Trusts: 2019-2020 Planning Roadmap Part 1

Planning before the 2020 Election; State Income Taxation of Trusts; Aging and Longevity

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Planning before the 2020 Election; State Income Taxation of Trusts; Aging and Longevity

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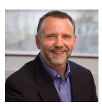

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Trusts: 2019-2020 Planning Roadmap

Introduction

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Introduction

- With a possible shift of control in Washington on the horizon, various demographic trends, and increasing elder financial abuse, estate planning has become ever more complex. This presentation will explore various planning strategies that practitioners may employ to help clients capitalize on the estate tax environment created by the 2017 tax act, with consideration of these newer developments and trends.
- In this world of constant uncertainty, only one thing is clear, planners need a roadmap in an attempt to craft strategies to preserve and protect their clients' wealth.
- What follows is a discussion of a wide range of planning considerations in this challenging planning environment.
- Part 2 of this Powerpoint addresses more complex trust planning and planning techniques to be considered for larger estates in the current planning environment.

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Trusts: 2019-2020 Planning Roadmap

Planning Before the 2020 Election

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Clawback of Temporary Exemption

Why wait to use it?

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Clawback of Temporary Exemption

- Regulations were issued confirming that a taxpayer's use of the temporarily enhanced gift tax exemption will not result in a recapture or clawback when the exemption declines.
- The "off the top" gift tax issue was negatively resolved. Assume that a taxpayer makes a gift of $5M in 2019 and makes no further gifts. If the taxpayer dies after 2025 and the enhanced exclusion no longer provides benefit. Some had speculated that that the gift might have been treated as if made off the top of the exclusion amount. That could have left the remaining exclusion intact, but it appears that this is not an appropriate interpretation and clients cannot make a gift of the top portion of the exclusion.
- Prop. Regs. 20.2010-1(c); Reg-106706-18.

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Clawback of Temporary Exemption - Planning

- The fact that the clawback issue has been resolved may serve as a strong incentive for "moderate wealth clients ("moderate" relative to the current high exemptions) to plan and make gifts before 2026 when the exception is set to decline if nothing happens before then. If the "blue wave" of the 2018 mid-term election continues, the exemption amount could be reduced before the 2026 scheduled sunset reduction of the exclusion. For example, the estate tax proposal by Bernie Sanders proposes a mere $1 million gift exemption and a $3.5 million estate tax exemption. Practitioners may wish to proactively educate and encourage clients to plan and thereby hopefully avoid a repeat of the 2012 deluge of clients trying to get planning done just prior to a possible change in the exemption. Client's may also wish to, consider more robust plans than many executed in 2012.

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Clawback of Temporary Exemption - Democrats

- But will claw back really be avoided?
- If the Democrats gain control in 2020, what might they make the effective date of any new estate tax legislation?
- Will they change the status of no-clawback?
- Practitioners might also caution clients about the risks of gifts not succeeding because of this uncertainty.
- Practitioners might also caution clients about the risks that gifts may not accomplish their intended goal if laws change.

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Estate Tax Proposal – Bernie Sanders

"For the 99.8 Percent Act"
A Template for Dem Tax Proposals?

Thanks to Bob Keebler from some of the slide info

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Template for Democratic Proposals

- The Bernie Sanders estate tax proposal follows in many respects the Obama Greeenbook proposals and may be the model for a Democratic tax proposal if the Dems gain control in 2020.
- Bottom line – clients may choose to act now to secure benefits before the election.
- By planning in 2019 you may be able to implement planning options that could mitigate step transaction and reciprocal trust challenges. This may not be as readily feasible if clients wait until the election to "see what happens."
- **We will review the proposals quickly and focus more time on the discussion of planning steps practitioners should take in the following section.**

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"For the 99.8 Percent Act" Exemptions

- Gift Tax Exemption:
  - $1,000,000 in 2020
  - Not indexed for inflation
- Estate and GST Exemption:
  - $3,500,000 in 2019.
  - Indexed for inflation.
  - "Portability" retained.
- Would radically transform current planning options for clients who may be ignoring planning given the current high exemptions.
- It is advisable for clients consider planning options before a Dem proposal might ever become law.

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"For the 99.8 Percent Act" New Basis Consistency Rule

- Basis consistency rules.
  - Basis must also be consistent with the amount reported on gift tax returns.
  - Similar reporting regime as under § 1014(f). This might add substantial costs to gift tax return filings which, with a $1M exemption could expand substantially.

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"For the 99.8 Percent Act" Help For Small Business/Farms

- Sec. 2032A - Special Use Valuation Changes.
  - Increase to reduction in FMV from $750,000 to $3,000,000.
  - Applies after 12/31/19.
- Sec. 2031(c) - Conservation Easement Changes.
  - Increase reduction in FMV from $500,000 to $2,000,000.
  - Increase to reduction in fair market value from 40% to 60%.
  - Applies after 12/31/19.
- These changes could be helpful for some taxpayers.

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"For the 99.8 Percent Act" Valuations and Discounts

- General Valuation Rules.
  - The "Non-business" assets of an entity transferred are valued as if the asset were transferred directly (non-actively traded interests) – no discounts of any nature.
  - Non-business assets means any asset not used in the active conduct of a trade or business. What of working capital?
  - "Passive assets" not treated as used in active business.
- Discounts.
  - No discount allowed if the transferee and family members have control or majority ownership (non-actively traded interests). This eliminates the discount "elixir" that has propelled much of modern estate planning.
- Clients needing discounts to make a transaction succeed might proceed before a law change.

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Slide 16

SG14 Similar reporting regime as under § 1014(f). Given the potential decrease in the exemption, this might add substantial costs to gift tax return filings as well as increase the number of returns that might be required.

Sandy Glazier, 10/7/2019

"For the 99.8 Percent Act" GRATs No Longer GREAT

- GRAT changes
  - Minimum 10-year term. This eliminates the common rolling or cascading GRAT technique. Taxpayers cannot count on re-GRAT'ing payouts from existing GRATs.
  - Maximum term of the life expectancy of the annuitant plus 10-years. This eliminates the so-called 99-year GRAT that is used under current law as an interest and valuation play.
  - Remainder interest not less than an amount equal to the greater of:
    - 25% of trust value.
    - $500,000.
    - This eliminates the Walton or Zero'ed out GRAT.
- Is there any benefit to GRATs left?

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"For the 99.8 Percent Act" Grantor Trusts Emasculated

- Grantor trust changes are harsh and appear to emasculate a favored planning tool.
  - Estate will include:
    - Assets in grantor trusts.
    - Distributions from grantor trusts during the life of the deemed owner.
    - The assets of a grantor trust when the trust changes to a nongrantor trust.
- This effectively would eliminate the use of grantor trusts after the effective date of the act. When might that be?
- Should taxpayers create grantor trusts now hoping for grandfathering? Might the possible benefit of a grandfathered grantor trust outweigh the current income tax benefits of a non-grantor trust?

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"For the 99.8 Percent Act" GST Tax

- GST changes
  - Inclusion ratio of any trust other than qualifying trust must be 1, meaning no GST benefit.
  - Qualifying trust must terminate not later than 50-years after the trust is created. That eliminates the tax benefit of long term/perpetual trusts.
  - Pre-existing trusts must terminate within 50-years of enactment. Might this eliminate grandfathering? Might this suggest that the earlier a trust is created perhaps the greater the likelihood that it might be permitted to be grandfathered?
  - This could radically change trust and intergenerational planning as we know it.

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"For the 99.8 Percent Act" Annual Exclusion Gifts Restricted

- Annual Exclusion Gifts.
  - $10,000 limit per donee.
  - $20,000 limit per donor.
- This could transform planning for clients of all wealth levels including the ubiquitous irrevocable life insurance trust ("ILIT") and front loaded 529 plans.
- Clients with ILITs and other trusts that are accustomed to using annual gifts should evaluate making a larger gift now using available exemption to fund those trusts to avoid the need for future gifts which would require the filing of a gift tax return and which after $20,000 would reduce the $1M lifetime gift exclusion.

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"For the 99.8 Percent Act" Rethink Upstream Planning

- Many practitioners have touted the use of "upstream" planning to salvage otherwise unusable exemptions of the client's elderly relatives.
- Example parent has an estate of only $4 million, child could create a trust with $7 million, and give parent a general power of appointment ("GPOA") over that trust. The intent of the plan was that parent's estate would include the assets in the trust and those assets would garner an estate tax free adjustment (hopefully step-up) in income tax basis on parent's death.
- If the exemption is reduced to the $3.5 million as in the Sanders' Act, the benefit of most or all upstream planning would be obviated. If that occurs practitioners might want to review that planning to be certain that the estate inclusion in the upstream plan does not inadvertently trigger an unintended estate tax on the senior generation's death. While many such upstream plans were likely crafted to only include in the senior generation's estate an amount that does not trigger an estate tax, the more prudent course of action would be to confirm that. Clients who only recently had planning updated to address the inclusion of GPOAs to a higher generation will likely be frustrated by the yo-yo tax law changes and ongoing planning updates.

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Dem Possible Tax Proposals – Steps to Take Now

Clients may wish to consider completed gift transfers to lock in exemption, and trusts that provide access

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Downstream Planning

- A valuable "asset" of many ultra high net worth ("UHNW") families is the unused exemption of their children. But in many cases children of even UHNW families do not have sufficient resources to make gifts to use their exemptions.
- If the parents endeavor to loan funds to the child so that the child can make gifts to use exemption those loans may be re-characterized as a gifts, triggering gift tax on recharacterized loan (i.e. a purported loan re-characterized as a gift).
- Perhaps an alternative might be for an existing dynasty trust, of which the children are beneficiaries, to guarantee the loan so that it may in fact be characterized as a loan. The child/borrower may then use the funds to consummate a gift.

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Only One (Not Both) Spouses Should Make Gifts?

- **Example**: Husband and wife have a combined estate of $16 million and are willing to make $8 million in transfers to irrevocable trusts to secure a portion of the temporary exemption. If each of husband and wife transfer $4 million to a non-reciprocal spousal lifetime access trust ("SLAT") in 2026 when the exemption declines by half, to perhaps $6 million, each spouse will be left with $2 million of exemption, or a total of $4 million.
- If instead husband alone transferred $8 million to a trust for wife and descendants, wife would still have her entire $6 million exemption left. For taxpayers with estates of a size where there is no need to preserve the new GST exemption, it might be prudent to make late allocations of GST exemptions to existing trusts so that if a future administration rolls back the 2017 Act's benefits, those trusts will already be exempt.

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DAPTs more Important then Ever

- Access to assets to be transferred in order to use the temporary large exemptions may be critical for many clients other than certain UHNW (ultra-high net worth) clients. Many single clients, and even many married clients, will want or insist on being able to access the assets transferred. With historically high exemptions, very large transfers (relative to the net worth of moderate wealth clients - perhaps, defined as those having estates between $5 million to $40 million) are necessary to make a meaningful impact in securing the large temporary exemption.
- Consider recent cases.

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DAPT Variations Essential For Many Client Plans

- Modern trust planning techniques provide an array of options to permit a client to benefit from assets transferred to completed gift trusts that can use exemption. Access is key for most clients. These include:
- DAPTs – 19 states now permit DAPTs. Consider having the client move to a DAPT jurisdiction.
- Hybrid-DAPTs where someone in a non-fiduciary capacity can name the settlor as a beneficiary.
- SPATs: special powers of appointment to direct a trustee to make a distribution to the settlor. The trust is not self-settled since the settlor is not a beneficiary. That is the touchstone for attachment in many jurisdictions. If the power holder will not be an adverse party, the trust will be a grantor trust, under Sections 676 and 677.

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DAPT Variations Essential For Many Client Plans

- Variations of non-reciprocal SLATs
  - e.g. non-reciprocal SLATs that include hybrid DAPT or SPAT provisions).
  - This is a powerful variation of the more traditional non-reciprocal SLATs and deserves more attention.
  - Rather than focusing on the SLAT acronym focus on maximizing access while controlling the perceived risks of estate inclusion.
  - The plan could be non-reciprocal SPATs, or perhaps a traditional SLAT for one spouse (e.g. a spouse with significant wage income or large IRAs that cannot be transferred), and a hybrid DAPT or SPAT for the other.

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DAPT Variations Essential For Many Client Plans

- Restrict the trust so that no distributions can be made to the grantor for ten years and one day after transfers are made to the trust to address the rights of a bankruptcy trustee to disavow a self-settled trust under the Bankrupt Code 548(e).
- Some practitioners provide that the Grantor cannot be added or appointed to be a beneficiary unless there is a divorce or death of a spouse.
- Reasonable compensation from entity interests owned by the trusts.

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Other Means of Providing Access

- Loan powers not to primarily assure grantor trust status but to provide access.
  - If the trust is structured so as not to be a grantor trust, loan provisions may provide a means of access before turning on DAPT status.
  - But if the loan may be made without the requirement of adequate security or adequate interest, grantor trust status will also ensue. Indeed, loans to the grantor from a trust, regardless of the terms of the loan, may cause the trust to be taxed as a grantor trust under Section 675(3).
- Floating spouse-clauses.

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GRATs in the Current Environment

- For many, if not most, wealthy (not uber wealthy) clients GRATs are not an optimal tool in the current environment because they do not use the current high but temporary exemption.
- If you believe that there is any risk of a Dem victory and harsher estate tax, i.e. reduced exemptions, GRATs may not be advisable for clients with unused exemption.
- If GRATs do make sense for the particular client consider that the Dem proposals emasculate GRATs so that the traditional application of GRATs as rolling or cascading GRATs may not be possible. Don't count of being able to roll a GRAT as that may be eliminated. Make sure the plan works even under that scenario.

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Revise Power of Attorney and Revocable Trust Gift Provisions

- Consider that Dem proposals include a cap on annual gifts and/or Crummey powers of $20,000/donor.
- Fund ILITs and other irrevocable trusts now to avoid the detriment of a gift tax cap. That may also use current exemption.
- Modify POA and RLT gift provisions to permit funding existing ILITs even if the gifts have to exceed annual exclusion amounts. Many standard forms cap gifts based on annual exclusions which may be too low to fund SG46 many existing life insurance plans.

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SG46 "maintain" as opposed to "fund"
Sandy Glazier, 10/7/2019

Life Insurance, ILITs, Credit Shelter Trusts

- Some clients have terminated or are in process of terminating Life Insurance, ILITs, Credit Shelter Trusts because there is no benefit with current high exemptions. If the Dems win in 2020 that may change dramatically.
- Consider modifications to such trusts instead of terminating them.

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Trusts – State Income Taxation

Supreme Court

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Kaestner

- On June 21, 2019, The U.S. Supreme Court decided the case of the North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust, upholding the state court's decision that taxing the trust on a beneficiary's mere presence in the state violated the due process clause.
- Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Dept. of Revenue, 814 S.E.2d 43 (N.C. June 8, 2018), aff'g 789 S.E.2d 645 (N.C. App. 2016).

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Post-Kaestner Planning Considerations

- Decant trusts with mandatory distributions.
  - The trust at issue in the *Kaestner* case had been previously decanted from a trust that terminated at a specified age. Consider whether effectuating a non-judicial modification to curtail beneficiary control might taint the result as evidencing beneficiary control (in contrast to a decanting effectuated by the trustee). If the beneficiary must consent (or, at least, not object) to a non-judicial modification, might a court view that as the beneficiary actively participating in or controlling the decision? In contrast, it might be possible f[SG48]ecanting to be effectuated by the trustee with no beneficiary involvement.

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Post-Kaestner Planning Considerations

- Avoid making distributions to in state beneficiaries.
  - The terms of the trust may permit loans to the beneficiary, which may address short-term cash needs. Any loans must carry adequate interest and be memorialized with appropriate documentation which evidences an intent on the part of the beneficiary to pay the loan back.
  - The trust may make payments on behalf of the beneficiary without causing taxability of the trust in the state of the beneficiary's residence. By way of example, if the trust were to acquire a property outside the beneficiaries' home state and allow the beneficiary to live in it, this would not necessarily cause the trust to be taxable under the state law at issue in Kaestner.
  - Theoretically, if a person in a non-fiduciary capacity directed the trustee to transfer funds from the trust to a named person, pursuant to a power of appointment, such a payment may not be deemed a "distribution" and the recipient might not be deemed a "beneficiary." This is called a Special Power of Appointment Trust or "SPAT."

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Post-Kaestner Planning Considerations

- Although Kaestner was a very narrow opinion, the planning lessons that can be learned are quite broad and have applicability to many clients. Practitioners might consider proactively modifying irrevocable trusts to enhance or secure state tax planning benefits.
- Choose an institutional trustee in a tax-friendly jurisdiction.
  - Why isn't this the default plan in all instances for those in high-tax jurisdictions creating trusts?
- Organize an LLC in a tax-friendly jurisdiction.
  - Name the LLC as trust protector and outline the specific powers and responsibilities such entity would have over the trust.
  - Have the entity via its managers, not residents of the high-tax state, provide services to the trust.

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SG48 in some jurisdictions, and depending upon the terms contained within the trust,
Sandy Glazier, 10/7/2019

Post-Kaestner Planning Considerations – Contacts 1

- Avoid certain contacts with the taxing jurisdiction.
- Store records out of state. It is not clear whether this inquiry will continue to be relevant in the modern digital age. In any event, Kaestner makes clear that a trustee should not store physical records in the taxing jurisdiction whose authority to tax is trying to be avoided.
- Trust asset custodians were located in a state other than the taxing state in Kaestner. Engage investment advisors physically located outside of the taxing jurisdiction and also prefer advisors which do not have locations within the jurisdiction if possible.
- Avoid renting or owning an office in the taxing state.
- Avoid owning real property or tangible personal property in the taxing state. Therefore, if the trust acquires property for the beneficial use of a beneficiary, consider dividing the trust so as to avoid tainting the entire trust corpus for taxation purposes.

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Post-Kaestner Planning Considerations – Contacts 2

- The trust should not have any direct investments in the taxing state. Some states take the position that any active business in their state will taint the entire income of the trust as taxable. If that situation affects a trust, consideration may be given to dividing the trust. Many trust documents permit the trustee to divide the trust for a variety of reasons. If not, state law might permit division. If that isn't the case, decanting may provide another possible way to cure this state tax issue.
- The number and location of meetings between the trustee and beneficiary may be relevant. The Court noted: "the trustee's contacts with Kaestner were 'infrequent.'" Therefore, consider having beneficiary meetings in a tax neutral location.

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Trusts: 2019-2020 Planning Roadmap

Planning for Aging Clients

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Aging

Later Life Planning, Elder Abuse

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Aging and Abuse

- **While the focus is on planning for the current environment, with an aging client base, that planning should encompass considerations of planning for our aging clients.**
- Senior citizens may lose nearly 25 times more to scammers than what is reported.
- 200,000 cases of elder financial abuse are reported annually to U.S. authorities with losses of $1.17 billion.
- Actual number may be 5 million cases with losses of $27.4 billion a year.
- A lot of the financial abuse is perpetrated by family members or people the elderly trust, so they are reluctant to report it; they may be ashamed they got scammed, or they may not realize it.
- 1 in 10 people in the US over the age of 65 fell victim to elder fraud in the last year.

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Aging and Abuse

- Practitioners need to make later life planning, and planning with safeguards to minimize the risks of elder financial abuse, standard. Common planning steps for aging, like preparing a durable power of attorney, need to be rethought in light of these risks. What safeguards can be built in? What monitor relationships external to the document can be created for the client? Might a revocable trust with a trust protector and co-trustees provide a better set of checks and balances?
- Traditional estate planning in many ways still seems mired in the historic view of intact families in first marriages and family loyalty that in many situations is inappropriate or inapplicable. The common approach of naming a spouse then children in age order as agents perhaps should be discussed in detail with clients along with other planning options.

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FINRA Rule 2165

- Financial professionals can restrict distributions from accounts if they have a reasonable belief that the client/account owner is being subjected to financial exploitation.
- The adviser must have names and contact data for trusted contact persons to reach out to.
- FINRA rule also appropriately broadens the discussion to include not just elderly clients (which most articles unfortunately restrict their discussion to) but clients with other health or cognitive challenges that make them susceptible to abuse. "*…the term "Specified Adult" shall mean: (A) a natural person age 65 and older; or (B) a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests*."

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Longevity

Wealthy Live Longer

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Longevity and Wealth

- "Men in the top one-fifth of America by income born in 1960 can on average expect to reach almost 89, seven years more than their equally wealthy brethren born in 1930. (Life expectancy for men in the bottom wealth quintile remained roughly stable at 76.)"
- Consider what the above longevity statistics mean to planning. Using table life expectancies could understate actual life expectancy for the wealthy clients almost all advisers serve. Also, in the discussion of societal goals and the estate tax, the shocking statistics of expanding life expectancy for the wealthy and stagnant life expectancy for the lower tiers of wealth may well serve as an incentive for the proposals of universal health care to be paid for by a harsh estate tax.
- Simone Foxman, "U.S. Billionaires Are Living Longer Than Ever, Making Heirs Wait," Apr 3, 2019, Bloomberg.

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Assisted Suicide

NJ Becomes the 8th State to Permit

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Assisted Suicide - Background

- The preamble to the bill proposed provides insights into the right to die movement and the realities of the legislation enacted in other states.
- "*Recognizing New Jersey's long-standing commitment to individual dignity, informed consent, and the fundamental right of competent adults to make health care decisions about whether to have life-prolonging medical or surgical means or procedures provided, withheld, or withdrawn, this State affirms the right of a qualified terminally ill patient, protected by appropriate safeguards, to obtain medication that the patient may choose to self-administer in order to bring about the patient's humane and dignified death;*

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Assisted Suicide - Background

- *Statistics from other states that have enacted laws to provide compassionate aid in dying for terminally ill patients indicate that the great majority of patients who requested medication under the laws of those states, including more than 90% of patients in Oregon since 1998 and between 72% and 86% of patients in Washington in each year since 2009, were enrolled in hospice care at the time of death, suggesting that those patients had availed themselves of available treatment and comfort care options available to them at the time they requested compassionate aid in dying;*
- *The public welfare requires a defined and safeguarded process in order to effectuate the purposes of this act, which will.*

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Assisted Suicide – NJ Requirements

- Be an adult, defined as 18 or older.
- A resident of New Jersey. This might preclude a transfer of a patient from a state not permitting assisted suicide into New Jersey to avail herself of the New Jersey statute.
- Be mentally capable (means having the capacity to make health care decisions and to communicate them to a health care provider, including communication through persons familiar with the patient's manner of communicating if those persons are available).
- Be terminal which means that the patient is in the terminal stage of an irreversibly fatal illness, disease, or condition with a prognosis, based upon reasonable medical certainty, of a life expectancy of six months or less. A patient shall not be considered a qualified terminally ill patient until a consulting physician has: examined that patient and the patient's relevant medical records; confirmed, in writing, the attending physician's diagnosis that the patient is terminally ill…

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Assisted Suicide – NJ Requirements

- …Verified that the patient is capable, is acting voluntarily, and has made an informed decision to request medication that, if prescribed, the patient may choose to self-administer.
- The attending physician has determined to be terminally ill as defined.
- Who has made an informed decision. This means a decision by a qualified terminally ill patient to request and obtain a prescription for medication that the patient may choose to self-administer to end the patient's life in a humane and dignified manner, which is based on an appreciation of the relevant facts and after being fully informed by the attending physician of...

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Assisted Suicide – NJ Requirements

- …after being fully informed by the attending physician of:
  - The patient's medical diagnosis.
  - The patient's prognosis.
  - The potential risks associated with taking the medication to be prescribed;
  - The probable result of taking the medication to be prescribed; and
  - The feasible alternatives to taking the medication, including, but not limited to, additional treatment opportunities, palliative care, comfort care, hospice care, and pain control.
- To obtain self-administered medication to terminate her life.

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Conclusion and Additional Information

2020 Planning and More

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Conclusion

- Many clients, even moderate wealth clients, could be planning aggressively now in advance of the 2020 election.
- Clients should not wait as starting the planning in 2019 gives more time and may negate step transaction and reciprocal trust doctrine challenges.
- Planning is similar to 2012 – use exemption, but with the high exemptions, preserving access to assets is more important then ever.
- Planning should consider the needs of our aging clients.

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