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PRACTICAL PLANNER® NEWSLETTER
MARTIN M. SHENKMAN, PC
PO Box 1130, Fort Lee, NJ 07024
Email: newsletter@shenkmanlaw.com

More Info:

Comments: Email questions, comments or suggestions to newsletter@shenkmanlaw.com.

Linkedin: https://www.linkedin.com/in/martinshenkman/

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Planning Potpourri

■ Taxpayers might take the position that a promissory note issued in a family context should be valued for estate tax purposes at less than its face amount plus accrued interest. Example: Mom loans the kiddies or a family partnership $1M evidenced by a note bearing a current interest rate. Years later mom passes, and the family has the note appraised in order to report its value for estate tax purposes and the appraiser determines that the value is less than the $1M face amount. The IRS has long expressed its lack of love for such positions. Nonetheless, in the settlement of a recent high-profile case, Cahill, it appears that the IRS conceded on the discounted value on a number of notes (although the settlement hammered the taxpayers on the valuation of an economic benefit split-dollar insurance arrangement). The IRS has indicated that it will again address below-market loans under Code Section 7872. Proposed Regulation Section 20.7872-1 addressed the rules in Code Section 7872(i)(2) "under regulations prescribed by the Secretary, any loan which is made with donative intent and which is a term loan shall be taken into account for purposes of chapter 11 [the estate tax chapter] in a manner consistent with the provisions of subsection (b) [providing for the income and gift tax treatment of below-market loans]." That change could radically affect loan split-dollar and many other common estate planning transactions. REG-209226-84. The Treasury appears poised to revisit the Proposed Regs. Stay tuned.

■ "I need a will." Yeah? A client recently came in asking for a will. Not uncommon, the house was owned jointly, bank accounts were all joint or POD (pay on death), life insurance and retirement plans would pass by beneficiary designation. The only asset her will would apply to was her checking account, an insignificant part of her wealth. So why do so many focus on a will instead of how their assets will really pass? Probably the same reason that the most other planning issues are ignored. It's easier to rely on a magic bullet then to address the real details. A large bank recently polled its own employees about how many had designated beneficiaries for their 401(k) plans. The results were pretty shocking. Wish we could share what we read to drive the point home. Add to your New Year's resolutions confirming that you have completed beneficiary designations for all appropriate assets, that they are current, and that you have named contingent beneficiaries. Save a copy of each beneficiary designation so it can be accessed in an emergency. PP

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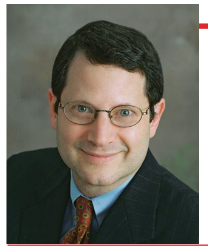

Shenkman

Practical Planner®

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD

Planning Ideas to Fill Your Holiday Stocking

Summary: Everyone likes a good stocking stuffer. What could be more exciting than sharing tax tips over eggnog?

■ R-ING in the Season: INGs are today's hot acronym. Taxpayers seem to love the hot item of the day. It's kinda like asking your doctor for the purple pill. Never mind whether you need a pill of that color, the commercial said ask your doctor, so you dutifully do. Adviser phones are r-ING-ing off the hook with questions about INGs. These are Intentionally Non-Grantor trusts (or Irrevocable Non-grantor Trusts). Now, I love a good ING as much as the next tax geek, but wouldn't it make more sense to tell your planning team about your circumstances and let them recommend the best acronym for you (you might similarly tell your doc about your symptoms and let her recommend the best color pill)? INGs are non-grantor trusts. Why are these so cool (when done right)? They can avoid state income tax (although NY can be a bit finnicky). That's a good thing to do in light of the new state and local tax (SALT) limitations since you might not get a deduction (you might not have anyhow because of the AMT – call your CPA to explain that acronym). INGs might also permit you to obtain charitable contribution deduction (the new rules doubling the standard deductions eliminate charitable deductions for most folks). They might provide you with bigger 199A QBI deductions (boy, we tax geeks have more acronyms than a box of Alphabet cereal). That's the new 20% deduction for flow through businesses. One ING-er wanted to gift slices of her licensed practice to a series of INGs (why have one ING if you can ING-a lot!). But the IRS has come down harsh on whether non-grantor trusts, including INGs, will really succeed in this type of planning. That ING-er not only missed the regulations, but can she even legally assign an interest in such a licensed business? As they say the tax devils are in the tax detail-ING. INGs also chime in different flavors. Should it be a completed gift ING to use the temporary estate tax exemption or a more typical incomplete gift ING? The heart of the ING is a committee including adverse parties (that means people in tax speak who have to approve distributions you get). Who might fulfil that role that you are comfortable naming? Most INGs are formed and administered in states that permit self-settled trusts (a trust you form and for which you are a beneficiary, or if you prefer yet another acronym a DAPT). But is that necessary? There are other approaches to non-grantor trusts. Grantor trusts might be better for some. Another ING-er called insisting they needed an ING to save state income taxes but that they absolutely did not want to address estate planning. Huh? So, ING-ing could be a good idea, but when you r-ING your tax adviser, don't ask for a purple pill or an ING, but review your plan and see what r-INGs true.

■ Divorce Taxes: If you divorce after 2018 alimony you pay won't be deductible. The 2017 Tax Act flips the historic tax treatment of alimony (payor deducts, payee reports as income). Can you salvage any tax benefit? Consider giving your ex-spouse more of your retirement plan using a qualified domestic relations order (QDRO). If you transfer a retirement plan to your ex, and the ex takes distributions from the plan or the IRA, the ex, not you, reports the income to the IRS. That has the same effect as if you had gotten a deduction for paying alimony! But before you let the tax tail wag your QDRO-dog consider that you are giving up an asset that has tax deferral and asset protection benefits.

■ 199A and Prenups: 199A is

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Checklist: Financial Tips

Summary: Estate plans without your wealth adviser won't work. Read on.

√ Hug Your Financial Adviser Before Retiring: Little tweaks to your financial plan can pay great dividends. You might call an estate planner looking for a will. But have you first addressed your financial plan? Every estate plan should be built on the foundation of a solid financial plan. Otherwise, you might not have much net worth for your will to distribute! (For the wealthy financial forecasts are helpful to formulate complex plans-but that's a different subject). An interesting study shows how critical hugging your financial adviser before retirement can be. Professor John Shoven, as quoted in ThinkAdvisor, presented a study showing that postponing retirement by just 3-6 months is equivalent to saving an additional 1% of earnings for 30 years. Wow! Working a tad longer increases your Social Security and boosts the balance in your retirement accounts and may let you spend more in your golden years. So, before retiring have your wealth adviser model the results and see what they show before deciding. In the above case, the results were surprisingly positive. These steps are critical

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Planning Ideas to Fill Your Holiday Stocking

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the new 20% deduction for qualified business income (QBI) for flow through entities not tainted as specified service trades or businesses (SSTBs). The quirky wage requirements might have your CPA suggest restructuring some portion of the income that might have been paid to you as wages to maximize that benefit. While that might enhance your 20% deduction, what about matrimonial considerations? If you restructure business operation to increase wages that otherwise might have been business earnings that may change the characterization of the income under a premarital agreement. If your prenup says that income from separate property (e.g. a rental property you inherited) remains separate, but earned income during the marriage are deemed marital property, you might have transformed separate assets that would be immune from divorce into property subject to division if you divorce. Before restructuring compensation and entities to maximize new 199A benefits, consider all the possible ramifications (including that the 199A deduction might disappear in 2026).

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Reviewer: *Andrew Wolfe, CPA, Esq.*

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■ <u>Family Limited Partnerships and Powell</u>: Planning should be reviewed in light of the 2017 Powell case. That case held that partnership assets were included in the decedent's estate because the decedent, "in conjunction with" others (the heirs in that case) controlled the partnership. That caused estate inclusion. Although the facts in Powell reflected bad planning, some worry that the IRS will extend the reach of this "in conjunction with" argument. That argument, was recently reinforced by a split-dollar life insurance case, Cahill, where the court used the "in conjunction with" argument on an economic benefit split dollar plan to cause estate inclusion. Understand that assets transferred to an FLP/LLC could be included in your gross estate under Section 2036(a)(2) because you "in conjunction with" other persons, could determine whether and when distributions could be made to the partners/members, and the amounts of distributions. Amend governing docs to remove any involvement you might have to determine distributions, liquidations or dissolutions, and power to vote with all of the other partners for an amendment to the partnership agreement. Also, evaluate ownership of entity interests and contractual arrangements to determine if modifications might reduce or eliminate this tax risk. For example, did you retain a percentage of limited partnership interests in a plan that was done years ago? Perhaps you should transfer those remaining interests so that there is no "in conjunction with" tie? Even if you are below the new estate tax exemption amount of 11.4M in 2019, the threat of the exemption sunsetting to one-half the current amount in 2026, or being changed by future legislation, should be considered. For GP interests, FLP cases like Estate of Turner v. Commissioner would seem to pull in the partnership if GP interests are retained. So, address those. Don't assume that this can't be an estate tax problem relying on a temporary high exemption.

■ <u>Wandry'ing about Powell</u>: Consider what a Wandry valuation adjustment clause might do. If you're left with some LP interests under a Wandry clause, because they weren't transferred, might the IRS argue Powell and you, "in conjunction with" whoever, control the asset so it's included in your estate? Ouch! Might a King type adjustment clause be worth reconsidering? A King adjustment can be illustrated as a sale of an asset at its appraised value for a note, and if the IRS adjusts the valuation, the note face amount increases accordingly. There are lots of different opinions on Wandry, King and all valuation adjustment mechanisms. One would hope that since the Powell case was premised on horrible facts its conclusions would not be applied to better planning. Will the IRS limit Powell arguments to just bad fact cases? Predicting what positions the IRS, or the courts, might take is not possible.

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■ <u>Powell Planning and Smaller Estates</u>: There has been much talk in the professional literature about liquidating FLPs and LLCs to avoid valuation discounts to a larger basis step-up on death. Before liquidating evaluate the pros/cons: the risks of the exemption sunsetting, loss of control features, loss of asset protection benefits FLPs provide, etc. If real estate is held in an LLC and there would presumably be discounts, liquidating the LLC and losing the above benefits to gain a better basis step-up might still seem warranted in some, but not all, situations. But what bigger basis step up will actually be realized? Real estate held by former partners but now in their individual names is still subject to a partition discount. Will that be less than the discount if the property is retained in an FLP? A 44% partition discount was found in the Estate of Williams, TC Memo 1998-59 (1998). So, liquidating might provide no better basis step up (but a loss of control and asset protection) if you get William'ed. In re Ludwick, TC Memo 2010-104 (2010) there was a 17% discount for partition costs. Liquidating for tax bennies sounds good but may not be advantageous. PP

…Checklist: Holiday Financial Tips

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today with increasing longevity. You don't want to outlive your money. Project how additional work time might increase the likelihood of your not running out of money during your anticipated life expectancy. Use age 95 or 100 to be safe. How much longer would you have to work for a comfortable likelihood of your money lasting those extra years? Peace of mind worth waiting to enjoy the early bird specials.

√ <u>Quickie Financial Plan</u>: We often complete a 30 second financial plan to help folks get a handle on where they are. Even rich folks can spend so out of proportion to their wealth that they are at risk. Try the "4% Rule." Add up your investments leaving out houses, bling and toys. Multiple by 4%. Ballpark (subject to lots of other points) is that's about how you can spend each year and not run out of money for decades. One footnote is that this rule assumes you're invested with a diversified portfolio (not just CDs or tax-exempt bonds). This is based on a 1994 study by William Bengen. A New York Life survey showed that 77% of adults 40+ either overestimated the amount of money they could safely withdraw each year in retirement or owned up to being clueless about the appropriate withdrawal rate. Them's not encouraging stats. Recently Michael Kitces, a financial consultant (this guy is brilliant, if you don't read his blog you should), noted that since the early 1870s - more than 140 years - there's never been a 30-year period over that time in which a retiree following the 4% rule would have run out of money." Hey, in another recent article Bogle predicted lower market returns for stocks at 6% (perhaps less) and 3.1% for bonds. This might mean a return of 4.84% [(60% x 6% = 3.6%) + (3.1% x 40%) = 1.24]. If you pay say a 1% account level fee to your wealth adviser and say an average 1% on underlying assets (higher on actively managed funds, more on alternatives, less on ETFs), the math looks a bit funky. The returns on a 60/40 allocation, if Bogle is right, less 2% average fees, won't leave the 4% you think you can withdraw. No doubt there are lots of opinions on all of this, but the take home message is clear. Possibly lower returns mean you have to regularly monitor your budget (perhaps cut expenses), financial forecasts, overall fees for your portfolio, and more. Before you make annual gifts or larger irrevocable transfers to use your temporary estate tax exemption, run the numbers! Before you fire your wealth adviser - who is going to help you with forecasts to keep you on track and determine appropriate planning.

√ <u>Life Settlements</u>: Big estate tax exemptions made some to sell life insurance they no longer need ed to pay an estate tax. Prior law calculated gain as proceeds reduced by your tax basis in the policy (what you paid less the cost of insurance). The 2017 Tax Act changed this rule and you no longer have to reduce tax basis by the cost of insurance when your policy is sold in a life settlement. This is retroactive so if you sold a policy you might still be able to amend your income tax return. Call your CPA!

√ <u>Insurance Trust Trustees</u>: Recent warnings, e.g. The Wall Street Journal, on universal life, are scarier for trustees of ILITs than Freddy Kreuger. If you haven't had an insurance consultant evaluate all policies, put down the remote and call one now!

√ <u>Fraud and Cyber Crime</u>: Data breaches at many well-known consumer companies have led to personal identifying info like Social Security numbers, credit card data, and more being snagged by the bad guys. In 2017 losses from this were about $16.8 billion. What are you doing to proactively protect yourself? Do you monitor credit cards and balance monthly account statements and immediately report any oddities? More worrisome, who is watching out for older or infirm loved ones? PP

Recent Developments

■ <u>NJ Tax Amnesty</u>: Tax amnesty runs to January 15, 2019 so if you have NJ tax issues, call your CPA immediately and take advantage of the opportunity to waive penalties and cut interest on late payments, if you qualify.

■ <u>Estate Tax Exemption</u>: Increases to 11.4M in 2019. Rev. Proc. 2018-57. Use it before you lose it! Look at financial modeling to make this decision, not your Ouija Board. Be sure the transfers are to trusts you can access. Using exemption has further incentive because of the recent IRS ruling below.

■ <u>Clawback Ain't Happening</u>: Clawback is not a special at Red Lobster. It's what tax folks worried might happen if you made a large gift now using temporary expanded exemption, then you died after 2026 when the exemption drops by ½, would excess exemption be recaptured? Nope. You can make a taxable gift in 2019 of $11.4 million with no worries that there would be a phantom estate tax on your death after 2025. IR-2018-229. Some planners said that worry kept clients from moving forward to use their exemption. Really? Maybe the real reason was that estate planning was just a few notches below getting a root canal on their to-do list! Get planning on your 2019 New Year's resolution list. If the Blue Wave continues 2020 may bring a change in the administration in Washington that leads to adverse tax changes. Make 2019 the year to get all your planning in place, and early 2020 to wrap up those plans.

■<u>Retirement Amounts</u>: 401(k) contribution limit in 2019 is $19,000, up from $18,500 in 2018. IRA contribution limit in 2019 is $6,000 up from $5,500 in 2018. Catch-up contributions for oldsters 50+ $6,000.

■ <u>Tax Act Impact on Valuations</u>: The 2017 Tax Act effects are still being identified. If buying a CPA practice and paying 125% of gross what impact might the new tax law have? In 2017 30 million taxpayers itemized, in 2018 only 5 million will. 1040 clients with postcard returns won't need a CPA or may insist on price reductions. But business clients might prove more profitable in coming years because of the complexity of 199A deductions. The multiple of gross that might be used for a practice might have to be reconsidered based on the component parts of the practice, and how the new law might impact each of them. Perhaps lower the up-front price and increase contingent payments. PP