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Steve Leimberg's Estate Planning
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Subject: Bob Keebler & Jim Magner - A First Look at Congress' Tax Reform Blueprint, What Advisors Need to Know Now to Better Inform Their Clients

*"The Unified Framework for Fixing Our Broken Tax Code was released on Wednesday, September 27th, and contains a number of items that are sure to be of keen interest to **LISI** members and their clients. This newsletter reviews many of the important issues facing advisors as they try to get up to speed and counsel clients in a timely manner.*

The one thing we'd like to leave members with is a sense of urgency. Even though some pundits discount the possibility, a bill could pass as early as December. Regardless of when something does pass, clients need to understand what's happening right now to be able to move like lightning when a tax bill is enacted. What we encourage advisors to do is consider the likely outcomes, what clients should do if those are the outcomes, and then develop lists of clients to speak with about specific issues. In many cases, there may not be enough time to learn the law, figure out how to react to it and then figure out which clients it applies to. In this very short window, it may be helpful to be in action mode now and ready to react."

Bob Keebler and **Jim Magner** provide members with their commentary on the Unified Framework for Fixing Our Broken Tax Code.

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Estate Planning Advisory Board. His practice includes family wealth transfer and preservation planning, charitable giving, retirement distribution planning, and estate administration. Mr. Keebler frequently represents clients before the National Office of the Internal Revenue Service (IRS) in the private letter ruling process and in estate, gift and income tax examinations and appeals. In the past 20 years, he has received over 250 favorable private letter rulings including several key rulings of "first impression." Mr. Keebler is nationally recognized as an expert in estate and retirement planning and works collaboratively with other experts on academic reviews and papers, and client matters. Mr. Keebler is the author of over 75 articles and columns and editor, author, or co-author of many books and treatises on wealth transfer and taxation, including the Warren, Gorham & Lamont of RIA treatise Esperti, Peterson and Keebler/Irrevocable Trusts: Analysis with Forms. Mr. Keebler is the Chair of the AICPA's Advanced Estate Planning Conference. He is a featured columnist for CCH's Taxes Magazine – "Family Tax Planning Forum," Bob is also a contributing author to the American Bar Association's The ABA Practical Guide to Estate Planning. Robert.Keebler@KeeblerandAssociates.com

Jim Magner is an advanced planning attorney at **The Guardian Life Insurance Company of America**.[i] Prior to joining Guardian, Jim was General Counsel for a broker dealer/brokerage general agency. Jim previously worked as an Attorney-Advisor in the IRS's Office of Chief Counsel in Washington, DC. While with the Office of Chief Counsel, Jim wrote private and public rulings on estate, gift, GST and charitable remainder trust issues. Jim's articles have appeared in such publications as Estate Planning, Tax Notes, the Journal of Financial Service Professionals and Steve Leimberg's newsletters. Jim has coauthored a number of books on estate and insurance planning topics, including Estate and Personal Financial Planning and Life Settlement Planning.

Here is their commentary:

EXECUTIVE SUMMARY:

The Unified Framework for Fixing our Broken Tax Code was released on Wednesday, September 27th, and contains a number of items that are sure to be of keen interest to **LISI** members and their clients. This newsletter reviews many of the important issues facing advisors as they try to get up to speed and counsel clients in a timely manner.

COMMENT:

Estate and GSTT Repeal

The Framework calls for the repeal of the estate and generation skipping transfer taxes,[ii] and if enacted would generate a plethora of issues and planning opportunities:

- **Client Longevity Assumptions Become Critical:** Because passage of a tax bill may require the use of the budget reconciliation process, repeal may last for only 10 years, although there was talk earlier in the year about extending the budget window to 20 or even 30 years.[iii] If you represent a 99-year old client who is in average health, that client might think that they will die within the 10-year window. However, if you represent that client's 75-year old daughter or their 55-year old granddaughter, they may be operating under the assumption that there is a greater likelihood that they will survive the 10-year window. So, in terms of long-term estate planning, the 10-year timeframe may or may not be significant, depending upon a client's assumptions about their longevity.

- **Liquidity Planning May Be Critical Even with Repeal:** It is interesting to recall that Candidate Trump ran on the elimination of the estate tax and no basis step-up for assets exceeding $10,000,000. While it's currently unclear whether the Administration supports an income tax recognition event at death or simply carryover basis, the implications are significant for liquidity planning.[iv] A forced recognition event like Canada's "deemed disposition" tax would require liquidity planning, but the current 40% estate tax would be replaced with a lower, as-yet to be determined capital gain rate. States that tax capital gains but do not have an estate tax would likely be eager to collect the additional revenue under a "deemed disposition" tax. Further complicating planning is the lack of specifics on exemptions that would be available should Congress opt for a forced recognition event at death.

- **9-Year GRATs:** GRATs that expire in nine years may become attractive. If the client dies in the GRAT's term, they may be able to get a step-up, and if they outlive the GRAT's term, the growth above the hurdle rate could be shifted downstream.[v]

- **Two-Path GRATs:** In the future, it may be advantageous to consider creating "Two Path" GRATs. One path would be triggered if the GST were in place where children would be given a standard General Power of Appointment, and the other path would be triggered if the GST is not in place, and the trust would benefit skip persons.

- **Dynasty Trust Planning:** There are many families whose sole goal is to pack as much into dynasty trusts as possible. If we wake up on January 1, 2018 to a world with no GST, dynasty trust planning could be an incredible opportunity for many advisors and their clients, especially if these trusts were grandfathered and the GST returns in 10 years.

Planning for the Elimination of Itemized Deductions

The Framework would eliminate most itemized deductions except for charitable and mortgage interest, and this could have a variety of impacts:

- **Impact on CPA and Tax Return Preparation Firms:** With a $24,000 standard deduction and limited itemized deductions, many taxpayers won't have to itemize and may no longer need tax return preparation services. This could put pressure on tax return preparers who operate "below" the CPA level, and they may try to move "up market" in a way that could put pressure on the services provided by CPA firms. When these proposals first came out, the valuations of national tax preparation stocks initially took a hit.[vi]

- **Planning Around the Section 691(c) IRD Deduction:** If itemized deductions are limited as described in the Framework, the Section 691(c) income tax deduction for estate tax paid on IRD items would be lost. If a client dies in 2018 and the estate tax has been repealed, this is totally irrelevant. On the other hand, this could be significant for clients who died in prior years who paid estate tax and may have hundreds of thousands of dollars of 691(c) deductions that would have been taken when the money comes out of an IRA and went to a designated beneficiary. The teaching point is that the 691(c) deduction might die on December 31, 2017, and there may be two possible plans of action: 1) continue the life expectancy distribution method and lose the 691(c) deduction or 2) take a 100% distribution in 2017 and utilize the 691(c) deduction while it's still available.

- **Incomplete Non-Grantor Trusts Could Take on Added Importance:** If clients are no longer allowed to deduct state income taxes, there will be an increased interest in incomplete non-grantor trusts, aka DINGs, WINGs, SINGs and NINGs. For clients in states that do not have so-called "long arm" statutes, avoiding state income taxes could be very attractive.[vii]

- **Deductibility of Common Estate Administration Fees:** While some in the press have focused on how the loss of itemized deductions could disproportionately impact taxpayers in so-called "Blue" as opposed to "Red" states, the impact could be significant in the world of trusts and estates. For example, the legal, appraisal, executor and accounting fees that are incurred in the typical estate administration could be lost.

AMT Repeal

The Framework calls for the alternative minimum tax (AMT) to be repealed, and there could be significant issues planners have to deal with in a very short window:

- **ISOs, the Loss of AMT Carry-Forwards & Executives in Black Out:** Some clients have AMT credit carryforwards, and those carry-forwards could evaporate in the final statutory language. Clients who exercised Incentive Stock Options in prior years are a prime example of taxpayers who may have AMT carryforwards, and if the AMT is eliminated, their carryforwards might be lost. When these executives sell post-exercise, they may have to pay income tax but may not be able to get a credit. More importantly, some executives may be in blackout periods in the last quarter of 2017 and may not be able to sell, which puts a premium on planning sooner than later.

Changes to IRAs and Qualified Retirement Plans

- **Watch for a Five-Year Distribution Rule:** Although this wasn't mentioned in the Framework, one thing the Senate has considered is a five-year distribution rule. By way of example, this would mean that when someone dies with IRAs worth more than a certain dollar threshold, everything would have to come out of the IRA within five years. If enacted, this would eliminate the "Stretch-IRA" planning technique that has become popular with so many planners.

- **Rothification:** The concept of "Rothification" (i.e., the compulsory conversion of some or all traditional defined-contribution plans to Roth-like plans) made headlines this summer.[viii] Although this wasn't explicitly mentioned in the Framework, it bears watching as the debate unfolds because Rothification has been touted as a "pay-for" for rate reduction and simplification.

Impact of Lower Individual Income Tax Brackets

Under current law, taxable income is subject to seven tax brackets, and the Framework would consolidate the seven bracket system into three brackets of 12%, 25% and 35%:

- **Timing of Gains and Losses:** Regarding the timing of gains and losses, the smart approach may be to accelerate losses and, depending on the long-term capital gain tax rate we get under the revised law, defer gains. The same may hold true for ordinary income items.

- **Accelerating SALT Deductions:** With regard to the SALT deduction, it may be smart to run the numbers both ways, because accelerating state and local tax payments can put clients into the alternative minimum tax. Under current law state income taxes that were deducted in the prior year are taxable income in the current year if refunded, and the Framework does not mention how that would unfold if the SALT deduction is eliminated.

- **Fiduciary Income Tax Planning:** For advisors who have clients that have passed away since January 1, 2017, at some point in time a decision will need to be made on the selection of a year end. If we start with a cutoff of January 1, 2018, that would tell most of us that we want to be on the other side of that line. There's a discussion in the Framework that there might be a higher tax rate than 35 percent for wealthy Americans, i.e., the so-called Buffet Rule.[ix] Historically, attempts to disproportionately tax high income earners have included trusts in the definition of a wealthy person, and a trust might suffer that rate. For fiduciary tax planning purposes, we could be looking at vanishing itemized deductions, which might suggest implementing a November 30th year-end where December 1st would start a new year. In that event, the idea would be to deduct expenses from December 1, 2017 through November 30, 2018.

- **Interest Carry-Forward Anomalies:** Another anomaly the Framework creates is with the investment interest expense deduction carryforward. In any year, you cannot deduct more in investment interest than you earned in investment income. However, you can carry-forward your "disallowed" investment interest to the next year. If interest becomes non-deductible in the future, that carry-forward amount will likely evaporate. But this presents a planning opportunity in 2017 to generate additional investment income to absorb the investment interest deduction before 2018. By way of example, if a client has $200,000-$300,000 in investment interest carry-forwards, they could potentially realize two or three hundred thousand dollars of investment income, to offset their carry-forwards. Advisors should factor in the 3.8% net investment income tax (wherever that ends up) when determining whether accelerating investment income makes sense or not. In the end, timely planning could save some clients thousands of dollars.

- **Planning for Charitable Contributions:** Clients may want to consider setting up Donor Advised Funds in case charitable deductions are more attractive this year than next year. A decision to fund those DAFs can be made in November and December as more details become known.

- **Education Planning & 529 Plans:** If 529 plans are eliminated and December 2017 is the last time clients can fund those plans, it puts pressure on the decision-making process, especially with regard to whether those plans will be grandfathered.

Impact of C Corporation Rate Reductions

The Framework would reduce the top corporate tax rate to 20%, which will likely trigger intense choice of entity and tax election conversations between clients and their advisors. This is especially true given that the framework also limits the maximum tax rate applied to the business income of “small and family owned businesses” (defined in the Framework as sole proprietorships, partnerships and S corporations) to 25%. The Framework also “contemplates that the committees will adopt measures to prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate.”

- **Business Entity Reclassification:** Going from a 39.6% rate to a 25% rate will represent a major savings for many clients that operate as pass-throughs, and from a practical standpoint, restructurings may have to be done in December and some of them may have to be in place in January. Don’t be surprised if some of the language in Section 1202 dealing with “qualified trade or businesses” is incorporated into the final bill to determine where the bright line works to “…prevent the recharacterization of personal income into business income to prevent wealthy individuals from avoiding the top personal tax rate.”[x]

- **Split Dollar:** A rule of thumb in the field of life insurance planning says that to maximize leverage, find the lowest tax bracket and buy your insurance at that tax bracket. Split dollar can remove equity out of business while minimizing the current income tax consequences to the participant, and a reduction of the top corporate rate would make split dollar arrangements more attractive for many clients.

Immediate Expensing of Capital Investments

The Framework calls for the ability to immediately expense the costs of new investments in depreciable assets. Although this provision may expire after five years, and does not include "structures" (a term which is not defined in the Framework) it would include investments made after September 27, 2017. The impact on the cost segregation industry is unclear:

- **Cost Segregation:** A cost segregation study identifies and reclassifies personal property assets to shorten the depreciation time, which reduces current income tax obligations. In a cost segregation study, certain commercial building costs previously classified with a 39-year depreciable life can be classified as personal property or land improvements, with a 5, 7, or 15-year rate of depreciation using accelerated methods. In an environment of rate reductions and the immediate expensing of certain capital investments, cost segregation could be more beneficial in the short term.

Conclusion: The Importance of Planning Now

The one thing we'd like to leave **LISI** members with is a sense of urgency. Even though some pundits discount the possibility, a bill could pass as early as December. Regardless of when something does pass, clients need to understand what's happening right now to be able to move like lightning when a tax bill is enacted. What we encourage advisors to do is consider the likely outcomes, what clients should do if those are the outcomes, and then develop lists of clients to speak with about specific issues. In many cases, there may not be enough time to learn the law, figure out how to react to it and then figure out which clients it applies to. In this very short window, it may be helpful to be in action mode now and ready to react.

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

Bob Keebler

Jim Magner

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LISI Estate Planning Newsletter #2585 (October 2, 2017) at http://www.leimbergservices.com,

CITES:

Unified Framework for Fixing Our Broken Tax Code.

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[i] Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation. Not practicing for Guardian or any subsidiaries or affiliates thereof. 2017- 47298 (Exp. 10/2019).

[ii] Although there is no effective date in the Framework, this newsletter assumes that it will ultimately be January 1, 2018. We have no basis for that assumption, and the authors of the Framework haven't shown any cards regarding effective dates, but this newsletter will focus on the issue of fiscal years for estates and trusts, so it is important to have a firm reference point.

[iii] See Dylan F. Moroses & Stephen K.Cooper, "Questions Raised on Budget Window Extension for Tax Reform," Tax Analysts, May 13, 2017.

[iv] 2010 was "The Year Without an Estate Tax" with executors having the Hobson's choice of estate tax and basis step-up, or, no estate tax and modified carryover basis treatment via a Section 1022 election and the filing of Form 8939.

[v] But note that if the estate tax is repealed for 10 years and we have carryover basis with no step-up, the heirs could get a carryover basis.

[vi] "H&R Block Stock Drops Following Trump Tax Reform Announcement," The Street, April 26, 2017.

[vii] Connecticut, the District of Columbia, Illinois, Michigan, Minnesota, Ohio, Pennsylvania, Virginia and Wisconsin are so-called "residence by birth" states that base the residence of a trust exclusively on the residence or domicile of the grantor.

[viii] Stephanie Cumings, "'Rothification' Uncertainties Draw Concerns from Industry," May 30, 2017.

[ix] In the Framework, this is described as follows: "An additional top rate may apply to the highest-income taxpayers to ensure that the reformed tax code is at least as progressive as the existing tax code and does not shift the tax burden from high-income to lower- and middle-income taxpayers."

[x] Under Section 1202, a "qualified trade or business" is defined as any trade or business other than those involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any other trade or business where the principal asset of the trade or business is the reputation or skill of one or more of its employees. The term also excludes any banking, insurance, leasing, financing, investing, or similar business; any farming business (including the business of raising or harvesting trees); any business involving the production or extraction of products of a character for which percentage depletion is allowable; or any business of operating a hotel, motel, restaurant, or similar business.