Wolters Kluwer

When you have to be right

Estate Planning Review The Journal

VOLUME 44 | ISSUE 11 | NOVEMBER 20, 2018

Contents

Highlights of the Wolters Kluwer Financial and Estate Planning Advisory Board Meeting

Estate Planning Review The Journal

Advisory Board Members

For article submission guidelines, contact Bruno Graziano, ESTATE PLANNING REVIEW—The Journal, 2700 Lake Cook Road, Riverwoods, IL 60015, or send e-mail to EPRJournal@wolterskluwer.com.

ESTATE PLANNING REVIEW—THE JOURNAL

(ISSN 0098-2873), published monthly by Wolters Kluwer, 2700 Lake Cook Road, Riverwoods, IL 60015 **POSTMASTER:** SEND ADDRESS CHANGES TO ESTATE PLANNING REVIEW, 2700 Lake Cook Road, Riverwoods, IL 60015. Printed in U.S.A.

CURRENT FINANCIAL AND ESTATE PLANNING TRENDS

Highlights of the CCH Financial and Estate Planning Advisory Board Meeting—Planning in the Aftermath of the Tax Cuts and Jobs Act

Recently, the Wolters Kluwer Financial and Estate Planning Advisory Board met to discuss the topic of planning in the aftermath of the Tax Cuts and Jobs Act of 2017 (P.L. 115-97). The Advisory Board, along with moderators **Sidney Kess** and **Martin Shenkman** and members of the Wolters Kluwer editorial staff, considered many of the ramifications this far-reaching legislation is having on estate planners and other professionals as they guide their clients. The following is an edited version of that discussion.

Participants and contributors to this discussion included **Ben G. Baldwin, Jr.**, Baldwin Financial Systems, Inc., Arlington Heights, Illinois; **Lyle K. Benson, Jr.**, L.K. Benson & Company, PC, Towson, Maryland; **Jeremiah W. Doyle IV**, BNY Mellon Private Wealth Management, Boston, Massachusetts; **Sidney Kess**, Of Counsel to Kostelanetz and Fink, Senior Consultant, Citrin Cooperman & Co., LLP, New York, New York; **Stephen J. Krass**, Krass, Snow & Schmutter, PC, New York, New York; **Barbara J. Raasch**, RCL Advisors, New York, New York; **Theodore J. Sarenski**, Blue Ocean Strategic Capital, LLC, Syracuse, New York; **Sanford J. Schlesinger**, Schlesinger Lazetera & Auchincloss LLP, New York, New York; **Martin M. Shenkman**, Martin M. Shenkman, PC, Fort Lee, New Jersey; **Lee Slavutin**, Stern Slavutin-2 Inc., New York, New York; and **Julie Welch**, Meara Welch Browne, P.C., Leawood, Kansas.

BUSINESS TAX PLANNING

Choice of Entity

Julie Welch, along with Martin Shenkman and Sidney Kess dive into some of the many considerations that must be addressed when making choice-of-entity decisions following passage of the Tax Cuts and Jobs Act of 2017.

Martin Shenkman: The Tax Cuts and Jobs Act [P.L. 115-97], including the Code Sec. 199A deduction and reduced corporate and individual tax rates, has had a significant impact on choice of entity. Does anybody want to discuss how the Act has changed choice of entity decisions and how you're guiding clients in that regard?

... while existing clients are asking questions, we're comparing and discussing the different options and what's available, for example, LLC versus S corporation versus C corporation.

Julie Welch: There is still a lot of uncertainty and a lot of calculations and comparisons going on. So, while existing clients are asking questions, we're comparing and discussing the different options and what's available, for example, LLC versus S corporation versus C corporation. But, at this point, I don't have many clients actually changing their form of operation yet. They are going to wait it out at least for 2018 and then, maybe by December they will have a little bit better idea of what they want to do.

But again, this is a waiting game—waiting and looking at the situation. Now that the Code Sec. 199A initial guidance is out, that's helped. But, it requires planning and showing clients what they can do with what they have right now, whatever their entity is, what the benefits and, ways to make things work best in their favor.

Sidney Kess: Julie, are you finding your clients raising the question?

Julie Welch: Yes. A lot of clients at least want to talk about it. And, of course, they all jump to, "Oh, I want to be an S corporation," in a lot of cases because of the perceived payroll tax savings in there. However, they have to have reasonable compensation and enough wages. There are a lot of factors that go into analyzing choice of entity.

Martin Shenkman: One of the things that I've seen is this presumption by some clients that they should go out and form C corporations because of the lower tax rate. And I know that we, as advisors, are all aware of the potentially very negative tax impacts of getting out of C corporations. It's easy to get in, but can be costly to get out.

Have any of you had any experience with clients trying to use C corporations because of just the simplistic perception that the tax rate is lower

Julie Welch: I did have one client that is operating an S corporation and they immediately wanted to yank their S election. Our response was, first off, if you do that, there is a five-year wait if you want to come back. And, if you go through the numbers, using the 21-percent tax rate and then do a liquidating distribution out and get the capital gains rate, the end result is somewhat close to the individual rate.

Basically, it's just running the numbers and showing clients what the numbers are with respect to taxes and knowing that some of this is going to probably be short term as opposed to long term. And, if they make an entity change, they may be stuck for awhile.

Martin Shenkman: It seems to me that one of the things that we all have to be alert for is the potential for the personal holding company tax and the accumulated earnings tax. The accumulated earnings tax has been off-radar for most advisors for a long time. But, now that the corporate tax rate is meaningfully lower than the individual tax rate, perhaps that should be something we need to be paying more attention to, in order to guide clients.

So, for example, this might be a question to raise at an annual review meeting as something to be looked at. When accountants are doing tax returns for C corporations, they should be mindful of how much earnings have been accumulated. And, one of the things to address is to try to document and corroborate the planned use of those funds, why they've been retained, and the business purpose for those funds.

... one of the things that we all have to be alert for is the potential for the personal holding company tax and the accumulated earnings tax.

Decades ago, that was not so uncommon to be done in annual minutes, and maybe even having exhibits or supplements to the minutes to corroborate the business purpose for the funds retained, because anything over $250,000 could be subject to an accumulated earnings tax.

Code Sec. 199A and Proposed Regulations

Martin Shenkman, Sanford Schlesinger, Julie Welch, and Theodore Sarenski analyze the details of the recently proposed regulations on Code Sec. 199A.

Martin Shenkman: Everybody has been anxiously waiting for Code Sec. 199A guidance, why don't we jump into that? Sandy, do you want to kick off that discussion?

Sanford Schlesinger: One case I have where a client wanted to take advantage of Code Sec. 199A, it seemed like a lot of work for very little tax savings. The situation I had with somebody in a closely-held business, which he owned 100 percent and it was a combined group. It was a group of entities all under one umbrella and each of the individual entities under it were LLCs for the most part. The idea was to give certain members of the family a small percentage in order to qualify for the Code Sec. 199A deduction.

And, when we ran numbers, we found that even with a very substantial business, the savings individually tax-wise didn't look great. Does anybody have my perception that the savings may not be huge? It seems to me that there is a lot of sound and fury signifying nothing for a lot of people.

Martin Shenkman: I agree with you. We have to be mindful that in 2026, this is all gone unless "Tax Reform 2.0" changes it. And, it may be possible that, if there is a change in the Administration in Washington in 2020 or 2024, all of these rules could be history. So, I think we need to be very mindful of how much cost a client incurs in doing this planning, not only because the benefits are often not as large as what clients anticipate, but because of the potential sunset.

According to the regulations, the estimated average annual burden in hours per respondent will vary from 30 minutes to 20 hours. And, they estimate the average time to deal with all of the 199A complexity is a mere 2.5 hours—that is far from realistic.

Sanford Schlesinger: Then I must be the slowest learner in the history of the world.

Julie Welch: Did they read the regulations in 2.5 hours?

Martin Shenkman: What's also interesting from the regulations is the estimate that this provision is going to affect 10 million taxpayers. And, I think the 2.5-hour average is ridiculously low.

Sanford Schlesinger: I agree.

Martin Shenkman: But, addressing Sandy's point, the problem that we're presented with is that, in order to go through these regulations requires a monumental time investment. To master them sufficiently to advise clients is a very significant time investment. And, many clients have a simplistic misconception, "Oh, I get a 20-percent deduction," without any concept of the incredible complexity underlying that premise. Does anyone have any suggestions for dealing with this with clients?

Sanford Schlesinger: Well for one second let's be clear as to what is at stake here. As I understand it, that 20-percent deduction brings the 37-percent tax rate down to 29.6 percent. And, it's a deduction that's neither above the line or anything else; it's a *sui generis* deduction.

So, we're talking about a less than eight-percent tax savings. I hope that puts it in some degree of perspective. For some reason, everybody is looking at Code Sec. 199A as the most important part of the entire Act as it applies to individuals.

And, to my knowledge, New York State has not adopted it. I don't know about other states.

Martin Shenkman: Does anyone know of any states that have?

Julie Welch: I think Connecticut just did something concerning a tax on pass-through entities, although that involves a different issue. Connecticut put a 6.99-percent tax on pass-through entities to help avoid the issue with the state and local tax deduction on individuals. I'm not sure how it is going to flow through on the individual return, but the entity will have paid the tax so presumably less income will flow through to the individual since it will be net of the new tax.

[**Editors' Note:** As of November 2018, most states have not yet issued guidance on the adoption of the Code Sec. 199A deduction. Only a few, such as Idaho, have actually done so. States like Hawaii, Illinois, and Kansas use federal adjusted gross income as the starting point for computing state income tax, so no adjustment is required. Others, such as Colorado and Nebraska do not need to because they incorporate federal law by reference. Finally, others, such as South Carolina and Wisconsin, have specifically excluded the pass-through deduction from their conformity provisions.]

Specified Service Trade or Businesses

Martin Shenkman: Why don't we take a look at just a few of the definitions of a specified service trade or business? I assume most people reading this are going to be familiar with the specified service trade or business (SSTB) definition, which includes lawyers, doctors, and accountants, but not engineers and architects.

Sanford Schlesinger: At least one prominent member of the trusts and estates community thinks this is outright discriminatory, and that millions of accountants and attorneys should unite and try to have it changed. And, of course, there is the idea of separating the "business part" from the "professional part" and creating two separate entities. With respect to lawyers, it looks like that strategy is not going to work under the proposed regulations

Martin Shenkman: If you take a look at what they've provided in the proposed regulations as to the definitions of each SSTB, the guidance is only marginally useful. For example, with respect to "health," none of them are very helpful. So, health clubs or health spas are excluded. Research testing and the manufacturer or sale of pharmaceuticals or medical devices are excluded from the SSTB definition. But, that leaves a really overly-broad swath of things that are deemed to be medical, and doesn't really give us a lot of understanding of what might be excluded.

There's another issue with medical that's worthy of note. The regulations say that the health category includes "Professionals who provide medical services directly to a patient." So, if a radiologist reads x-rays, MRIs and he or she merely provides a report to the physician that ordered it, is that something that's "directly to a patient"? Are they somehow excluded, whereas other providers are included?

There are a lot of questionable things in the proposed regulations and a lot of uncertainty even with the definitions. At first blush it looked very helpful that the regulations went category-by-category detailing each SSTB. But, when you read it, it leaves the impression that the regulations don't provide the specificity that we need, and it seems that the SSTB definitions are over-broad in terms of pulling things in.

For example, if a real estate developer owned a building and rented it, he or she would earn income that would be deemed qualified business income (QBI) and be entitled to the 20-percent deduction. If Sandy and I, as lawyers, owned the building that we were in and rented it to our practices, with the aggregation and control rules it's not going to work. But, if Sandy, I, and a third attorney could each own a third of the building and rent it to our separate practices, and we might avoid or circumvent the common control rule, and we might be able to then qualify that as rental, which requires an unreasonable variation from how professionals—doctors, lawyers, accountants who own their buildings, practice.

Given the backdrop of what Sandy talked about in terms of how small the real benefit is and the sunset, how many people could possibly be willing to restructure their practices in that significant of a way to have a non-controlling interest with other colleagues?

And the irony or unfairness of all this is, as Sandy pointed out a few minutes ago, if an architect or engineer owned the building that their practice is in and rents it, that fully qualifies as does their practice. And, what's the relevant difference?

When you look at the field of law, they exclude stenography services. Sandy, do you get a lot of income from stenography services or delivery services

Sanford Schlesinger: I'm brushing up on that.

Martin Shenkman: So, the exclusions are not particularly helpful, which is unfortunate. So again, at first blush it looked good that they were providing guidance, but when you get down to the nitty-gritty, it's not sufficiently helpful.

Now, if you take a look at the SSTB of "accounting," bookkeeping services are included. You don't need to be a licensed professional to provide bookkeeping services. So, many of us had speculated, before the proposed regulations were issued, that accounting firms might have bifurcated their practices and separated out bookkeeping services and forensic work, and carve off cost segregation studies because those may even be done by engineers, not CPAs.

And, they may still be able to, but they likely won't benefit because of the common control and aggregation tests. But, the common control test would probably bring those in.

Sanford Schlesinger: What about for accounting firms that have broken up into a major portion of business consulting. Would consulting services qualify?

Martin Shenkman: Consulting also is characterized as an SSTB as well.

I don't think there's really a lot of room to navigate around this. Have any of the accountants on the call thought of ways to navigate around this? Okay.

Theodore Sarenski: No, I have not.

Martin Shenkman: And, I think, again, you go back to what is the benefit. How many years will this be around? How many gyrations to legally restructure or break apart a practice do you have to do? And even if you do, the consulting category is quite broad and that could seem to eliminate that option. Then you have the aggregation and control test as well, all of which could be a problem. I'm not sure how much latitude there is with respect to that.

Sanford Schlesinger: Going back for a moment to our earlier discussion about breaking up the law firm from stenography, that strategy has been referred to as "crack and pack" and it is largely a no-go according to the proposed regulations.

Martin Shenkman: That's absolutely correct. I had written some articles speculating, because it made sense that, for example, law firms, accounting firms, medical practices could carve off expensive equipment, carve off real estate. It's no different than when a real estate developer and equipment leasing company has it.

But, the aggregation rules and common control rules make that very difficult to do in any meaningful way. And I'll echo Sandy's earlier comment, there is something inherently not only unfair, but irrational about all these rules. They just don't make a lot of sense.

Net Leased Real Estate and Code Sec. 199A

Martin Shenkman: Let's address another issue under the proposed regulations. Does anyone have any thoughts as to whether net leased real estate will qualify? It's clear that under Code Sec. 199A, the proposed regulations refer back to Code Sec. 162 for a definition of a trade or business. And, it appears on one level that you have to qualify as a trade or business under Code Sec. 162 in order to qualify for the Code Sec. 199A 20-percent QBI deduction.

The difficulty in interpreting that is, if you look at the proposed regulations, they contain an example involving an unmarried individual who owns several parcels of land. They are leased to a suburban airport for parking lots and they generate $1 million of QBI.

Well, that suggests that if this raw land generates income, that net leased real estate, even raw land, would be a qualified business because they're suggesting that the $1 million of income is qualified business income.

The problem with this is they use the word "manages" and the taxable income is $980,000. The implication is there is a mere $20,000 of deductions, which is completely insignificant. How much management can you do if you net lease raw, unimproved

land to an airport as a parking lot? What does "manage" mean in that context?

There are almost no expenses, so what are you really doing? Presumably, the $20,000 of expenses could be insurance and nothing more. But, that seems to be a qualified trade or business, and it seems that the implication is that net leasing raw land would qualify and net leasing a building would certainly qualify

The next example they give in the regulations addresses the lease of improved land with parking structures on it. Again, we see the same insignificant $20,000 of expenses, but they use the same term "manage" in this context.

So, I'm not really sure how to interpret that. My sense is that the intent is to qualify for the Code Sec. 199A deduction with any net leased real estate. The bottom line is it's certainly not assured because is it really a Code Sec. 162 trade or business? It seems like the regulations refer to Code Sec. 162, but they appear to override that on net leased real estate.

Final Comments on Code Sec. 199A

Martin Shenkman: Does anyone have any other thoughts?

Theodore Sarenski: I do have one other comment on Code Sec. 199A. Is there a way to get government statistics? My feeling is that there are small businesses that are below the $157,000 and $315,000 limits and what we can do to restructure them and get this 20-percent deduction.

I don't think enough has been written about the new tax law to gauge the benefits for businesses that fall below those numbers, and I don't know if there are some government statistics that we could find to say that, X number of thousands of businesses fall below this in income, and this 20 percent could mean a great deal to allow them to expand—to add people to their business.

Mark Luscombe: Ted, the Tax Policy Center came out with a study that's not directly on point, but it tends to indicate that a lot of smaller businesses, because of their limited QBI, would receive fairly limited benefits from the deduction. But, I think they're talking generally about, Schedule C filers in their analysis. If they have a lot of QBI, but are still under the taxable income limits, then I would think there would be some benefit. But, the overall conclusion of the Tax Policy Center study is that there are a lot of pass-through businesses that would receive limited benefit, just because of their limited QBI.

Martin Shenkman: The target group that is going to be hurt most is licensed professionals in high-tax states like New York, New Jersey, Connecticut, and California. So, for instance, a successful estate planner in New York City who is paying substantial New York State and New York City taxes, only $10,000 of which may be deductible on their federal return, and who can't qualify for the 20-percent QBI deduction because of the specified service trade or business rule, would be an example of one of the segments of taxpayers harmed the most by the new law.

They pay the highest taxes, but only a limited deduction for the state and local portion. One really has to wonder about the fairness and equity of all this. And, those are going to be the clients who, once they see their 2018 returns and how badly they've been hurt by a supposed tax cut, they're going to be very unhappy.

Why don't we move to the multiple trust rules provided in these regulations and take a look at them.

Multiple Trust Rules

Martin Shenkman: Let's start with the source of where this all came from. Code Sec. 643(f) provides for what's known as a "multiple trust rule," and Code Sec. 643(f)seems to have required the issuance of regulations in order to be effective. That provision would not seemingly be effective without proposed regulations, which for about 40 years weren't issued, but now have been.

The IRS appears to have responded to some of the planning that was suggested in articles in the professional literature about the need to issue regulations and the speculation in articles that Code Sec. 643 wouldn't apply. When you read Code Sec. 643, it says that, if trusts have substantially the same grantors and substantially the same primary beneficiary and a principal purpose to avoid tax, then the IRS can aggregate those trusts.

The word "and" means "also," meaning all three of these requirements have to be met. Yet, what the IRS

appears to do in the proposed regulations is basically to violate the whole statute, at least as I read it. I'm curious if any of you have comments on it.

The proposed regulations include an example [Proposed Reg. §1.643(f)-1(c)] of how to create a trust with different beneficiaries. And, they conclude that, in the absence of other facts or circumstances that would indicate a principal purpose for creating two trusts as tax avoidance, the trust will not be aggregated.

If you go back to what the statute provides, the example in the regulations seems to ignore the statute. Even if you have substantially different grantors or substantially different primary beneficiaries, so long as you have a principal purpose of tax avoidance, even if you meet the first two requirements, if you don't pass the final test of "principal purpose" you're caught by the multiple trust rules. So, that it appears that the regulation may be contrary to the statute, and that leaves open what will happen. Does anyone have comments or thoughts?

Sanford Schlesinger: Let's go back a step, Marty, to put it in context. Why is this important now? It's important now because people may create multiple trusts to take the benefit of certain of the new tax rules, such as avoidance of the state and local tax (SALT) deduction limit?

Martin Shenkman: Absolutely. And, in the context of the Code Sec. 199A regulations, many of our colleagues—and I may be a guilty party as well—had speculated in articles published before the regulations were issued, that if we set up separate non-grantor trusts, so long as we didn't violate the reciprocal trust doctrine, we could set up, for example, a separate non-grantor trust for each one of a client's five children and six grandchildren. So, we could create 11 non-grantor trusts and give a slice of the equity in a qualified business interest to each. Each trust would have its own taxable income threshold amount, and we'd put in a small enough business interest that each trust's taxable income would be under the $157,500 taxable income threshold. Accordingly, each of those 11 non-grantor trusts would qualify for a full 20-percent deduction, and effectively we would have helped the client circumvent the taxable income threshold rule under Code Sec. 199A.

But, the proposed regulations say, no, that would be a violation of the multiple trust doctrine. Again, in my view, I think the regulations went too far and really you violated the statute in that regard.

Sanford Schlesinger: But, that's only for purposes of Code Sec. 199A. Isn't multiple non-grantor trust status significant now because of the SALT deduction limit, as a means to achieve an additional $10,000 deduction limit by using each of several trusts?

Martin Shenkman: Yes.

Sanford Schlesinger: In addition, even though trusts and estates hit the maximum tax rate bracket at about $12,500, if you have enough multiple trusts, it may be feasible to save that way as well—effectively, going back to the old days. Although by time you finish doing the tax returns and everything else, are you really saving anything?

Martin Shenkman: It's an interesting question and let me answer it in a broad way. I think that the people who have looked at it and then said, "There's not enough savings here to warrant the cost of creating these trusts," have been looking at things as you describe, from solely a Code Sec. 199A deduction perspective.

But, if you take a look at the use of a non-grantor trust in connection with different benefit you may achieve, the aggregate of those benefits may well make the planning worthwhile. There may be a nontax benefit of asset protection planning. That is something that may be difficult to quantify but is clearly a benefit to the client.

If you can put slices of a home into multiple non-grantor trusts—and it's not assuredly clear that you can successfully do that after the proposed regulations—it would be possible to salvage $10,000 of property tax deduction per trust.

If you structured non-grantor trust owned slices of a qualified business interest, that is one way to end up with a 20-percent Code Sec. 199A deduction, but the regulations came down pretty hard on that strategy. However, it appears that you should be able to set up at least one non-grantor trust, so long as you have proper purposes for it, and not be snagged by the multiple trust rule, even if you accept the IRS's interpretation.

So, if you add together all the non-tax as well as tax benefits, then it may make sense for some clients to pursue this planning. The final piece is, and I think this is where planning has become so complex under the new law; we have a very high temporary

lifetime estate tax exemption. So, it behooves many of our clients who are in the moderate wealth category ("moderate" relative to the new high exemptions), from maybe $5 to 40 million, to use up as much of that exemption as they can now under current law, because who knows what the future will bring.

The law is scheduled to sunset in 2026, but we may have a change in the Administration in Washington, and it may change before that, no one can predict. Consequently, if you can structure a non-grantor trust that is a completed gift to use this temporary exemption, that's also a very significant non-income tax benefit for such a trust.

And by the way, that's another interesting point. If you read how principal purpose of tax avoidance is defined it simply refers to income tax.

If you have a significant purpose that's not income tax related, you may be able to avoid the taint of the principal purpose restriction. In other words, using your temporary exemption may suffice, along with the other benefits and asset protection, for the creation of these multiple trusts.

Sandy, the determination of what planning may prove worthwhile really depends how many different benefits apply. And, I think that's going to vary significantly from client to client. In some instances, you can create a simple, inexpensive local non-grantor trust. For other clients, the cost and the hassle is not going to justify the planning. But, I think it really will vary from client to client.

Sanford Schlesinger: I agree. I am wondering if anybody on the call has created substantial numbers of non-grantor trusts. Also, keeping in mind, as you brought up initially Marty, this is one of the provisions that are set to expire on January 1, 2026.

Martin Shenkman: Right. But that's why I think we need to look at the aggregate of all tax and non-tax benefits. So, for example, if I have a client who had a grantor trust and he used the exemption in 2012, now his New York income tax is not deductible and it's high. Maybe, if that trust owns only marketable securities, it would make sense to modify or decant it into a non-grantor trust and perhaps defer, if not avoid forever, New York income tax on the non-source, non-connected securities that are in that trust.

That's not planning that we didn't do before. That's just planning that has more benefit now because of the loss of the SALT deduction. If that planning makes sense generally, maybe it makes sense to do despite the sunset in 2026.

Sanford Schlesinger: The bottom line is, the way to avoid the New York problem, is to get out of New York.

Martin Shenkman: Yes, and that applies to the people affected by the SALT limit.

But, if you physically can't get out of New York, moving the situs of your trusts to Alaska, to South Dakota, Nevada, Delaware or wherever, and the cost of naming a pure administrative trustee to get situs there and have a non-grantor trust, the income and potential estate tax savings could easily outstrip the cost of doing the planning. And, that's not a multiple trust issue, it's using your phrase,—"getting out of Dodge"—getting out of a high-tax state.

Sanford Schlesinger: I agree.

Martin Shenkman: And, to get back to our discussion of the definition of principal purpose, using the temporary lifetime exemption, asset protection planning, those are all non-income tax benefits that I think can rationalize a lot of the planning we're talking about. But again, if you go back to the regulations, the IRS has taken a very harsh interpretation which seems to me to possibly violate the statutory mandate. But, that may be enough to have a chilling effect on clients, given the sunset.

Business Losses

Martin Shenkman: Julie, you had suggested the topic of business losses so I'm going to turn the discussion over to you.

Julie Welch: Basically, this has to do the cashflow impact on a company now and the future having a net operating loss. In the past, they could carry that net operating loss back and receive refunds, so their cashflow was much better. Now, they won't have the ability to do that.

Plus, carryforwards of a net operating loss will be limited to 80 percent of taxable income for that year. My point is that we are have to be watching more than just tax items, we're also going to have to watch their cashflow. Now, they are going to have to make sure they make money in the future to be able to get a benefit out of losses that they suffer.

LIFE INSURANCE

Life Insurance Planning

Lee Slavutin, Ben Baldwin, Jr., Sanford Schlesinger, Martin Shenkman and Barbara Raasch consider recent trends and new developments in the life insurance industry.

Martin Shenkman: We're going to turn to insurance planning. Any comments?

Sanford Schlesinger: I have one question. Are life insurance sales going up or down because of this Act? Personally, I'm totally conflicted.

Martin Shenkman: Why are you conflicted? Why would it go up?

Sanford Schlesinger: It would go up because people think the $22 million (per couple) lifetime estate tax exemption is going away. I am having younger people coming in wanting life insurance, term insurance that is relatively cheap, 20-30-year term, on the theory that they are going to receive a lot of money from older generation family members and they don't trust that the estate tax will be gone.

Martin Shenkman: You're talking about young heirs buying insurance?

Sanford Schlesinger: Correct.

Martin Shenkman: On their lives or the parents' lives?

Sanford Schlesinger: On their lives. And, one of the concerns is the failure of universal life policies. There has been a lot of publicity on this [See *Wall Street Journal*, September 19, 2018, p. A1]. And, if I may say, I take some credit and feel vindicated in that I was one of the biggest opponents of universal life.

Lee Slavutin:[1] I want to cover three topics relating to life insurance. One is the impact of the new tax law in terms of insurance planning. Second, an update on intergenerational split-dollar life insurance. And third, the last point, which Sandy was referring to, which is universal life.

With respect to the new tax law, there are three provisions that seem to be very relevant to life insurance planning. One is the increased gift/estate tax exemption. Secondly, the lower corporate tax rate of 21 percent and thirdly, the new rules on life settlements.

One of the questions we come across when the exemption goes up, as it has dramatically done, is, "Should I keep my existing life insurance if my wife and I now have an estate that is way below $22 million?"

Now, I have to say I don't get that question very often from my clients. I get the question from other advisors. The only clients who I have found who cancel insurance do so, not because the exemption went up, but because they need the money. They surrender their whole life policy or take a loan because they need cash. The people who get into financially difficult situations will sometimes cancel, but most clients do not.

Why? Because as Sandy mentioned, the very generous exemption amount may not be here forever. It might go back to $5 million adjusted for inflation. It might be about $6 million in seven years. Number two, insurance is an asset. A whole life policy can accumulate money and be an important source of liquidity. So, I don't see clients canceling policies.

The second point about the increased exemption, besides the obvious point of giving people room to

make gifts to trusts to buy insurance, is that it also provides people with a mechanism for getting out of costly or troublesome arrangements. For example, for people who got into a split-dollar arrangement and now, 20 or 30 years later, the economic benefit is very high or the loan interest is very high in a premium finance arrangement, this large exemption amount gives the client the ability to make a gift to the insurance trust. And, in turn, the insurance trust can then repay the donor in a split-dollar or a premium finance arrangement to get out of the arrangement.

One note of caution with split-dollar, you must be careful about terminating the arrangement. If it is an old grandfathered equity split-dollar arrangement, it may result in a taxable event on termination, so that needs to be looked at carefully before terminating.

Another point about the new exemption in relation to life insurance planning is that clients who have life insurance policies inside a retirement plan can now get that policy out of the plan and remove it from their estate. If the policy remains inside a retirement plan, it will be part of their estate.

One note of caution with split-dollar, you must be careful about terminating the arrangement. If it is an old grandfathered equity split-dollar arrangement, it may result in a taxable event on termination, so that needs to be looked at carefully before terminating.

You can now make a gift to the trust. The trust can buy the policy out of the retirement plan so long as you follow the rules of Prohibited Transaction Exemption, 92–6. And, even if the plan doesn't have those provisions, the retirement plan can be amended. You can get those policies out of a retirement plan now and put them into a trust.

The second provision of the tax law, which is of great interest, is the reduced corporate tax rate of 21 percent. This is for C corporations. Because our clients are usually not big, publicly-held companies, most of us are dealing with private family businesses and most of our clients are not C corporations. They are usually LLCs, partnerships, or S corporations.

But it's interesting, this year I was working with an accountant and he converted five of his clients from S corporation to C corporation because of the tax savings. You might say, why would you do that because you have a double tax with a C corporation?

Well, not necessarily. If you have a C corporation that needs the money to stay in the business for inventory or development or equipment, then that money will not actually come out and be taxed a second time; it will only be taxed once at 21 percent.

In fact, the Wharton School of Business published a study that the effective tax rate for C corporations generally this year, 2018, is not going to be 21 percent, it's going to be significantly lower. When you include the deductions and credits that the corporation will take, the actual net effective rate will be about nine or 10 percent on average.

So, if I have a C corporation client where there is a need for life insurance, the obvious advantages of split-dollar will be available. Generally, there will be a much lower gift tax cost—you're only looking at either the loan or the Table 2001 costs, not the entire premium—so this presents a wonderful way of getting money from the C corporation into an irrevocable life insurance trust (ILIT).

You pay an extremely low tax rate on the earnings as they come out of the C corporation, and all the money in the ILIT, other than the amount that will ultimately be returned to the corporation, will effectively be removed from all future taxation—income, gift and estate tax. So, split-dollar in the context of a C corporation is now a very interesting and attractive possibility for those clients who do have the insurance need.

The third provision of the law that's interesting in insurance is the life settlement rules. Under the revised rule, when a policy is sold as a life settlement transaction, the basis of the policy is no longer reduced by the previous years' costs of insurance (COI). This was a position the IRS had adopted in 2009 in a revenue ruling [Rev. Rul. 2009-13, IRB 2009-21, 1029]. And, in the Tax Cuts and Jobs Act, Congress reversed it. Not only did they reverse it, they reversed it retroactively to 2009!

If you have a client who did a life settlement in the last few years where the income tax return is still open and where you could apply for a refund, you could potentially get a refund on the tax paid on a life settlement because now the basis amount is higher under the new tax law.

There is also a new reporting requirement when the life settlement is done [Code Sec. 6050Y]. But, fortunately, the effective date for that requirement has been delayed until the IRS issues final regulations on the life settlement rules.

Intergenerational Split Dollar

The second major subject I wanted to cover briefly is intergenerational split-dollar. Just one general point is, we should not confuse intergenerational split-dollar with traditional "vanilla" split-dollar. Intergenerational split-dollar is a rarefied kind of split-dollar for the very wealthy, involving three generations in the family. It's not what everybody does for split-dollar, so we should not confuse the two.

This summer (2018), there was a negative decision on intergenerational split-dollar in the *Cahill* case [*R. Cahill Est.*, 115 TCM 1463, Dec. 61,194(M), TC Memo. 2018-84]. In *Cahill*, $10 million was deposited into an insurance trust in 2010 by the grandfather. Life insurance was purchased on his son and his daughter-in-law and the $10 million premium purchased $80 million of insurance.

The grandfather died one year later and the estate claimed that the $10 million premium receivable was worth $186,000 in the estate. How can you discount $10 million down to $186,000 in 12 months? The IRS argued that Code Secs. 2703, 2036 and 2038 should apply to the valuation of the estate's receivable. The taxpayer asked the court, in a partial summary judgement motion, to rule that these sections do not apply. The court denied the motion and shortly thereafter the estate settled the case and conceded in full on the valuation issue.

Two other cases dealing with intergenerational split dollar are pending in the Tax Court, *Morrissette*, and *Levine* [*C. Morrissette Est.*, Docket No. 004415-14; and *M. Levine Est.*, Docket No. 13370-13]. In *Morrissette*, the parties are going to trial probably next year. *Levine* has already gone to trial, but we don't yet have a decision.

Once those two cases are decided, we should have complete resolution on the issue. In the interim, I do not think it's wise to begin a new economic benefit intergenerational split-dollar plan if you're contemplating a significant discount on the back end. We should wait for the court's guidance in *Levine* and *Morrissette*.

As far as the loan arrangement type of intergenerational split-dollar, I would probably also be very cautious.

Martin Shenkman: Readers should also be aware that the Treasury and the IRS have indicated [see REG-209226-84] that they will again address below-market loans under Code Sec. 7872. Proposed Reg. §20.7872-1 addressed the rules in Code Sec. 7872(i)(2) "under regulations prescribed by the Secretary, any loan which is made with donative intent and which is a term loan shall be taken into account for purposes of chapter 11 [the estate tax chapter] in a manner consistent with the provisions of subsection (b) [providing for the income and gift tax treatment of below-market loans]." This could prevent a note issued in a family context from being valued for estate tax purposes at less than its face amount plus accrued interest. That change could radically affect loan split-dollar and many other common estate planning transactions. The Treasury appears poised to revisit the proposed regulations and perhaps finalize them in some revised format.

Universal Life—Cost of Insurance Increases

Lee Slavutin: The last subject has to do with the point Sandy was raising on universal life (UL). It's a serious problem. I have definitely seen cases where a client bought a universal life policy 20 or 30 years ago and they were paying $10,000 or $20,000 in

premiums and now they receive an updated in-force illustration, which shows that at age 75 to keep that policy in force until life expectancy—you probably want to keep it at least to age 90 or 95—the $20,000 premium goes up to $50,000, or more.

The first message I can give about universal life—it's true of all cash value policies, but certainly universal life—is that it's so important to monitor the performance of policies. Because, if you don't monitor the performance, you end up in a situation where the premium increase is completely impossible to deal with.

At least if you had looked at the situation maybe 10 years ago as this problem was developing, you had the chance of dealing with it earlier, when the required premium was much lower, not when it's too late.

Ben Baldwin: I second your warning Lee. Whole life policy owners have two escape hatches when premiums become a burden via two optional modes of settlement: reduced paid up insurance or extended term insurance whereas UL policy owners have no contractual escape hatch and ever more annual increasing costs of insurance. The only escape hatch for UL policy owners is the Life Settlement market, especially with the greater clarity on taxation. Now, UL policyowners who own old UL policies and are now less healthy than and older than when the policy was issued can look forward to getting their cash value plus, in some cases, a substantial gain and some reduced paid-up life insurance if they choose. Nobody, but nobody, should be cancelling life insurance of any kind without checking the Life Settlement market place. Determining whether a Life Settlement is worth exploring is quick and easy by calling the largest life settlement underwriters.

Martin Shenkman: Lee, do you want to make just a quick comment concerning what trustees of insurance trusts should be doing in light of the *Wall Street Journal* article on universal life?

Lee Slavutin: I think trustees have an extra responsibility. Obviously, they are fiduciaries and they are running the trust. I know there are some states that allow a trustee of an insurance trust—I think Florida is one of them—to delegate the responsibility of monitoring the insurance to somebody else, although I don't know if that really allows the trustee to get off the hook completely.

But, there is obviously a responsibility to manage the policy, which includes not only the performance of the policy but the strength of the company. In the last 30 or 40 years we have witnessed some large insurance companies getting into serious financial problems, and that results in very high increases in the cost of the policy.

Regular monitoring of the policy by the trustee is important. I remember we had a client a few years ago, a lady in her 80s, who stopped smoking. If we didn't go back to the insurance company and ask them to change the rate from smoker to nonsmoker, she would be paying a much higher premium than she's paying today.

So, you have to go back and look at the policy, the strength of the company, and the pricing of the policy. All these things need to be monitored. Certainly, a trustee should be doing this review at least once every two years, if not every year.

Barbara Raasch: So, Lee, you're probably familiar with those long-term care insurance policies that are linked to universal life. Can you give us any guidance or concerns about those?

Lee Slavutin: Long-term care insurance is another difficult area because the standalone long-term care policies, just like universal life, have gone through significant price increases.

The one positive aspect of the old long-term care policies is that, even though the price increase is very substantial, you will find almost always that the policy is still a very attractive policy. For example, you have an old long-term care policy where you were paying $5,000 a year, now the insurer wants to increase the premium to $12,000.

But, if you look at that policy, if it's with a decent company, it could be very valuable. Many of these old policies provide lifetime benefits. Today, you can't get a long-term care policy with a lifetime benefit. Today, you get a policy for five years of benefits, eight years of benefits, 10 years maybe. A policy with lifetime benefits is golden. So, even though the premium went up substantially, in my experience it's often a very worthwhile policy with a good company.

As to your question, Barbara, about universal life connected or linked with long-term care, these are becoming more popular. That is because, even though you have the risk of a price increase on the long-term care rider, when you have it linked with a

universal or a whole life policy, there is usually a cap on that increase, unlike a standalone policy.

The issue, Barbara, is that, again, you want to choose a strong company and a conservative product. My leaning would be to buy a whole life policy with a long-term care rider from a mutual company. If you can get a universal life with guarantees, that would be good.

Ben Baldwin: Let me echo Lee's cautions. The life insurance market place is a very unfriendly place of all advisors today. COI litigation is almost circular today. For all the COI reasons Lee has described, life insurance companies continue to struggle.

In our COI litigation column of March, 2017 [see Estate Planning Review—The Journal, March 16, 2017, p. 48], we listed 32 life insurance companies subject to COI litigation. Of the companies on that list, the following have announced the closing of their life insurance businesses.

- Aetna
- Allstate
- Aviva
- Cigna
- Genworth
- Hartford
- Jackson
- Met Life
- Sun Life
- Travelers

On October 31, 2018, Leslie Scism announced the 11th life company that will cease selling life insurance to individuals. VOYA will cease selling life insurance to individuals at the end of this year (2018). VOYA leaving the life business means that the companies that ING put into VOYA when it created it a few years ago will also quit. These are companies such as ING, Banner Life and the once highly favored life insurance company of past years, Security Life of Denver.

The message to all advisors is that the quality of these companies when existing life policies were put in place has deteriorated and the company actions, as they deal with their closed blocks of business needs to be watched carefully. The need for some remedial action is likely. With *ALL* of these companies, the company you bought the policy from is *NOT* the company you are insured with today.

Martin Shenkman: Let me just throw out one additional insurance consideration. With these exemptions of potentially $22 million-plus per family unit, many clients will have to transfer larger percentages of their wealth than they've ever transferred before.

Sanford Schlesinger: And, it would seem to me that one of the things to think about is looking at insurance not just from the perspectives that we normally do, but also from the perspective of shoring up the client's finances and position in light of the large contemplated wealth transfers intended to secure temporary exemption. So, if a client is worth $30 million and wants to transfer $15 million to use up all of one spouse's exemption and maybe some of the other's, that's a bigger percentage of asset transfer than we have ever really seen. Such a client might benefit from a more robust life insurance, long-term care insurance and property, casualty and liability insurance program then in the past to assure they are secure after such a large transfer.

I think that the sort of financial forecasting, modeling, insurance planning all needs to be looked at in light of that.

Endnote

[1] *The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any federal tax penalties. Lee Slavutin is not authorized to give legal or tax advice. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal tax or legal counsel.*

MARRIAGE AND DIVORCE

Matrimonial and Divorce Considerations

Martin Shenkman leads a discussion of changes affecting divorcing couples with comments by Julie Welch, Theodore Sarenski, Sanford Schlesinger, Jeremiah Doyle, Stephen Krass, and Sidney Kess.

Martin Shenkman: The 2017 Tax Act had a very significant impact on the rules affecting divorce. Would somebody like to comment and explain some of the new rules, what they're doing about it and how it's affected planning?

Julie Welch: Starting January 1, 2019, for divorce agreements finalized on that date or later, there will be no more deductions for alimony, and no more income inclusion for the recipient of the alimony.

The old divorce agreements retain treatment under the old law, where they are deductible and taxable, unless the agreements are modified and specifically state that they are intending to follow the new rules. I think we're all seeing an increase in divorces before the end of the year. That's why Congress gave an extra year as to when this provision became effective, so people could try to plan for it.

Because the Tax Cuts and Jobs Act came into law just a few days before the end of the year, there wasn't enough time to deal with the larger issues that would have been presented with an in-progress divorce. Although we still had some similar confusion with many of the business issues that we had to deal with, perhaps Congress thought this area was a bit more problematic for a large group of people.

In terms of planning from an income tax standpoint, we just have to be careful that if, somebody is getting divorced, and he or she is going to be the payor, that they are aware that alimony is no longer deductible, and payments may need to be adjusted accordingly. In many cases, payments will be lower than they were in the past.

In terms of planning from an income tax standpoint, we just have to be careful that if, somebody is getting divorced, and he or she is going to be the payor, that they are aware that alimony is no longer deductible, and payments may need to be adjusted accordingly. In many cases, payments will be lower than they were in the past.

Theodore Sarenski: A partner of mine works exclusively in that area and this change is going to affect families because there's going to be less money available for everyone. In most divorce situations, you have a high-income earner and a lower-income earner. Very rarely does a divorce involve two people of equal incomes.

Under the "old" system, the higher earner was getting a large tax deduction and was willing to pay more possibly, and the lower-income person was receiving it and not paying a lot of tax on it. This made for a lot of negotiations in the divorce process that are not available now. You could call it a government subsidy, but this change is really going to affect families negatively, especially if they have children. It's going to be a huge planning issue going forward.

Martin Shenkman: Furthermore, the recipient of the alimony payment, usually the Wife, was often not picking up the receipt as income. There is a tremendous discrepancy between the amount of income that was picked up and the amount of deductions.

Sanford Schlesinger: Isn't that one reason for the legislation?

Martin Shenkman: Exactly.

Sanford Schlesinger: By the way, one other comment, New York is not conforming to the federal. Meaning, in New York and probably other states will follow if they haven't already, the payor spouse can still deduct the alimony payment for New York State income tax purposes and have it taxable to the payee spouse.

Martin Shenkman: That will be very complicated for people to understand.

Theodore Sarenski: That's one way to get people to move to New York.

Sanford Schlesinger: At least the payor spouse.

Stephen Krass: Something that people may want to consider in that situation is doing a qualified domestic relations order (QDRO), and there is a similar provision for IRAs. By transferring a plan account or an IRA, or a portion of it to the spouse, and having the spouse then take distributions from the plan or the IRA, it then effectively becomes deductible to the payor-spouse and taxable to the payee-spouse.

Theodore Sarenski: The law change does solve one issue in divorce negotiations. Under the old law, if you didn't structure child support and alimony properly, the alimony could be deemed child support if certain ratios weren't achieved. So, it does simplify something like that in the divorce process.

Martin Shenkman: What about life insurance? In many cases, insurance taken out in a divorce is pegged to the amount of alimony. Is this going to lower those amounts of life insurance, too, going forward? And, is that reasonable?

Theodore Sarenski: It should.

Martin Shenkman: I'm just noting some of the many little ripple effects of this legislation that haven't really been talked about anywhere.

Theodore Sarenski: In child support, that would end upon the death of the payor, so there was no insurance for that.

Sidney Kess: Another thing in connection with the divorce, since they have eliminated the personal exemptions, that was also an important item in the negotiations—who took the child as a dependent Now, there is the child credit that has to be considered.

Martin Shenkman: Right and that's going to be very unfair to people who have negotiated for real value to get those exemptions in the past.

Sanford Schlesinger: Another area that I think should be of great concern is the effect on existing prenuptial and postnuptial agreements. Those are negotiations that are often not very pleasant, particularly if you want to renegotiate.

Jeremiah Doyle: With respect to the prenuptial and the postnuptial agreements, keep in mind that there is a push by the ABA Family Law Section to get this provision repealed and have alimony deductible again. So, if anybody is contemplating a prenuptial agreement, you ought to think about what's going to happen if the law does get repealed. Consequently, it would be advisable to include some flexibility in the agreements.

Another thing people have to keep in mind, I know a lot of divorce attorneys who think you must have a decree by the end of the year. But, the divorce or separation agreement is defined in Code Sec. 71(b) and there are three sections there. Two of them deal with decrees, and the one in the middle is a written separation agreement.

However, there is no definition of what a written separation agreement is in either the Code or the

regulations. You could have a situation where two attorneys are negotiating a divorce for a Husband and Wife and we have letters between ourselves in which we agree on what the payment provisions are going to be. And assuming, we agree to pay in cash and it's going to cease at death and we will meet the other alimony requirements, that would be a written separation agreement that would constitute deductible alimony, if we get it done by the end of this year. I think people have to pay attention to the definition of what a divorce or separation agreement is. It's not necessarily a decree.

I think people have to pay attention to the definition of what a divorce or separation agreement is. It's not necessarily a decree.

Martin Shenkman: There is another potential trap practitioners should be aware of. We spoke extensively about 199A earlier. If business entities are restructured and the client has a prenuptial agreement, how might that be affected? For example, if a client has a business operated as an LLC she might benefit by restructuring as an S corporation so payments to owners will be characterized as wages for purposes of the 50 percent of W2 wages test (or the 25 percent of W2 wages + 2.5 percent of tangible property test). The result might be a recharacterization of revenue as salary. How does the prenuptial treat that change? If the business was deemed a separate asset, but income, including salary, is deemed marital, the 199A planning could wreak havoc with the prenuptial.

Does anyone want to comment on alimony trusts?

Jeremiah Doyle: Well, the example I always use for an alimony trust basically involves setting up a grantor trust Husband sets up a grantor trust for Wife. He's taxed on the income. The alimony trust under Code Sec. 682 is designed so that when Husband and Wife get divorced and Wife is collecting the income from the trust, she would be taxed on that income under the subchapter J rules, and the Husband would not.

Even with the repeal of Code Sec. 682, given the fact that the law allows grandfathering, if you have an agreement before January 1, 2019, Code Sec. 682 still applies. But, in the future, Code Sec. 682 is gone. Wife is collecting the income, but Husband is paying the tax on the income, from the trust that Wife is now collecting. That doesn't seem quite fair.

One other thing, I'd say about divorce is that a lot of people, when they get divorced, one of the spouses—usually the Wife—is going to file as head of household. In the Tax Cuts and Jobs Act there is a penalty provision under which the Treasury is instructed to issue regulations on how a tax preparer needs to do due diligence to make sure the person claiming head-of-household status actually qualifies. And, if they don't do that due diligence, there is a $500 per-incident penalty.

[**Editors' Note:** Regulations were issued, effective November 7, 2018 (T.D. 9842; IR 2018-216)]

DEDUCTIONS POST TCJA

Planning Considerations with the Enlarged Standard Deduction

Lyle Benson, Julie Welch, Sanford Schlesinger, Martin Shenkman, Jeremiah Doyle, Stephen Krass, Theodore Sarenski, and Sidney Kess take a deep dive into the changes in planning resulting from large increases in the standard deduction amount.

Lyle Benson: I would like to start a conversation about itemized deductions and bunching.

We're seeing that with the limitation in state and local taxes (SALT) to $10,000 and the increased standard deduction to $24,000 or $12,000 for single individuals, a lot of our clients, especially those who are retired and don't have a mortgage anymore, they will have years where they are well below the $24,000 amount.

We have found that doing multiple-year tax projections and tax planning is really critical for clients in that situation. There are a lot of opportunities to shift deductions around, especially with respect to charitable donations. One idea involves donor-advised funds (DAFs) because that's a way for a lot of clients to manage itemized deductions.

In one year, they put a large amount into the DAF, placing them well over the $24,000 in order to itemize, and they won't do any charitable donations directly. They will just make charitable donations out of the DAF for the next couple of years until they get in a situation where they can go over the $24,000 standard deduction amount again. We are seeing this affecting quite a few clients and I think it really increases the need to do detailed tax projections on an ongoing basis.

Martin Shenkman: It strikes me, Lyle, who "bunching" might only work for those clients that are close to or on the cusp of hitting the standard deduction, and that might be a limited group of clients. Certainly for some clients bunching is not going to give them much benefit. And if charity, as you suggest, is the tax benefit at issue, it would seem to me using a non-grantor trust, if they are not old enough to qualify for the charitable IRA distributions, may be a better answer for some clients. However, the non-grantor trust approach is certainly more costly and complicated than bunching and DAFs. This is the same theme we've seen with many of the planning ideas we have discussed, planning is more granular, more client specific. That makes planning more complex and challenging for practitioners.

Lyle Benson: I agree that it's the less wealthy clients, or the clients who don't have major charitable deductions each year, because after the $10,000 SALT deduction, if they don't have medical expenses and no miscellaneous deductions, which have been eliminated, they're essentially stuck with the standard deduction. Charitable and state and local tax is really it.

Sanford Schlesinger: And the SALT deduction is limited to $10,000, which in a lot of places is not significant.

Lyle Benson: Right. A lot of our clients go from year to year. They might make big contributions in one year and not any significant donations in the following year.

Julie Welch: For single filers, they are going to be almost at the $12,000 standard deduction amount when they include the $10,000 of state and local taxes. Consequently, I think single people may end up doing bunching more frequently.

Lyle Benson: That's true. We have also had a number of clients ask about whether they should keep their mortgage in place. They have retired, but they still have a mortgage sitting out there with a relatively low rate. But, if they are not itemizing, they are really not getting the benefit of that mortgage interest deduction any longer and it changes the dynamic on doing the math for them.

Martin Shenkman: But, I think it is important to caution clients before they pay off a mortgage that the new rules are all set to sunset in 2026.

Using Non-Grantor Trusts to Salvage Itemized Deductions

Martin Shenkman: The use of a simple, inexpensive non-grantor trust would be as follows. Client is a moderate-wealth client, not needing complex wealth-shifting strategies. But, they tithe, they give to charity each year, and they are losing most or all of their charitable contribution deduction. The problem with bunching is for, let's say, a married couple, if they have the $10,000 SALT deduction, they still have to have $14,000 of contributions before they realize any tax benefit from itemizing.

I just haven't seen people very comfortable in changing their pattern of giving, because it's not just about the deduction, it's also about being a regular contributor each year to charities that are important to them. That makes the DAF approach difficult for some.

So, here is a simple example of a non-grantor trust. The client can set up a local trust. They don't have to go to Delaware or some other trust friendly jurisdiction. Name a family member who is not going to charge a fee as trustee. Let's say the client has $200,000 they put into the trust. Let's say they're earning five percent on it. If those assets aren't needed by them today, they gift the $200,000 in the irrevocable, non-grantor trust. And, if the trust earns five percent, $10,000, the family member trustee can donate that to charity. Because trusts don't have a standard deduction, dollar-for-dollar you get a full deduction. Do note, however, that the trust must meet the requirements of Code Sec. 642(c). The donation must be made from gross income. This contrasts to planning for individual contribution deduction for which an individual non-trust taxpayer can transfer appreciated stock to a charity and realize a deduction. A trust must sell the shares and donate the resulting cash.

The couple could keep that up until they are age 70½ and then can utilize the qualified charitable distribution from an IRA. They can name, not just the charities as beneficiaries, but all their descendants. It's really academic whether it's an efficient use of estate or generation-skipping transfer (GST) exemption for most clients because in this sort of wealth strata, the exemptions are substantially in excess of the wealth levels of most of the clients for which this planning would be useful. So, it doesn't matter that this might be an inefficient use of GST exemption.

That is a fairly inexpensive, simple way to get dollar-for-dollar charitable contribution deductions. If the law changes or when they reach age 70½ and want to use their IRA, by having named all their descendants beneficiaries of the non-grantor trust, in future years whenever their family member trustee wants, they can make distributions to children or grandchildren instead of charity if they don't need that deduction anymore. That seems like a very viable option for some clients when the bunching approach is not viable.

Jeremiah Doyle: I would like to take that one step further. If you set up that trust as a fully discretionary trust, and you comply with Code Sec. 642(c), you are going to get the income tax charitable deduction if you make the donation to charity. You have a fully discretionary trust with a charity as the beneficiary as well as individual beneficiaries.

When you make that distribution to charity, it reduces the distributable net income (DNI) that's available for the discretionary or second-tier (tier-two) beneficiaries. If you flush out enough money in the charitable deduction to use up all the DNI, you could make a tax-free distribution to those discretionary individual beneficiaries. This is because, under the trust tier system of taxation, charitable deductions reduce DNI first, before the DNI is calculated for second-tier or discretionary beneficiaries. So, you could benefit charity and get a tax-free distribution to your individual beneficiaries, e.g., children, as well.

Martin Shenkman: That is a great idea. I don't think this is that costly or complicated to set up, and it should work for a lot of moderate-wealth clients.

IRA Qualified Charitable Distributions (QCDs)

Sanford Schlesinger: I think the IRA donations to charity are now the premier planning technique for qualifying taxpayers because you don't get into the whole issue that we have just been discussing about deductions. If the couple is over age 70½, each spouse can give up to $100,000 a year. This not only avoids the prior discussion, the best part is it doesn't come into income in the first place.

Stephen Krass: Remember, you have to be 70½ in order to do that, and that's actual age 70½. That technically comes before reaching the required beginning date. But, the donor does have to be 70½.

Julie Welch: And, the other thing is, it has to be from an IRA. It cannot be from a qualified plan—it has to be from an IRA.

Sanford Schlesinger: And, the contribution has to be to a public charity or a private operating foundation. And, as of today, am I right, donor-advised funds still do not qualify.

If a charity gets a direct charitable IRA rollover, some IRA custodians will make the charity set up their own account with the financial firm holding the IRA, and they have to go through all the Patriot Act procedures and disclosures before they will distribute the money to the charity.

Stephen Krass: Well, a private foundation doesn't either.

Sanford Schlesinger: I know, but private operating foundations do.

Stephen Krass: Correct.

Jeremiah Doyle: The other point that's confusing for a lot of older people is you tell them that if they make this direct transfer from their IRA to a public charity, it's going to be an exclusion from income. But, at the end of the year they get a 1099R and they call you up and they say, "Hey, you told me it was going to be tax free, but I got this 1099R." What they have to understand is that the amount on the 1099R goes on one line—line 15A of the 2017 Form 1040, and you pull it out on line 15B and write QCD for qualified charitable distribution in the margin.

The other thing people and charitable organizations have to realize, is that the $100,000 exclusion can't be given in return for any *quid pro quo*. If there is any benefit that is coming back, like the rubber chicken dinner that I use as an example, that is a *quid pro quo*.

Granted, there are *de minimis* rules for what you can get in a *quid pro quo*, but I think charities have to realize that if they give something back to the donor in return for that up to $100,000 direct transfer from an IRA, that does not qualify for the exclusion.

Sanford Schlesinger: If I may, two more comments to be complete. One is it also qualifies for the donor's required minimum distribution (RMD), if he or she has one. That is very significant because it doesn't go into income. You don't get a charitable deduction and it qualifies for your RMD.

The other thing I've learned as a practical matter, is the difficulty in affecting the transfer, because it has to be direct. It can't be distributed to the participant, it has to the go directly to the charity.

Jeremiah Doyle: Just to be clear, you can receive a check from the IRA custodian made out to the charity and then personally deliver it to the charity. Just make sure you get a receipt. So, it can be done that way, but the check itself has to be made out to the charity.

Sanford Schlesinger: Has anybody had a problem doing this? I mean I had a problem personally. The organization that administers the IRA, which I will not name, was difficult. The aggravation of trying to get them to do it in a timely manner was so excessive, I gave up.

Lyle Benson: Logistically, it can be a real challenge. Different custodians handle it differently, too. That's why I think it is intimidating and confusing for clients to do at times.

Sanford Schlesinger: I agree completely. The lack of cooperation from the administrators is egregious. And, I understand from an accountant yesterday that they are working on solving this problem by creating a form that's going to be easier to use.

Jeremiah Doyle: Here's the problem that I've run into. If a charity gets a direct charitable IRA rollover, some IRA custodians will make the charity set up their own account with the financial firm holding the IRA, and they have to go through all the Patriot Act procedures and disclosures before they will distribute the money to the charity.

So, the charity has to go set up their own account with the custodian. They distribute it from the IRA owner's account to the charitable account and then out to the charity. And, the reason I'm told that is the requirement is because of an operational issue. They can't issue a 1099 under their system, and I think the same thing applies to other mutual fund companies. They can't process a 1099R, so they make you set up a new account.

Because I know a lot of charities have run into that problem with the mutual fund companies, making you set up a new account in the charity's name before they give the charity the money from the IRA. That has been a frequent complaint of the charities.

Sanford Schlesinger: And, that is exactly what happened in my case.

Jeremiah Doyle: And, it's all an operational issue that should be easy to solve.

Julie Welch: I would like to add one more point. Back when we were talking about who can receive the QCD, somebody said no donor-advised funds. I am not positive on this but I believe the Greater Kansas City Community Foundations, which have donor-advised funds in them, will accept QCDs.

Sanford Schlesinger: That distribution would be to the Community Foundation.

Julie Welch: Assuming I'm 70½, I make my contribution into the Greater Kansas City Community Foundation. Then, I get to advise when those donations go out, just like a donor-advised fund. So, I can put the $100,000 in this year, but then spread the donations out over the next five or 10 years, however long I want.

Sanford Schlesinger: Is it technically not a donor-advised fund, but a community trust?

Julie Welch: It's probably more of a community trust. They call them donor-advised funds within there I think. A quick Internet search shows the Community Foundation of South Puget Sound, and they are talking about making a QCD there. So, I'm guessing that it is very similar to the Greater Kansas City Community Foundation.

Jeremiah Doyle: For people who need some extra guidance, there was a notice, Notice 2007-7 [2007-1 CB 395] that gives guidance on various types of distributions from qualified plans, including the IRA qualified charitable distribution. Buried in the middle [Part IX of Notice 2007-1] there is a lot of information on how the QCD works.

Julie Welch: And that's the age 70½ issue that was raised earlier. The donor has to actually be at least 70½. Even if someone is in his or her 70th year, at 70 and three months, it doesn't qualify, but at 70 and six months, it does qualify.

Donating Appreciated Assets

Martin Shenkman: Julie, did you or somebody else want to comment briefly on donating appreciated stock?

Julie Welch: Again, I think that it is a huge planning opportunity that—because of the logistical things that we just talked about with the QCDs—people just don't do. But, again, if somebody, who is still itemizing deductions and has lots of appreciated stock, they can donate it and not have to pick up the capital gain on it.

Martin Shenkman: But, isn't there a change coming now since the number of taxpayers receiving a charitable contribution deduction is going to be a fraction of what it was? The number I heard is that we had 30 million taxpayers who itemized in 2017, but it's going to be down to perhaps 5 million, so that most people will not get a charitable contribution deduction. They would still get the benefit of not reporting the appreciation in income, but they may not necessarily get the deduction they did previously.

Jeremiah Doyle: One of the things that people have to be aware of when giving appreciated stock, if you go through a broker, in a lot of cases the charity does not want the stock itself. They want the cash. Frequently, what will happen is the brokerage firm will sell the stock on behalf of the charity. And, then the question becomes has the donor given up dominion and control over the appreciated stock and is the broker selling on behalf of the charity or on behalf of the donor?

You have to be careful and make sure that the stock is being sold for the benefit of the charity so that the gain does not get imputed back to donor. And, often, what will happen is they will transfer the stock to a suspense account, sell it in the suspense account. But, that doesn't mean that the donor can't get the money back.

What I have told people is to have the charity set up their own account with the brokerage firm, have the broker transfer the stock from the donor's account into the charity's account and then sell it from the charity's account. Basically, you need to watch out for potential imputed gain back to the donor.

Sanford Schlesinger: Another important point with respect to appreciated stock, it must be qualified appreciated stock, which is generally publicly traded stock, in order to get a deduction.

Jeremiah Doyle: Or a private foundation.

Sanford Schlesinger: Yes, or a private foundation. It must be qualified—publicly traded stock in order to get a deduction for the full, fair market value if it's being donated to a private foundation.

Jeremiah Doyle: Because otherwise you get stuck deducting only the cost basis of the stock.

Sanford Schlesinger: Correct.

Mortgage Interest Deduction

Theodore Sarenski: Lyle mentioned that most people have their mortgages paid off and with the $10,000 SALT deduction limitation, they would need $14,000 of charitable contributions or large medical expenses to exceed the standard deduction for joint filers.

But, what would be wrong with suggesting to some folks, if they don't have a mortgage on their home, then get one. 15-year mortgage rates are still less than four percent in many places. Hopefully, their investments are doing better than that. Or, they can invest that money and earn at least the four percent to pay the mortgage interest, resulting in the charitable deductions and medical deductions all potentially deductible, even considering the $10,000 SALT limitation. Has anyone considered this strategy?

Julie Welch: It would have to be for a new acquisition. For interest to be deductible, the mortgage has to be for acquisition indebtedness. You can't just go out and get a home equity line of credit (unless used for home improvements) or take out a mortgage on an existing home. It would be on the purchase of a new home or on a significant improvement to an existing home.

Theodore Sarenski: Why not a mortgage to the extent of the person's original mortgage? Can that no longer be done?

Julie Welch: Oh, if you have a mortgage right now you can refinance it but not for more than the current mortgage balance. So, if I have a mortgage right now on my house and the principal balance is down to $50,000, then if I take out a loan for more than $50,000, I can't deduct that extra interest unless I was substantially improving my home or purchasing another home.

Theodore Sarenski: Right. But, what if you took out the mortgage 20 years ago, on a 30-year mortgage, and you took it out for $200,000 back then, and have paid it down, so your acquisition indebtedness is now paid down.

Julie Welch: You cannot go back and get $200,000. You are limited to what your current indebtedness amount is. So, if you originally took out $200,000 and the balance is down to $50,000, if you refinance and take out $200,000, you are only going to be able to deduct interest on $50,000 out of $200,000.

Theodore Sarenski: Because the rule changed to acquisition indebtedness only?

Julie Welch: Yes.

Jeremiah Doyle: People have to realize that when they go to their bank and they take out what the bank refers to as a "home equity loan," that doesn't necessarily mean that the interest is no longer deductible because you can't deduct home equity indebtedness. If that home equity line qualifies as acquisition indebtedness, like Julie said, it's incurred to buy, construct,

or substantially improve your residence and the loan is secured by the residence, even though the bank calls it a home equity loan, people have to realize that is still deductible interest. That is not home equity indebtedness. I think people get that confused.

Martin Shenkman: The requirement that it secure the home is a potential trap on intra-family loans. If the family does not take the commercial precaution of a mortgage to secure the loan the interest will not be deductible. Also, if the loan is not secured it may be less protective in the event of the child divorcing, etc.

Medical Expense Deduction

Martin Shenkman: Let's go on to the next topic. Julie, do you want to comment about medical expenses?

Julie Welch: The 7.5-percent of adjusted gross income threshold for deducting medical expenses is supposed to rise to 10 percent next year (2019), unless legislation changes that rule. As a reminder of the way for people to plan around that, unless they have significantly large medical costs coming up that they know are going to exceed those limitations, is to take advantage of other options, such as flexible savings accounts (FSAs). Unfortunately, the limit on FSAs is not particularly high, $2,550. Another option is the health savings account (HSA). HSAs can be attractive for people who have high-deductible insurance plans.

Lyle Benson: We are seeing a lot of clients set up HSAs. Most of our clients have them and view them as a medical IRA, essentially. They are just putting money aside. They often don't use money from the HSA while still working or before they need to start drawing from it. But, it is a great tool for later on in life.

Julie Welch: The problem I'm seeing lately is that many of the health insurance plans that are high-deductible plans, have gotten costlier. Before, it was advantageous for businesses that were choosing the insurance, to go with the HSA, because it was much cheaper. This allowed them to contribute to the employee's HSA and still save money. And, now that's not the case. With many of the plans costing as much as the others options cost, there's no extra money to help fund into the individual HSA.

Theodore Sarenski: I did want to add one point to the HSA discussion. A common perception is that HSAs stop when a person goes on Medicare, which is correct. But, if the individual is employed and continues to be employed by a business that has 20 or more people, they can still participate in that plan's regular health insurance and continue to contribute to that HSA.

You do not have to go on Medicare if you are employed at a place with 20 or more people until you are no longer employed at that place. People who go beyond age 65 and continue working at one of those places with 20 or more people can continue to put money into that HSA account.

A common perception is that HSAs stop when a person goes on Medicare, which is correct. But, if the individual is employed and continues to be employed by a business that has 20 or more people, they can still participate in that plan's regular health insurance and continue to contribute to that HSA.

State and Local Tax (SALT) Itemized Deduction

Martin Shenkman: Does anyone want to chat about SALT deductions? I know we talked a bit about this topic earlier, but we haven't addressed the

topic as much as is warranted, nor have we addressed the proposed regulations [NPRM-112176-18] that were recently issued to stop states from using a charitable workaround.

Sanford Schlesinger: This is a disaster for the several states that have high state income taxes or high real estate taxes, or any other state and local taxes due to the $10,000 cap on deductibility. What fascinates me is, if you file a joint return, it's not $20,000, it's still $10,000. This is stunning to me as an incredibly unfair marriage penalty.

Worse than that, and I'm a New Yorker, the attempt of the state to work around the cap with a charitable deduction, which would then be credited in whole or in part to your tax liability to the state, was pretty effectively shut down by the proposed regulations. I don't think that should be a surprise to anybody. The IRS said they were going to shut it down and I think they did. Does anybody disagree with that?

Martin Shenkman: No, they did, and we all pretty much expected it.

Sidney Kess: Sandy, have you found many of your clients leaving the state?

Sanford Schlesinger: The answer is absolutely yes, But, it's not like half my clients are moving to other states, the truth of the matter is a lot of them are.

What is happening is that the people who would spend some time in places like Florida or somewhere else, are saying, "Hey, you know what? I spend this much time in Florida, the hell with it. Let's get out of here."

People do not necessarily want to leave a state like New York, but now more are inclined to feel "why not?" What am I getting by staying? And, living there is very expensive. You've got to remember, New York has this marvelous thing, which is almost indigenous primarily to New York, called co-ops and co-op maintenance used to be deductible. Now, co-op maintenance would be subject to the $10,000 cap.

This is a problem for states like New York and California and New Jersey. And, another thing to remember, a lot of states, about 30 now, do not have an estate tax. So, you don't have to go to Florida anymore to avoid the estate tax or, in many cases, an income tax. Other options are available. And, I think it is absolutely an impetus for people to move out.

Martin Shenkman: Let me make three more comments very quickly about the SALT limitations workaround and what the IRS did in the regulations.

What the regulations say is, for example, if you give $1,000 to a state charity and you expect to get a tax credit of 70 percent of that, then your deduction is reduced by the $700 and you, at most, will get a $300 charitable contribution deduction. And, it's not the actual credit you realize, it's what you could "expect" to realize. They have taken the worst option of the two.

There are a couple of interesting thoughts in the regulation that I just think are worth sharing. The first one is, and I think these numbers are astounding, $668 billion in revenue over 10 years is coming from the SALT restriction. And, that is primarily from taxpayers in the high-tax states. But there is another statistic from that proposed regulation, which is truly remarkable.

It's estimated that 90 percent of taxpayers will not claim any itemized deductions—none. Only five percent of taxpayers will itemize and be impacted by the SALT cap. So, if this is creating $668 billion of additional tax, doesn't this suggest that most of that $668 billion is coming from five percent of taxpayers, meaning to say a very small number of the higher-income earners in the high-tax state are bearing the brunt of raising the money to pay for most of what they call "tax reform"?

EDUCATION AND DISABILITY PLANNING

529 Plans and ABLE Accounts

Barbara Raasch and Martin Shenkman discuss recent changes to 529 plans and Achieving a Better Life Experience (ABLE) Accounts.

Martin Shenkman: Does anyone want to talk about ABLE accounts, 529 plans?

Barbara Raasch: As I'm sure you are all aware, 529 plans are provided for the purpose of helping against the ever-increasing cost of higher education. Since their inception in 1997, the plans have evolved for the better by providing greater investment options, lower fees, improved planning tools and friendlier client interfaces.

The scope of the plans has also broadened quite a bit. Starting in 2018, $10,000 per year can be withdrawn to pay for private elementary through high school tuition. The plans offer several benefits, including tax-free compounding of investment returns, potential tax deductions on income taxes, as well as the ability to transfer funds to multiple family members, and multi-generational education funding opportunities.

The ability to choose plans outside of one's home state increases the opportunities for greater benefits. However, these additional choices add to the complexity of analyzing competing 529 plans, thereby making the right decision more difficult. It's also very important when thinking about 529 plans, especially those outside of a person's own state, that those that are made available through brokers can be significantly more expensive, causing the returns to be significantly lower.

The ability to choose plans outside of one's home state increases the opportunities for greater benefits. However, these additional choices add to the complexity of analyzing competing 529 plans, thereby making the right decision more difficult.

For example, the South Carolina plan is terrific for South Carolina residents, but if you are looking at investing in, the South Carolina plan because a broker told you to, it may not be as attractive a choice.

Our firm has an analysis of all of the 529 plans across all the states. So, the first thing that we do when a client is interested in using a 529 plan is we look at their state of residence and check if a tax deduction is available for contributing to that state's plan.

The same kind of analysis applies with respect to ABLE accounts. ABLE accounts have not been around as long, and so it is not as complicated

to figure out what states to use, because in some cases, you have to use your own state's plan. Also, there just aren't as many different limited number of investment options and different types of plans.

In a number of states, you do get a tax deduction as well for making contributions to an ABLE account, It's hard to really argue going against a plan that provides a state tax deduction one-for-one on the contribution amount that you're making.

Martin Shenkman: Do you have any comments about the recent changes to ABLE accounts?

Barbara Raasch: For ABLE accounts, the contribution amount went up to $15,000. Here is how the ABLE accounts work. If, before a disabled person's 26th birthday, he or she is eligible for Social Security Disability or have been diagnosed by a physician with a physical or mental disability, resulting in marked or severe functional limitations that is expected to last no less than 12 months, they qualify for an ABLE account.

I think he only real change to the ABLE account is the amount—$15,000. That $15,000 that can be rolled over from a 529 plan or contributed to the account. The ABLE account has to be in the name of the disabled individual. And basically, the available reasons for withdrawals from an ABLE account are broader than what is eligible for 529 plan withdrawals. That is a big benefit for disabled individuals.

If you have a client who has a disabled family member or loved one, what you want to do is to look at the rules governing their state plan to see if that is the plan that you want to use. And, you make assessments just like you do with a 529 plan. You look at what the investment options are, what the fees are for the investment options, what the annual fee is.

Then you look to see if there are other states' plans that might be more advantageous, taking into consideration not only the investment side, but also the tax side. Because there are a number of them, like Iowa, Maryland, Michigan, Montana, Missouri—that provide a tax deduction for making contributions. And so, in the same way as you have been maximizing opportunities with clients for 529 plans, do that for ABLE accounts as well.

RETIREMENT PLANNING

Retirement Planning and Social Security

Stephen Krass and Theodore Sarenski join Martin Shenkman and Sidney Kess in an examination of recent changes in the area of retirement planning.

Martin Shenkman: Steve, do you want to talk about retirement planning?

Stephen Krass: There really wasn't that much retirement-oriented material in the Tax Cuts and Jobs Act of 2017. I think the most important thing was the change concerning recharacterization of Roth IRA conversions. Under prior law, if you did a Roth IRA conversion in 2017, and the amount you converted decreased in value, you could recharacterize it. And, under the law in effect for 2017, you have until you timely file your 2017 income tax return to recharacterize, which on extension takes you to October 15, 2018.

So, if I converted an IRA into a Roth IRA at $100,000 in 2017 and now with my great investment ability, its value is down to $70,000. I can now convert it back to an IRA and then still reconvert 30 days later at $70,000 and only have to pick up $70,000 in income instead of $100,000.

However, if I did my conversion in 2018 and the value has gone from $100,000 down to $70,000, I can no longer recharacterize it. Instead, I'm stuck with what I've done. So, that is a pretty big change.

Another change in the Tax Cuts Act deals with plan loan offsets. Let's say I participate in a plan, and I've taken out a loan and now $10,000 is outstanding. My account is worth $100,000. I terminate employment. I will receive, $90,000 in cash and get my loan back of $10,000.

If I want to roll over the $100,000 to an IRA, then I have to find $10,000 of cash from my own money to do that. Under the new law, with regard to the qualified plan loan offset amount, I now can do that anytime up until I file my income tax return for the year, including extensions. This is a much longer time than the 60-day period that was in effect before.

One other thing, the Act changed the cost of living index to be used to calculate increases to various adjustments and income thresholds. The IRS then came out and said, based on rounding, not one of these items involving retirement plans, originally listed in Notice 2017-64 [IRB 2017-45, 486], changed.

Recently, when I was updating a chapter for The 2019 Pension Answer Book, I was looking at something called a QLAC. A QLAC is a qualifying longevity annuity contract. During the Obama Administration, there was great concern that people were going to outlive their retirement benefits.

In response, they did not amend the Internal Revenue Code, but instead the IRS came out with regulations that permitted an IRA owner to take up to $125,000 and put it into a QLAC. Under a QLAC, you don't have to start taking distributions until age 85. You can take the money out earlier, but you could wait to start taking distributions at 85, hopefully, decreasing the possibility of running out of retirement money.

This was all done by regulations under Code Sec. 401(a)(9) [Reg. §1.401(a)(9)-6, T.D. 9673,

IRB 2014-30, 212]. When I was working on the book, I was looking at the IRS Notice and saw that for 2018, they had increased the amount that you could put in a QLAC from $125,000 to $130,000. I thought this was very interesting because when you look at the regulations, it says any change has to be in multiples of $10,000 and to the next lower multiple of $10,000. So, it's impossible to have a $5,000 increase in this particular provision.

I discussed this discrepancy with an IRS representative. On November 1, 2018, the IRS issued Notice 2018-83 setting forth the adjustments for 2019. In the Notice, the IRS advised that the dollar limitation on premiums paid with respect to a QLAC remains unchanged at $130,000. However, in a footnote, the IRS noted that Notice 2017-64 raised the limit from $125,000 to $130,000 although the regulations provide for increases of the $125,000 limitation only in multiples of $10,000. The IRS stated further that the limitation will remain at $130,000 until it would be adjusted to $135,000 pursuant to the regulations. For subsequent years, the limitation will be adjusted only in increments of $10,000.

Changes done in the Bipartisan Budget Act of 2018, including those to 401(k) plans and hardship distributions, don't apply until 2019. There are some potential retirement plan changes in the so-called Tax Reform 2.0, but nothing has happened yet and may not happen this year, if at all.

Social Security

Sidney Kess: Maybe Ted has other suggestions in the area of Social Security.

Theodore Sarenski: With lower tax rates right now for folks who are retiring, but are not yet at their RBD and who are going to defer taking Social Security, this is a perfect time to be doing a Roth conversion. Even though the ability to recharacterize is gone, there is still the opportunity to move a lot of money into a lower-tax bracket until the years they start receiving Social Security benefits and RMDs.

There are some fantastic planning opportunities between now and 2025 for folks who are retiring around this time, who are in their late 50s, early 60s, who can defer their Social Security, and don't have the RMDs coming in.

It also affects their potential in terms of the RMDs they need to take later on and I think smooths out their tax brackets a little better. We have done some computations on this strategy. What happens in the early years is that, if somebody were to die in one of the first five or six years, certainly they would pay tax that they wouldn't have and their total estate is worth less. On the other hand, when you get out to the 15-, 20-year time horizon—their life expectancy—they may have the same amount of money at that point in time, but they have moved it from the taxable box to the nontaxable box. And, if you look out another 10 years after that, there are significantly more assets in their estate that can be left as a legacy.

There are some fantastic planning opportunities between now and 2025 for folks who are retiring in their late 50s, early 60s, who can defer their Social Security, and don't have the RMDs coming in.

PRACTICE MANAGEMENT

Thriving In the Wake of High Exemptions and Standard Deductions

Sidney Kess leads a discussion with Lyle Benson, Theodore Sarenski, Stephen Krass, Barbara Raasch, and Martin Shenkman on tips for practice management following the Tax Cuts and Jobs Act.

Sidney Kess: We've talked about all these changes, how the estate tax exemption has increased, how the standard deductions increased and how there will be fewer people who are itemizing. What new things are firms doing today to make up for the loss of business on income tax returns? Are there new areas that firms are focusing on?

Lyle, the Personal Financial Planning (PFP) Section of the AICPA, where you used to be the Chair of the Executive Committee, had some concern about this problem years ago. What have you found happening now? Are more people getting into financial planning, for example?

Lyle Benson: We are seeing a real increase in the number of CPAs who are realizing that they have to provide broader services to their individual clients. They are getting squeezed by technology, by simpler returns for many of their less wealthy clients and by other competitors—including investment firms and wealth management firms and trust companies doing tax compliance work. I think more CPAs, as a broad, general statement, are looking at trying to add this broader planning to the work they do.

Sidney Kess: So, what are some of the things they are doing?

Lyle Benson: A lot of them that are tax oriented are starting from the tax return. They are looking for planning opportunities springing from those tax returns that they have not talked about previously with clients.

They are building off of that tax relationship and trying to deepen their relationship with clients as a result of that, as they should be. CPAs that have that relationship with clients, that have that tax connectivity, are in a great position to be able to provide a broader range of services and address areas like retirement planning and cash-flow planning and bringing estate planning into the discussion.

Sidney Kess: Elder planning, which is one of the offerings things that the AICPA thought leadership is focusing on this year, is an emerging practice area.

Lyle Benson: Absolutely. Our clients are getting older just like we are and I think elder planning becomes that much more of an important element of what we do. I don't really see this as a separate service as much as a sort of a shift in some of the things that become the discussion points and the areas you address with client. Where you now are talking to them about housing and when you realize they are going to soon be at a point where they can't stay in the house that they live in, you need to transition the discussion to housing alternatives.

A lot of it revolves around CPAs having conversations with their clients in advance and being proactive and trying to get those discussions going before it becomes a crisis situation. And, that is how you work with clients all the way through the various stages of life.

Sidney Kess: Marty, you've spoken a great deal on this topic. In fact, at the Heckerling program you

concluded that different areas had to be focused on. Can you share with us some of these areas?

Martin Shenkman: I find that a lot of accountants are very hesitant to expand into areas that are not traditionally what they feel they have expertise in. And, I think it's really critical that more accountants do exactly what was just described and proactively start to discuss later life planning and broader holistic financial planning with all of their clients for whom it may be relevant.

I find many CPAs are reluctant to address elder law services, even when I try to bring them in as the estate planner to encourage that kind of work. Some dismiss it as merely bookkeeping type work that is not profitable for them. And, I think that it's important to differentiate what you might consider bookkeeping from what I'd really call later life management planning services.

Bookkeeping may be part of it, but it's really much more. It is a real value-add for clients. And it should be billed as such. It's critical for the security of clients with elder financial abuse, cognitive issues, and all the challenges of aging. This can really be a value that is billed and a service that clients should greatly appreciate.

Another point that I think is just important to quickly mention, it's not just the accountants that are affected by all these changes, but estate planning attorneys are very significantly affected. For many attorneys, when we had a $1 million estate tax exemption, a dramatically greater number of clients needed estate tax planning and, thus, more sophisticated estate planning documents.

A lot of clients don't understand the critical role their estate planner can still play in creating documents and planning for later life management as they age, including asset protection, proper trusts for children and all the other things we all know. The key to all of this happening is for all of the allied professions—trust officers, financial advisors or wealth management personnel, as well as the accountants and attorneys—to advocate the same educational message for our clients. The message is that clients really need, and will benefit from, a collaborative team effort to address these issues.

Otherwise, too many clients are not going to want to deal with the realities of aging. They are not going to consult with their accountants about what they really need to. They are not going to let their attorneys do proper planning. They may go get something online or from a general practice attorney. And, clients are going to get hurt. The challenge for all of us is to educate clients, so we can all do a better job for them. Some of the things to consider depending on the status of the particular client might include:

- Bill paying;
- Budgeting;
- Financial forecasting;
- Review of property casualty and liability insurance;
- Review of medical, long-term care and other insurance;
- Creating, funding and using revocable trusts with built-in safeguards that might include an institutional trustee;
- Bringing care managers into the planning team;
- Reviewing and modifying existing irrevocable trusts;
- Serving as a co-trustee or trust protector;
- Coordinating and fostering regular review meetings with all advisers; and so much more.

Does anyone else have any thoughts or comments on Sid's point, which is an excellent one, about the change to the professions and what we all need to do going forward?

Theodore Sarenski: Let's go back to the comments about accounting firms' reluctance to get into more planning type engagements. I contend that they have been doing that right along. And, the issue is just their perception that this can't be billed for. They have been giving advice when they had the tax return. Now, that CPAs are not going to be handling as many tax returns, a lot of the advice they gave along with those tax returns is where the value was provided.

So, there has to be a mindset change that it wasn't the production of that tax return that produced the income, or the reason that person came back year after year to have their return done there. It was the other things that were talked about. It was the advice they were given. It was the tax planning. It was the, "Well, what are you doing for your kids' education," and talking about 529 plans. It was, "Gee, when did you update your estate planning documents? You need to contact your attorney."

It was all those types of things that they talked about, which is valuable information that they haven't, up to this point, regarded as valuable enough to bill for.

Lyle Benson: Adding to Ted's great comments, we see a lot of CPAs that equate financial planning with giving investment advice or selling products or managing money, and they don't realize that they are doing financial planning when they address these other issues with clients.

What we try to encourage them to do is take it the next step. Make sure you have enough education in each of those areas. Make sure you know what you're doing and be more proactive with your clients about raising these questions. Look at it from the big picture perspective of their personal finances. And, don't think that you have to be managing investments in order to provide financial planning services.

Tax Compliance and Client Communications

Stephen Krass: I have one question directed to Julie and Lyle. Is there any thought in the accounting profession when doing 2018 income tax returns for clients to include a page to show the difference as to what it would have been under law in effect in 2017 to see how much we are getting hurt, or how much help we are receiving?

Lyle Benson: Our returns typically show a two-year comparison column for every client—every return we do, actually. And we're doing that on the front end now with the planning we do during this year. We are always looking back to try to make sure they understand the difference, last year versus this year.

And, quite honestly, for many of our clients, even though, they have heard about the great reduction in the top tax rate and all those sorts of things, they are paying more tax in 2018 than they were in 2017.

Stephen Krass: Actually, I'm looking for something different. As opposed to a comparison of 2017 and 2018, a comparison as to what 2018 is under the law in effect for 2018 and what it would have been in 2018 had the law not changed.

Lyle Benson: Good point.

Julie Welch: What we did with our individual clients through October 15, is for all the tax returns we print off a summary showing this is what your 2017 tax is and this is what your 2017 tax would have been had the 2018 rules been enacted.

They can see that the tax deductions are limited, the miscellaneous deductions are gone. They can see all of that and what it means to the bottom line for them based on last year's numbers. And, we can tweak last year's numbers as well, but most clients just want to see what the actual tax law change meant specifically to them.

Barbara Raasch: What are people doing with that information, just being happy or unhappy?

Julie Welch: We are using it to talk more about different strategies, some of which we talked about today, the bunching, qualified charitable distributions, deducting medical expenses, etc. It's also useful to have this information if certain personal changes are being contemplated, a divorce, for example. But, basically, as a starting point, it's a very good discussion piece for clients, very beneficial for them. You are able to help somebody do something, rather than just giving them a tax return.

Lyle Benson: We found that the more that we are able to show them proactively here's what happens with the 2018 law applied to your situation, the more engaged they are in the process about planning opportunities, as Julie pointed out. What can we shift around? What can we do about your situation from an overall personal financial planning standpoint that might help from a tax standpoint?

ESTATE PLANNING

Estate Planning After TCJA

Martin Shenkman, Sanford Schlesinger, and Stephen Krass describe the impact of the Tax Cuts and Jobs Act on the estate planning community.

Martin Shenkman: Sandy, why don't you kick it off on any estate planning topic you would like.

Sanford Schlesinger: My only overall comment is that estate planning is a nightmare. Aside from the fact that only 2/10ths of one percent of people are going to file a federal estate tax return, you get to the fact that the estate tax provisions are included in the individual provisions of the Tax Cuts and Jobs Act. And, they are scheduled to expire after December 31, 2025, which makes it very difficult for doing planning for any client under age 109.

... if a couple can afford to give away $22 million plus they ought to give it away now because I don't believe in the "clawback" argument.

The big issue is about how to make the best use of the expanded exemption equivalent. Obviously, if a couple can afford to give away $22 million plus they ought to give it away now because I don't believe in the "clawback" argument. And by the way, the exemption is supposed to go to $11.4 million January 1, so it would be $22.8 million in 2019.

The main problem is doing long-range estate planning and how to draft wills and trusts. We are moving (with a great deal of trepidation about whether people will carry it out) to using disclaimer trusts as our basic planning format, because that gives you the maximum flexibility possible. Whereas unified credit trusts, though I think they are the best way to go, are the most difficult. This is especially trus when you add in the states that still have a state estate tax, and then when you add in the states like New York, which have a cliff tax. So, my real overall comment, it's just unbelievably complicated and very, very, very difficult to explain to clients.

Martin Shenkman: Let me tell a quick horror story because I think we all need to do a really proactive job to get clients to focus on planning. My experience is that, other than the ultra-high net worth clients that feel this may be the last great opportunity to plan, for people in the $5 to $40 million range, it's like pulling teeth to get them to come in to the office because their view is "Gee, the exemption is really high. The exemption is so high the estate tax doesn't really apply to me."

I had a situation recently where someone had come to me, they had another lawyer many years ago, draft a will. At the time the will was drafted, there was $1 million exemption. The client, like too many clients, just wanted simplicity. And so, she bequeathed an amount equal to her GST exemption

to her grandchildren, and the remainder to be divided equally among the children.

At the time, there was a $1 million GST exemption. So, the lawyer drafted a document saying that the GST exemption amount will go to grandchildren. Because she had 10 grandchildren, the anticipated $1 million bequest to them was $100,000 per grandchild. She chose not to set up trusts because for $100,000 she deemed it not necessary. Many people would view it as more economical and reasonable and simpler to not have a trust.

So, at the time the plan would have been $100,000 per grandkid and everything else divided among the children. Well, now we have an $11.18 million exemption. Her estate had grown to over $10 million. She died and the children called me after she died, "What do we do?"

You really have a mess because the entirety of the estate goes outright to grandchildren; nothing is left for the children. There are no trusts to protect the grandchildren's inheritance either. And the amount that she thought would be modest when she did these has now ballooned to over $1 million per grandchild, with no trusts to protect it.

It's a total disaster. So, one of the comments is that it's really important that we all educate clients because there are clients out there with wills that are 10 and 20+ years old and may contain serious defects. The formula clauses will not work. There were changes in the law that none of us, even with crystal balls, could contemplate. I think it's critical that everybody try to help encourage clients to go back to their attorneys.

And, that return is going to be exactly how Sandy described it. It's complicated and it's bizarre—it's almost unbelievable for clients to that think, "Well, gee, if the exemption is so high, shouldn't this be simple?" And as Sandy pointed out, from many perspectives, planning is more complicated for a lot of clients than it has ever been.

We all need the support of a team effort to help educate clients, get them back to their attorneys. And, whatever approach is used, I think the key is that we revisit what's out there and we use a deliberate approach that makes sense for the client.

Just consider the discussions we have had on this call with respect to using various types of non-grantor trusts, the existing grantor trusts, trusts under wills, the number of different approaches that can be used. Disclaimer trusts, as Sandy recommended can be useful tools. Some people love *Clayton* QTIP trusts in the current environment. There are some people that like to use formulas to bracket the amounts to a credit shelter trust and the remainder to a QTIP or marital type disposition. There are so many different variations now that it's really important to help clients understand what they should do because the answers will be different for different clients.

Stephen Krass: I think we have to all remember that wills are not just to save taxes. They are to carry out what the family, what the testator or testatrix wants to do, and taxes should not be the tail that wags the dog.

I think we have to all remember that wills are not just to save taxes. They are to carry out what the family, what the testator or testatrix wants to do, and taxes should not be the tail that wags the dog.

Martin Shenkman: I think that's a critical point and I think given the high exemptions, a lot of what we call moderate-wealth clients are completely forgetting that. And, that's why I made a broad appeal to everybody, from the accountants, to the wealth advisors, to the insurance consultants, everybody on the team who has contact with the client needs to encourage them to go back to the attorney because too many clients are just really mistakenly, almost foolishly, assuming that they don't have to do anything and it's just really not the case.

One of the things I think is important when we talk about non-grantor trusts is to note that there are a number of different ways to create these trusts. But, I think we have a unique situation in terms of

planning that we have never had before, and that is the following.

We want to have in some cases, absolutely not in all cases, non-grantor trusts for some of the tax benefits we discussed earlier. However, to use these temporary exemption amounts, you need completed gifts or you are not using any exemption. So, you use a common non-grantor trust that we're all familiar with, the "ING" intentionally non-grantor trust. These are called a DING when the trust is created in Delaware, a NING if created in Nevada, and so on. Those historically have always been structured as incomplete gift trusts because very wealthy clients used them to avoid state income tax on, let's say, the sale of a large asset like a business interest.

But, INGs in the traditional context don't work under the current planning scenario for moderate-wealth clients—and for that definition I'm using a very rough range of $5 to $40 million—because moderate-wealth clients will oftentimes want or should want to make completed gifts to use this temporary exemption, as Sandy pointed out.

What kind of trusts do work? Well, maybe we need to do a variation of the traditional ING trust that is a completed gift. Another option is something that I call a SALTy SLAT (spousal lifetime access trust). Ed Morrow referred to this type of trust as a "SLANT"—a spousal lifetime access non-grantor trust. If you leave aside the acronyms, this planning is just trying to get a point across of doing a trust that a spouse has access to, but that qualifies as a non-grantor trust to secure possible income tax planning benefits.

That type of trust would require the approval of an adverse party for distributions to the spouse in order to accomplish all these goals. So, you could create a non-grantor trust that's a completed gift. The clients have access, which from a financial perspective may be incredibly important for the clients given the size of the gifts they want to make.

But, will clients actually be comfortable letting an adverse party, let's say, their child, approve distributions to them? I'm not sure that many clients would be comfortable doing it. So, we may have an ideal in terms of how to plan under the current environment, but how many clients will do it?

And, then you have the complexity issue, which Sandy pointed out and I guess I've just demonstrated by explaining some of the planning that we may want to do. It is a very difficult environment to plan in. We may have the answers, but how do you make them practical, how do you make them understandable and how do you get clients comfortable doing them?