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SO MUCH GOING ON! NEW CASES, NEW IDEAS!

Summary: Lots of new tax developments that affect planning. New planning ideas to consider. And a bunch of oldies but goodies in the estate planning department many should be considering.

■ **Defined Value Mechanisms**: So, spilling over any "excess" from a defined value clause into a charity is perhaps the best approach. But what if you want to cap what goes to charity? Some folks like spilling over into a GRAT 'cause its sanctioned by the Regs. Some worry that a GRAT might raise issues as to when the spill over was funded, if the annuity adjustment in the Regs apply, etc. Other folks think an incomplete gift trust is the cat's meow. Well, why not double your pleasure and double your fun, just like Doublemint gum and combine the techniques with any portion spilled into a GRAT that creates a gift tax cost above a specified amount pouring into an incomplete gift trust?

■ **199A and Real Estate**: 199A is that magical new Code provision that might give you a 20% income tax deduction. That's big. For real estate to benefit it must qualify as a "trade or business" under new safe harbors. Landlords should keep diaries of services they provide to their tenants. When a contractor is hired, landlords should require the vendor indicate not just the price, but also the hours worked thereby forming a record to corroborate the hours towards the landlord meeting the 250 safe-harbor hours. Time spent on an improvement appears to be excluded from the 250-hour safe harbor count. How can one differentiate an improvement from a repair, the time for which would appear to count towards the 250-hour safe harbor? How much patching of a parking lot may occur before it is equivalent to a capital improvement? Landlords should reserve some services and expenses when negotiating leases to meet the 199A requirements. Taking a higher rent but retaining the burden of some expenses may be preferable for meeting the trade or business test. Consider maintaining a diary of each activity done. It might be better to engage in different activities on different days to increase the days for which entries are made to enhance the appearance of continuous involvement. Corroboration will be important. Perhaps a landlord should visit the rental property monthly or quarterly and take videos of the property to corroborate the site visit and review. The Final Regs suggest that travel to and from the property are not counted. Separate books and bank accounts are advisable. Using a single management LLC to incur and handle all maintenance and administrative costs, using one bank account to minimize paperwork, etc. might no longer be optimal.

■ **199A and S Corporations**: 199A includes a 50% of wages (or 25% of wages and 2.5% of UBIA) test. This has resulted in some taxpayers restructuring business operations as S corps to enhance their Section 199A benefit. The definition of W-2 wages includes amounts paid to officers of an S corporation, so some think S corp status may be better to goose-up their 199A deduction. However, amounts paid as W-2 wages to an S corporation shareholder cannot be included in the recipient's qualified business income (QBI). This should all be considered in the analysis of any estate plan. Do current estate plans include trusts which meet the requirements to own S corporation stock? Do the planning documents include appropriate S corporation provisions for QSSTs and/or ESBTs? Have buy-sell agreements been updated? Don't overlook the myriad of ripple effects that changing one component of your plan (e.g. an LLC to an S corporation) can have on other aspects of your planning (e.g. trusts).

■ **Elder Financial Abuse**: It's dramatically underreported according to a new study. Instead of the 200,000 cases of elder financial abuse that are reported annually to U.S. authorities, the actual number may be as high as 5 million, with losses of $27.4 billion a year, not the $1.17 billion that

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CHECKLIST: KAESTNER

Summary: The US Supreme Court, on 6/21/19 held in North Carolina Dept. of Rev v. Kaestner 1992 Family Trust, that NC violated the 14th Amendment's Due Process Clause by taxing trust income that had not been distributed to NC beneficiaries solely on the basis that those beneficiaries lived in NC. While the Court's holding is narrow, the implications to trust planning are wide-ranging.

√ If you have trusts in North Carolina (or states with similar law) that may have overpaid state income tax, call your CPA and file a refund claim.

√ Call your estate planning attorney, and if you have an institutional trustee, your trust officer, and review what you might do to improve an existing trust to strengthen a position that tax is not due to a particular state. In many cases, trust situs can be moved, trustees replaced, existing trusts merged (decanted) into new trusts with better provisions to avoid state income tax.

√ Some commentators are now pushing using non-grantor trusts to avoid high state income tax (e.g. you live in NY and set up a non-grantor trust in DE that avoids NY income tax on trust investment income). That can be great and deserves more attention. But think through the pros/cons carefully. For some, a grantor trust may be

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So Much Going On! New Cases, New Ideas!

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is officially reported. That is HUGE! And suggests that most financial and estate planning misses the point. Protecting those with health challenges and the difficulties of aging should be at the core of every plan. It's not because talking about GST tax minimization is just sexier (really?). Professional advisers in all the allied professions need to make later life planning including safeguards to minimize the risks of elder financial abuse, a standard part of the planning process. 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 to a durable power and all other aspects of the plan? What type of monitoring external to the documents can be created for you? Might a revocable trust with a trust protector and co-trustees provide a better set of checks and balances? A planning team of independent experts can provide additional checks and balances, but that doesn't happen often enough because too many advisers focus on being the big cheese of the plan and not doing what is best for the client they are serving. Consumers need to insist on collaboration! As but one example, financial advisers can restrict distributions from accounts if they have a reasonable belief that the client/ account owner is being subjected to financial exploitation under FINRA Rule 2165. The 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. But consumers need to work with advisers, consolidate assets with one or two firms, and then develop a close enough relationship with a financial professional to help.

■ **Assisted Suicide**: New Jersey and Maine recently enacted right to die (assisted suicide) legislation becoming the 8th and 9th states to permit this (California, Colorado, Oregon, Montana, Vermont, and Washington, also do). Be sure your health care related documents address your wishes in this regard. If you have a terminal diagnosis and might consider this option, you have to act. All states that permit this have safeguards to prevent abuse. You have to be a resident of a state that sanctions the right to die. You have to be mentally capable of making health care decisions and communicating them. You have to be 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 physician has to examine you and your relevant medical records and confirm the diagnosis and that you are acting voluntarily, and have made an informed decision.

■ **IRA Division**: An estate was the sole beneficiary of an IRA. The IRA was divided, through a trustee-to-trustee transfer, into inherited IRAs for each beneficiary. The IRS held that this did not result in taxable distributions. The beneficiaries were permitted to take required minimum distributions (RMDs) from each of their inherited IRAs which could be determined independently of the RMDs of the other beneficiaries. The division of the IRA was not a transfer under Code Sec. 691(a)(2) causing recognition of the income in the accounts. LTR 201909003

■ **IRA Disclaimers and Rollover**: A surviving spouse will be treated as having acquired an IRA directly from the deceased spouse, not from the estate or testamentary trust. The testamentary trust was designated as the beneficiary of an IRA. The trustee disclaimed and the IRA passed to the decedent's estate. The decedent's child and several grandchildren all disclaimed their interests in the IRA. The net result was that the surviving spouse inherited the IRA as the beneficiary of the estate. The surviving spouse was permitted to rollover the IRA to an IRA established and maintained in her own name. LTR 201901005. If an IRA beneficiary designation is not set up optimally this Ruling suggests the flexibility that might be available to correct it.

■ **2020**: Electioneering is in full swing. While my Crystal ball is too cracked to make political predictions the tone of the Democratic Presidential hopefuls is pretty clear: "Tax the rich folk." Universal health care, student debt relief, and more will require new tax dollars. Higher income and estate taxes on the wealthy are a prime source. Also, the concerns over wealth concentration are growing. So, if you have even moderate wealth, what are you waiting for? Get your planning into full swing before tax-swinging is legislated away. And do it prudently in ways that you can still access funds you need. If you are more of the Richie Rich type then dive in and swim fast as this may be the last planning opportunity to move large wealth. PP

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Checklist: Kaestner: State Taxation of Trusts

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a better overall option even if it means paying current state income tax. Don't just grab the latest hot tax tip. Make sure it's hot for you.

√ In Kaestner, the residence of individual trustees was a crucial factor. No trustee lived in NC. This suggests the benefit of using an institutional trustee based in a tax-friendly jurisdiction. That is an important planning step that too often is not used as those creating trusts tend to often name family members as trustees. The drawback of that is family members named may live in a taxing state. It may prove much less costly to name an institutional trustee in a no tax state (and no presence in a taxing state) and pay their annual fee. √ What does this mean in terms of other trust positions? What of a trust protector? Trust investment director? Various power holders? All of these positions, if the individuals named reside in a taxing state, might taint the trust as subject to that state's tax system? So, consider where the person you name as a trust protector, etc. resides. Perhaps a trust protector should act in a non-fiduciary capacity and/or reside in a state without a state income tax. Another option might be for the trust to name an entity, e.g. a limited liability company (LLC) formed in a tax friendly state (presumably the same tax friendly state where the trust is based) as trust protector (or investment advisor, etc.) and have the individual desired to provide services as a manager of that LLC. Might that suffice to prevent a high tax state from taxing the trust? If you think your trust now or in the future might avoid state income tax, meet with your estate planner and reconsider all these positions.

√ The physical location of trust records in Kaestner was in New York, not in NC. Where are your trust records kept? In a digital age, how relevant will the location of physical records be when most if not all records might consist of cloud based digital records? Will moving all records to the cloud solve the issue?

√ The trust should not have any direct investments in the taxing state. Might this suggest that any, even insignificant, investment in the taxing state might taint the entire trust? Might those administering trusts be advised to divide the trust with one component trust holding any investments in the state, and all other investments being bifurcated in a separate trust? 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 your trust try to divide 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 solution.

√ The trust should not own real property in the taxing jurisdiction. What if the real property is held in an entity, such as a limited liability company or other disregarded entity, that would characterize the property as an intangible asset. Consider segregating real property in a taxing state in a separate trust.

√ The Kaestner Court noted that the trust did not terminate at a specified age distributing corpus to the beneficiary in the state in question. If your trust does, decant, which is what the Kaestner family did. If the trust distributes at age 25 all assets to the beneficiary, would that suffice to permit the state to tax the trust? What if the beneficiary is 1 year old and the trust distributed at age 75? Would that suffice for tax nexus? Although this is all unclear the more modern way to draft many trusts as long term or even perpetual is certainly a safer option not only for state income tax, but for estate tax minimization and asset protection as well. PP

Recent Developments

■ Decanting: Merging or decanting an old trust into a new and improved trust has become so popular that some have pushed the edges seeking to expand the scope of what is possible. In a recent case, a trustee tried to decant half of a trust's assets from the existing charitable trust into a new one. The Court denied the decanting because the trust instrument required a unanimous vote of the trustees to make a distribution. Only one of the two co-trustees wanted to decant ½ of the trust into the new trust. That new post-decanting trust would continue the purpose of the transferor trust but with just one trustee as the sole trustee. The old trust would retain ½ of the assets and have the other co-trustee solely in charge. The court determined that the requirement in the governing instrument for both trustees to agree had to be met. In the Matter of the Fund for the Encouragement of Self Reliance, An Irrevocable Trust, 135 Nev. Adv. Op. No. __ (March 21, 2019).

■ Gift Tax Claim for Refund: A taxpayer can file a protective claim for a refund for gift taxes. While the gift tax law does not permit filing a protective refund claim. it does not prohibit such a filing. Therefore, the IRS saw no basis to deny such a filing. CCA 201906006.

■ GST Allocation: A taxpayer can allocate increased GST exemption to modify the inclusion ratio of a trust created in a prior year. Joint Committee on Taxation's Blue Book for the Tax Cuts and Jobs Act Footnote 372, p. 89. In another GST matter the IRS provided leniency to a taxpayer by granting an extension of time to opt out of the GST automatic allocation rules. Specifically, the decedent's spouse was granted a 120 day extension of time to elect under Code Sec. 2632(c)(5) out of the GST automatic allocation rules for gifts made in 17 prior years. If you've made transfers to trusts that inadvertently failed to opt out of the automatic GST allocations this ruling might provide a template to correct the situation. PLR 201903006.

■ Loans: Would a LLC be entitled to claim a deduction for a worthless debt? The court found that the indebtedness was bona fide. The existence of a bona fide debt is a critical issue in many estate planning transactions. 2590 Associates, LLC. PP

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■ Breast Cancer: About 12.8% of women will be diagnosed with breast cancer at some point during their lifetime. Female breast cancer is most frequently diagnosed among women aged 55-64. A diagnosis of breast cancer will affect every aspect of your life, not just health issues. It will affect finances, life expectancy, insurance coverage and estate planning. Will your health insurance cover most or only some of the treatment costs? Who will assist you with all of the paperwork, forms, and insurance documentation? Can you afford a care manager to assist you? Will your spouse, partner, or other family caregiver be willing to permit a care manager to assist, or will he view it as his responsibility or domain to handle these matters? Your cancer journey may necessitate rethinking budgets, revising financial forecasts, curtailing spending and certainly annual gift program to children, and other steps. These financial challenges may serve to exacerbate the insecurities and angst you are already feeling from the medical challenges. Deferring addressing these issues, however, may only serve to draw out the angst that a revised and viable financial plan might alleviate. If you have not had a diagnosis, plan comprehensively now. If you have had any type of negative medical diagnosis, don't put off addressing planning. It is certainly not something you want to devote energy and effort to, but not doing so will be worse.

■ Insurance Trusts: The Sanders tax proposal calls for limiting tax-free annual gifts to a mere $20,000 per donor (it's now $15,000 per donee). While that is unlikely to be enacted with Trump White House or Republican Senate, if the Dems take over at some point this type of change might be enacted. Limiting annual exclusion gifts this severely will hinder funding life insurance plans and insurance trusts. Consider prefunding insurance plans/trusts now. Consider modifying gift provisions in durable powers of attorney to permit funding historic gifts to insurance trusts even if it exceeds the annual exclusion. Most powers limit gifts to the annual exclusion amount and that would likely prevent an agent from continuing to fund an existing insurance plan.

■ Longevity: 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 the implications!!! PP

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