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Subject: Martin Shenkman & Jonathan Blattmachr - Summary of Selected Considerations After the 2017 Tax Act

"This newsletter explains several new planning opportunities and key planning points based on the new Federal tax act commonly known as Tax Cut and Jobs Act of 2017 ("TCJA") that practitioners in all disciplines related to financial and tax advice should consider."

Martin M. Shenkman, Esq. and **Jonathan G. Blattmachr, Esq.** provide members with commentary that reviews a number of important planning considerations presented by the Tax Cuts and Jobs Act of 2017.

Martin M. Shenkman, CPA, MBA, PFS, AEP, JD is an attorney in private practice in Fort Lee, New Jersey and New York City who concentrates on estate and closely held business planning, tax planning, and estate administration. He is the author of 42 books and more than 1,000 articles. Marty's latest book, Estate Planning After the Tax Cut and Jobs Act of 2017, is available at the link below as an e-book on https://www.amazon.com/Estate-Planning-after-Jobs-2017-ebook/dp/B0797F1NVD/ref=sr_1_5?s=books&ie=UTF8&qid=1516724216&sr=1-5&keywords=martin+shenkman or as a PDF download on www.estateplanning2018.com. **Steve Leimberg** recently noted that:

> Every tax professional in the country will (or should be) reading this book! This is the most complex and far reaching tax law passed in the over 50 years I've been studying, teaching, and writing about tax law and this resource arms you not only with the necessary and vital information you need to know but also the thinking and planning concepts of three of the brightest minds in the tax world!

Marty is the Recipient of the 1994 Probate and Property Excellence in Writing Award, the Alfred C. Clapp Award presented by the 2007 New Jersey Bar Association and the Institute for Continuing Legal Education; Worth Magazine's Top 100 Attorneys (2008); CPA Magazine Top 50 IRS Tax Practitioners, CPA Magazine, (April/May 2008). His article "Estate

Planning for Clients with Parkinson's," received "Editors' Choice Award." In 2008 from Practical Estate Planning Magazine his "Integrating Religious Considerations into Estate and Real Estate Planning," was awarded the 2008 "The Best Articles Published by the ABA," award; he was named to New Jersey Super Lawyers (2010-15); his book "Estate Planning for People with a Chronic Condition or Disability," was nominated for the 2009 Foreword Magazine Book of the Year Award; he was the 2012 recipient of the AICPA Sidney Kess Award for Excellence in Continuing Education; he was a 2012 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Counsels; and he was named Financial Planning Magazine 2012 Pro-Bono Financial Planner of the Year for his efforts on behalf of those living with chronic illness and disability. In June of 2015 he delivered the Hess Memorial Lecture for the New York City Bar Association. His firm's website is www.shenkmanlaw.com where he posts a regular blog and where you can subscribe to his free quarterly newsletter Practical Planner. His website www.shenkmanlaw.com has information of interest to advisers and you can register for his quarterly planning newsletter Practical Planner.

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Here is their commentary:

EXECUTIVE SUMMARY:

This newsletter explains several new planning opportunities and key planning points based on the new Federal tax act commonly known as Tax Cut and Jobs Act of 2017 ("TCJA") that practitioners in all disciplines related to financial and tax advice should consider.

TCJA includes sweeping provisions that affect almost every aspect of tax, estate and other financial planning. More specifically, on December 20, 2017, the House of Representatives passed, as the Senate had a few days earlier, legislation initially called (and still referred to by many as) the Tax Cuts and Jobs Act of 2017. That short title was deleted in the reconciliation process so that the official name became: “an Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.” President Trump then signed the Act into law on December 22, 2017. It is Public Law 115-97.

COMMENT:

The TCJA is worrisome, complex, disjointed, nettlesome, and worse. The legislation was formulated and made final in a very short time frame. Challenges for advisers and clients include:

- Many changes turn upside down traditional tax treatments advisers and clients have long been accustomed to (e.g., C corporation rates lower than individual rates, alimony not being deductible).
- The complexity is daunting (e.g., new IRC Sec. 199A).
- Tax provisions changed from the House, to the Senate, and again to the Conference Report. And if that wasn’t confusing enough, there were even three more changes made by the Parliamentarian.
- There are at least several inconsistencies between the Conference Report and the statute enacted.
- The array of sunset provisions is disconcerting.

Major Topics Covered by this Newsletter

While the scope of the TCJA is incredibly broad, this newsletter will address five topics:

1-Planning for increased temporary wealth transfer tax exemptions.
2-Large estate planning during the current window of opportunity.
3-Trusts to capture income tax deductions.
4-IRC Sec.199A – some additional thoughts.
5-Miscellaneous planning ideas post TCJA.

Increased Temporary Exemptions

TCJA doubled the transfer (gift, estate and generation-skipping transfer or GST) tax exemption from $5M to $10M (both adjusted for inflation since 2012) but this increase sunsets after 2025. This presents an incredible planning opportunity for many clients. The nature of this change, how it should be used, present unique challenges as will be explained.

The new increased exemption is a “use it or lose it” benefit. Practitioners should explain this to clients so they can plan to take action. The “lose it” is not only the 2025 sunset but could occur if a future administration takes legislative action to change the law before 2026.

Both clients and practitioners need to understand the broader implications of the exemption. Many will dismiss planning for moderate wealth clients as their net worth may be sufficiently below the new high exemptions that they may not perceive a need to plan. But it would be a mistake to only compare the client’s current net worth to the current exemption. Consider the client’s current wealth but also potential future wealth. A net worth of $5M might be $10M+ in 2026 when the increased exemption sunsets. And, over a longer period, a client’s wealth may increase significantly. For example, if the client’s wealth grows at seven percent annually, a $5 million base today would grow to $10 million by 2028, to $20 million by 2038 and to $40 million by 2048 and, in each of those cases, the exemption will remain at only $5 million (adjusted for inflation). Even if a client is not concerned with estate and GST taxes, asset protection and other goals may remain vital for him or her. Indeed, asset protection, as one example, has been affected in surprising ways that advisers should consider, as will be discussed below. The current exemptions are now approximately $11 million, but will revert to around $5.5 million (adjust for further inflation) after 2025.

Using the temporary enhanced exemption will have different implications for ultra-high net worth (“UHNW”) client than for more moderate wealth clients. Critically, planning for more moderately wealthy clients, perhaps from $5M to $50M of net worth, will in many instances be more complex and require novel planning approaches. Given the large size of current exemptions, planning for these more “moderately” wealth clients will have to balance competing goals of access to assets transferred, income tax issues resulting from the TCJA, and completed gift challenges to use the new temporary enhanced exemption. One factor is an important one to emphasize to clients: a taxpayer may not just use the $5 million increase in the exemption (which is to disappear after 2025); rather, to use the increase, the taxpayer must use it all (e.g., make a gift before 2026 of $11 million and not just $5.5 million). This is because the use of $5.5 million of exemption before sunset, would result in approximately $5.5 million remaining. If sunset then occurs, the incremental $5.5 million of new exemption enacted by the JCJA would disappear leaving no remaining exemption. Thus, using more of, if not the entirety of, the exemption is the only way to secure it from the impact of sunset.

For UHNW clients, planning in many respects might proceed as "business as usual." The new exemptions may be modest relative to their estates and thus be readily used to augment existing plans. For example, a UHNW client might simply gift discounted interests in entities to existing irrevocable trusts to use their enhanced exemptions. But there are several new planning ideas that might be added to the practitioner's quiver for these clients, as discussed below.

Common Plans to Use Doubled Exemptions

For moderate wealth clients, using the exemption will require more access to assets to achieve a sufficient level of comfort to make gifts. Several options exist to meet this goal post-TCJA.

A planning structure that has become relatively common will serve as good foundation for many moderate wealth clients post-TCJA. That plan is the use of non-reciprocal, grantor, dynastic (long term), GST exempt, spousal lifetime access trusts ("SLATs"). SLATs have and continue to serve many clients well as a means to use exemption, but nonetheless preserve access to the assets transferred to the trusts. A planning issue for SLATs has always been to avoid the reciprocal trust doctrine which might be used by the IRS to uncross the trusts causing estate inclusion, or be creditors to pierce the plan. Post-JCJA avoiding the reciprocal trust doctrine might be more difficult in light of the larger portion of wealth moderate wealth clients may commit to such plans in order to use exemption.

For single clients, they might do non-reciprocal trusts with another family member. Indeed, the first significant estate tax reciprocal trust doctrine involved two brothers. Lehman v. Commissioner, 109 F.2d 99 (2nd Cir. 1940). Alternatively, a non-married person (or a married one but who does not wish to do non-reciprocal trusts with his or her spouse) might use a domestic asset protection trusts ("DAPT") or variations of a self-settled trust, which likely will be more common to facilitate single clients using more of his or her exemption. Because of the concern some commentators have over the use of DAPTs variations, which might be referred to as "almost-DAPTs" may be more popular. For almost-DAPTs the settlor is not named as an immediate beneficiary but rather a person in a non-fiduciary capacity is given the power to add settlor as beneficiary. Another approach might be to provide for distributions to the settlor (or to descendants of the Settlor's grandparents) only in the discretion of a non-fiduciary. This may enhance asset protection of the trust as a trust which does not permit distributions to the settlor by the trust is, by definition, not a self-settled trust. (The Restatement (Second) of Trusts Section 156(2) (1959) provides in relevant part "[w]here a person creates for his own benefit, a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount *which the trustee under the terms of the trust could pay to him or apply for his benefit.*" Emphasis added.)

A power to loan has traditionally been used to achieve grantor trust status. See IRC Sec. 675(2). Perhaps, that power should be revisited and strengthened for the purpose of permitting the settlor access to assets. Perhaps, the power to loan to beneficiaries should generally be evaluated so that if a much greater portion of moderate family wealth is transferred to irrevocable trusts another option to access those assets will exist. (Caution must be taken to ensure that any power to borrow held by the settlor or a beneficiary will not cause the property in the trust to be included in the gross estate of the settlor or the beneficiary.)

In addition to assuring access to trust assets, steps should be considered to facilitate basis inclusion. Consider, for example, adding the power for someone to grant an IRC Sec. 2038 power to the trust settlor to create a mechanism to cause the trust estate to be included in the client's estate to achieve a basis step up.

Asset Protection and Irrevocable Trust Planning

The TCJA's large "use it or lose it" exemptions will encourage some clients to gift larger portions of their wealth to secure those temporary exemptions. This will have significant impact on planning and the actions different types of planners might consider.

Some trust companies and other advisers have rules of thumb they have long used as to what portion of a client's asset should be transferred to a DAPT or other irrevocable trust structure or otherwise given away. Should advisers and trust companies loosen old rules of thumb on percentage of wealth that can be transferred? If not, those old rules of thumb, created when exemptions were not only smaller but perhaps when exemptions were perceived as permanent (acknowledging the similar fear of exemption decline that existed in 2012), are not loosened, those rules could prove the limiting constraint preventing a client from maximizing the use of the new temporary exemptions. What other types of assurances, and what new benchmarks, will trust companies and other planners accept to be comfortable with higher percentages of asset transfers to irrevocable trusts?

Should solvency affidavits and other due diligence be used more frequently with plans that include greater portions of the client's wealth being transferred? Perhaps, even if state law does not require these items, they should be used given the larger percentages of wealth moderate wealth client may and often should transfer post-TCJA.

Access to transferred assets, if more of wealth transferred to use the new higher exemption, is critical. Does this change the calculus of using long term care and life insurance to protect transferors and their families? Perhaps, more insurance should be used to backstop planning to use the exemption, regardless of the fact that the large exemption might on initial reaction suggest less need for insurance. Maybe, the need for life insurance coverage is not less, just different.

A Few Planning Ideas for UHNW Clients

While, as noted above, for many UHNW client planning as usual should continue. The estate tax is not being repealed. If there is a change in administrations in Washington there could be a backlash to the perceived favoritism shown UNHW taxpayers in the future. With high exemptions and the Proposed Regulations under IRC Sec. 2704 off the table, now may prove to be that proverbial "window of opportunity" to plan for UHNW clients. There might be a few new approaches or spins on traditional planning that might be considered in appropriate circumstances.

Sale to Non-Grantor Trust: Note sales (that is, installment sales) to grantor trusts have been and will remain foundations of many UHNW plans. But what about note sales to non-grantor trusts? Many UHNW clients have large existing irrevocable trusts that once the client has died are obviously no longer grantor trusts. Those non-grantor trusts might be useful in note sale transactions. The loss of grantor trust status will accompany the death of the settlor. So, the assets passing from the estate of the settlor/decedent will have a basis step up and current value which might be used by the surviving spouse in a sale to a non-grantor trust. It is possible that the risk of selling those assets to a non-grantor trust may not be intolerable. Because the assets received a stepped-up basis on death no gain might be realized on the sale. This type of sale might be combined with a more traditional note sale to a grantor trust, e.g. by the surviving spouse, to fractionalize ownership of a controlling equity position as between sales to the grantor and non-grantor trusts.

If the assets pass on first spouse's death to a QTIP trust ,that trust should have sufficient flexibility to permit the distribution of the equity to the surviving spouse to consummate the sale. If that QTIP trust has a HEMS standard or limitation on principal will that prevent the plan from proceeding? Not necessarily.

If a sale is consummated to a non-grantor trust, a defined value clause of the type described and "approved" by the United States Tax Court in *Wandry v. Commissioner,* TC Memo 2012-88 (even though the IRS has non-acquiesced to the case) could be used because of the large size of a hard to value asset. But will a traditional defined value mechanism suffice? Perhaps, not as a two-tier mechanism may be required as there could be both income and gift tax audits because the sale is to a non-grantor trust so gain for income tax purposes could be recognized. If the IRS challenged the sale on an income tax audit they could argue that for income tax purposes the shares were worth more so that the sale should be recast as a part gift-part sale. The income tax audit would not preclude a separate gift tax audit challenge to the same transaction.

Another approach might be integrated into the traditional note sale to maybe make a challenge by the IRS more difficult. There could be a collateral swap. Assume an existing now no longer grantor trust has substantial assets that have grown over the years. In a typical note sale transaction, the client would sell stock to an irrevocable trust for note and secure that note with the stock sold. But for some older trusts that might not be the only option. Consider using different assets of the old trust as collateral for the note and not the assets sold. Example: Old no-longer grantor trust holds LLC interests in XYZ. These interests were sold years ago when valued at $5 million and have appreciated to $25 million. Surviving spouse sells interests in ABC, LLC to that trust valued at $20 million. There is no concern about gain because the basis was stepped-up at death of the first to die spouse. The transaction might be structured using $20 million in value of XYZ, LLC as collateral for the note the trust issues to surviving spouse instead of using interests in ABC, LLC. Might that reduce the linkage between the surviving spouse and the interests in ABC, LLC sold in the event of an IRS challenge of the transaction as still included in the surviving spouse's estate?

Another interesting technique for large clients pursuing aggressive planning is the melting a grantor retained annuity trust (GRAT) described in Reg. 25.2702-3 by combining the borrowing of securities from a dynasty trust and gifting those securities, subject to the loan agreement, to a GRAT. See Gooen, Snow and Harris, "The Estate "Melt": GRATs Are Only the Tip of the Iceberg," VOL. No. 44 Estate Planning 3 (Nov. 2017).

Asset Protection Planning-Are Non-Grantor Trusts Needed?

The JCTA provides another wrinkle to traditional asset protection planning. With the new high exemption levels, clients who had pursued transfers to irrevocable trusts to facilitate estate tax minimization and asset protection planning may not have any estate tax concerns post-TCJA. That might leave the asset transfers having little other non-asset protection justification. But some of the new perspective on post-TCJA trust planning below might provide a solution.

As an example, consider a single physician who want to pursue asset protection planning. Her net worth is about $10 million. Under prior law she would have faced an estate tax. Thus, creating and funding an irrevocable trust plan would have provided valuable tax as well as asset protection benefits. Under current post-JCTA law there is no estate tax benefit, although the physician can certainly argue that she made irrevocable transfers to use the temporary exemption. The potential loss of a step-up might be viewed as a detriment to the plan. Does the use of the temporary exemption suffice to justify that the planning was not solely for asset protection purposes? If instead of the traditional transfer to a grantor trust, the physician uses a non-grantor trust plan that provides immediate income tax benefits, will that provide a meaningfully stronger tax justification for the transfers that also benefit her asset protection plan? Consider the planning arrangements discussed below.

New Trust Structuring- INGs and Completed Gift INGs

As discussed above, clients post-TCJA will require several goals be met: using the new high exemption, assuring access to the assets transferred, and for many clients, especially those in high tax states, addressing the new restrictions the TCJA placed on state and local taxes ("SALT"). That will require a different spin on trust planning and drafting. Might it now be worth considering the limited use of non-grantor trusts to shift investment income out of the client/settlor's high tax state reach considering that those income taxes will not be deductible on the federal income tax return in excess of a non-inflation adjusted $10,000 limit on the deduction for such taxes (until 2026)? Might the tax benefit of a non-grantor trust be further enhanced by salvaging substantial portions or all of the client's home and vacation home property tax deductions?

Might these clients be able to structure completed gift (unlike the ING trusts), non-grantor (like the ING trusts) trusts to achieve both goals? (See Blattmachr & Lipkind, "Fundamentals of DING Type Trusts: No Gift Not a Grantor Trust," 26 Probate Practice Reporter 1 (Apr 2014).) Perhaps, the traditional SLAT can be reformulated (e.g., by a decanting—see, e.g., New York EPTL 10-6.6) into a non-grantor trust to achieve the above stated tax goals, without sacrificing the other post-TCJA goals

Moderate wealth clients will not make gift transfers they cannot access. So how can they use their temporary exemptions and save their SALT deductions? To provide access to assets in trusts like SLATs might it be feasible to have the spouse as a named beneficiary (or the grantor if in a jurisdiction that permits self-settled trusts), but restricting them so that they can only receive distributions with the consent of an adverse party to avoid grantor trust status?

Would such trusts, if feasible from a federal income tax planning standpoint, be able to be planned around New York's anti-ING legislation and avoid grantor trust status for New York purposes? The New York Senate just passed legislation (by a vote of 60 to 0) permitting full deductions for certain itemized deductions limited by TCJA on the client's New York personal income tax return. With that new regime, a traditional

ING will be grantor trust under New York law, although it will remain a non-grantor trust on the federal income tax level. This should permit the settlor to deduct property taxes on his or her New York return but remain a non-grantor trust for federal purposes. As a non-grantor trust on the federal return, each trust should be entitled to deduct $10,000 of property taxes leaving the client/settlor with $10,000 of other SALT deductions on her personal return.

How would a completed gift ING be structured? A trust may distribute income to the client/settlor's spouse, or accumulate it for future distribution to the settlor's spouse, all subject to the required consent of adverse party, and not be characterized as a grantor trust. IRC Sec. 672(a). An adverse party is a person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power. This might include trust beneficiaries, such as an adult child (Consideration must be given, of course, to whether an adverse party consenting to the gift would be making a gift.). IRC Sec. 2514. A default remainder beneficiary is an adverse party.

Some high earning UHNW clients used incomplete non-grantor trusts to shift income out of the reach of state tax authorities. These trusts were funded with incomplete gift transfers and were structured to avoid grantor trust status. The idea was that income (such as a large capital gain) might be earned inside the ING and avoid high state income tax. This type of arrangement had become so successful that New York enacted legislation to treat such trusts as grantor trusts subject to New York taxation. This will be a great tool for ultra-wealthy clients that have used all of their exemptions and who do not need to access assets in irrevocable trusts. For a large swath of clients, however, this will not be the optimal trust structure as they will want the transfers to secure their temporary exemption amounts.

For clients with moderate (relative to the new high exemption amounts) wealth, who reside in high income tax states, a different variation of all the above planning might be preferable if feasible to achieve. These clients, perhaps in a wealth stratum of $5-$50 million, may be sufficiently wealthy that estate tax planning should continue because the higher doubled exemptions will be rolled back in 2026 if not sooner. But these taxpayers may not be so very wealthy that they can afford (or be willing) to give up access to assets held in those trusts. Further, with the SALT deduction restrictions or elimination, it may be prudent to shift investment income to a different low/no tax jurisdiction if feasible.

The solution may be a new variant on the traditional ING trust that strips out the powers given to grantor in the ING trust that would cause transfers to the trust to be incomplete for gift tax purposes.

New Trust Structuring- SALTy SLATs

Clients facing significant SALT limitations, including loss of property tax deductions, might consider a non-grantor variant of the traditional SLAT, referred to as a “SALTy SLAT.” That non-grantor trust may own the client’s homes multiplying the $10,000 SALT deductions among several “new” taxpayers (that is, the non-grantor trusts). This planning might proceed as follows:

- Transfer both the taxpayer’s principal residence and vacation home each into separate limited liability companies (“LLC”).
- Be certain that SALTy SLAT will have enough income to pay and thereby offset property tax deduction – perhaps transfer a portion of non-retirement investment assets not needed to be expended soon. And it will be best to transfer assets that produce ordinary income (as opposed to long term capital gain or qualified dividends).
- The LLC will be taxed as a partnership as it will be owned by at least two trusts, e.g. two non-reciprocal non-grantor SLATs. To avoid the partnership tax filing consider having the LLC election out of partnership status. An organization used for investment purposes only and not for the active conduct of a business may, on the consent of all of its partners, elect to be excluded from Subchapter K (partnership tax rules) even though they are otherwise a partnership. IRC Sec. 761(a).
- The client and spouse would each gift LLC interests to the non-grantor trusts - SALTy SLATs.
- Each trust should qualify for a $10,000 property tax deduction.

Consider the potential loss of Sec. 121 home sale exclusion. Consider converting the SALTy-SLAT back to a grantor SLAT if the SALT rules are modified in future or if planning to sell house becomes important. The client will want the conversion done sufficiently in advance to start home sale 2 out of 5-year ownership period. (Ownership by a grantor trust qualifies toward the exclusion; ownership by a non-grantor trust does not.) Thus, for a client that will benefit from the IRC Sec. 121 home sale exclusion and plans to sell their home in the near term, this planning would obviously not be appropriate.

Some might question whether the multiple trust rules would derail the above plan. IRC Sec. 643(f): "…under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if— (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person…" But the regulations under 643(f) have never been issued. If no regulations are issued under such a situation, then the provision should have no enforcement power. SIIH Partners, 150 TC -No. 3 (2018).

How might a SALTy SLATs be drafted? Consider the following suggestions:

- Start with a form for a beneficiary defective irrevocable trust ("BDT").
- The trust should intentionally omit the swap power described in IRC Sec. 675(4)(C), and all other powers, that might make it a grantor trust as to the settlor.
- Delete the Crummey power that is included in the typical BDIT in order to make the BDIT grantor trust as to the beneficiary.
- Add a requirement for approval (or provide veto power) to a non-adverse party on distributions to the spouse.
- Form the SALTy SLAT in trust friendly jurisdiction, especially if it is envisioned that the beneficiary spouse upon death will exercise a special power of appointment to continue the trust for the settlor.

Trusts Structuring- BDITs

Might a variation of the Beneficiary Defective Trust ("BDT") be used to achieve new planning goals to address the SALT restrictions of the Act? A BDT is an irrevocable trust that is a grantor trust for income tax purposes as to the beneficiary under IRC Sec. 678 and not as to the settlor. For example, parent may set up a trust for child, and that trust could be crafted to exclude provisions that would make the trust grantor as to the settlor. The trust would include an annual demand or Crummey power making the trust grantor as to the child/beneficiary.

In the traditional BDT, the parent may create a BDT for a wealthy child with a $5,000 initial gift, so that the child could sell assets to the trust without triggering capital gain because the BDT would be a grantor trust as to the child. While some practitioners view this traditional application of the BDT as a useful planning tool (others do not) can this traditional BDT approach be tailored to address some of the changes, such a s the SALT limitations, created by the Act?

If the parent lives in a high-income tax state and the child in a no income tax state, might a variation of the typical BDT approach be used by the parent to shift income to a lower SALT environment to save SALT when they are no longer deductible?

Example: Mom gifts $5,000 to a BDT that is a grantor trust as to son, who lives in a low or no income tax state. Mom then directs a business opportunity to the trust which has no discernable gift tax value. Cf. Bross Trucking v. Commissioner, T.C. Memo. 2014-107. The income generated will be reported by son residing in the no-tax state. The value of the business opportunity would be grown outside the parent and child's estates well in advance of the anticipated sunset of the estate tax exemption reduction.

Charity, Tithing and New Standard Deduction Regime

Most taxpayers will not benefit by itemizing their deduction because the deductions allowed after 2018 and before 2026 will not exceed the standard deduction allowed for that timeframe ($24,000 for a married couple filing jointly and $12,000 for other individual taxpayers). Hence, these taxpayers will receive no benefit from charitable donations. Consider forming a simple local non-grantor trust with a non-compensated family member serving as trustee. Include the provisions set forth in IRC Sec. 642(c) (e.g., permitting the trustee to make distributions of the trust's gross income to charity) so that the trust can qualify for a charitable contribution deduction, and give sufficient investment assets to this trust to generate adequate income annually to pay intended charitable contributions. Name heirs as well as charities as beneficiaries and give trustee power to allocate or distribute in his or her discretion. This will permit clients to donate to charities and still obtain a full tax deduction. Because children and other heirs are included as permissible beneficiaries this trust structure can provide or direct distributions to heirs in a given year.

Other charitable considerations might include:

- Fund donor advised funds ("DAFs") in one year, producing a large charitable deduction at that time, even if the distributions from the DAF are not made until later years.
- Bunch other charitable deductions into one year between 2018 and 2025.
- Using make charitable contributions (of up to $100,000 annually) from IRAs after reaching age 70.5 years. These contributions are not included in the IRA owner's income (although he or she does not receive any income tax deduction) and yet count as minimum required distributions, reducing the amounts that must be withdrawn from the taxpayer's IRA each year one each that age.

Implications to Wealth Advisers

The type of non-grantor charitable trust, as well as the SALTy SLATs and completed gift INGs discussed above, create new "buckets" which wealth advisers can use to fine tune their asset location decisions. Asset allocation is how the family investment assets are allocated to different classes of assets to achieve investment and financial goals. Asset location deals with the determination of which accounts those various asset classes are held in so that income taxation of the assets can be optimized. These new trusts present categories with distinctive tax characteristics different from the traditional asset location buckets.

IRC Sec. 199A 20% Deduction for Pass-Through Entities

IRC Sec.199A - Is it an SSB? IRC Sec. 199A allows an individual taxpayer the opportunity to deduct up to 20% of qualified business income from taxable income. However, special limits on deduction the income from certain Specified Service Businesses ("SSBs") such as in the field of health, law, accounting and several others. Hence, taxpayers must bifurcate income along new never before used divisions: SSB income and non-SSB income. Consider the following illustration.

Example:

- A physician operates a practice. A family limited partnership ("FLP"), separate from the doctor's medical practice entity, owns the building where the practice operates and leases the facilities to the practice entity.
- Another FLP, independent from the practice and the real estate entity, was created by various family trusts and hired a graphics designer and marketing firm. Those contractors created a practice name, logo, slogan, consumer facing website (i.e., one without client data), and related marketing materials that were licensed to the practice. The practice operates under the licensed name, uses the licensed logo and marketing materials on all letterhead, advertisements, signage, website and more.
- Equipment was purchased and held in a third FLP (this approach was common in pre-LLC days, nonetheless many such structures continue to exist). The FLP leased equipment to the practice.
- These ancillary entities would all seem to be non-SSB's independent of the medical practice. Further, so long as the prices are arm's length for the rents and license fees the earnings in those entities should qualify for the IRC Sec. 199A deduction.

Consider gifting ownership interests to irrevocable trusts non-grantor trusts each of which has its own threshold amount.

The Conference Report for TCJA included the following: "*An activity has the same meaning as under the present-law passive loss rules (section 469). As provided in regulations under those rules, a taxpayer may use any reasonable method of applying the relevant facts and circumstances in grouping activities together or as separate activities (through rental activities generally may not be grouped with other activities unless together they constitute an appropriate economic unit, and grouping real property rentals with personal property rentals is not permitted). It is intended that the activity grouping the taxpayer has selected under the passive loss rules is required to be used for purposes of the passthrough rate rules. For example, an individual taxpayer has an interest in a bakery and a movie theater in Baltimore, and a bakery and a movie theatre in Philadelphia. For purposes of the passive loss rules, the taxpayer has grouped them as two activities, a bakery activity and a movie theatre activity. The taxpayer must group them the same way that is as two activities, a bakery activity and a movie theatre activity, for purposes of rules of this provision. Regulatory* *authority is provided to require or permit grouping as one or as multiple activities in particular circumstances, in the case of specified services activities that would be treated as a single employer under broad related party rules of present law.*"

How will rules designed to separate active versus passive endeavors be applied to reasonably govern the division (or not) of specified service business activities/revenue from non-specified service business activities and revenues? The constructs are different. The examples in the above quote are so obvious as to be of no practical value. Will future regulations restrict or prevent the type of planning suggested in the preceding example?

IRC Secs. 199A and 704(e): A client wants to maximize 199A deduction but has high taxable income which limits or eliminate the deduction. So, she gifts business interests to heirs who are in lower income tax brackets and below the taxable income threshold amount when the deduction is reduced or eliminated. Does it work? For a partnership (including an LLC taxed as partnership,) will IRC Sec. 704(e) (the family partnership income tax rules) and the requirement that capital be a material income producing factor impede the effectiveness of the gift?

IRC Sec. 199A and Real Estate Developers or Fund Managers: Consider a client who to maximize IRC Sec.199A deduction but all employees for real estate empire (or investment fund group) are housed in separate management company. Can the property LLCs (separate fund entities) contract with the management entity and pursuant to the terms of that contract characterize the management entity as an agent for each property entity (can the management entity opt to be a disregarded entity) and each property entity report a pro-rata (or other appropriate) share of payments for employees and treat those as W2 wages? While corporate counsel has suggested that this is feasible from a contract perspective, will future IRC Sec. 199A regulations negate this type of planning? Will the application of the IRC Sec. 469 aggregation concepts to 199A as discussed above prevent this? There may be yet another approach. Consider the following example. A real estate developer has aggregated all management and personnel activities in a management company. Each building he owns is held in a separate building entity LLC. Under pre-TCJA law this approach had no detrimental impact but perhaps the calculations of the 20% deduction under IRC Sec. 199A is constrained because the building entity

LLCs have no W-2 wages. As a planning idea, what if the developer contributed his ownership interests in the management LLC to each of the property LLCs and then the management LLC elected out of partnership tax status (see above). Then each item of income and deduction of the management company would be reported directly on the return of each property LLC. Might that enhance the calculation of the wage limit for those entities sufficient to justify the cost of the restructure?

IRC Sec. 199A and Large Law and CPA Firms: Large professional practice firms might consider forming a REIT with leasehold interests. Smaller firms might band together and do the same. Leasehold interests are intangibles and cannot qualify for 2.5% calculation (that only applies to tangible property). REITs automatically qualify for 20% deduction.

IRC Sec. 199A Restructuring: As clients restructure business entities to capitalize on the Code Sec.199A deduction, consideration should be given to the impact on buy sell agreements, estate plans (what if certain interests/entities are owned by a trust and others are not), etc. The ripple effects could be significant.

C Corporations and Accumulated Earnings Tax

Might C corporations that are accumulating earnings in the 21% C corporation solution use permanent life insurance to justify the retention of such earnings? Consider revising buy sell agreements funded with term insurance to instead do so with high cash value insurance.

Kiddie Tax and the NIIT

Is there a change to the implications of this to the Net Investment Income Tax ("NIIT")? The Conference Report says, "The provision simplifies the 'kiddie tax' by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child... Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates…"

It would seem that the foregoing statement in the Conference report suggests the application of a trust tax construct such that the threshold amount for NIIT purposes would be the $12,500 figure at which trusts reach the highest tax bracket.

However, the threshold amount in IRC Sec. 1411 does not appear to have changed so that a child would appear to still qualify for the $200,000 threshold amount.

So, trust distributions to a child beneficiary might still facilitate avoiding NIIT.

Tax Preparation Costs No Longer Deductible

The Act repealed the deduction for tax preparation expenses. Under the provision, an individual would not be allowed an itemized deduction for tax preparation expenses. The provision would be effective for tax years beginning after 2017 and until 2026. Under current law, these expenses are miscellaneous itemized deductions only deductible in excess of 2% of AGI, so many taxpayers may not have received significant benefit in any event.

This will likely result in taxpayers revisiting allocation of tax preparation fees as between business endeavors and personal returns preparation. Practitioners should be alert to possible ethical considerations if they bill the incorrect taxpayer (e.g., the client's business instead of the client for personal non-business services).

Practitioners might protect themselves by cautioning clients in retainer agreements or a footer on bills, concerning the improper payment or allocation of fees.

Sample Provision: "How you allocate legal fees, to various persons, entities or trusts could affect whether the payment is tax deductible. It is important that you use checks drawn on the appropriate accounts for the appropriate entities or persons when paying legal fees. Paying personal expenses from a business entity could be argued by a claimant or tax authority as evidence of your disregarding the independence and legal integrity of the entity. If you personally, or another entity, pays for legal fees for the services rendered to that person, entity or trust inappropriately, the IRS might argue that the payment is equivalent to an impermissible additional gift and that the tax position of the trust should not be respected."

Matrimonial Changes

Non-deductibility of alimony on divorces occurring after 2018 is a major issue, but there are other minor ones of importance.

- Personal exemptions for children were commonly negotiated but now they are gone
- Section 529 plans can be used for elementary and secondary school. Parties may have contemplated only college. Now what?

Existing Durable Powers of Attorney

Revisit gift provisions in powers of attorney. Are they useful or necessary considering the gift tax exemption has doubled? For many clients, the gift provision might warrant elimination by revoking the old power of attorney ("POA") and executing a new one that expressly prohibits gifts. For wealthy clients, they might wish to permit transfers of the exemption amounts but only to specified trusts. This might be appropriate if the clients are wary of using the new enhanced exemption amounts but want to facilitate further planning in the event they become incapacitated. Consider that an inadequate power of attorney was one of the significant issues in the Powell case.

What and How to Inform Clients

Do estate planners have an obligation to inform clients about the 2017 Act changes? For attorneys, if the client relationship was terminated or dormant, there is no obligation. If the client relation is still active, there may be an obligation. Differentiating the status of files is often not easy, and whatever determination the adviser makes, the client may have a different view. However, it might also be argued reasonably that every taxpayer should be on notice from the extensive media coverage of the new tax law and should themselves be responsible to contact their advisers to determine how they are affected.

Whatever the lawyer's view of the status of the client's file, what is the client's view? The steps to take will differ by practice. A planner with 100 clients can and will respond differently than a planner with 5,000 existing clients. Does email work? Older clients often don't have email. Consider a post-card mailing to each client (but be sure to put "This may constitute attorney advertising"). It can be easy, inexpensive and effective at getting a client's focus. It is easy to use inexpensive off-the-shelf software to extract data from electronic contact managers and email to printing/mailing firm to print, label, stamp and send, the entire process can be automated. It is inexpensive, visible and can succinctly communicate the message the client should see. Somewhat costlier would be a first-class letter to each client.

Conclusion

The TCJA has profoundly changed financial planning. This newsletter has provided an overview several different planning perspectives in light of the TCJA. Caution is in order as each client situation is potentially different, regulations may change some of the suggestions above, and future legislation may again change the landscape.

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

Marty Shenkman

Jonathan Blattmachr

CITE AS: