"Tax Reform"

Or How We Got To Where We Are And Where to Go From Here

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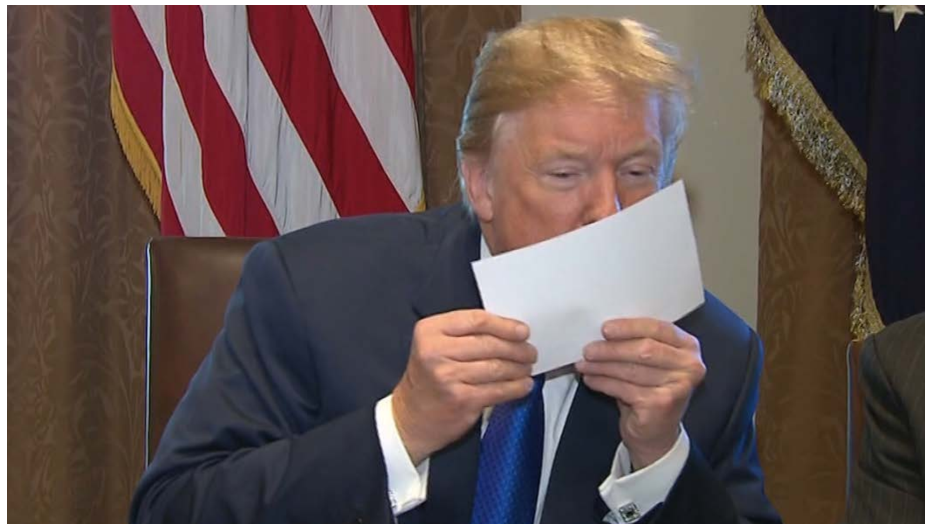
WHEW! WHAT A RIDE!

How did we get here?

The Goals: Reform, Simplify, and Cut



The Mechanism: Budget Reconciliation

The Timing: Approximately 7 Weeks!

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WHEW! WHAT A RIDE!

The Results Are In…

The Goals: Reform, Simplify, and Cut

- Reform-ish: Nearly all taxes affecting individuals are set to expire; "reform" may be short-lived because of lack of bipartisanship
- Simplify: Same number of brackets; incredibly complex pass-through entity rules; expiration dates; bizarre alimony rules; AMT still exists (!); the rush to push through the legislation will likely leave practitioners with unanticipated consequences
- Cut: For some but not all and may depend on where you live; net investment income tax lives on; capital gains taxes remain the same; the estate tax lives to see another day

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Overview of a Few of the BIG Changes

- New Rates and brackets (including for trusts)
- Nearly doubled standard deduction (elimination of personal exemptions)
- Chained CPI as measure of inflation
- SALT Deduction Limited to $10,000
- Elimination of Pease Limitation
- Mortgage Interest deductible at reduced levels
- Many deductions eliminated
- AMT remains but increased exemption and phase-out amounts
- Charitable contribution % limit for cash to public charities increased to 60%
- Gift, Estate, and GST Exemption amounts nearly doubled
- Changes to alimony income and deductibility
- Pass-through entity deduction
- Lower corporate tax rate and elimination of corporate AMT
- New Repatriation Rules
- Repeal of Obamacare Individual Mandate

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Trusts and Estates: the Same, but Different

What Did *NOT* Change under the Tax Cuts and Jobs Act

- §1014 remains unchanged
- Grantor-retained annuity trusts (GRATs)
- Qualified Personal Residence Trusts (QPRTs)
- Charitable Trusts
- Life Insurance Trusts and/or Crummey Trusts
- Annual Exclusion Gifts (now $15,000/individual/year)
- State Estate or State Gift Tax Regimes
- Discounts associated with lack of control or marketability
- Tax-free payments of tuition and/or medical expenses

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Trusts and Estates: The Same, but Different

New §2010

2010 Basic Exclusion Amount

PART VI—INCREASE IN ESTATE AND GIFT TAX EXEMPTION

SEC. 11061. INCREASE IN ESTATE AND GIFT TAX EXEMPTION.

(a) IN GENERAL.—Section 2010(c)(3) is amended by adding at the end the following new subparagraph:

"(C) INCREASE IN BASIC EXCLUSION AMOUNT.—In the case of estates of decedents dying or gifts made after December 31, 2017, and before January 1, 2026, subparagraph (A) shall be applied by substituting '$10,000,000' for '$5,000,000'.".

- Sunsets on December 31, 2025
- Inflation adjustments set to new chained CPI

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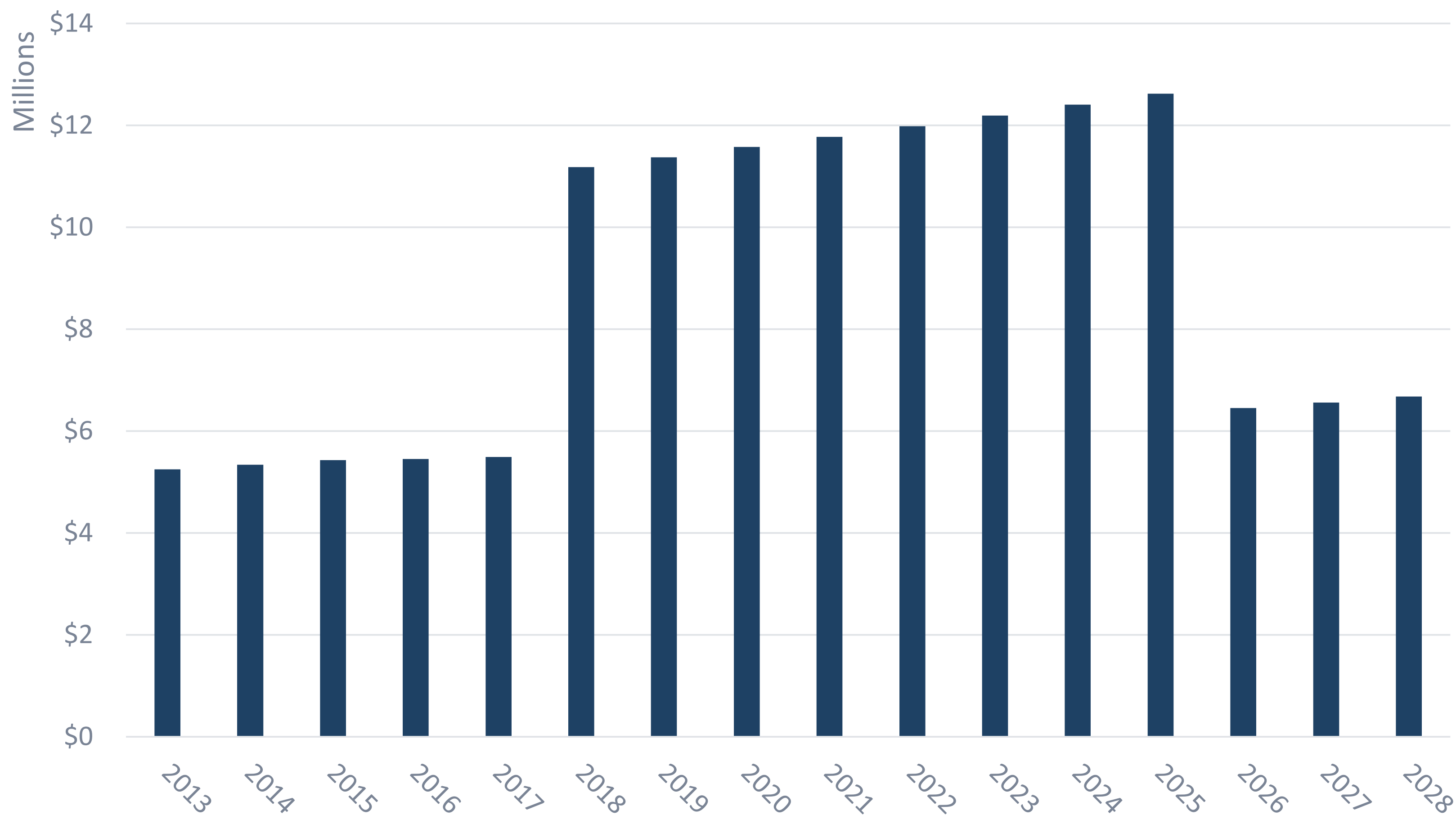
Exclusion Amounts

Where They’ve Been and Where They’re Going



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"OK, so we no longer need your services, right?"

WRONG: Trust advantages still remain

- Appropriate management of assets
- Providing limitations on how assets can be used for beneficiaries
- Protect trust assets from claims of beneficiaries' creditors
- Protect assets from claims of divorcing spouses or ex-spouses of beneficiaries
- Potential state estate transfer tax savings
- Potential state income tax savings

And don't forget that these exemption amounts expire at the end of 2025, and the exemption amounts will decrease significantly then, if not before then by a new administration, so unless the client has a crystal ball and knows when they'll die, plan now.

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Do Our Old Documents Still Suffice?

Existing Wills/Revocable Trust Formula Problems

- Our most common formula – one that distributes client's remaining exemption to a credit shelter trust for the benefit of spouse and descendants – may no longer meet the client's wishes
- GST formula problems may arise

EXAMPLE

When the GST exemption was $5 million, Lyla created a new revocable trust that allocated her remaining GST exemption to a trust for the benefit of her grandchildren in a GST-exempt trust; the balance was used to create a non-exempt trust for the benefit of her children. At Lyla's death when the exemption is $12 million, her net estate is valued at $15 million. The result leaves $3 million to benefit her children and $12 million to benefit her grandchildren, a result she would likely find displeasing.

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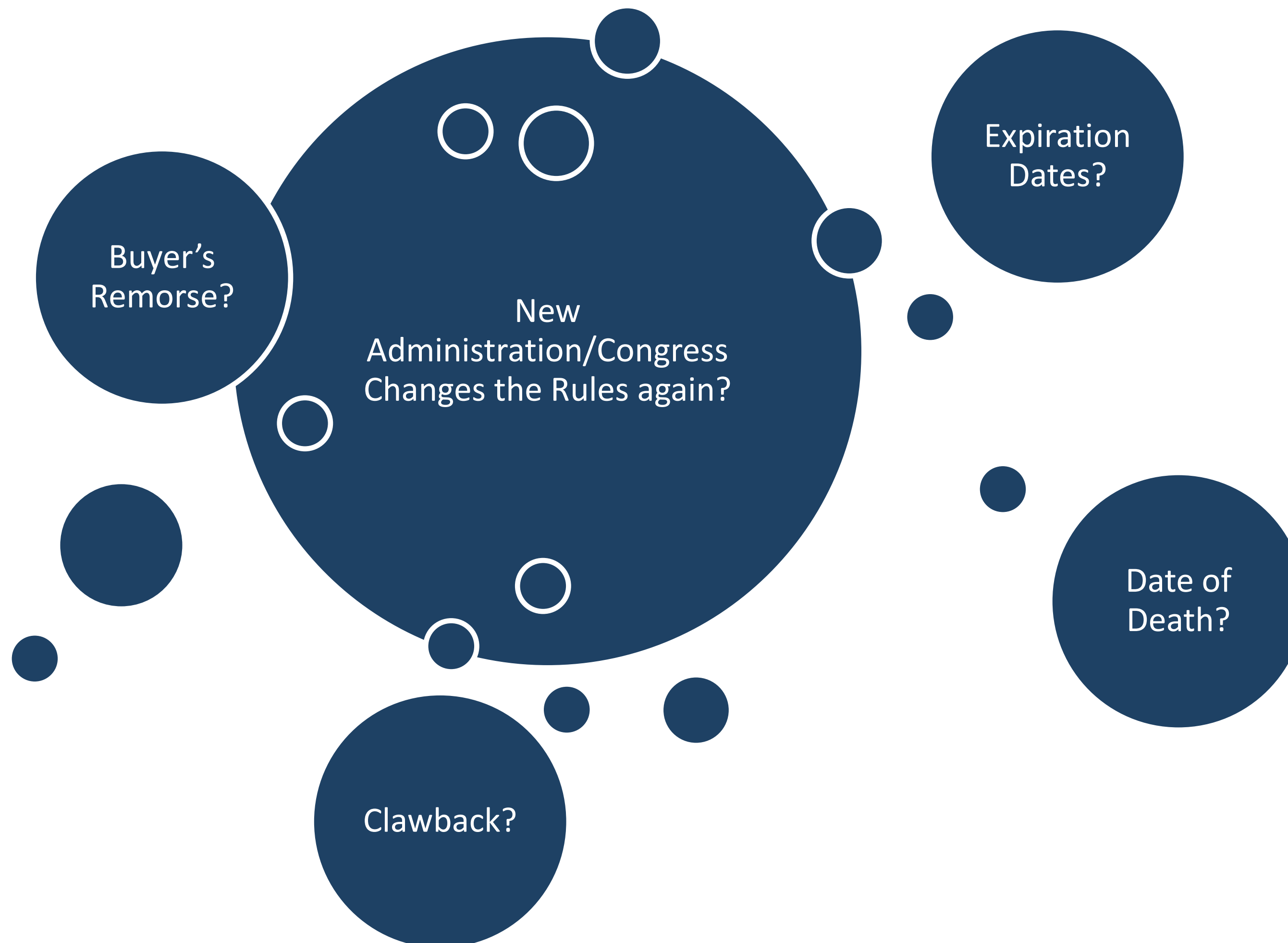
Planning with the New Exemptions

Flexibility is Key

"The one unchangeable certainty is that nothing is unchangeable or certain." – John F. Kennedy



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Planning with the New Exemptions

Flexibility is Key

- Nontaxable Powers of Appointment
- Broad distribution standards by independent trustees
- Substitution powers to settlor
- Basis adjustment planning
  - Giving nonfiduciary power to include POA to grantor to cause inclusion under §2036(a)(2) and 2038
  - Nonfiduciary grant GPOA to beneficiary
- Trust Protector Adding Grantor as Beneficiary
- Spousal Lifetime Access Trusts (SLATs)

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Planning with the New Exemptions

Non-reciprocal SLATs for potential "buyer's remorse"

- Both spouses may create "non-reciprocal" trusts that each name the other as a discretionary beneficiary along with descendants
  - Trusts should have sufficient differences to avoid reciprocal trust doctrine
- Original settlor could even become a discretionary beneficiary if the spouse predeceases as long as the settlor's creditors could not reach the trust assets under applicable state law
  - Only if domestic asset protection laws apply to trust or if state spendthrift trust law protects against settlor's creditors in "surviving scenario"
  - May mean choosing another jurisdiction with significant connection to trust, but risk whether domicile state would apply public policy exception to choice of law provision in trust agreement
- Should the trusts be grantor or non-grantor trusts?
- Generally useful for long-term, stable marriages
- May consider additional life insurance to protect against loss of income when beneficiary spouse dies
- Query whether non-grantor SLATs could be beneficial in new income tax environment

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Planning with the New Exemptions

Portability Takes a Front Seat

- If the first spouse dies before 2026 (or before a new administration changes the laws again), making the portability election should leave the surviving spouse with a DSUE amount of the higher exemption amounts, even if the basic exclusion amount decreases in 2026 (or before)

Treas. Reg. § 20.2010-2(c) Computation Of The DSUE Amount—

> **Treas. Reg. § 20.2010-2(c)(1) General Rule.** — Subject to paragraphs (c)(2) through (4) of this section, the DSUE amount of a decedent with a surviving spouse is the lesser of the following amounts—
>
> > **Treas. Reg. § 20.2010-2(c)(1)(i)** — The basic exclusion amount in effect in the year of the death of the decedent; or
> >
> > **Treas. Reg. § 20.2010-2(c)(1)(ii)** — The excess of—
> >
> > > **Treas. Reg. § 20.2010-2(c)(1)(ii)(A)** — The decedent's applicable exclusion amount; over
> > >
> > > **Treas. Reg. § 20.2010-2(c)(1)(ii)(B)** — The sum of the amount of the taxable estate and the amount of the adjusted taxable gifts of the decedent, which together is the amount on which the tentative tax on the decedent's estate is determined under **section 2001(b)(1)**.

- Example: Husband and Wife have made no prior gifts when husband dies in 2025 when the exemption is $12 million per individual. Exemption amount decreases per sunset provisions in 2026 to $6 million. Wife has DSUE amount of $12 million.

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Portability Takes a Front Seat

- Unless strong reasons for using a credit shelter trust for smaller estates exists, portability will be increasingly helpful.
- Portability has distinct tax advantages
  - Surviving spouse may use both spouses' exclusions against her estate
  - Basis step-up achieved at both spouses' deaths
- Flexibility remains important, since consideration to create a bypass trust following the first spouse's death can be delayed until after he or she has died using a disclaimer approach or a QTIPable trust.
  - Disclaimer: first decedent spouse's assets left outright to surviving spouse with disclaimer causing disclaimed assets to pass into trust with spouse (and others) as discretionary beneficiaries
  - QTIPable Trust: executor has up to 15 months to decide whether to make the election and over what portion of the trust
- Reasons to favor credit shelter trust remain
  - Likelihood of significant possibility of substantial appreciation of assets after first spouse's death
  - A state estate tax
  - Younger client scenario where remarriage of surviving spouse likely
  - Various non-tax reasons (e.g. blended family)

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Planning with the New Exemptions

GST Tax Planning Considerations

- Though not specifically stated in the Tax Cuts and Jobs Act, the GST exemption amount has nearly doubled, as well

I.R.C. § 2631(c)

GST Exemption Amount — For purposes of subsection **(a)**, the GST exemption amount for any calendar year shall be equal to the basic exclusion amount under section **2010(c)** for such calendar year.

- Prudent to use it before we lose it!
  - Consider allocating GST exemption to currently funded non-exempt trusts
  - Consider making distributions from non-exempt trusts to exempt trusts
  - Consider making late allocation of GST exemption to preserve benefit of higher exemption amount
  - Consider making distributions to skip persons from non-exempt trusts if needed

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Planning with the New Exemptions

Typical Planning Calculus May Change

- Annual Exclusion Gifts: Still a powerful planning tool, but the cost and bother of annual exclusion and Crummey Trusts may prove to no longer be worthwhile
- GRATs: larger exemption may mean that many clients, particularly more moderate wealth clients, may forego the hassle of this technique and simply make gifts to irrevocable trusts instead
  - Eliminates mortality risks associated with GRATs as well
  - Same may be true of other 2702 exception trusts, such as QPRTs
- Life insurance to pay an estate tax will be less relevant for many clients, at least for the next eight years
- Basis Planning will continue to play an increasingly prevalent role in planning

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Planning with the New Exemptions

New Gifting Opportunities

- Gifts to dynasty trusts to utilize higher exemptions
- Making late allocation of GST exemption to previously created trust
- Forgiveness of outstanding intrafamily loans
- Equalizing gifts
- Gifts to avoid Crummey hassle

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Planning with the New Exemptions

Income Tax Issues Become Magnified

- With an expected 1000 estate tax returns being filed in 2018, estate tax efficiency will likely become less important than income tax savings for many clients.
- Fortunately, section 1014 was unaffected by the Tax Cuts and Jobs Act, so achieving a step-up in basis will be crucial for most clients.

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Planning with the New Exemptions

Income Tax Issues

EXAMPLE

Atlas has a total estate of $5,000,000 and wishes to make a taxable gift of $1,000,000 to a trust f/b/o his children and grandchildren this year. Assume that the basis of the asset Atlas wants to gift is $500,000. Assume the asset appreciates to $2,000,000 by the time of Atlas's death and that his estate increases to $8,000,000 when the estate tax exemption is $12,000,000.

	NO GIFT	$1,000,000 GIFT
FMV of estate at death	$10,000,000	$8,000,000
Taxable estate	$0	$0
Capital gain if sold	$0	$1,500,000
Tax Paid	$0	$357,000

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Planning with the New Exemptions

Income Tax Issues

- For clients below the exemption amount, our most obvious planning tool – to get assets out of the estate ASAP – might not be so obvious anymore
- There may be more of a benefit to holding onto an asset until death than to gift it during life with the following considerations:
  - Cost basis as a percentage of FMV at the time of the gift of an asset will have a critical impact on whether to make gifts
  - Appreciation assumptions will also be important
  - GST considerations add a new variable to the calculations
  - Valuation discounts may affect the calculation
  - The exemption may decrease in 2026 or before, which could change the calculation

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Planning with the New Exemptions

Income Tax Issues

100% to Surviving Spouse

- Achieves step-up at first and second to die; spouse controls property; IRA benefits
- But first spouse's DSUE will not capture appreciation; GST exemption does not "port"

100% to Bypass Trust

- Growth exempt from estate tax; GST exemption preserved
- But no step-up at second death; income tax at trust level; IRA downsides

100% to Bypass Trust with Contingent GPOA

- Growth exempt from estate tax; step-up at second death can be achieved; GST preserved
- But income tax at trust level; IRA downsides

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Planning with the New Exemptions

Income Tax Issues

What about what to do with existing trusts that did not plan for income tax efficiency?

EXAMPLE: Decant (applicable for trusts in states with ability to decant)

After husband died in 2018 in Ohio, his entire estate – worth $5,000,000 – was transferred, pursuant to his will, to a credit shelter trust f/b/o his wife. In 2024, when the exemption is $12,000,000, the CST is valued at $10,000,000, having a built-in capital gain of $5,000,000. Wife's estate is currently valued below the exemption. If the CST is decanted into a new trust that gives the wife a GPOA over the trust assets, the CST will be includible in her estate and thus will receive a step-up in basis at her death, saving over $1,000,000 in taxes.

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Planning with the New Exemptions

Income Tax Issues

Tricky Drafting Suggestions

- **Basis adjustment for the settlor**: should we allow an independent third party authority to grand a power to settlor to cause estate inclusion (e.g. testamentary limited POA)?
  - Settlor could potentially be treated as having the power even if never granted
  - §2036 could arguably be applied for settlor retaining power to designate who can enjoy property
  - Remember that §2036 applies regardless of whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death
- **Basis adjustment for beneficiary**: should we allow an independent third party to grant a GPOA to a beneficiary to cause estate inclusion in his or her estate?
  - Is a duty to monitor created for the third party?
  - If the third party is non-adverse, the beneficiary might be treated as holding a GPOA whether the third party grants it or not
  - There may be creditor issues to extent that GPOA are exercised

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Planning with the New Exemptions

Income Tax Issues

Gifting Up

EXAMPLE

Madge has 1,000 shares of highly appreciated Amazon stock (valued at approximately $1.3 million). Madge's mother, Birtha, is 82 years old and will not have a taxable estate. With the new exemptions, Madge decides to gift the 1,000 shares to her mother, agreeing with her that the shares will be returned to her in Birtha's estate planning documents. Birtha dies three years later when the shares are valued at $1.8 million, and pursuant to her will, the shares are distributed back to Madge with a new basis equal to the fair market value. If Birtha's documents provided that the shares be distributed to a trust f/b/o Madge, the shares could be excluded from Madge's estate.

What if Birtha had died 11 months after the gift? §1014(e) would deny the step-up.

What if Madge had made the gift to a grandparent instead of a parent? §2613 defines "skip person" as a "natural person assigned to a generation which is 2 or more generations **_below_** the generation assignment of the transferor."

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Planning with the New Exemptions

Is Clawback a Real Risk?

- What happens when a client uses the higher exemption amounts prior to the sunset in 2026?

> "(2) MODIFICATIONS TO ESTATE TAX PAYABLE TO REFLECT DIFFERENT BASIC EXCLUSION AMOUNTS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between—
>
> "(A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and
>
> "(B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent.".

- In the history of the estate tax, the exemption amount has never decreased!
- What are we left to tell our clients?

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Miscellaneous Considerations

- Domicile: should clients finally consider a move to a non-income tax state?
- Matrimonial Matters: Starting in 2019, alimony is no longer deductible or taxable…but oddly, only for seven years before the new law sunsets
- 67(e) Deductions: 67(g) – the provision allowing for miscellaneous itemized deductions – was temporarily eliminated in the Tax Cuts and Jobs Act; there is an argument that trustee fees in 67(e) are not "itemized deductions" in the first place and are therefore not subject to the suspension in the Act.
  - Section 63 defines "itemized deductions" as deductions allowable under this chapter other than deductions allowable in arriving at adjusted gross income…
  - Miscellaneous itemized deductions are defined as itemized deductions other than deductions relating to interest and taxes
  - Trustee fees are mentioned in section 67, but because they are deducted from income to arrive at AGI, they do not meet the definition of itemized deductions and therefore cannot be miscellaneous itemized deductions subject to the suspension under the Act
  - The ABA has contacted Treasury regarding this issue; apparently guidance is "coming soon"

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Conclusion/Questions

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