three irrevocable, non-grantor trusts: Trust 1 for the benefit of A's sister, B, and A's brothers, C and D; Trust 2 for the benefit of A's second sister, E, and for C and D; and Trust 3 for the benefit of E. Under each trust instrument, the trustee is given discretion to pay any current or accumulated income to any one or more of the beneficiaries. The trust agreements otherwise have nearly identical terms. But for the enactment of section 199A and A's desire to avoid the W-2 wage limitation of that provision, A would not have created or funded such trusts. A names A's oldest son, F, as the trustee for each trust. A forms a family limited partnership and contributes the ownership interests in the pizzeria and gas stations to the partnership in exchange for a 50-percent general partner interest and a 50-percent limited partner interest. A later contributes to each trust a 15% limited partner interest. Under the partnership agreement, the trustee does not have any power or discretion to manage the partnership or any of its businesses on behalf of the trusts, or to dispose of the limited partnership interests without the approval of the general partner. Each of the trusts claims the section 199A deduction on its Form 1041 in full based on the amount of QBI allocable to that trust from the limited partnership, as if such trust was not subject to the wage limitation in section 199A(b)(2)(B). (ii) Under these facts, for Federal income tax purposes under this section, Trust 1, Trust 2, and Trust 3 would be aggregated and treated as a single trust

This example in the Proposed Regulations is not helpful to evaluating almost any real case scenario given the presumption: "But for the enactment of section 199A and A's desire to avoid the W-2 wage limitation of that provision, A would not have created or funded such trusts." The use of the temporary exemption suffices to negate the "but for" comments above. Almost any irrevocable trust has asset protection benefits. If the trusts are structured as directed trust with a person or committee appointed as successor investment trustee to A, then the trusts might provide a valuable succession plan. Any one of these factors alone might, or perhaps should, change the analysis and perhaps conclusions.

Example 2. (i) X establishes two irrevocable trusts: one for the benefit of X's son, G, and the other for X's daughter, H. G is the income beneficiary of the first trust and the trustee is required to apply all income currently to G for G's life. H is the remainder beneficiary of the first trust. H is an income beneficiary of the second trust and the trust instrument permits the trustee to accumulate or to pay income, in its discretion, to H for H's education, support, and maintenance. The trustee also may pay income or corpus for G's medical expenses. H is the remainder

beneficiary of the second trust and will receive the trust corpus upon G's death. (ii) Under these facts, there are significant non-tax differences between the substantive terms of the two trusts, so tax avoidance will not be presumed to be a principal purpose for the establishment or funding of the separate trusts. Accordingly, in the absence of other facts or circumstances that would indicate that a principal purpose for creating the two separate trusts was income tax avoidance, the two trusts will not be aggregated and treated as a single trust for Federal income tax purposes under this section.

Does this Example (2) suggest that trusts for different children will suffice to avoid the multiple trust rule as addressed in the Proposed Regulations by virtue of not having "substantially the same primary beneficiaries?" If so, common family planning might suffice to circumvent the multiple trust challenge. More disturbing with respect to the last sentence of the Example (2) is that it negates the requirements of the statute and should be stricken. The statute clearly provides for a three-part test each of which must be met, hence the emphasis on the "and" between each such part. Example (2) suggests that if the third test alone, "a principal purpose of such trusts is the avoidance of the tax imposed by this chapter" is violated, the trusts can be aggregated. That contradicts the plain language of the statute.

Non-Grantor Trust Possible Income Tax Savings

Non-grantor trusts, subject to various restrictions and limitations, might afford taxpayers income tax savings opportunities post-Act.

Charitable Contribution Income tax savings from Non-Grantor Trusts

Charitable planning will change considering the Act in many ways. One potentially significant transformation will be an increased use of non-grantor trusts. Most taxpayers will not exceed the new standard deduction threshold thereby losing tax benefits of charitable giving. The doubling of the standard deduction to $24,000 for a married couple has been estimated to lower charitable giving by $13 billion+ per year. The doubling of the estate tax exemption to more than $11 million has been estimated to lower charitable giving by $4 billion per year.[8] Creative tax planning, and emphasizing non-tax benefits, may help offset some of this loss. Apropos to this article, will be the use of non-grantor trusts to salvage much or all this deduction. While the media has focused on bunching itemized deductions and using donor advised funds ("DAFs") to circumvent the impact of the doubled standard deduction, that hardly seems feasible for most taxpayers. With the significant restrictions or elimination of so many itemized deductions bunching, even using a DAF to bunch charity, is unlikely to push many taxpayers over the new standard deduction threshold, and even if that threshold can be exceeded every 2nd or 3rd year of bunching, the donations made up to that level will still be lost.

Example: Client has $10,000 of SALT deductions and donates $5,000/year to charity. If they bunch donations to every third year they will have a $25,000 deduction in that year ($10,000 SALT + 3 x $5,000). But that would only provide a net incremental deduction of $1,000. So, while no doubt some taxpayers will benefit from bunching, the utility seems overstated.

[8] https://www.councilofnonprofits.org/sites/default/files/documents/tax-bill-summary-chart.pdf .

It is anticipated that the number of itemizers will plummet. One estimate was that the number of taxpayers who itemize will decline from 30 million in 2017 to only 5 million in 2018.

For both lower and moderate wealth taxpayers emphasizing non-tax benefits, using IRA funds for those over 70 ½, donating appreciate assets (and avoiding tax on the appreciation), may be beneficial charitable planning strategies.

For moderate wealth clients, creating a simple local non-grantor trust with a non-compensated family member trustee, may serve to salvage all of a contribution deduction. When crafting these trusts practitioners should be certain to include language in the instrument so that distributions to charity will be made from gross income.[9] These moderate wealth taxpayers can then gift enough investment assets to generate sufficient income to pay intended contributions. The trust instrument can name heirs as well as charities as beneficiaries and grant the trustee a flexible distribution power to allocate among charitable and non-charitable beneficiaries. This approach will facilitate moderate wealth taxpayers donating to charities and securing the equivalent of a full income tax deduction, or when they desire instead having heirs in a given year receive some portion or all the income, so that there is flexibility to the planning, even with using an irrevocable trust as the vehicle. For UHNW taxpayers more robust and complex non-grantor trusts achieving a range of goals may be used to also fund charitable gifts along similar lines. However, many UHNW clients already give donations that are substantially more than the standard deduction as increased that the impact on them may be insignificant.

Property Tax savings from Non-Grantor Trusts

Planning for a principal residence may be transformed. For many moderate and UHNW taxpayers the SALT limitations, including the loss of a property tax deduction on their homes, may be costly. Trust planning can help ameliorate this situation as a non-grantor trust should be able to deduct up to $10,000 of property tax it pays on a home it owns. If that deduction is offset at the trust level by trust income, the full benefit of that deduction can be realized by the trust, whereas if this planning were not undertaken the taxpayer herself may have obtained no incremental tax benefit from the property tax payments because the $10,000 SALT limitation would have been consumed by state and local income taxes, or she may not have in aggregate exceeded the new standard deduction.

The steps in the planning might entail the following:

- The client transfers ownership of her residence to a limited liability company ("LLC").
- The clients thereafter transfer most or all of the house LLC interests to one or more non-grantor trusts, although if more than one non-grantor trust is used the trusts will have to pass muster under whatever form the final regulations under 643 take.[10] These may be SLATs structured to be non-grantor trusts (see discussion below). These have been dubbed by some commentators as SALT deduction SLATs ("SALTy-SLATs") or as

[9] IRC Sec. 642(c).
[10] Proposed Reg. Sec. 1.199A, REG-107892-18. The multiple trust rule and planning to circumvent its strictures is discussed below.

spousal lifetime access non-grantor trusts ("SLANTs"). For some clients consider creating a number of trusts, e.g. one for each descendant, to secure a sufficient number of $10,000 property tax deductions. Have the LLC owning the house elect out of partnership tax status.[11] This can not only avoid the need to file a partnership tax return for the house LLC but then each trust would simply report directly on its own income tax return the tax paid.

- Each non-grantor trust, subject to the impact of the multiple trust rule limitations, may be able to deduct $10,000 of property taxes.[12]
- How should ownership be structured? Some have considered having the non-grantor trust or trusts own all the house LLC interests. If that is done, then the parent/transferor must be a beneficiary of one or more of the non-grantor trusts involved. But if the transferor (e.g. in a non-grantor hybrid DAPT), or the transferor's spouse (e.g. in a SALTy-SLAT) are to use the home, an adverse party must approve that use of the residence to maintain non-grantor status. If instead an intentionally non-grantor trust ("ING") is used that adverse party could be structured in the form of a distribution committee. In all these approaches there remains the question as to whether the IRS might argue that there was an implied agreement between the parent/transferor who continued to reside in the residence, and the non-grantor trust and supposedly adverse party.[13]
- Another approach to structuring the residence ownership might be to transfer 98% of the house to the LLC, with each parent/transferor retaining a direct 1% interest in the property. Another variation might be to transfer the entirety of the house to an LLC and then have each parent retain or a 1% interest in the house LLC, transferring perhaps 98% to one or more non-grantor trusts. Proponents of this approach suggest that holding/retaining that interest would give the parents the right to live in the house rent free as a co-owner. This might also avoid the need for the approval of a non-adverse party. However, based on some interpretations of the Powell case[14] , that would provide the IRS with an IRC Sec. 2036(a)(2) estate tax inclusion argument that the parents as owners of the nominal 1% had the right "in conjunction with" others to control the house LLC. For taxpayers below the exemption amount that might be a helpful argument to case basis inclusion and gain a basis step-up on death. For those above the exemption amounts, and subject to an estate tax, that could be a costly approach.

Another consideration in this planning is that the home sale exclusion ($250,000 for an individual and $500,000 for a couple) would be lost with a non-grantor trust as owner.[15] There are several possible steps that might be taken to ameliorate this potential tax cost. The trust or trusts owning the interests in the house could be converted to grantor trust status two years before a sale of the residence. This would enable the grantor to meet the two of five-year ownership and use test to qualify for the home sale exclusion. Even if the house remained owned by the LLC the trusts may have opted out of partnership tax status, as noted above. If the interests in the LLC are all owned by grantor trusts (post-conversion) that might permit qualification if the LLC is then owned by only grantor trusts. However, if each of a husband and

[11] IRC Sec 761(a); Treas. Reg. 1.761-2(a)(1).
[12] IRC Sec. 164(b)(6).
[13] IRC Sec. 2036(a)(1).
[14] Estate of Powell, v. Comr., 148 TC No. 18 (May 18, 2017).
[15] IRC Sec. 121.

wife created separate non-grantor trusts to own LLC interests (e.g. non-reciprocal SLANTs) then conversion of both of those trusts into grantor trusts would still have husband and wife owning the LLC interests through disregarded trusts. If husband and wife own an LLC it is not clearly disregarded so query whether they would in fact qualify for the home sale exclusion or whether the LLC would have to be liquidated. Alternatively, if the house had appreciated less than the home sale exclusion available when the non-grantor trust was funded, it could be sold to that trust using the exclusion to avoid any future capital gains tax on that amount of appreciation. That might make the later conversion back to grantor trust status unnecessary.

State Income Tax Savings from Non-Grantor Trusts

State income taxation on non-source, e.g. passive assets, may be deferred or avoided through the use of non-grantor trusts. This type of planning may be more common for two reasons. First, the SALT limitations make the net cost of state income taxes much higher than before the Act. Therefore, many taxpayers, especially those in high tax states, may wish to pursue this type of planning. Further, given the number of other tax savings opportunities from using non-grantor trusts, taxpayers may already be creating non-grantor trusts for other purposes after the Act.

Practitioners should evaluate whether existing trusts paying high state income tax be modified or moved so that the state income tax can be avoided. An existing trust may be able to be moved to a new state that has a more favorable tax system. That may require moving assets out of the initial state, changing trustees to out-of-state trustees, and assuring no initial state source income. If source income cannot be avoided it may be feasible to divide the existing trust using powers in the instrument, decanting or non-judicial modification, so that one resulting trust has solely non-source income and the other resulting trust earns all source income. Only the former trust would be moved. This type of planning can raise complex issues. What is source income? If the trust owns a partnership interest that has a modest amount of source income to the initial state that might suffice to taint the entirety of the trust as source income. In moving trustees out of state what of an investment advisor or trust protector in the initial jurisdiction? Will that taint the trust as still subject to taxation in the initial state? If so, would creating a limited liability company ("LLC") or other entity in the new jurisdiction to house the protector, investment adviser and other positions so that it is that entity and not the individual resident in the initial state that serves? Will that suffice to break the tie to the initial jurisdiction?

New non-grantor trusts might be created by transferring passive assets, e.g. portfolio assets, to a non-grantor trust in a trust friendly jurisdiction that would not impose any state income tax.

Sec. 199A Possible Benefits of Non-Grantor Trusts

Transfer business entity interests to non-grantor trusts might maximize the IRC Sec. 199A deduction by shifting taxable income to trusts with their own taxable income threshold for phase out purposes, if such planning can pass the requirements of the new multiple trust rules discussed above.

Example: The client has an interest in a specified service business ("SSB"). When her taxable income reaches $315,000 the 199A 20% deduction begins to be phased out. However, if she

transfers a portion of her equity to a non-grantor trust, that trust may have its own taxable income threshold of $157,500 (for a single individual), and the trust may qualify for the 20% deduction of its qualified business income ("QBI") from the business without being subject to the taxable income phase out. This might also lower the taxable income of the donor/client thereby enhancing her 199A deduction on remaining assets. MARTY: WHAT ABOUT THE AGGREGATION RULE IN THE PROPOSED REGS?

Caution will have to be exercised in such planning. The Proposed Regulations include not only the multiple trust rules discussed elsewhere but aggregation and other rules that restrict planning. A Specified Service Trade or Business (" SSTB") includes any trade or business with 50 percent or more common ownership (directly or indirectly) that provides 80 percent or more of its property or services to an SSTB. Additionally, if a trade or business has 50 percent or more common ownership with an SSTB, to the extent that the trade or business provides property or services to the commonly-owned SSTB, the portion of the property or services provided to the SSTB will be treated as an SSTB. This may not taint the planning in the preceding example because the SSTB status is not in issue. However, it will affect planning that might bifurcate SSTB into component SSTB and non-SSTB components.

Watch the family partnership rules as they may act to prevent the allocation of revenue to the donee trust.[16] Not only does fair compensation have to be paid for services rendered by the transferor/donor but capital must be a material income producing factor in the business. Many of the discussions of using non-grantor trusts to maximize IRC Sec. 199A deductions have not factored into the analysis this potential hurdle.

Net Investment Income Tax Savings

It may be feasible to use non-grantor trusts to save net investment income tax ("NIIT").[17] If the trustee is actively involved in the business held in a non-grantor trust the NIIT tax may not apply whereas had the client held that interest individually it would have had he or she not actively participated in the business. Remember that the determination of what is required for a trust to actively participate to avoid the NIIT tax remains uncertain. The IRS rulings on this matter have been rather harsh.[18] Several court cases, however, have taken a positive view of a trustee's participation as characterizing a trust as active.[19] hat if the trust involved is a directed trust and the general trustee is an institution that is not involved in management, but the investment adviser (or investment trustee) is actively involved? Does that suffice to characterize the trust as active to negate application of the NIIT? Another NIIT planning idea post-Act is to distribute to a child beneficiary who would still have his or her own $200,000 MAGI bucket before a NIIT was incurred.

Considerations of Using Non-Grantor Trusts

[16] IRC Sec. 704(e).
[17] IRC Sec. 1411.
[18] TAM 200733023, and TAM 201317010.
[19] Mattie K. Carter Trust v. US, 256 F. Supp. 2d 536 (N.D. Tex. 2003); Frank Aragona Trust v. Comr., 142 T.C. No. 9 (Mar. 24, 2014). IRC Sec. 642(h).

Proper Trust Operation Vital to Achieving Intended Income Tax Status

It may not be sufficient to craft the trust instrument as a non-grantor trust, or to convert a grantor to non-grantor trust properly. The trust must also be administered in a manner that conforms to the non-grantor trust requirements. For example, if the trustee unbeknownst to the practitioner purchases life insurance on the grantor's life, and pays a premium, that might characterize the trust in whole or part as a grantor trust. What if a loan is made to the settlor and the interest rate or security is inadequate? Should loans be prohibited? Even if prohibited by the instrument the trustee's authorized action of making a loan might undermine the intended non-grantor status. If the instrument prohibits distributions to the settlor's spouse without the consent of an adverse party, what if the trustee makes a distribution without such consent? What if the trustee or a protector acts in a manner that suggests and implied agreement to benefit the grantor thereby undermining non-grantor status? Perhaps, new types of savings language should be added to non-grantor trust instruments? In all events, as the complexity and variety of trusts in a client's plan expand the importance of annual reviews with counsel and the rest of the planning team becomes more essential. It will be more difficult for clients, and even some of the client's non-tax advisers, to differentiate grantor from non-grantor trusts, and to use the appropriate trust administration techniques for the right trust.

The SEC v. Wyly case continues to serve as a reminder about the importance of proper trust operation.[20] In Wyly the trust had trust protectors for each of 17 inter-vivos trusts. None of the persons serving as trust protectors were related or subordinate. Nonetheless the trustees followed all investment recommendations made by the protectors including collectibles, etc. The conduct of the trust protectors and settlors was such that the Court imputed all actions of the trust protectors to the settlors since there was a pattern of action. While the Wyly case might be a bit extreme, the concept of a pattern of conduct is problematic in so many situations (e.g., a pattern of distributions from a trust that is then attacked in later divorce). Clients so often do not understand the need to meet annually with legal counsel to identify inadvisable patterns of payments, investments, etc.

Converting/Toggling from Grantor to Non-Grantor Status

To convert an existing grantor trust into a non-grantor, trust the grantor, and perhaps the grantor's spouse, would have to release all the powers in the instrument that would taint it as a grantor trust. If there are Crummey powers in the instrument, once grantor trust status is turned off, the grantor powers that had trumped the Crummey powers ability to make the trust partially grantor as to the Crummey power holders will become effective and must also be addressed.

Can you convert/decant an existing grantor trust into a non-grantor trust? What about a non-grantor trust being converted to a grantor trust? Clearly with the changes in the law one characterization may have been preferable in the past, a different characterization may be more advantageous now, and if the individual tax changes sunset in 2026 a different characterization may be more important then. Practitioners should consider approaches to incorporate flexibility for this type of planning in trust instruments. For example, a power to swap assets and to lend without adequate consideration should be excluded if non-grantor trust status is desired.

[20] SEC v. Wyly et al, No. 1:2010cv05760 - Document 622 (S.D.N.Y. 2015).

However, it might be advisable to consider empowering a named person to add these rights back into the trust if appropriate at a future date.

Converting a non-grantor trust to a grantor should trust should not have any adverse income tax consequence.[21] If a non-grantor trust is converted to a grantor trust the non-grantor trust should file a final income tax return through the date of conversion. All income should pass to the new grantor trust.[22]

Converting from a grantor trust to a non-grantor trust may, however, trigger income tax costs, e.g. if there are liabilities in excess of basis. **Example**: Client engaged in note sale transaction with a grantor trust several years ago. The client sold a highly appreciated interest in a family business to a grantor trust for a note. Post-Act the client believes non-grantor trust status would provide additional state income tax savings and Section199A deductions and converts the formerly grantor trust into a non-grantor trust. That may trigger the gain on the conversion that had been avoided on the initial sale to the grantor trust.

If the individual income tax changes sunset in 2026 and could be modified by future legislation, is the cost of complex planning to endeavor to capture current but potentially temporary income tax benefits worthwhile? In many cases it might be. But practitioners might also contemplate possible sunset in planning documents, e.g. by empowering a trust protector or other person to turn on or off grantor trust status (e.g. convert a non-grantor trust into a grantor trust if the intended income tax benefits sunset). The IRS had held against toggling on and off grantor trust status, but the circumstances of that ruling were abusive and the same rationale may not apply to other situations, especially if the toggle is a result of a change in the law (e.g. sunsetting of Act changes).[23] Incorporating a decanting power to facilitate the trustee converting the trust status via decanting might also be worth incorporating. How effective will state efforts be to circumvent SALT limitations? Does this obviate the need to plan or should planning be pursued as it may provide tax savings with greater certainty? At the time of this writing the outcome of these efforts is uncertain, there are certainly practitioners who are skeptical as to the efficacy of that planning.

Another issue might arise on conversion. Could it create a claim by a beneficiary against the trustee now that the trust or beneficiaries, not the grantor, have to bear the income tax burden?

Not Every Trust Should be a Non-Grantor Trust

Given the enhanced benefits of using non-grantor trusts post-Act, articles and webinars have extolled the new benefits of using non-grantor trusts. But a broader and more balanced view of the decision process as to whether a grantor or non-grantor trust should be used is necessary. Not every trust should be structured, or restructured, to be a non-grantor trust. Planners will likely find that there will be a more diverse array of trusts in many client's plans consisting, depending

[21] PLR 200848017, CCA 200923024 cf. I.R.S. Notice 2007-73, 2007-36 I.R.B. 545.
[22] IRC Sec. 642(h).
[23] I.R.S. Notice 2007-73

on each particular client's circumstances, of a combination of grantor and non-grantor trusts and perhaps new types of trusts designed to meet current planning objectives.

Prior to the Act, most irrevocable trusts were structured as "grantor" trusts for income tax purposes. With a grantor trust the settlor bears the income tax cost of the income earned by the trust. This so-called grantor trust "tax burn" (of the settlor paying income taxes on income earned by and retained in the trust) further reduces the size of the settlor's estate. The settlor could retain the power to swap or substitute trust assets for personal assets and use it to shift appreciated assets from the trust into his or her estate to gain a basis step up on death. Appreciated assets could be sold to the trust to lock in discounts and shift future appreciation outside the estate without triggering capital gains.

For some clients the continued use of grantor trusts will remain optimal, at least for some of their planning. Existing trusts to which note sales were made of appreciated assets may not be able to convert to non-grantor trusts without triggering tax costs. For very high net worth clients the ability to sell assets to a grantor trust might justify retaining or creating a grantor trust.

If a trust owns S corporation stock, forming a non-grantor trust (or the conversion from a grantor trust to a non-grantor trust) will require conforming to the qualified Subchapter S trust ("QSST") or electing small business trust ("ESBT") requirements. It may be preferable for the donee trust to be characterized as a grantor trust rather than meeting QSST or ESBT requirements.

Will the client accept the steps necessary to make a trust a non-grantor trust? For a non-grantor SLAT (a so called "SALTy-SLAT"), is the client comfortable having a child/beneficiary as an adverse party approve distributions? While some will, many will not. Even if the client is agreeable, will designating a child remainder beneficiary to hold an approval power over distributions to the settlor's spouse suffice to constitute an "adverse party" for these purposes to assure non-grantor status? The Regulations require that the adverse party have a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power.[24] There is, unfortunately, little clarity on the delineation of what is "substantial." Thus, there may be more risk into the use of the adverse party mechanism to preserve or achieve non-grantor trust status then many realize. Is instead of using this technique giving a person in a non-fiduciary capacity a special or limited power to appoint to the spouse a better option? That technique might also be subject to a potential challenge based of an implied agreement between the power holder and settlor (or spouse).

Is an incomplete gift non-grantor ("ING") structure a safer approach to addressing the need for an adverse party as contrasted with the non-grantor SLAT approach of perhaps naming one diverse party? The answer is not clear. Also, given the approach taken in the proposed Section 643(f) multiple trust regulations, will the IRS continue to issue ING private rulings if it is concerned about the abuse of non-grantor trusts post-Act? Will the complexity of making the transfer to an ING trust a completed gift to use temporary exemption outweigh the advantages? Will the ING characteristic of a distribution committee (aka power of appointment committee), discussed below, add too much cost, complexity or administrative burden for some clients to accept?

[24] Treas. Reg. Sec. 1.672(a)-1(a).

Life Insurance Planning

Life Insurance Continues to Require Use of Grantor Trusts

Life insurance is a nearly ubiquitous asset in estate planning and presents its own unique tax considerations. If life insurance is involved with the non-grantor trust raise transfer for value issues? Can the use of income be to pay premiums on life insurance on the grantor's life be drafted around to avoid tainting the trust as a grantor trust? Perhaps, grantor irrevocable trusts should remain a cornerstone of many plans for this purpose. These trusts might take the form of simple traditional irrevocable life insurance trusts ("ILITs") or more robust trusts designed to hold other assets and provisions. Although the use of non-grantor trusts will receive more attention in the current environment, that status may be inconsistent with the ownership of life insurance. Identifying planning options that should be addressed with grantor trusts (e.g., life insurance), and others that might best be addressed with non-grantor trusts (e.g., charitable contributions for non-itemizers), and so forth, provides an approach to crafting the appropriate combination of trust structures for a particular client post-Act.

A trust holding life insurance may be characterized as a grantor trust if trust income can be used to pay life insurance premiums on insurance on the grantor's life. Generally, if trust income can be used directly or indirectly, to benefit the grantor, the grantor will be treated as the owner of the trust.[25] This includes the application of income to pay premiums on life insurance policies insuring the life of the grantor or the grantor's spouse.[26] Specifically, the grantor is deemed the owner of any portion of the trust or the trust income which can be used (without the consent of an adverse party) to pay premiums on life insurance policies.[27] Older case law held that the grantor was only taxable on trust income actually used to pay premiums.[28] The IRS has held that if the trust income was applied toward the purchase of life insurance, even in contradiction of the terms of the trust, the trust would nonetheless be characterized as a grantor trust.[29]

Thus, it may be difficult or impossible for a trust to own life insurance and not be characterized as a grantor trust.

There are potentially additional advantages to having life insurance held in grantor trusts. If two trusts are grantor trusts as to the settlor/insured, the transfer of insurance between trusts cannot create an income taxable event. There can be no transfer of the policy between trusts that are both disregarded for income tax purposes.[30] This can provide valuable flexibility. Transfers of a policy between two grantor trusts (e.g., in a decanting from an old trust to a better crafted new trust) should also qualify for and exception to the transfer-for-value rule, as a transfer to the

[25] IRC Sec. 677.
[26] IRC Sec. 677(a); Treas. Reg. Sec. 1.677(a)-1.
[27] IRC Sec. 677(a)(3).
[28] Rand v. Comr., 40 B.T.A. 233 (1939), acq., 1939-2 C.B. 30, aff'd, 116 F.2nd 929 (8th Cir. 1941), cert. denied, 313 U.S. 594 (1941).
[29] PLR 8839008. Under IRC Sec. 6110(k), neither a private letter ruling nor a technical advice memorandum may be cited or used as precedent.
[30] IRC Sec. 101(a)(2).

grantor/insured. Similarly, a sale of a policy from a grantor trust to another grantor trust will not trigger the transfer for value rules.[31]

As more assets grow post 2017 Tax Act in non-grantor trusts because of the income tax benefits these provide, those non-grantor trusts may loan money to a grantor trust pursuant to a split-dollar arrangement to fund the cost of insurance and avoid the issues of the insurance recharacterizing the non-grantor trust as a grantor trust. The income tax and cash flow considerations of this arrangement should be considered.

)

Split-Dollar Life Insurance Developments Will Affect Planning

Split-dollar life insurance has been used as a means of structuring the payment of life insurance premiums. Recent developments have affected split-dollar planning and should be considered by practitioners in their review of existing trusts and split-dollar plans, and the creation of new split-dollar plans.[32] The IRS has argued for the application of Sections 2036, 2038 and 2703 to negate the discount on the value of the advance under an economic benefit split-dollar arrangement. The Tax Court refused to rule favorably on the taxpayer's request for summary judgement that Sections 2036, 2038 and 2703 were not applicable in this context. It might not be advisable to create a new economic benefit inter-generational split-dollar insurance plans until the final Cahill (Estate of Cahill v. Commissioner, T.C. Memo. 2018-84) and Morrissette decisions Morrissette v. Commissioner (U.S. Tax Court Docket No. 4415-14, Order dated June 21, 2018) are issued if there is an objective of discounting the donor's repayment rights.[33] It is possible that these recent decisions may not affect *loan* split-dollar transactions, although practitioners should endeavor to better corroborate business purposes for such transactions in the wake of Cahill and Morrissette.

A point of more general concern from these cases is the manner in which the Tax Court may be applying Code Section 2036 and 2038. Code Sec. 2036 can apply to include in the value of the gross estate the value of: All property that the decedent had transferred during lifetime, and over which the decedent retained for life the right, alone or in conjunction with another person, to designate the person or persons who shall possess or enjoy the property or the income therefrom. This is similar to an argument in the landmark Powell limited partnership case in 2017 in which the Tax Court also took a harsh interpretation of the "in conjunction with another" argument.[34] This may become a new weapon of choice in the IRS attacking a range of planning transactions and therefore may affect how practitioners might plan certain transactions. For example, if a taxpayer is holding a modest entity interest after prior planning transfers it may be advantageous to consider a transfer of the remaining interests to an irrevocable trust to avoid the "in conjunction with another" argument. In split-dollar transactions if the advance contract were disposed of prior to death to a different irrevocable trust, might that lessen the risk of this type of challenge?

[31] PLR 200518061 and 200514001; Rev. Rul. 2007-13, IRB 2007-11, 684.
[32] Slavutin, Harris & Shenkman, "Intergenerational Split Dollar - Recent Adverse Decisions in Morrissette and Cahill, Where Do We Go from Here?" Steve Leimberg's Estate Planning Email Newsletter Archive Message #2651, Jul 17, 2018.
[33] Estate of Morrissette v. Commissioner, 146 T.C. 171 (2016); Morrissette v. Comr. Tax Court Docket No. 4415-14; Estate of Cahill v. Commissioner, T.C. Memo. 2018-84 (June 18, 2018).
[34] Estate of Powell v. Commissioner, 148 T.C. No. 18.

Both Code Sections 2036 and 2038 do not apply if the transfer was a bona fide sale for full consideration in money or money's worth. Perhaps more attention might be given in the wake of these cases to corroborating the consideration with a professional appraisal and corroborating the business purposes to support a bona fide sale.

Increased Use of DAPT and DAPT-Like Trusts in the Current Planning Environment

Self-settled domestic asset protection trusts ("DAPTs") may be more important post-Act. Access to assets to be transferred to use the temporary large exemptions is critical for most clients other than certain UHNW clients. For single clients, and even many married clients, they will want or insist on being able to access the assets transferred. With historically high exemptions very large transfers relative to the net worth of moderate wealth clients (perhaps defined as $5M to $40M) are necessary to make a meaningful impact on securing the large temporary exemption.

When evaluating the possible use of a DAPT practitioners should consider the recent Wacker case.[35] While some commentators have concluded that DAPTs are no longer viable post-Wacker, most practitioners may believe that the Wacker case was a bad fact case that does not inhibit the use of DAPTs, although alternative approaches and structures to lessen possible risks appear to be more commonly used. The view the Wacker case as quite limited and that it does nothing to change the risks of the use of DAPTs even by those residing in non-DAPT jurisdictions. Rather, they view Wacker as a limited case addressing jurisdiction, and another warning that no type of trust, self-settled or otherwise, can protect against a fraudulent conveyance.[36]

All that the Supreme Court of Alaska held was that Alaska could not require that proceedings relating to the transfer of assets to an Alaska self- settled trust be exclusively before an Alaska court. It did not invalidate self-settled trusts created in that state. Although courts in other jurisdictions entered a default judgment on fraudulent transfer allegations, the viability of Alaska self-settled trusts to shield trust assets from the claims of the grantor's creditors was not disturbed.

The facts in Wacker included that after a Montana state court issued a series of judgments against Donald Tangwall and his family, the family members transferred two pieces of Montana real property to the "Toni 1 Trust," a trust allegedly created under Alaska law. That constituted a fraudulent conveyance under Alaska law.

Planning Post-Wacker and Post-Act might be somewhat different then under prior law. Even DAPT proponents seem to suggest a wide array of variants of the traditional DAPT technique to provide more security. A common-sense precaution that should be used in all instances is to take proactive steps to corroborate that the trust and transfer to it are not fraudulent conveyances. These might include lien and judgement searches, other due diligence steps, having the transferor

[35] Toni 1 Trust v. Wacker, 2018 WL 1125033 (Alaska, Mar. 2, 2018).
[36] Blattmachr, Blattmachr, Shenkman & Gassman on Toni 1 Trust v. Wacker - Reports of the Death of DAPTs for Non-DAPT Residents Is Exaggerated, Steve Leimberg's Asset Protection Planning Email Newsletter Archive Message #362, Mar. 18, 2018.

sign a solvency affidavit whether or not state law requires it, forecasts by the client's wealth adviser demonstrating no anticipated need to access the DAPT assets, etc. Different requirements in light of larger percentage of wealth transfers for moderate wealth clients in order to use large temporary exemptions.

What life and long-term care coverage is in place pre-transfer? Should a large personal excess liability policy (umbrella) be assured before a transfer? Should broader than traditional lien and judgement searches be obtained? Should a solvency affidavit be obtained even if applicable state law does not require it?

One popular approach is referred to by some as a hybrid DAPTs in which the descendants of the settlor's grandparents can be added back as beneficiaries in the discretion of a person named to act in a non-fiduciary capacity. But if someone holds this power to add a beneficiary the DAPT will be characterized as a grantor trust which may not be desirable in some instances post-Act. Practically, what this might mean, as noted above in other examples, is a combination of various trusts (grantor and non-grantor, as well as other characteristics) tailored to the particular client's situation.

Another approach is to permit a person named in a non-fiduciary capacity to direct the trustee to make a distribution to the settlor. In this way the settlor is a beneficiary. This should not characterize the trust as a grantor trust.[37] Loan provisions may provide a means of access before turning on DAPT status. But if the loan is not for adequate security or adequate interest grantor trust status will ensue. Another approach is to draft limitations into the governing instrument. For example, no distributions can be made to the Grantor for ten years and one day after transfers are made to the trust to address the rights of a bankruptcy trustee to disavow a self-settled trust. Some practitioners provide that the Grantor cannot be added or appointed to be a beneficiary unless there is a divorce or death of a spouse.

If the trust is drafted as a third-party trust (that is, one not created by any beneficiary), and not a DAPT, but a general power of appointment ("GPOA") is provided to a senior family member, that GPOA can be exercised in favor of an appointment to a trust that includes the original trust's settlor/grantor. That should not be characterized as a DAPT as the exercise of a GPOA probably should characterize the power holder, not the initial settlor, as the transferor.

The opinions of well-known practitioners vary across a wide spectrum from DAPTs do not work so therefore use only foreign asset protection trusts ("FAPTs") to achieve these goals. Other practitioners express considerable discomfort with using FAPTs and prefer variations of DAPTs.

If a primary goal of the DAPT is as a backstop to a prenuptial agreement would the risk/reward calculus be different?

UHNW Irrevocable Trust Planning and Documentation

[37] It may be feasible to create a non-grantor DAPT. Makransky v. Comm., 321 F.2d 598 (3rd Cir. 1963).

UHNW clients generally appear to be planning with vigor considering the withdrawal of the 2704 Regulations, the current high exemptions, the belief that the best opportunity to repeal the estate tax may have been missed, and that worse legislation may be enacted by a future administration in Washington. Practitioners may see growing activity amongst the wealthiest clients leading up to the 2020 election.

While there are myriads of planning techniques available to UHNW clients, and a significant body of literature practitioners can refer to, one issue that seems a constant in audits of these plans is the demonstration of adherence to formalities. So-called "bad-fact" cases are often replete with tales of administrative lapses. Thus, when planning, implementing and administering these transactions practitioners should endeavor to address proper formalities and documentation. Unfortunately, the most significant challenge in many of these issues is convincing a client to continue to expend effort, and incur fees, after the transaction documents are signed. What administrative steps and documentation might be suggested? As UHNW clients shift more wealth during this perceived window of planning opportunity practitioners should be mindful of the documentation that should be considered for each transfer. While the documentation will vary the following checklist may be helpful.

- Date. All documents need to be dated the date signed and indicated as effective the date that the gift is intended. That might generally be the date of signature although it might make it easier administratively to select a date like a month or quarter end to make allocations easier. In some jurisdictions, signatures must be acknowledged before a notary public.
- Declaration of Gift. For each entity being gifted to the Trust, the donor should sign a declaration indicating the membership interests or other assets being gifted, confirming the intent for the transfer to be a gift. In some cases, the language of the gift letter follows the Wandry clause formulation of making a gift of a specified dollar amount of interests. For example, if the appraised value of the client's interests in a particular entity is $25,000, then a gift of $25,000 of entity interests, not a specified membership interest (or number of shares). In this way some protection may be had if the IRS argues that the gifts are worth more and a taxable gift was made. The same Wandry formulation should be carried out through all documents. While there are various approaches to a defined value mechanism a Wandry approach has been used by some practitioners as less complex and costly then a McCord type spillover to a GRAT, charity, an incomplete gift trust, a QTIP trust, etc. In some transactions a Wandry clause is used for the seed gifts and a more complex but robust mechanism for a sale following the seed gift. **Example**: "*I have this day executed this Declaration of Gift and separate Assignments and Stock Powers Separate from Certificates (the "Assignment") transferring (the "Transfer") shares of stock (the "Gift Shares") bearing the following values, as of the date of this transfer, to the Thomas Client-Name 2018 Irrevocable Trust ("Trust"): Dollar Number ($_____.00) value of the shares of Common Stock, no par value, of Entity-Name Corp., a State-Name corporation ("Entity-Name") (the "Entity-Name Gift Shares"). The Transfer of the Gift Shares to the Trust is intended to constitute, and constitutes, the complete and irrevocable gift of all of the aforementioned Gift Shares. The Transfer is made by way of gift and without any consideration. I have had a good-faith determination of such values made by an independent third-party professional experienced in such matters and appropriately qualified to make such a determination.*

Based on such determination, the number of shares constituting the Entity-Name Gift Shares is_____Number shares. Nevertheless, if the IRS challenges such valuation and a final determination of a different value is made by the IRS or a court of law, the number of gifted Shares shall be adjusted accordingly so that the number of Shares of each entity gifted to the Trust equals the dollar amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or a court of law. I declare under the penalties of perjury that the foregoing is true and correct and further declare that this Declaration of Gift is being executed effective as of the date of the signature below."

- Valuation documentation. Each entity should have documentation regarding the value being gifted to the Trust. If the interest in the entity was recently purchased, the purchase price may be sufficient, but usually an appraisal should be procured. The appraisal must be a "qualified appraisal" as such term is defined for federal gift tax purposes. This is an appraisal prepared by a qualified appraiser (see below) which contains: (1) a description of property; (2) its fair-market value on date of its charitable contribution and specific basis for valuation; (3) a statement that an appraisal was prepared for income tax purposes; (4) appraiser's qualifications; (5) appraiser's signature and identifying number; and (6) such additional information as the regulations may acquire. A "Qualified Appraiser" is an appraiser who is qualified to make an appraisal of the type of property donated. The following people are not qualified appraisers: the taxpayer, a party to the transaction in which the taxpayer acquired the property; the donee; any person employed by any of the above-listed persons, or who bears a relationship to any of the above-listed persons; or any person whose relationship to the taxpayer would cause a reasonable person to question the appraiser's independence.
- Direction Letter. A general direction letter to any directed trustee of each trust participating in the transaction to hold, and continue holding, the entity interests involved after the completion of all gifts to the particular trust should be prepared. Provision of a direction letter may corroborate that the transaction is being handled in a manner consistent with the underlying trust structure.
- Entity Good Standing Certificate. Consider corroborating on the appropriate state agency's website that the entity or entities involved in the transactions are in good standing, or more formally obtaining a good standing certificate for every entity for which interests will be transferred in the transactions (e.g. by gift or sale to a trust).
- Prerequisites to Transfer Confirmed Met. Any requirement in the governing documentation (formation documents, operating agreements, bylaws, shareholder's agreements, etc.) for the entity interests being gifted should be met (or it should be documented that none exist). For example, a shareholders' agreement might require a 3/4ths approval of shareholders for a transfer to be made. In other instruments transfers to trusts for a shareholders' family may not require any approval or other prerequisites. In the latter case this should be corroborated. If the prerequisites to transfer contained in the governing documents are not met the IRS is unlikely to respect the transfers.
- Assignments of Entity Interests. Assignments, or other appropriate transfer documentation, should be created and properly executed, effectuating the transfer of all entity interests intended to the donee or purchasing trust. If some type of defined value mechanism is intended to be used in the transactions, the same formulation (e.g., a Wandry clause) should be carried out through all documents, such as in each assignment.

- Governing Documents. Governing documents for each entity (operating agreement for LLCs, partnership agreement for partnerships, and shareholder agreement for corporations) might be created so that appropriate documentation exists prior to and after the transfer. The amended and restated post-transfer governing agreement should reflect the new ownership. This new ownership should be reflected not as a percentage interest or specified number of shares but as the dollar amount as per the Wandry clause.
- Real Estate Documents. If an entity transferred owns leased real property. who is it leased to? Is the lease in proper form and reflective of the entity owning the property? Does the lease contain any restrictions on transfer? Is the deed correctly recorded in the name of the entity listed as owner? Are there any transfer or recording fees triggered? Is there a mortgage? Has lender approval been obtained if required? If real estate (or other underlying significant assets are owned) represents less than 100% of the entity interests that are owned and being transferred, an appraisal of the underlying property value (e.g., building) and an appraisal of the discounted value of the entity, both may be required.
- Forms K-1. For pass-through entities all K-1s should reflect the change in ownership to the Trust. Further, consideration might be given to using a symbol, e.g. an asterisk "*" be placed by the percentage ownership interest with the explanation "see attached statement." A statement might be attached to each entity return for all years until the gift tax statute of limitations tolls, or an audit adjustment is finalized, indicating that the interest is subject to a Wandry (or other) adjustment clause based on transfer documentation dated [date assignment or other transfer instruments effective]. **Sample Clause**: "The Corporation represents, warrants and covenants that it shall list on Forms K-1 for share ownership of the Buyer and the GRAT, or on an attached statement, that the number of Shares indicated on each such K-1 is 'Subject to the terms of a Share Determination provision in a Stock Purchase and Transfer Agreement, dated as of September 27, 2017, until the year of the Distribution Date. This provision shall expressly survive the Closing until said date. This shall be referred to as the K-1 Disclosure.'"
- Gift tax Form 709. A gift tax return should be filed "adequately disclosing" all required information under Reg. 301.6501(c) for every transfer in order to begin the running of the statute of limitations to assess additional tax. For disclosures that may not be required, practitioners should carefully weigh the pros and cons of disclosing optional items (e.g., non-gift transfers). In many cases creating an index of exhibits will assure that all key disclosure documents required by the Form 709 instructions, or the desire to comply with the adequate disclosure rules, are not overlooked.

Some UHNW Irrevocable Trust Planning Considerations

Hart Scott Rodino Implications

Practitioners should be mindful that large estate planning transactions may trigger reporting requirements under Hart-Scott-Rodino Antitrust Improvements Act ("HSR").[38] HSR imposes an obligation to file a premerger notification report form with the Premerger Notification Office of

[38] See Jay D. Waxenberg and Jason A. Lederman, "The intersection of trusts and anti-trust: Why you, an estate planner, should care about Hart-Scott-Rodino," 51 real Property, Trust and Estate Law Journal, at 431.

the Federal Trade Commission ("FTC"). This may all counterintuitive since a sale of interests in a closely held or family business to a trust created by the family can hardly be viewed as negatively impacting competition, but meeting the filing requirements, or finding an exemption, is necessary to avoid potential onerous penalty provisions.

Acquisitions resulting from a gift, intestate succession, testamentary disposition or transfer by a settlor to an irrevocable trust may be exempt from the filing or other requirements of HSR.[39] However, the conclusion may not be simple or assured and practitioners should consider consulting with an expert in these matters. There could be an impact on the HSR determination based on trustee and trust protector provisions included in the trust instrument, and, specifically, who should have the ability to remove and replace trustees.

- A settlor's retention of the ability to remove and replace the trustee, or the right of a trust protector to do so, of an irrevocable trust might cause the trust's voting securities to be treated as part of the settlor's ownership share of an entity for purposes of HSR testing.
- If the trust protector of a trust has the contractual power to remove and replace 50 percent or more of the trustees, the protector may be considered a control person. Pursuant to informal conversations with the FTC staff that power of the trust protector must be absolute and not, for example, merely the power to name a successor trustee without the power to remove, and not in instances where the power to remove and replace is subject to consent of a third party.
- In testing HSR filing requirements, holdings of spouses are considered to be the holdings of each them.[40]

The company is its own Ultimate Parent Entity ("UPE") in that no other entity "controls" it; and after the acquisition, and the protector might be viewed as in "control" of the entity by virtue of holding 50% or more of its voting securities. In addition to control meaning holding 50% or more of voting securities, there is an alternative control test for control of corporations of having the contractual power presently to designate 50% or more of the directors. If a person did hold that power that person may be viewed as the UPE or, post-acquisition, a UPE in addition to the protector. Inquiry might be appropriate as to whether an investment advisor (investment trustee) in a directed trust who can vote the equity interests might thereby be classified as a UPE based on the above. This nonetheless may not affect the HSR analysis as to whether an exemption applies.[41]

If the exemption does not apply and filing is required, the protector or perhaps investment trustee may be considered the "acquiring person" and the company (since it is currently its own UPE) would be the "acquired person". Should that occur then perhaps both the trust protector and the company could be required to file. There would be one filing fee which would be based on the value of voting securities of the company that the protector would "hold" as a result of the acquisition (both what is currently held and what is being acquired). The filing fee would be based on the size of the transactions.

[39] Sec. 802.71.
[40] Sec. 801.1(c)(2).
[41] Sec. 802.71.

An informal opinion might be obtained from the FTC as to whether a proposed transaction, e.g. a note sale transaction to a grantor trust, is exempt under Sec. 802.71 even though the transfer would meet the HSR size of transaction and size of person tests.

The FTC may not dispute the proposition that essentially internal, estate-planning-driven transfers of family businesses to a trust should be exempt, while acquisitions by a trust from third parties should not.

There is no reason why government should be concerned about a family transaction as this has nothing to do with significant businesses combining. The regulators may respond that they do not think that trust protector status is significant. Nonetheless, any time a large transaction is contemplated, a mergers and acquisition specialist should be involved to parse through the HSR exceptions to confirm no filing needed.

Defined Value Mechanisms

Can the potential gift tax risk of a large transaction be minimized? Large transactions often include mechanisms to minimize current gift tax risk. But there seems to be less agreement on how to structure such arrangements then might be anticipated. For UHNW clients pursing current large dollar planning, using some variation of these mechanism may warrant consideration. Some transactions are structured using some application of one of the key defined value cases.[42] These types of mechanisms are based on the entirety of the intended value being transferred away from the transferor. However, if there is an excess value over what the buyer in the transaction is paying, as a result of an IRS audit adjustment, that excess value is poured into a non-taxable receptacle. This non-taxable receptacle could be a charity (but be cautious if a private foundation is used, it may not be feasible), a grantor retained annuity trust ("GRAT"), marital trust ("QTIP"), or an incomplete gift trust. However, as with many aspects of planning there is less agreement amongst practitioners as to which spillover or structure is best. Practitioners will have to weigh the options in evaluating UHNW transfer planning. While the law is not new in this area, there are new perspectives and planning structures that the following discussions endeavor to present. A complete discussion of already established law will not be provided.

Is Wandry King?

The King case might provide a planning option to consider.[43] The King case upheld the use of a price adjustment clause. **Example**: Simplifying, this might be as follows. Taxpayer hereby transfers $100 worth of stock to XYZ trust for a note. If the value of the stock is finally determined for gift tax purposes to be greater the face amount of the note shall be adjusted accordingly. Some practitioners believe it works and indicate that they have used a King type price adjustment clause many times. Some practitioners report what they described as favorable results on audits using this approach. Others suggest less optimistic results. Some practitioners

[42] McCord, CA-5, 2006-2 USTC ¶60,530, Petter Est., 98 TCM 534, TC Memo. 2009-280 or Christiansen Est., 130 TC 1, CCH Dec. 57,301, aff'd CA-8, 2009-2 USTC ¶60,585

[43] J. King, CA-10, 76-2 USTC ¶13,165.

are simply not comfortable with a King type approach. Some object to King based on the structure of the adjustment. For example, might the adjustment of the note be viewed as an impermissible condition subsequent under Procter? Some view it as an "outlier" not to be relied upon because it is only a 10th Circuit case. The Ward case rained a bit on the King parade according to some views.[44] A variation of a traditional King type approach might be for the note's face value to be defined as being the gift tax value as finally determined.[45] Does this negate a challenge under Procter?[46]

Wandry might present another option to consider as part of the efforts to minimize gift tax.[47] In the Wandry case the tax court upheld an approach that relied on the transfer of a fixed value of assets to a trust rather than a specified portion of equity. **Example**: Simplifying, this might be as follows. Taxpayer hereby transfers $100 worth of stock to XYZ trust. While many practitioners prefer a Wandry approach to a King approach the IRS has non-acquiesced to the Wandry decision.[48] Thus, in a "traditional" Wandry clause the taxpayer may transfer a fixed dollar amount of shares only. Another variation of a Wandry approach is too have the beneficiaries of the buying trust executing a disclaimer of any value in excess of the specified value. The concept is that this would make it difficult for the IRS to argue more was transferred if the recipient trust were prohibited by the disclaimer from accepting the incremental value.[49]

There might be a different variation of a Wandry clause that might be useful in certain circumstances. In particular, if the transferor must transfer all shares at the closing, can the typical Wandry clause be improved upon? What might be dubbed a "Two-tiered Wandry" may provide a planning solution. A "two-tier Wandry" arrangement would consistent of a two-part transaction: a traditional Wandry transfer, followed by a simultaneous sale of any shares (or other assets) left by the Wandry adjustment clause if it is triggered. There may be income tax or contractual reasons for the need to transfer all equity. The problem with a Wandry clause is that it could leave shares in the selling taxpayer or trust's hands, which may not be desirable for business or personal reasons. This could create uncertainty with respect to the trust's ESBT status if all S corporation shares are sold but the operation of a Wandry clause results in shares having remained in the trust. For example, does the ESBT election end when all shares are sold? If so what occurs when it is later determined that S corporation shares are held in the selling trust? The second tier of the Wandry arrangement would consist of a second sale of any shares, effective as of the same date as the primary Wandry sale, that remain in the selling taxpayer or trust's hands. The price for this second sale, if any, would be for a price equal to the gift tax value as finally determined. This second tier Wandry sale would be supported by a note for that on which interest would accrue from closing and be made current within a specified time period, e.g., 90-days of the final determination.

2519 Considerations

[44] C. Ward, 87 TC 78, CCH Dec. 43,178.
[45] This idea is attributed to Steven Gorin, Esq. #MUST ASK STEVE
[46] Comm'r v. Procter, 142 F.2d 824 (4th Cir. 1944), cert. denied, 323 U.S. 756 (1944).
[47] Wandry et al., 103 TCM 1472, CCH Dec. 59,000(M), TC Memo. 2012-88.
[48] IRB 2012-46.
[49] This idea is attributed to Stacy Eastland. #MUST ASK STACY

The transfer of the qualifying income interest of the spouse is a transfer by the spouse subject to gift tax under § 2511.[50] If the IRS were to successfully assert a 2519 transfer, the entirety of a QTIP trust would be deemed transferred with potentially significant gift tax consequences for UHNW clients (for lesser wealth clients the current high exemptions might eliminate any tax cost to a 2519 challenge and hence make this otherwise worrisome tax challenge an affirmative planning tool).

The draconian consequences a successful Code Section 2519 challenge could have to a client transaction suggest that if steps can be taken to insulate or minimize that risk, or in some instances alternate planning structures used, it might be advantageous. If a sale is to be made by a trust that is part of a QTIP trust, perhaps steps can be taken to insulate the remainder, or main QTIP trust. A 2014 PLR provides a suggestion as to how, in part, this 2519 insurance can be obtained. [51] The concepts in the PLR might be extended further to provide insulation to different types of estate planning transactions.

The PLR provided as follows: "*Decedent's executor elected to treat Marital Trust as qualified terminable interest property (QTIP) under § 2056(b)(7) of the Internal Revenue Code...The trustees of Marital Trust propose to divide Marital Trust into three separate trusts, Trust 1, Trust 2, and Trust 3. The terms of Trust 1 will be identical to the terms of Marital Trust. Following the division, the trustees intend to convert Trust 2 to a total return unitrust with an annual unitrust payment equal to not less than three percent or more than five percent of the fair market value of the assets of Trust 2 determined as of the first day of each taxable year. The trustees, with the consent and joinder of the trustees of Family Trust and Decedent's children, will petition Court for a court order to terminate Trust 3 and distribute the assets of Trust 3 equally to Decedent's children…the division of Marital Trust into three separate trusts each separate trust will be a QTIP trust under § 2056(b)(7) and the division will not be a deemed gift or other disposition under § 2519.*"

But the division of marital trust might be used more proactively to insulate against an IRC Sec. 2519 attack if the QTIP trust is selling an asset. Assume, for example, that an irrevocable trust that qualifies as a QTIP trust is, pursuant to the terms of the governing instrument, to be combined or poured into a QTIP trust. If that first trust is to engage in a sale or transaction that might pose any 2519 arguments, perhaps the two QTIPs can be bifurcated to prevent a 2519 attack from reaching the second QTIP. The same governing instrument might include powers to divide trusts and even not to merge trusts. "Whenever two trusts created under this Will are directed to be combined into a single trust (for example, because property of one trust is to be added to the other trust). The Trustee is authorized, in the exercise of their sole and absolute discretion, instead of combining said trusts, to administer them as two separate trusts with identical terms in accordance with the provisions that would have governed the combined trusts." It may be feasible for the trustees of each of the QTIP trusts to exercise these powers in advance to prevent merger and to otherwise administer the trusts as independent and separate QTIP trusts. If an institutional trustee is named in any of the QTIP trusts it may be feasible for the institution to confirm the action to prevent a merger of the separate QTIP trusts to provide greater

[50] Section 25.2519-1(a).
[51] See PLR 201426016.

independence to the transaction then if merely family members approved the transaction.[52] This affirmative action prior to consummating a transaction may make it difficult or impossible for the IRS to assert a 2519 challenge against the QTIP trust that did not engage in the subject transaction.

Use of an Independent Escrow Agent

If a sale occurs subject to a defined value mechanism and/or a deferred payout supporting the note, who holds the collateral for the note? Who holds what documentation pending the resolution of the defined value mechanism? In most cases these documents are held by the estate planner crafting the transaction. Might there be a better option? The Ward court noted: "Furthermore, since there is no assurance that the petitioners will either recover the excess shares or, at the time of their deaths, possess the power to recover such shares, and since the shares are not worthless, the petitioners' estates may be reduced by the transfer of the shares."[53] Might having title documented held in the hands of an independent escrow agent's hands assuring that the adjustment has to be made, deflect this concern? Using an independent law firm, not a firm otherwise involved in the transaction, with a detailed escrow agreement specifying which documents should be held, and how they should be handled, might add additional credibility to the arrangement and negate the issue raised by the Ward court. Endeavoring to adhere to all relevant formalities could be important.

In the Wandry case the taxpayers listed percentage interests on the schedules attached to the gift tax return, not dollar figures as would have been consistent with the transfer of a fixed dollar amount. While the Court did not change its conclusion because of this issue, it is certainly better to avoid such inconsistencies. Adhering to the formalities of a detailed escrow agreement, one reviewed along will all documentation by an independent agent, may also help safeguard transactions from these issues.

Ordinary Course of Business Exception

While it is inherently difficult to bring any family transaction within the ambit of an arm's length transaction, to endeavor to qualify for the ordinary course of business exception, perhaps effort could be made to do so. The intent to do this could be corroborated in the transaction documents. "*Transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth…*"[54]

[52] Acknowledgements to Lynn for this suggestion.???
[53] The Ward Court referenced See Harwood v. Commissioner, 82 T.C. at 275 n. 28. Ward v. Comm'r., 87 T.C. 78 (1986); Rev. Rul. 86-41, 1986-1 C.B. 300. Cf. King v. U.S., 545 F.2d 700 (10th Cir. 1976).
[54] Treas. Reg. §25.2512-8.

Three-Appraiser Method

Might a three-appraiser methodology commonly used in closely held business transactions/buyouts with unrelated parties increase the likelihood of meeting the ordinary course of business exception? In a closely held business buyout arrangement with unrelated parties, issues of value are often resolved using a three-appraiser mechanism. For example, the entity can hire an appraisal. If the shareholder being bought out does not agree with that appraisal she can hire an independent appraiser. If the two appraisals differ by more than some percentage, the two appraisals select a third appraiser. A possible strength of this arrangement is that the taxpayer themselves cannot control the process or the selection of the third appraiser. While this has some appeal, some practitioners do not believe so.

Sample Clause: If the Corporation and the representative of the deceased Shareholders' estate cannot agree on the fair market value of such Shares, then the schedule attached to this Agreement of the Stated Value of the Corporation's Shares, if such value is not more than One (1) year old from the date of the death of the Shareholder whose interests are being repurchased, shall establish a value for such Shares. If the values in such schedule are more than One (1) year old, then the Corporation shall, at its sole expense and within the time periods required above, select an independent appraiser. If either party does not accept such appraised value of the Corporation's interest in the Business, then such party shall, at its sole expense and within the time periods required above, select its own independent appraiser to value the deceased Shareholder's interest in the Corporation. If the appraisers cannot agree on a value for such interest, then the appraisers shall select another independent appraiser, at the expense of the Corporation, and the appraisal of such appraiser shall control.

If the three-appraiser method is not viewed as adding additional comfort, perhaps a review report on the appraisal relied upon, prepared by an independent expert appraiser, will bolster the position?

Economic Adjustments in Defined Value Mechanisms

Inherent in many defined value mechanisms is that an adjustment might be made at a future date as to which taxpayer owns the particular assets (e.g., stock in a closely held business or an LLC interest) from the inception of the transaction. While defined value mechanisms routinely address the allocation of these equity interests, how are the economic implications of the adjustment provided for? If five years pass from the date of a transaction until the interests sold are determined definitively, how are the economic consequences of that five-year period addressed? This might include dividends or distributions that need to be repaid from the recipient to the correct party, e.g., the seller. Also, what mechanism will be used to assure that the equity interests are properly adjusted? Would merely providing for an adjustment clause alone suffice? Consider the following possible approach illustrating provisions when the valuation adjustment mechanism uses a spill-over of excess value to a grantor retained annuity trust ("GRAT") described in Reg. 25.2702-3.

Sample Economic Adjustment Clause Between Buying Trust and GRAT: A reallocation of funds may be required as a result of any reallocation of the Shares from the Buyer to the GRAT

under the economic adjustment provisions of the Transfer Agreement following an initial adjustment (e.g., an income tax audit). A second reallocation of funds may be required as a result of a second adjustment to the allocation of the Shares from the Buyer to the GRAT following a second and final adjustment (e.g., a gift tax audit following an initial income tax audit). It is understood that the Escrow Agent shall not release any of the Shares to the Buyer or the GRAT until the Buyer and the GRAT: (i) acknowledge in a written document acceptable to the Escrow Agent (the "Escrow Release") that pursuant to the terms of the Transfer Agreement, the Buyer and the GRAT have determined the number of Shares to be sold to the Buyer (i.e., the Actual Sale Shares) and the number of Shares to be gifted to the GRAT (i.e., the Actual Gift Shares") and (ii) set forth in such Escrow Release instructions directing the Escrow Agent as to the number of Shares that are to be released to each Party…. It is understood that the CPA Report will corroborate the amount of dividends, other distributions, or other economic benefits that accrued to the Buyer prior to the Distribution Date (as defined in the Transfer Agreement), and that are properly allocable to the GRAT, if any. The Escrow Agent shall not submit the Existing Stock Certificate, the Sale Stock Power or the Gift Stock Power to the Corporation (or its transfer agent) pursuant to Section X until after the Escrow Agent receives written notice signed by the Buyer and the GRAT, in form and substance satisfactory to the Escrow Agent, that the Buyer has reimbursed the GRAT, or made adequate arrangements to reimburse the GRAT as permitted under the Transfer Agreement, for any amounts payable to the GRAT pursuant to the CPA Report."

Sales to Non-Grantor Trusts

The use of non-grantor trusts may have application beyond planning post-Act to garner income tax benefits. A sale to a grantor trust would be essential if there is significant gain in the assets being sold, to avoid recognition of gain. Also, use of a grantor trust provides continued tax burn, and the ability to exercise a swap or substitution power which could be indispensable to basis step-up planning (by trading high basis assets the grantor owns for low basis assets in the trust, before the grantor dies). But in some instances, use of a non-grantor trust might be advantageous as the buyer in a note sale or other transaction, even if unusual. The basis step-up on the death of the first spouse's might permit avoiding capital gain on a sale. Also, an old no-longer grantor trust may have substantial assets and avoid the need for seed gifts or guarantees and make the perceived risk of the transaction lower.

How should a defined value mechanism be structured for such a transaction? It would appear that a two-tier defined value mechanism would be necessary to address both income tax audit results as well as gift tax audit results, since a sale to a non-grantor trust could trigger both income and gift tax audit adjustments. The income tax audit adjustment could be based on an IRS argument that the value of the asset(e.g., stock in a close corporation) was understated so that the transaction is in reality a part gift/part sale with less shares having been sold. This adjustment could be independent from a later gift tax audit that argues that the valuation was low, and hence a gift made. Thus, in contrast to the economic adjustment clause illustrated above for a sale to a grantor trust, a two-tier adjustment might be necessary to conform the economics to the ultimate result of the transaction.

Sample Clause: "The Parties acknowledge that a second economic adjustment may be required if there is a second tax adjustment (e.g., a gift tax audit following an earlier income tax audit at which time an adjustment was made). Should this occur, the Parties further agree to take any and all reasonable additional actions, and to execute any additional documents, in order to effectuate such adjustment payments, as the Accountant determines appropriate, if any."

An escrow agreement governing the holding of transfer documents might address both the income and gift tax audit which would impact the release of equity as well as the holding of equity as security for the note.

Sample Clause: "Allocation of the Shares. The Shares shall be held by the Escrow Agent pending the events necessary for the Shares to be valued, which may occur in two tranches, resulting from an income tax audit and a gift tax audit. As a result of that valuation process, the Parties shall determine, pursuant to the Transfer Agreement, the number of Shares that shall be deemed sold to the Buyer effective as of the date hereof (the "Actual Sale Shares") and the number of Shares that shall be deemed gifted to the GRAT (the "Actual Gift Shares")…All of the aforementioned steps are independent of the events associated with the repayment of the Secured Promissory Note (as defined herein)."

Since the buyer is a non-grantor trust it may have incurred income tax as a result of distributions, dividends or other economic consequences while holding business interests it purchased pending a final determination of the gift tax value and the adjustment to reflect that result. Does this tax cost get factored into the economic adjustment clause concept discussed above?

Guarantees and Collateral on a Note Sale

When selling assets to an existing irrevocable trust that has already benefited from prior planning another planning option might be to consider using assets other than the assets being sold in the current transaction as collateral. **Example**: ABC, LLC interests were sold to a trust years ago and that transaction has been completed and any note repaid. Now, the taxpayer is contemplating selling XYZ, LLC interests to the same trust. Instead of using XYZ, LLC interests as collateral on the note the trust gives the selling taxpayer, what if instead ABC, LLC interests are used as collateral for the note? Might that reduce the potential strings attached to the asset sold which could cause estate tax inclusion?

What if a guarantee is used and the terms require that the seller/lender/donor must first proceed against the guarantor before proceeding against the collateral? While unconventional, might that create more distance from the asset sold if there is no other collateral to use? How would the guarantee fee have to be adjusted to reflect this increased risk? Since the guarantor would be first "in line" before the collateral the fee to be charged would have to be greater than in a traditional guarantee arrangement.

Community Property

Practitioners might give consideration to planning to USE community property rules to obtain a full basis step up on the death of the first spouse to die (subject to the normal exceptions, such as

for income respect of a decedent). While there are 11 states with community property laws, three OF THE states provide elective community property laws that anyone can avail themselves of: Alaska (need to be residents of Alaska, Tennessee and South Dakota). Residents of non-community property states, for example, can create a community property trust in Alaska and obtain a full basis step up on the first spouse's death on all assets held in that community property trust. In reality, it is not a step up but more akin to a mark to market regime as basis can be stepped down as well. That can be valuable for many client situations and thereafter estate tax minimization planning might proceed without being hindered by low basis issues on those assets. For example, if a highly appreciated rental property or business interest were transferred to an Alaska community property trust by a domiciliary of a non-community property state, e.g. New York, on the death of the first spouse the entirety of that asset would benefit from a basis step-up. Thereafter, one-half of the assets, with a basis equal to fair value, would be distributed as would the estate of the first spouse die, and one-half to the surviving spouse. For a non-resident of Alaska to create an Alaska community property trust as in the above illustration a requirement to benefit from the Alaskan law is to name a qualified trustee AS AN administrative trustee, e.g. an Alaskan trust company.

Upstream Planning

Upstream planning, to shift values to a higher generation family member not subject to the estate tax has been discussed by a number of commentators. This type of planning, while still relatively unconventional deserves attention, especially in light of the current large temporary exemptions. Clients have a net worth substantially in excess of the approximately $22 million per couple exemption, might consider upstream planning if, for example, the client's parents have a net worth combined of well under the current exemption, e.g. only $2 million.

Upstream planning might be effected by the clients creating a GRAT that is calculated to vest in each parent somewhat less than the maximum amount which, when added to their other assets, would not exceed each parent's estate tax exemption at the time that each parent dies. The parents can revise their estate planning documents to bequeath the remainder interest to a trust for the benefit of the client and the client's descendants. This transfer might not only absorb the parent's estate tax exemption but might utilize each parent's GST exemption (because there is no ETIP with respect to the parent as beneficiary of the upstream GRAT). The IRS might have no objection to this planning because it actually uses exemption, rather than being an assignment on day one (or two) of a nominally valued remainder interest.

Another approach to upstream planning is to create an irrevocable trust with a general power of appointment ("GPOA") to a person living in a non-decoupled state who has a modest estate of her own. The presence of that GPOA should cause estate inclusion of trust assets in that person's estate generating no estate tax but an adjustment of basis on her death.[55] This type of GPOA planning raises a host of questions to consider.

[55] IRC Sec. 2041.

How can protection before afforded against an unintended or undesirable exercise of the GPOA granted? For example, the exercise of the GPOA could be conditioned upon the consent of a non-adverse party providing a measure of protection. Instead of a GPOA, a limited power of appointment ("LPOA") could be provided to that intended person, and another person can be given the power, in a non-fiduciary capacity, to convert the LPOA into a GPOA before the powerholder's death. If the trust is formed in a jurisdiction that permits silent trusts, is there a need to even inform the power holder of the existence of the GPOA? The scope of the GPOA could be limited. For example, the power holder may only be granted the right to appoint to the creditors of her estate and to the descendants of the grantor of the power or trusts for their benefit.

This type of upstream GPOA planning might raise creditor issues. Confirm that the existence and exercise of the GPOA will not subject the trust assets to the claims of the creditors of the powerholder. If that is a risk, might conditioning the exercise of the power on the powerholder being solvent limit such risk? A GPOA may also subject the assets to a parent's or other power holder's Medicaid claim for reimbursement.[56]

An alternative is to consider allowing the Delaware Tax Trap to be trigger. Essentially, under Section 2041(a)(3), property subject to a non-general power of appointment is included in the gross estate of the power holder who exercises it in certain way.[57]

Trust Variations for the Current Planning Environment

Incomplete Gift Traditional INGs

The traditional intentionally non-grantor ("ING") trust is structured as an incomplete transfer for gift tax purposes. While INGs have traditionally been used to save state income tax on a large capital gains, and are still beneficiary in that application, post-Act there may be several new applications of the ING.[58] Note that New York has expressly legislated against this technique.

All the benefits of non-grantor trust planning mentioned above may encourage a greater use of ING planning. But in the current environment with large temporary exemptions, INGs, as incomplete gift transfers, and will not use exemption and thus provide no protection of exemption before the scheduled drop in exemption amounts in 2026. Thus, INGs may be the optimal tool for UHNW clients who have used their full exemptions, but less optimal for moderate wealth clients who might benefit not only from non-grantor trust planning but from completed gift transfers to use exemption as well.

Traditional INGs have been structured with the settlor making transfers that are incomplete for gift tax purposes. This has often been accomplished by the settlor reserving a power to name new

[56] Acknowledgement to Bernard Krooks, Esq. for this caution.
[57] See, Blattmachr & Pennell, "Using 'Delaware Tax Trap' to Avoid Generation-Skipping Taxes," 68 The Journal of Taxation 242 (April 1988).
[58] See Blattmachr & Lipkind, "Fundamentals of DING Type Trusts: No Gift Not a Grantor Trust," 26 Probate Property Report 1 (April 2014), and Lipkind, Shenkman and Blattmachr, "ING Trusts: Completed Gifts or Not: Their Time Has Arrived," Trusts and Estates to be published.

beneficiaries or to change the interests of the beneficiaries as between themselves. That power is expressly crafted not to be held in a fiduciary capacity nor limited by a fixed or ascertainable standard.[59]

A slightly different application of the ING technique, restructured to be a completed gift ING, could provide the non-grantor trust benefits to the moderate wealth client yet also secure their temporary exemption. This might be done by drafting the trust instrument to expressly exclude any reserved powers that could taint the transfers to the trust as incomplete gifts.

Post-Act for UHNW clients, who have already used the entirety of their gift tax exemption, the traditional application of the ING technique remains beneficial without change.

Non-Grantor Trusts with Spousal Access

A common planning technique for many years, and especially beginning in 2012 when taxpayers sought to use exemption before it purportedly would decline from $5 million to $1 million was the use of non-reciprocal spousal lifetime access trusts ("SLATs"). In this technique each spouse would create a trust for the other spouse and descendants. The trusts would be crafted to have sufficient differences so that neither the IRS or hopefully a creditor could "uncross" the trusts and undermine the planning. The benefit of the SLAT technique is that a couple could use exemption and retain access to assets transferred, all while achieving asset protection goals. Planning in the current environment has important similarities and differences from the SLAT planning of 2012. These can be used to highlight how planning might optimally be structured now.

- Like 2012 current wealth transfers should seek to secure the high estate tax exemptions before they are reduced by half in 2026 (or by legislation prior to that if there is a change in administration in Washington).
- Like 2012, but even more pronounced, is the need for most taxpayers using current exemption to have access to the assets transferred. The reason access is more important is obvious, the exemptions are larger, and more wealth can be transferred.
- Unlike 2012 SLATs in the current environment should in many, but certainly not all, instances be structured as non-grantor trusts to garner potentially a number of different tax benefits (even considering the 199A Proposed Regulations.

Threading the tax and trust "needle" to meet the above requirements requires a different type of trust, and different planning and drafting then has been historically common. Just as with the completed gift ING suggested above, a new variant of a spousal trust will be necessary to achieve the disparate goals above. This new variant has been referred to as a "SALTy-SLAT" by virtue of the non-grantor SLAT being able to facilitate planning to salvage some of the state and local tax ("SALT") deductions. Others have referred to it as a Spousal Lifetime Access Non-Grantor Trust ("SLANT"). Whether a new acronym is used, drafting non-grantor, completed gift, trusts that are accessible, is a technique to consider for some clients in the current environment.

[59] Reg. 25.2511-2(c) (second sentence).

If the trust is properly structured (no grantor powers to the settlor spouse) and the beneficiary spouse can only receive distributions with the consent of an adverse party, the trust may achieve all objectives: completed gift to use exemption, non-grantor trust for any or all of the planning benefits of non-grantor trust in the post-TCJA environment, and access.

Beneficiary Defective Irrevocable Trust ("BDIT")

Might a variation of the Beneficiary Defective Trust ("BDT") be used to achieve new planning goals to address the SALT restrictions of the Act? A BDT is an irrevocable trust that is a grantor for trust for income tax purposes as to the beneficiary and not as to the settlor. For example, parent may set up a trust for child, and that trust could be crafted to exclude provisions that would make the trust grantor as to the settlor. The trust would include an annual demand or Crummey power making the trust grantor as to the child/beneficiary.

In the traditional BDT (BDIT) the parent may create a BDT for a wealthy child with a $5,000 initial gift, which would be subject to the child's power of withdrawal which would lapse without gift or estate tax consequences but would remain a grantor trust as to the child so that he or she could sell assets to the trust without triggering capital gain. A good plan, but how can this be spun for the Act?

If the parent lives in a high tax state and the child in a no tax state, might a variation of the typical BDIT approach be used by the parent to shift income to a lower SALT environment to save SALT when they are no longer deductible?

Example: Mom gifts $5,000 to a BDIT that is grantor to son in a low tax state. Mom then directs business opportunity to the trust which has no discernable gift tax value. The income generated will be reported by son in the no tax state. The value of the business opportunity would be grown outside the parent and child's estate in contemplation of the sunset of the estate tax repeal.

Grantor Trust as to an Existing Trust

UHNW taxpayers proceed with planning as the Code Section 2704 Regulations have been withdrawn, the temporary increase in the exemption facilitates wealth transfers, and there is concern over what future law changes might do.

Example: UHNW clients if they have, for example, large non-GST exempt trusts, might create new GST exempt trusts. A family member may create a new irrevocable trust that is an IRC Sec. 678 grantor trust as to the existing non-GST exempt trust, funding that new trust using a portion of her new gift and GST exemption. That new trust could be designed by its terms to be grantor as to the old non-GST exempt trust. Then old non-GST exempt trust could engage in transactions to shift value to the GST exempt trust, before the laws change unfavorably. One approach to this might be for the non-GST exempt trust to sell assets in a note sale transaction to the new GST exempt trust thereby freezing the value in the non-GST exempt trust. Some have referred to this as a Beneficiary Deemed Owner Trust ("BDOT").

This could be a useful planning tool but at present there is limited guidance. Two trusts and one trust deemed the owner of the other trust for income tax purposes under the grantor trust rules.[60] This creates the opportunity to facilitate transfers between new parties, e.g. beneficiary and testamentary trust deemed grantor under IRC 678(a)(1). This 678-Trust or BDOT is quite different then the technique of a BDIT noted above. In the BDIT a Crummey power is granted to the beneficiary to create grantor trust status as to that particular beneficiary. In contrast the Code Section 678 trust relies on a different mechanism to create grantor trust status as to the existing or old trust: "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…"[61] In one case, the beneficiaries held the power under Code Section 678 to demand that the trustee distribute capital gains to them. Regardless of the fact that the power was not exercised, the beneficiaries where characterized as deemed owners of the trust.[62] While some have suggested that if a settlor(e.g., a parent creates an irrevocable trust which provides the beneficiary, such as a child of the parent,, the right to withdraw all taxable income, it will be characterized entirely as a 678 trust as to the beneficiary child. The same could be done with two trusts. If the new trust is fully grantor as to the beneficiary/child that child could engage in a large sale to the grantor trust income tax free. Further, some have suggested that on the death of the child only the taxable income which the beneficiary/child has not withdrawn is included in his or her estate. However, it is suggested that, perhaps, the entirety of income or corpus of a new trust should be subject to a withdrawal power by the trustee of the existing trust to fully assure grantor trust status for the entirety of the new trust.

The terms of the new trust should give the existing trust, the right to withdraw ordinary income and capital gains and that characterizes the existing/old trust as the deemed owner of the new trust. While some have suggested that the right to income alone might characterize the existing trust as grantor as to the new trust, others believe that a safer approach might be to give the trustee of the existing trust the right to withdraw income or principal to assure grantor characterization

Addressing Existing Pre-Act Irrevocable Trusts

Mistake is unlikely to support unwinding and old trust

Can a mistake be used to unwind a prior transaction? Some taxpayers, seeing the large increase in exemption, may feel the estate tax is not relevant or even if relevant that a prior transaction is no longer necessary or perhaps not optimal. It is unlikely that mistake will support unwinding a prior transaction done before the Act. For example, in the Breakiron case, after the term of a QPRT expired, the taxpayer desired to shift his interest in the property to another heir. The issue was whether there would be a negative gift tax consequence.[63] The taxpayer hired counsel and was incorrectly advised that he could sign a qualified disclaimer within nine months of the

[60] PLR 201633021.
[61] Code Section 678(a)(1).
[62] Campbell v. Commr., TC Memo 1979-495.
[63] Craig Breakiron v. Lauren Breakiron Gudonis (No. 1:09-cv-10427, Aug. 10, 2010).

expiration of QPRTs' term and transfer the property in that manner. As is obvious to most practitioners, the law requires that the disclaimer, to be qualified, had to have been made within nine months of the creation of the QPRT. Because of this incorrect advice, the disclaimer was not qualified, and the taxpayer incurred a gift tax liability. The taxpayer petitioned the court to permit rescission of the inappropriate disclaimer and thereby negate the unintended gift tax. Because the disclaimer was due to a mistake that undermined the intent for the transfer, the court permitted the rescission, and the taxpayer avoided gift tax. While this case presents an interesting avenue for correction a less than optimal plan it is not likely to provide a basis to unwind prior planning.

An argument of mistake will also not generally permit restructuring a no-longer-beneficial transaction. In another case, the settlor created a QPRT to minimize tax but overlooked the generation-skipping transfer tax implications of grandchildren being named beneficiaries.[64] The court permitted the substitution of the children for the grandchildren, as it was viewed as implementing the grantor's intent to reduce taxes. While this case was certainly helpful to the taxpayer, it too seems unlikely to provide a broader resolution to unwinding planning made obsolete by the Act.

Decanting

Decanting might provide a mechanism to modify older planning that is not optimal post-Act. Decanting is the merging or pouring of an existing or old trust into a new trust. While much can be achieved or changed through a decanting, in general terms it is only the administrative provisions of the trust that can or should be changed. Beneficiaries should generally not be changed nor should the rights of existing beneficiaries, however, if the existing trusts permits changes or grants powers to persons to change beneficiaries that too may be done.

There may be several options that can be explored for decanting. The trust instrument itself may incorporate decanting provisions. If those suffice to accomplish the intended goals the analysis may stop there. If the instrument is silent or inadequate, then state law decanting statutes and/or common law should be considered. Finally, if the law of the jurisdiction governing trust administration is not sufficient for the intended objectives, the situs and governing law of the trust might be changed to a more favorable state that has a more robust decanting statute. In many instances, existing trusts are decanted to new better trust jurisdictions so the application of the decanting statute of the new jurisdiction is an obvious outcome of the process. In particular, post-ACT, moving an irrevocable trust from a high-tax state to a low/no tax state to save state income tax in light of SALT limitations may be more common than in prior years.

While there may not be negative tax consequences resulting from the transfer of assets from an existing trust to another trust by decanting, caution is in order as there are exceptions. In all instances, especially if there are changes to beneficiaries or beneficiary rights, practitioners should be cautious about possible income tax implications. If negative basis property (liabilities in excess of basis) is transferred care should be exercised to avoid deemed gain recognition.[65]

[64] Simches, Trustee 1 v. Simches, Trustee 2 and Others (433 Mass. 683, Nov. 6, 1996).
[65] Crane v. Commissioner, 331 US 1 (1946).

Transfer tax consequences should also be evaluated prior to consummating a decanting. Will the transfer of assets to the new trust trigger a taxable gift? Even if a taxable gift is triggered, what is the value of that gift? In some instances, a taxable transfer may occur but one for which there is no ascertainable or determinable value. Also, confirmation that no generation skipping transfer ("GST") tax consequences are triggered, especially if the decanting affects a "grandfathered" GST exempt trust.

Court Approved Modification of a Trust

In some instances, it might be beneficial, or perhaps essential, to have a court approve a modification of a trust instrument to address the changes in the tax environment by the Act and other developments. Court approval, however, should not be assumed to be automatic, even if the matter is uncontested. In Flint, the Delaware Court of Chancery denied a beneficiary's unopposed petition to modify the terms of a testamentary trust established by her father in his will because the modification violated the testator's intent.[66]

The current income beneficiary of a testamentary trust petitioned the court to modify the trust's administrative provisions converting the trust from a traditional, trustee-managed structure that the settlor contemplated into a directed trust under which the trustee would serve only an administrative role.

The court held that the wishes of living beneficiaries, even if they all concur, should not automatically prevail over the intent of the testator as evidenced in the governing instrument. The Court held that Delaware should give deference to the testator's intent. Delaware law gives maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments."[67] The beneficiaries wanted a far greater degree of control over investments of the trust then the will that created that trust provided. The court made clear that it would not rewrite a will, contrary to what that will indicated the testator intended, simply because the beneficiaries all desired that result.[68]

Non-Judicial Modification

Another approach to modifying older pre-Act planning in light of recent changes might be to use a non-judicial modification of an existing trust. For non-judicial modification to be feasible the grantor must not have died, the requirements of the statute must be met, and the parties (e.g. an institutional trustee) must be willing to forgo the certainty a court approval might provide, etc.) then the parties may opt to have court approval of the desired trust modifications.

[66] C.A. No. 10593-VCL (June 17, 2015).
[67] 12 Del. C. § 3303(a).
[68] See In re Peierls Family Inter Vivos Trusts, 59 A.3d 471 (Del. Ch. 2012), aff'd in part & rev'd in part, 77 A.3d 249 (Del. 2013); In re Ethel F. Peierls Charitable Lead Unitrust, 59 A.3d 464 (Del. Ch. 2012), aff'd sub nom. In re Peierls Charitable Lead Unitrust, 77 A.3d 232 (Del. 2013); In re Peierls Family Testamentary Trusts, 58 A.3d 985 (Del. Ch. 2012), aff'd in part & rev'd in part, 77 A.3d 223 Del. 2013).

Many states permit non-judicial modification of a trust. Delaware's law is particularly robust and, so long as the settlor is alive and other requirements met, a trust can be modified in almost any manner. The trust might therefore be moved to Delaware, which would require appointment of a Delaware trustee.[69]

UTC May Permit Modifications

The UTC contains provisions permitting modifications of trusts, reformations to correct mistakes, and combinations and divisions of trusts. The UTC provides that a non-charitable irrevocable trust may be modified or terminated (with or without court approval depending on the jurisdiction) upon consent of the settlor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust.[70]

Conclusion

Planning for, drafting, funding and administering irrevocable trusts has always provided challenges to practitioners. The Act complicates the options available but leaves considerable opportunities to benefit clients. However, now that the Act has begun to be digested and its more significant planning implications understood, practitioners might begin to take a broader view of the current trust planning environment. Stepping back and considering the many recent changes, not just the Act, new planning ideas and drafting concepts, and more, a more interesting and tailored view of trust planning in the current environment can help practitioners better serve clients.

CITE AS:

LISI Income Tax Planning Newsletter #163 (December 3, 2018) http://www.leimbergservices.com Copyright 2018 Leimberg Information Services, Inc. (LISI). Reproduction in Any Form or Forwarding to Any Person Prohibited – Without Express Permission.

[69] 12 Del. Code section 3342.
[70] Section 411(a).