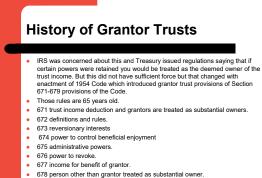


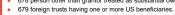


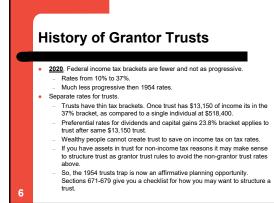
#### **History of Grantor Trusts**

- Under 1954 Code the Federal income tax was more progressive. No separate tax rates applicable to trusts, trusts were treated as individuals for federal income tax.
- Lots of tax brackets from 20% to 91%. 91% at \$200,000 of income = \$19.8M in
- current dollars. Fewer than 1,000 taxpayers were in that bracket. But many high-income taxpayers were in 60%+ income tax brackets
- So, planning often included pushing investment income into trusts to take a separate ride up the progressive tax rates to pay lower tax. This is why idea of creating trusts to house investment income to reduce federal income taxes first arose.
- Before grantor trust rules were enacted you could draft trust so that grantor could retain interests in trust, but trust remained respected as a separate taxpaying entity. You could give grantor access to income, power to reacquire property, you could give grantor ongoing power to change beneficiaries, and still have income taxed to trust at lower rates.

4







# When Client Might Prefer Grantor Trust

- When do you want a grantor trust?
- Family/overall pay less federal income tax if trust income is taxed to grantor.
- Allow for later transactions with the trust (e.g. swaps, sales, etc.).
- As a general rule you will want to structure a trust as a grantor trust for these reasons.
- Grantor trust status was the default presumption until 2017 tax act.
- Comment: Consider risk of Democratic victory in 2020 and proposals to include grantor trust assets in estate. Will a new grantor trust now be grandfathered?

7

#### When Might Client Prefer Non-**Grantor Trust**

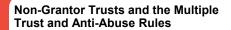
- ING = incomplete gift non-grantor trust. Was initially marketed by Delaware. Retain DE trustee and avoid state income taxation since DE worit tax if not distributed to beneficiary in a high tax home state. Position is home state cannot tax the income since it is DE sourced income so it provides a state income tax savings.
  - An ING can simultaneously be incomplete gift for gift tax purposes but a nongrantor trust for income tax purposes
  - All states without income taxation all provide a planning option. •
  - Delaware Incomplete Non-Grantor Trust = DING. Nevada Incomplete Non-Grantor Trust = NING. •
  - Strategy obviously does not work if the trust is structured as a grantor trust as all income will be taxed back to the high tax home state. Most form trust language for trusts are by default structured as grantor trusts so you must be careful not to have grantor language in that trust.

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# **Non-Grantor Trusts and 199A**

- 199A enacted as part of the 2017 tax act provides a 20% deduction for flow through business entities for Qualified Business Income ("QBI"). The statute favors production industries, real estate and disfavors many services business which are labeled Specified Service Trade or
- Business ("SSTBs") which are subject to a phase out and limitations once a threshold amount of income is exceeded. If as an S corporation shareholder if you have too much taxable
- income to get a 199A benefit you may shift stock into a non-grantor trust. The trust can claim a QBI deduction just like an individual and has same phase-out as individual. That may provide another threshold amount, 163,300, of taxable income where you don't have to worry about phase outs.



- Can you slice and dice pass through entity ownership into multiple trusts to replicate threshold amounts? Maybe but watch the multiple trust rule of Sec. 643(f) an the anti-abuse rules in the final 199A Regs.
- Regulations finalized in 2019 provide that Treasury can disregard multiple trusts if created with a <u>principal</u> purpose of avoiding Federal income tax. Regs defer to statute.
- If same grantor create trust for same beneficiaries and only creating multiple In same granulo deale dust to same beneficiants and only dealing include trusts for tax avoidance the Treasury can disregard those multiple trusts and defeat the strategy. Notice requirements: (1) substantially the same grantor, (2) substantially the same beneficiary, and (3) a principal purpose of tax avoidance.
- Must have same beneficiaries so if each trust is for a different child doesn't that break the multiple trust rule? Might have to provide in each trust that the "second" child cannot be a beneficiary of the first child's trust.

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#### Non-Grantor Trusts and SALT **Deductions**

- If a client has a vacation home and real property tax exceeds \$10,000 the cap of \$10,000 on SALT deductions would prevent any deduction. What if put vacation home inside a trust as a trust has same \$10,000 SALT cap that an individual has. If create non-grantor trust and seed with investment income the trust would get a \$10,000 SALT deduction for the property tax to offset the investment income.
  - Can you create multiple trusts? •
  - Can you create multiple trusts? Assume vacation home has \$20,000 of property tax. Create two new irrevocable trusts one for each child. Put vacation home into LLC and gift ½ of LLC to each trust. Have investment income in each trust of \$10,000. Can each trust then use \$10,000 property tax deduction since each trust may get a \$10,000 SALT deduction to offset \$10,000 of investment income? Perhaps, subject to the multiple trust rule. •
  - See Blattmachr. Shenkman and Gans. Use Trusts to Bypass Limit on State and Local Tax Deduction, 45:4 ESTATE PLANNING 3 (April 2018).

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# Non-Grantor Trusts and Tax Prep Fees

• Individuals cannot deduct miscellaneous itemized deductions (until after 2025).

• Trusts can deduct tax preparation fees as those may be classified as a trust administrative expense, and not as a miscellaneous itemized deduction as they would be for individuals.



#### Non-Grantor Trust and Charitable **Contribution Deductions**

- Income tax deduction for contribution may be more readily obtainable with a non-grantor trust since trusts don't have the standard deduction hurdle individuals do.
- Individual itemized deductions were restricted or eliminated severely by the 2017 tax act. The standard deduction was also doubled. SALT deductions were capped at \$10,000. The result is that most individual taxpayers will no longer itemize, which means no benefit from charitable contributions.
- · QCDs and bunching will help some taxpayers on donations.
- For others transferring investment assets to a non-grantor trust and •
- making contributions from the gross income of that trust, will provide a dollar for dollar contribution deduction. Be certain that the trust has 642(c) language.

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#### Third Party Treated as "Grantor" or Deemed Owner of Trust

- Some of the grantor trust rules serve to make another person a deemed owner of a trust.
- Sec. 678 can make the beneficiary the deemed owner in certain cases, and Sec.679 makes the US beneficiary of a foreign trust the deemed owner.
- 678(a)(1) A person other than the grantor shall be treated as the owner of an portion of a trust with respect to which such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself.
- If you can pull out income you are deemed owner of the
- income.
- If you can pull out corpus it is grantor as to corpus.

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#### Third Party Treated as "Grantor" or Deemed Owner of Trust

- Beneficiary Deemed Owned Trust = BDOT.
- Give beneficiary right to pull out income under 678(a)(1) that beneficiary is deemed the owner of the taxable income. And that income would be taxable to that beneficiary and not to the trust.
- This can be used to shift income out of trust, not to settlor as in the typical 'grantor' trust, but rather to lower bracket beneficiary.
- Note that beneficiary does not need to actually withdraw the income she merely needs to have the power to do so to get this tax result.
- This BDOT can be an attractive alternative to reduce overall family income tax costs but yet still perhaps control the distributions of trust income (i.e. it may not have to be distributed out to make the income flow out as with DNI). .
- But note that if the trust gives the beneficiary the power to withdraw, the child can actually exercise that power. That has real economic consequences and this is why some clients are loath to use a BDOT as a strategy.
- Differentiate a BDIT which is a different strategy that also involves Sec. 678.

#### Third Party Treated as Owner -BDIT under 678(a)(2)

- Under Sec 678(a)(1) beneficiary only has power to vest corpus or the income while the Crummey power is effective. At all other times, the beneficiary has no such power, so §678(a)(1) should not apply.
- Under §678(a)(2), the beneficiary will be treated as the owner for income tax purposes even if he or she has released the power to access trust funds, but only if the beneficiary "retains such control as would subject a grantor of a trust to treatment as the owner. When the right to withdraw lapses the beneficiary doesn't retain ongoing control over the trust corpus or income so Sec. 678(a)(2) should not apply to cause the beneficiary to be taxed. Even if the beneficiary and a "hanging power" the beneficiary should be taxed only on proportionate share of trust income that accrues during the period in which the "hanging power" can be exercised.
- Comment: Blattmachr PLR Consider adding general power subject to HEMS.

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# Foreign Trust: Grantor Status under Sec. 679

- Sec. 679 is a trap not a planning opportunity.
- 679 requires a US person to make a transfer to a foreign trust and that foreign trust has one or more US beneficiaries.
- A "US Beneficiary" is any US person, citizen or resident. If a foreign trust has any (not a majority) US beneficiaries, Sec. 679 could be triggered (as well as perhaps Sec. 684 – "Recognition of gain on certain transfers to certain foreign trusts and estates").
- "US Person" for purposes of Sec. 679 is not limited to the grantor of the trust. The grantor/settlor/creator could face this problem, but so too could any third party who makes a transfer of property to a foreign trust. It is not limited to solely the grantor.

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### Foreign Trust: Grantor Status under Sec. 679

- "Foreign trust" is any trust other than a trust that meets two tests:
  - US court has primary jurisdiction over the trust.
     US persons control substantially all decisions with respect to the
  - US persons control substantially all decisions with respect to the trust.
- If fail either of the above two tests it is a foreign trust.
- A transfer to a foreign trust may be treated as a taxable sale. Under 679 US person could be treated as owner of property contributed to the trust. So, if US person gifts property to a foreign trust that US person could be treated as deemed owner.
- Planning can be done to avoid unintentional grantor trust status.
   Sec. 679 (and Sec. 678) identify situations in which person other than grantor can be deemed owner of the trust.

### Powers that Will Not Create **Grantor Trust Status**



- Power to appoint income or principal to a charity of the grantor's choice.
- Power to control timing of distributions.
- Since these powers cause estate inclusion, they may be useful to garner a
- basis step up. Not-Grantor Trust and No gross estate inclusion
- Mere administrative power.
- Power to distribute limited by an ascertainable standard.
- Power to withhold income during minority or disability.
- Powers held by independent trustees. These don't cause inclusion unless grantor can remove or replace the trustee.
- Independent trustee power to distribute (unless grantor can replace).

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#### Powers that Will Create Grantor **Trust Status and Estate Inclusion** Gross estate inclusion. Most reversions. Most powers to control distributions during grantor's life. Testamentary power to appointed accumulated income.

- Grantor power to deal trust property for less than full
- considerations.
- Grantor power to vote to controlled corporation stock in a nonfiduciary capacity. Makes grantor deemed owner of that stock not everything else in the trust.
- Retained right to income.
- All of the above will permit basis step up on death (and create grantor status).

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#### Loan Power – Creates Grantor Trust Status but May Not Cause Estate Inclusion

- Power held by nonadverse party to enable grantor to borrow on unsecured basis. <u>comment</u>: Consider for access in 2020 planning. The loan power should be expressly contained in the trust instrument. Loan power cannot be implied from a general grant of powers to the trustee.
- Grantor is deemed owner of trust for federal income tax purposes.
- Statute says get grantor status if borrow at below market interest rate but you should not give power to borrow for less then AFR as creating deemed gifts. So, avoid waste of exclusion and draft so only can borrow unsecured.
- . Must pay adequate interest to avoid estate inclusion under 2036 and 2038. Actual loans.
  - What if trust set up as non-grantor trust and decide that you want the trust to be a grantor trust. Grantor trust rules say if grantor or grantor's spouse has <u>actually</u> borrowed assets from the trust on an unsecured basis (without pledging collateral) if that loan is outstanding on the first day of the tax year that trust is a grantor trust for the entire taxable year. The trustee cannot be the grantor, grantor's spouse or a related or subordinate party.

#### **Charity Power – Creates Grantor Trust** Status but May Not Cause Estate Inclusion

# Power to add charitable beneficiary. Power held by anyone other than the grantor.

- To add 1+ charities as beneficiary.
- Without consent of adverse party. .
- If third party not decedent held power no estate inclusion. It third party not decedent net power no estate inclusion. Madorin v. Commissioner, 84 T.C. 667 (1985) linvolved a trustee who had power to add 1 or more charities as remainder beneficiaries to the trust. That was the power to control beneficial enjoyment without the consent of an adverse party. That made it a grantor trust but because it was held by third party, not be the decedent, it did not cause estate inclusion.
- Clients generally do not like this power as it is a control issue even if an effective way to make an income tax grantor trust and avoid estate inclusion.
- Comment: Power to add a charity creates grantor trust status. In a non-grantor trust just give limited power of appointment to direct gross income to charity consistent with 642(c).

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#### Swap Power – Creates Grantor Trust Status but May Not Cause Estate Inclusion

- 675(4)(C) if anyone, grantor or otherwise, holds a power in a nonfiduciary capacity the power to reacquire trust property by substituting (swapping) property of equivalent value, exercisable in a nonfiduciary capacity, the trust is a grantor trust.
- Since in a non-fiduciary capacity do not need trustee's approval. This is not a means of getting wealth back but grantor can get back a • specific asset. This is why most believed this swap power did not cause estate inclusion.
- Revenue Ruling 2008-22 confirmed a swap power generally should
- not cause estate inclusion and will yield grantor trust status
- Some insert additional provisions to corroborate equivalent value. Most have practiced with trusts without that additional language.

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#### Swap Power – Creates Grantor Trust Status but May Not Cause Estate Inclusion

- Example: 10 years ago, created grantor trust with swap power. Highly appreciated asset shifted into grantor trust. Client has \$10M of cash. If client dies appreciated asset in trust does not get a step up in basis that are in the defective grantor trust. Swap asset back into estate for step up. No gift, no gain, no added gross estate inclusion.
- Consider swapping loss assets (basis greater then fair market value) from the client into a grantor trust to avoid a step-down in basis on death.
- Swap life insurance into granton use to avoid a step-down in DBBIS 01 08810. Swap life insurance into granton trust. Have trust buy life insurance policy for its FMV. If client terminally ill cannot use life tables. But if client not terminally ill and can use tables to value policy the value of the policy will be less then death benefit. No gain under Rev. Rul. 85-13, no violation of transfer for value rule under Sec. 101, no gift, limited gross estate inclusion of policy just of cash trust paid to buy policy at FMV.



Comment: If elderly or infirm grantor prepare documents in advance.

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# Crummey Powers Impact on **Grantor Trust Status**

- Can you give the beneficiary a Crummey power? Does that interfere with grantor trust status as to the settlor of the trust (e.g. a settlor holding a swap power)?
  - Create vested remainders for heirs but want gifts to trust to qualify for gift tax annual exclusion. A gift that adds to remainder interest will not qualify. Crummey power qualifies gifts to trust as a present right, not future right, so qualify for annual gift exclusion. .
  - If give remainder beneficiaries say 30 days to pull out their proportionate share of what was given to the trust this converts what would have been a future interest into a present interest. Crummey v. Commr. was the case that sanctioned this in 1968. Appealed to 9th Circuit which approved this. .
  - Cristofani case approved Crummey powers to contingent remainder heneficiaries

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### Crummey Powers Impact on **Grantor Trust Status**

- But, does inclusion of Crummey powers jeopardize grantor trust status as to the settlor?
- settlor? In Rev. Rul. 81-6 a Crummey power renders the beneficiary taxable for income tax purposes to the Crummey power holder under Sec. 678(a). That makes the beneficiary the deemed owner. If you had relied on a technique that made the trust a granter trust as to the settlor does the Crummey power jeopardize that strategy? No.
- But consider what you are getting. A Crummey power is only \$15,000 and if making a \$10M gift and have any concern, exclude the Crummey power out of the grantor trust as "an abundance of caution." <u>Comment</u>: Different Crummey powers in non-reciprocal SLATs.



#### Will life insurance as a trust asset taint the intent of the transaction?

- An irrevocable life insurance trust is a grantor trust when income may be used to pay policy premiums. IRC Sec. 677(a)(3).
- ab pay poincy premiums into Sec. of (a)(5). 3-year rule on gift still applies to life insurance. 2035 has exception for bona fide sales for full and adequate consideration in money or money's worth. So can sell policy to ILIT to avoid 3-year rule. Better to have trustee purchase a man policy. new policy.
- new policy. 677(a)(3) if there is an express power in trust document to allow trustee to use trust income to pay premiums on grantor's life it is a grantor trust for income tax purposes. If put other assets into the trust it remains a grantor trust. Issue of life insurance in a grantor trust is whether a swap power creates an incidence of ownership. Rev. Rul 2011-28 eliminated concerns about ILIT with swap power. A swap power itself will not be treated as an incidence of ownership in the policy even if grantor could reacquire the policy up until death so this will not include insurance in gross estate. So you can include swap powers in an ILIT.

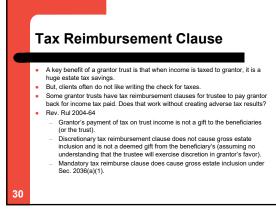
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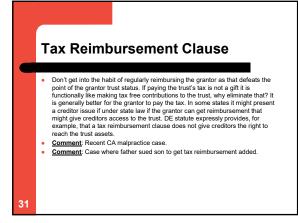
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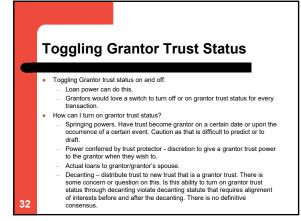


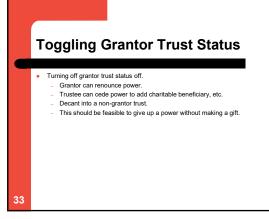
- What if you swap a policy, will that trigger the transfer for value rule? Consider above comment about selling policy to the trust under Rev. Ru. 85-13.
- Rev. Rul. 2007-13 if transfer policy between two grantor trusts it does not trigger transfer for value rulings. The transfer of a policy from one grantor trust to another is not a "transfer for value" that would make some of the death benefit taxable to the extent it exceeds what was paid for the policy. No. it is not a transfer for value for income tax purposes.

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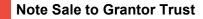






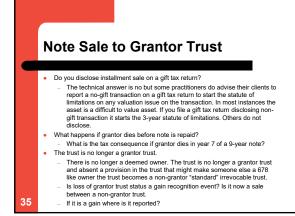


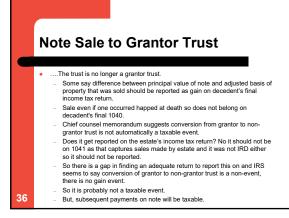


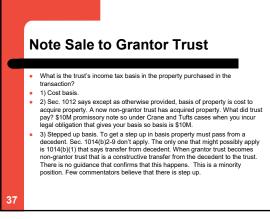


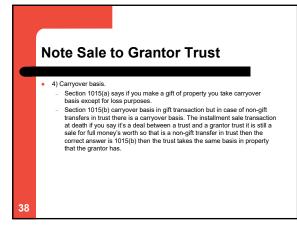
- Grantor sells assets to grantor trust for a promissory note. Must use appropriate AFR (short = under 3 years, mid or long = more than 9 years) Once trust term ends a balloon payment is due, etc.

- Once trust term ends a balloon payment is due, etc. No gift, no gain, interest tax free, fixed values in gross estate, note is included in gross estate. No recognition of gain on sale as selling to yourself. Hope/goal is that there is significant growth in value of the asset post-sale. Issue of selling to a trust with no assets for a promissory note? Some say trust should have equity equal to 10% of the purchase price in the transaction. To buy \$10M of assets needs \$1M of assets. This concept is borrowed from charitable trust planning. There is no controlling authority to say this is the right amount. amount.
- Comment: Conventional wisdom says there should be 10% equity but that is not viable for larger transactions.
- There are many aspects of this transaction that lack authority.
- Comment: How do practitioners apprise clients of risks?







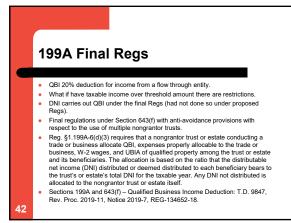






- Can you allocate to transfers that took place before 2017 Act became law. Change in BEA is effective for decedents dying after 12/17 but what if gift made years before?
- Can you use the increased GST exemption for old gifts? .
- Can you use the increased GSI exemption for old gits / Answer is not clear with the effective date rules but the policy is clear. The Blue Book issued December 18, 2018. An example in the Blue Book shows you can allocate GST exemption to past transactions. This is similar to past increases with inflation adjustments etc.
- If you made a given inaccess with mature region region region and the provided of the second .
- Comment: This is a huge opportunity especially for smaller clients







- Someone makes \$11M gift and dies after 2025 when exclusion amount has dropped to \$5M indexed remains. Do they owe tax on excess? Under current law they would, but Regulation fix. The exclusion amount is larger of BEA at date of death, or the BEA amount applied to gifts during lifetime. Clients should consider gifts before exemption declines.
- No off the top off the gift tax regime. Some had hoped gifts would come off top of 11M but final Regs made clear it is not. .
- You can use increased GST exemption for prior gifts. Many will be reluctant to give large amounts of their estates. So want to retain income from assets given to trusts. Sec. 2036 will apply if retain income interest. The \$11M is brought back into the estate, but because of anti-clawback Regs. the \$11M gift exemption remains. You may make a gift of \$11M, retain income, estate inclusion, but you may have locked in your exemption. In final Reg IRS solid it was reserving comment and will make further consideration. So be careful of using this kind of strategy. Back State 101 (10) TD 984 (blue 20 2010) 84 EED BEC 64006 (blue 26
- Reg, §20.2010-1(c), T.D. 9884 (Nov. 22, 2019), 84 FED. REG. 64995 (Nov. 26, 2019).

#### **General Powers of Appointment Court Reformation to Avoid Estate Inclusion**

- Powers of Appointment: PLRs 201845006, 201920001-201920003
- Grantor set up trusts for grandchildren and split gifts with spouse. Grantor left at death part of estate to these trusts. Each trust has GPOA and Crummey withdrawal powers.
- Primary beneficiary held a testamentary GPOA with permissible appointees = primary beneficiary's creditors and descendants. Trust appointed an independent special Trustee with power to: (1) create a
- testamentary GPOA in any of grantor's descendants. (2) convert GPOA to LPOA, (3) power to eliminate a power of appointment in whole or in part. The trust did not have an independent special Trustee acting.
- Trustees said grandparents did not want trusts included in grandchildren estates. Grantor's CPA and attorney said trust was intended to be GST exempt.
- Court limited withdrawal to lesser of 5/5 power and struck language that POA was included in grandchildren estate (i.e. restricted GPOA into LPOA). This was a generous ruling.

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#### ILIT Reformed to Restrict Rights of Trustee/Beneficiary to avoid Estate Inclusion

- Settlor established Trust, an irrevocable trust for the benefit of Child 1 and Child
- Settlor establisme i metrocoure uses to uno beneficio a la construcción de la construcció
- but because Child 1 held LPOA and is the Trustee, the insurance proceeds would be included in Child 1's gross estate. Before buying policy Child 1 as Trustee petitioned court to reform Trust to: (i) remove Child 1's testamentary LPOA over any life insurance policy on Child 1's its testamentary LPOA over any life authority over insurance policies on Child 1, and (iii) require that premium payments on life insurance policies on Child 1 and (iii) require that premium payments on life insurance policies on Child 1 must be paid out of Trust corpus.
- Rev. Rul. 95-58 concept would be expanded into 2042.
- PLRs 201919002 & 201919003.
- Comment: Use concept to add insurance trustee to old SLAT so insurance can be purchased by the trust if child is insured beneficiary.

#### Valuation – Tax Effecting S **Corporation Interests - Kress**

#### In flow through entities income taxes will be born by recipient.

- If S corporation is valued on income method look at income and determine cap The to multiply to get value. Where do you get capitalization factors? From similar public companies. But the earnings of the publicly held C corporations have already paid their income taxes so that is not the right factor to use for a flow through entity. So, need to 'tax effect' the earnings.
- Gross v. Commr. 20 years ago was viewed as saying no tax effecting on S corporations. Justina and other cases HO 54 have taking this position. Appraisers however have continued to tax effect as they believe it's the correct result.
- Kress v. United States, 372 F. Supp. 3d 731 (E.D. Wis. March 26, 2019) both IRS and taxpayer appraisers tax effected. This was a gift tax case so no decedent was involved.

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### Valuation – Tax Effecting S **Corporation Interests - Jones**

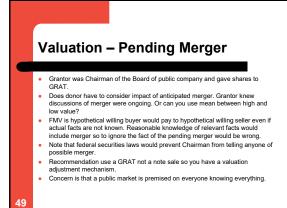
- Gifts of timberland in partnership and saw mill owned in S corporation. Court said income method was appropriate since family would hold timber for long term so income approach, not a net asset value approach, was the appropriate approach to use.
  - Taxpayer's appraisal tax effected the earnings. IRS agent did not disagree. IRS experts were notably silent on the valuation tax effecting.
  - This court viewed Gross case not as saying to you cannot tax effect, but rather that the Gross case was a fact-based decision that did not tax effect based on facts in Gross
- Judge in Jones case said tax effecting made sense.
- Estate of Jones v. Commissioner, T.C. Memo. 2019-101 (Aug. 19, 2019).

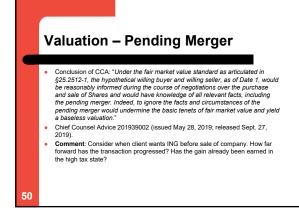
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# Valuation – Merger **Parent/Children Companies**

- Parents company formed to manufacture tools and parts used by other Parents company formed to manufacture tools and parts used by other companies in assembling their own products. Parent's company developed a special prototype tool, with which it had limited success. Sons developed interest in the special tool, improved and marketed it. Sons formed their own company to sell tool. Years later parent and sons' companies merged. Issue was whether the sons received too large an interest in the merged company.
- IRS argued that overvalued sons' corporation and undervalued parent corporation in merger.
- Key issue was no legal documentation on transfer of patents for special tool from parent company to sons' company. Court made math changes to appraisal reduced appraisal from \$29M to \$22M. .
- In gift tax issues must look at what is actually transferred. What was transferred here was transferred to each of 3 sons so minority interests should have been applied. This was not argued in the case.
- Cavallaro v. Commissioner, T.C. Memo. 2019-144 (Oct. 24, 2019), on rem'd from 842 F.3d 16 (1st Cir. 2016), rev'g and rem'g T.C. Memo. 2014-189.





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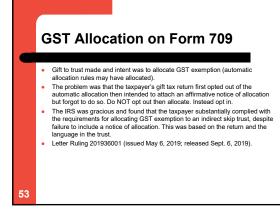
# Valuation – Charitable Bequest to Foundation

- Interests in business passed to private foundation. Valuation was done on a non-discounted basis. Estate tax deduction was \$18.2M but IRS held \$6.4M went to foundation. Court said deduction was only \$6.4M and had to pay estate tax on difference.
- One son wore 3 hats: executor of the estate, trustee of the private foundation, and ran the corporation whose stock was bequeathed to the foundation.
- Family put money into corporation and redeemed shares in corporation so a minority interests then passed to the foundation.
   When family later purchased shares from the foundation they used a minority interest discount.
- The charitable deduction should have been the amount actually transferred to the Foundation, not the amount reported on Form 706.

### Valuation – Charitable Bequest to Foundation

- Because the executor's actions altered Decedent's estate plan by diverting value that should have been transferred to the Foundation in favor of three of Decedent's children.
- If an independent person, not the son, was in charge of the foundation they would have prevented a redemption to reduce the value of what the foundation received. If trustee did not object that is an act of selfdealing as it benefited the son who was a disqualified person (son of donor/decedent). The self-dealing penalty is 200% of the amount involved.
- Estate of Dieringer v. Commissioner, 917 F.3d 1135, 123 AFTR 2019-1020 (9th Cir. March 12, 2019), aff'g 146 T.C. 117 (2016).

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# CLAT and Notes – Can LLC Avoid Self-Dealing Issue?

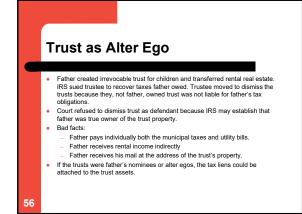
- Notes can be a problem with a private foundation. If you give notes to
  private foundation it is OK if foundation doesn't have control over the
  note. Solution Stick note in LLC and give non-voting LLC interests to
  the foundation.
- What if you do a note to a CLAT? CLATs are not subject to all the private foundation rules but are subject to many. E.g. self-dealing rules of Sec 4941 by reason of Sec. 4947(a)(2).
- Solution Do a sale and take back note and want note to go to a CLAT. Put note into LLC and give non-voting interests to CLAT.
- Is this substance over form if LLC is controlled by family, i.e. same people that control the foundation.
- The IRS approved putting notes into a CLAT by using an LLC.
  PLR 201907004 (released Feb. 15, 2019).
- I

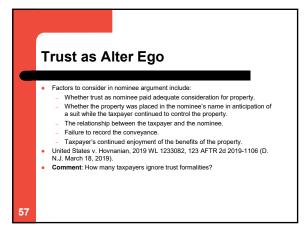
# CLAT and Notes – Can LLC Avoid Self-Dealing Issue?

- Structure used in PLR was transfer of notes to note-LLC owned by trustee of family CLATs (Rev. Proc. 2007-45) and by another LLC, voting-LLC. The other voting-LLC held all voting interests in the note-LLC. Voting-LLC was owned by descendants of the trustee. Voting-LLC contributed cash to note-LLC and the trusts contributed notes to note-LLC.
- Power to manage the affairs of note-LLC is vested in manager.
   Trustee holding nonvoting interests has no management or voting rights . Note-LLC may be dissolved only with written approval of all members, whether holding voting or nonvoting interests.

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#### Kaestner and State Income **Taxation of Trusts**

#### Supreme Court on trust income taxation

- 2005-2008 state income tax. North Carolina attempted to tax undistributed income of trust based on sole contact of beneficiary living in NC. Nothing else was in NC.
- . There was a loan made of \$250,000 to the beneficiary.
- Court followed existing precedent.
- •
- Jurisdiction to tax and collect are related. You have to submit yourself voluntarily to the state that wants to tax you.
- . Property was never distributed, and beneficiary had no way to know if they had income.
- NC argued that holding would allow avoidance of state income taxation of trusts as you can pick and choose where you want a trust taxed.
- . Kaestner was a very narrow ruling.
- Supreme Court said it was not changing any pre-existing law
- Now important is physical presence in today's technological world? NC made a big deal that it allows rich people to avoid state income taxation on their income from trusts.

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# Comment: Post-Kaesnter Planning Ideas From Blattmachr and Shenkman: "State Income Taxation of Trusts: Some Lessons of Kaestner," Estate Planning, October 2019. Lessons of Natestiner, Estate Planning, October 2019. Use of decanting, Decant trust to remove a "5/5" power described in Section 2514(e), a HEMS (health, education, maintenance, and support) standard, or other provisions that might give the beneficiary any rights to demand trust income or otherwise a right to control, possess, or enjoy trust assets, or a trust that terminates at a specified age. In the Kaestner case the trust was decanted from the original trust that was to terminate at a specified age. Consideration might also be given to whether effectuating a nonjudicial modification to curtail beneficiary control might tain the result as evidencing beneficiary control (in contrast to a decanting effectuated by the trustee).

Nongrantor trust. Review benefits of converting a grantor trust to a nongrantor trust to save state income taxes if the grantor is subject to such taxes. Restrict distributions. The trustee may choose not to distribute any of the income to the beneficiary in the taxing jurisdiction.

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# Comment: Post-Kaesnter Planning Ideas

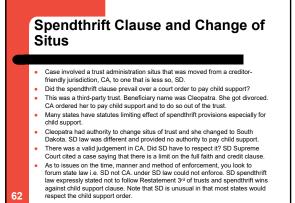
- Choice of laws. Having the trust be subject to governing law of a different jurisdiction than the taxing jurisdiction may help. The trust in Kaestner was subject to New York law, not North Carolina law.
- subject to New York law, not North Carolina law. Residence of trustees. The residence of individual trustees is a crucial factor. In the Kaesther case, no trustee lived in North Carolina. How will this apply in terms of an institutional trustee? Perhaps, this suggests the benefit of using an institutional general trustee based in a tax-friendly jurisdiction in lieu of a friend or family trustee in the taxing jurisdiction.
- Trust protector. The Kaestner Court did not address other common positions In a modern trust. What of a trust protector? Trust investment director? Various power holders? Might all of these positions, if the individuals named reside in a taxing state, taint the trust as subject to that state's tax system?
- Location of records. Thought should be given to the physical location of trust records. In Kaestner, the trustee kept the trust documents and records in New York, not in North Carolina. In a modern digital age, how relevant will this be when most if not all records might consist of cloud-based digital records? Will moving all records to the cloud solve the issue?

### **Comment: Post-Kaesnter Planning** Ideas

- Location of assets. Consideration should be given to where any trust asset custodian is located. Is it relevant where a large institutional investment advisor is located as to the state taxation? Yet this seems to be a factor noted by the Court. Location of office. The trust should not rent or own an office in the taxing
- Location of investments. The trust should not have any direct investments in the taxing state. If this tain exists, are alternative arrangements available? •

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# Spendthrift Clause and Change of Situs

- This is a full faith and credit issue. This is the big issue in self-settled trust cases. The Cleopatra case suggests this is a matter for the SD law. The reasoning of Cleopatra is supportive of this. If Cleopatra case had been judged under CA law the result would have been .
- different •
- In re Cameron Gift Trust, 931 N.W.2d 244 (S.D. 2019). . Apparently subsequent to the above the CA courts have issued orders against the SD Trustee and Cleopatra the beneficiary.

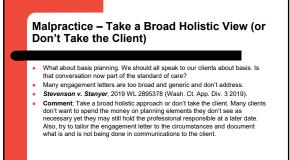


#### Malpractice – Take a Broad Holistic View (or Don't Take the Client)

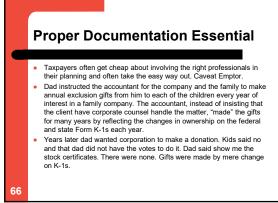
- Mom and dad had a lake house. Put house in trust since wanted kids to have it and assumed it would go up in value and wanted to avoid estate tax. Dad died.
  Mom goes to attorney and updates here estate plan. Estate plan updates
- documents but does nothing, and is not asked to do anything, concerning the lake house.

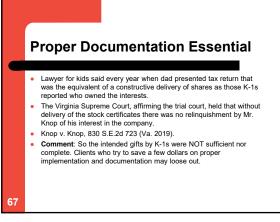
  Mom dies.
- Kids sell lake house shortly after mother's death and they owe capital gains tax.
  Kids sued lawyer for not having addressed basis issue when he updated mom's estate plan. Kids claimed lawyer should have advised mom to enter into agreement with children, terminate trust and put Lake house into Mom's estate to get a step-up.
- Lawyer's defense was he had not been asked to do tax work for beneficiaries.
   Court said cannot blame lawyer that no basis step up. There was no evidence that this desire to avoid tax was communicated to the attorney. Court did not see that retaining lawyer for mom's estate planning should automatically encompass tax planning for trust mom had.

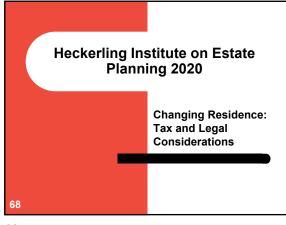
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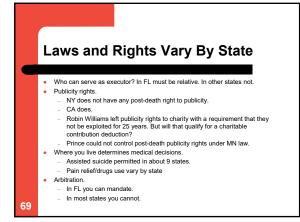


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#### Laws and Rights Vary By State

#### Homestead exemption FL very significant.

- State income taxation Kaestner Have you advised trustees to file claims for refunds? If did not file will fiduciary be surcharged?
- Only state of domicile may impose tax on intangibles. If you live in FL and have summer home in NY you will have to pay NY tax .
  - If you make a subset of an angle property is situated can impose its tax. If file non-resident return will get sent form TT-14 asks where you served in military, where you went to college and more. So, if you have something in NY to prompt NY audit consider getting rid of it.
  - Coop is an intangible but clothing you keep in the coop is tangible. Wine collection is a tangible that might impact argument.
  - Consider "count the day rule."

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# Laws and Rights Vary By State – **Marital Rights**

- Community property entitled to  $\frac{1}{2}$  of community property and presumption that  $\frac{1}{2}$  of all property during marriage is community property.
  - In all states you can have a prenuptial agreement but some states, like OH prohibit post-nuptial agreement.
  - States allow divorce but vary on how enforceable a prenuptial agreement is. Generally enforceable if not unconscionable etc. Before move to new state check with matrimonial attorney in that state as to validity of existing prenuptial.
  - What if kep separate property separate even if no prenuptial agreement? This might deflect argument of merger, or other spouse adding to it. That might help deflect a claim but if move to CA anything that would have been community property had they lived in CA takes on a status of "quasi community property" that is similar to community property.
  - In CT or MA judge doesn't care how property was acquired all property is in play and judge can make equitable division of the property.

  - NY law if have children surviving spouse gets 100,00 and 1/2 remainder. In Wyoming in most cases surviving spouse gets all. How differentiate?

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#### Laws and Rights Vary By State – **Creditor Rights**

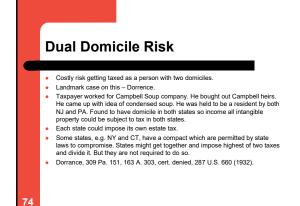
- Debtor and creditor rights vary dramatically by state.
- · Renson case. Trust in Belize and sued in FL added cash to trust and trustee purchased annuity which is exempt under FL law. FL court disregarded trust but respected annuities.
- 19 states have DAPT statutes. CT and Illinois are the two most recent states.
- Note that an ING trust must be done in DAPT jurisdiction because if creditors can attach assets in trusts it makes it a grantor trust.
- Is there an alternative? Yes a SPAT = special power of appointment trust. This should work in non-DAPT states like NY and CA.

### Debt To Reduce Value of Home in **High Tax State**

- Suppose you have someone who lives in a no tax state like FL and has large home in the Hamptons in NY or CT.
- Preferable to sell home to break ties with high tax state. But what if the family • really wants to hold the vacation home?
- •
- •
- really wants to hold the vacation home? Regulations under Sec. 2053 If you have debt on property and loan is non-recourse as to owner, then only the net value has to be reported. Example: If you have \$10M home in CT and family wants it but you want to avoid CT estate tax, get non-recourse lien on home for \$9.9M so only \$100,000 net value is reportable on a CT estate tax return. Most states follow federal law on this. .
- .
- What happens to step up in income tax basis? Have not lost basis step up. Reg Sec 1.742-1 based on Crane v. Commr. Supreme Court said net value only is included in the estate because of debt. However, you can add debt to basis and that would be what the basis would be to inheritor.

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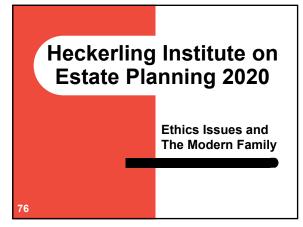
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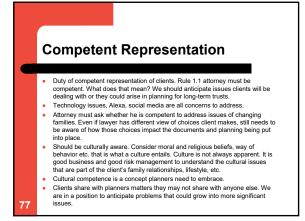


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# ING Trust to Avoid State Income Tax

- What can be done if moving from no tax to high tax new home state? Use ING trusts. If move from low to high tax to the moving non-compensation income into an ING trust. This can be done even if a resident of • a high tax state.
  - (i) to source. WY passed legislation in 2014 providing that if you transfer assets to an incomplete gift ING that it will be treated as a grantor trust for NY income tax purposes. Speaker believes that this may be unconstitutional under Mercantile Safe Deposit Trust Co. case. May be able to avoid by using a completed gift non-grantor trust a completed gift ING.
  - Rev Proc 2020-3 when IRS will rule on ING.
- Client does not have to give up interest in property as property in ING can come back to grantor or grantor's spouse.
- Trust as non-grantor trust is subject to high rates of income tax just over about \$13,000 of income. •

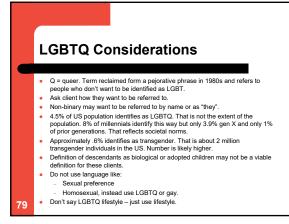


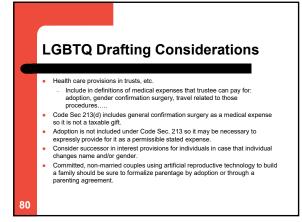


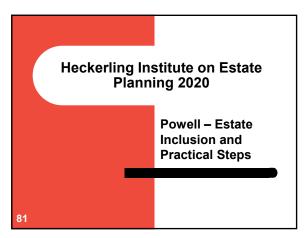
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# **Modern Family**

- In 1960 households of married couples only father employed in 70% mother
- employed 2% and dual income 28%. By 2012 dual income households the norm 60% only 31% had father as sole income producer. In opposite sex households 39% woman is now the primary breadwinner.
- Must ask questions as to each person's background and skill sets. . Stop assuming what circumstances are based on a few facts.
- . Adoption.
  - Total number of adoptions 110,000 per year.
  - Terminology that should not be used (cultural competence). Birth parent or family versus real parents. Don't refer to adopted child but to "child". To "place a child" not "give up a child."
  - Even if legally same sex couples can adopt it doesn't mean that the adoption agencies will be friendly to them or treat them appropriately. Not all countries that permit Americans to adopt will permit LGBTQ to adopt.



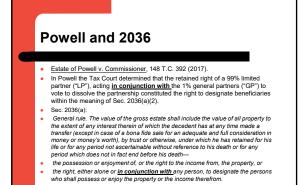


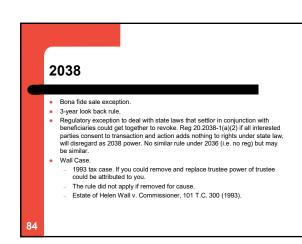


### **Byrum Case**

- Good facts good law. But what is breaking point? Powell exceeded it. In Byrum taxpayer owned 70% of shares in 3 corporations. Other 30% was owned by unrelated parties.
- Corporations engaged in active businesses with boards of directors. Mr. Byrum gave away by gift shares to trusts for children. Mr. Byrum reserved right to vote shares in corporations, veto investments and veto transfers of trust assets, and remove and replace directors. 2036(b) the "anti-Byrum" statute now prohibit this. .
- prohibit this. Right to remove directors equated to right to change dividends which equated to right to change trust beneficiaries. But court said Mr. Byrum did not have a "right" since directors had fiduciary duty to the shareholders and could not merely follow Mr. Byrum's directions. They would not breach their fiduciary duties and adopt a different dividend policy just because Mr. Byrum said so. Trustees had fiduciary duties to beneficiaries. All these fiduciary duties resulted in preventing Mr. Byrum from having the right to designate who would get income from the corporation. This was the correct result.

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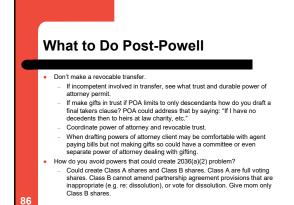


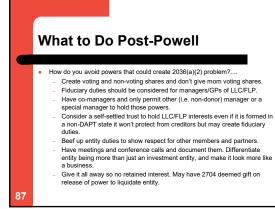


# Powell Facts/Analysis vs. Byrum

- What happened? Mrs. Powell owned 99% LP interests and gifted them to a CLAT.
- FLP agreement allowed all partners to get together and dissolve partnership or amend FLP agreement.
   Court determined that because 99% LP interest, <u>in conjunction with others</u>,
- could dissolve so that equated to right to determine who possessed partnership property. Previously LP was passive ownership interest.
- Property removally LT was passive ownership interest.
   What about fiduciary duties? Court said they were illusory because the GP was the son who was also the agent under mother's durable power of attorney. Those fiduciary duties trumped his duties as a GP. So, court attributed powers of GP to mother.
- Quoting from Strangi, the court in Powell said, "Intrafamily fiduciary duties within an investment vehicle simply are not equivalent to the obligations created by U.S. v. Byrum."
- Court distinguished Byrum where there was a real business so that director decisions had meaningful impact and there were third party owners.

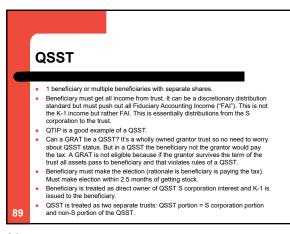
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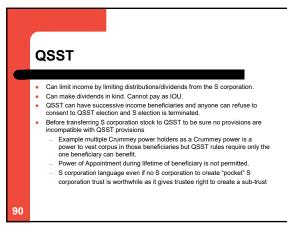


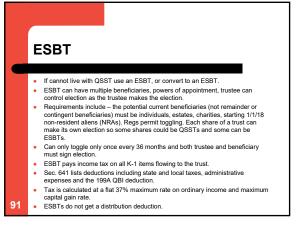


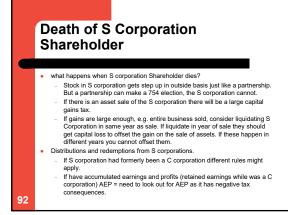


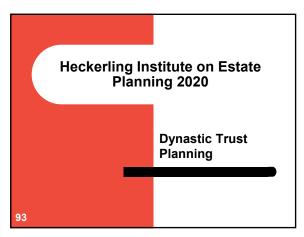


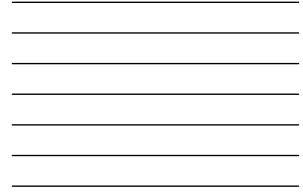


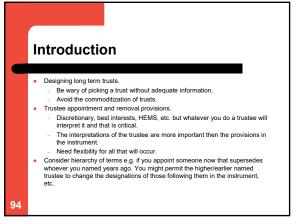


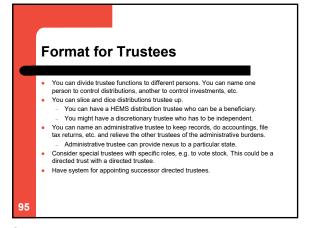




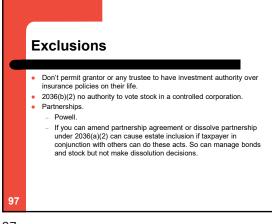






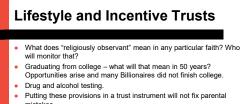








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- mistakes.
  Prenuptial agreement is this practical? What if child decides not to marry to avoid the requirement?
- Incentive trusts match 50 cents for each dollar child makes. So stay at home parent gets no payment. Social worker child gets less money then CEO child. What if can't work due to a disability (e.g. not just child but child's spouse or her children), etc.

# **Defining Beneficiaries**

Descendants How do you define descendants?

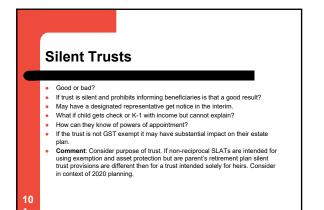
- Is it descendants of either spouse or both spouses? You may represent both spouses so should it be limited to children of just the current marriage?
- Unintended children are they included or not included? When does a child get include? If acknowledged? How? What if there is no relationship and they are only there for the money? Posthumous children? Frozen genetic material how should it be treated?
- Spouses.

#### How define?

Child's spouse is an in-law should they be included? Should it be a bloodline bequest? But that spouse will be matriarch or patriarch of the family at some point. How will other future descendants view their being cut out?

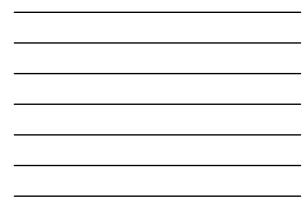
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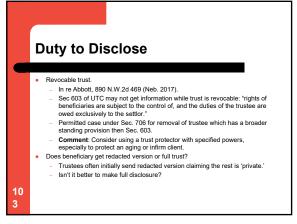
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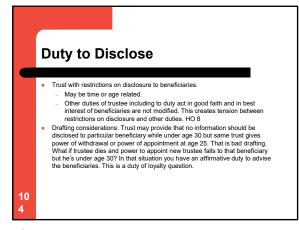


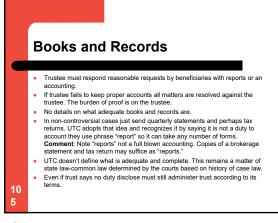
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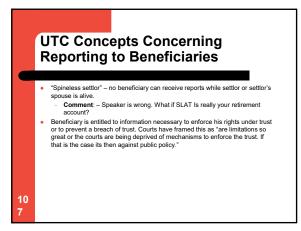


#### UTC Concepts Concerning Reporting to Beneficiaries

- Eliminated outdated concepts of "beneficiaries" and created new concept of "qualified beneficiary" defined as the next in line beneficiary who will receive property if trust ended.
- UTC makes clear distinction between duty to account and duty to inform. . Focus on who the duty is owed to. •
- Qualified beneficiary must be reasonably informed.
- .
- •
- Copy of trust instrument should be provided to a beneficiary. Duty to report is owed to a current beneficiary. Duty to report to a qualified beneficiary is only owed if information is requested. Some states have a concept of a designated representative to whom the trustee can report when not required to or when prohibited from reporting to beneficiaries. They don't change obligation to account but they can designate a person to whom that duty is owed, someone other than a beneficiary. .

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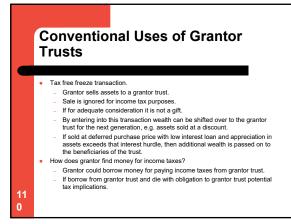




## **Conventional Uses of Grantor** Trusts

	•	Grantor trust status for a trust to pass outside the estate.
		<ul> <li>Grantor pays tax on taxable income of the trust so trust gets tax free growth. This is a potential for a massive wealth sift.</li> </ul>
		<ul> <li>Rev. Rul. 2004-64 IRS conceded that payment of income tax of trust is not a gift for gift tax purposes.</li> </ul>
	•	Tax free swap of assets.
		<ul> <li>With limited exceptions property acquired from a decedent obtains a fresh FMV basis at death. This is a tax free step up.</li> </ul>
		<ul> <li>Grantors who spot low basis assets in an irrevocable grantor trust, the settlor buys the assets back, so they qualify for step up at death. Giving in exchange cash or high basis assets.</li> </ul>
		<ul> <li>Since grantor trust does not have separate identity for income tax purposes the swap transaction does not cause gain to be recognized.</li> </ul>
0		<ul> <li>What is basis when grantor trust status ends? A bit of a puzzle, and this is a Treasury guidance project, unless trust is pulled back into the estate, it is a carryover basis. 1015(b).</li> </ul>

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## Conventional Uses of Grantor Trusts

Lending.

- Family member may want funds to borrow to buy a home, or parent with mounting end of life expenses, a loan can provide liquidity. mounting end of line expenses, a loan can provide induitity. Problem with lending to an individual. Interest must be charged at 7872 rate. That generates taxable income to lender but no deduction for borrower may occur. Individual lender could consider lending instead to a grantor trust. If loan is respected as loan to the trust will not generate taxable income Rev Rul 85-13 grantor trust does not have separate identity for income tax
- purposes. • Trustee can then distribute funds to the beneficiary.

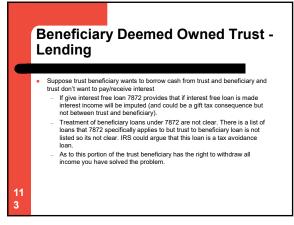
  - This completes the gift for income tax purposes and should be treated as an excluded gift.
    Only should be done if grantor trust has adequate assets to repay the loan.

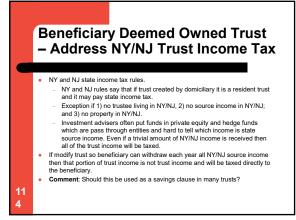
## 3-Beneficiary Deemed Owned Trusts

# Terminology. 3 paths to have beneficiary deemed to own trust. 678(a)(1) – person other than grantor has sole power to vest corpus or income in himself (unless a grantor string overrides it). If can withdraw income the term is used BDOT = beneficiary defective owned trust. Once had sole power to vest income or corpus and partially released and otherwise modified the power and retained a string that would cause a grantor to be treated as owner of the trust (and unless a grantor string overrides it). This called BDT = beneficiary defective inheritor's trust. QSST by election of beneficiary can be treated a owner by the beneficiary if trust meets certain requirements and owns 5 corporation stock. If so, beneficiary can be elected to be treated as owner of S corporation stock.

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## Non-Grantor Trusts – State Income Tax

- Trusts reach maximum bracket at about \$13,000 of trust income.
- When trust and beneficiaries are all subject to maximum brackets use of nongrantor trusts might achieve significant state income tax savings.
   Challenges – must make sure trust is not subject to state income tax.
- Must give beneficiary enjoyment of trust assets without subjecting the beneficiary to state income taxes?
- If trustee makes distributions to beneficiary then she will be subject to high state income taxes.
- state income taxes. ESBT Approach: Put all trust investment property into an S corporation and elect ESBT treatment. Trust will pay tax on all trust income at highest rate.
   ESBT doesn't get distribution deduction so beneficiary has no income. ESBT trustee can make distribution to high tax beneficiary and there should be no state income tax on the distribution.

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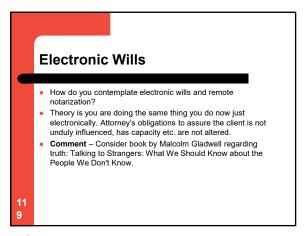
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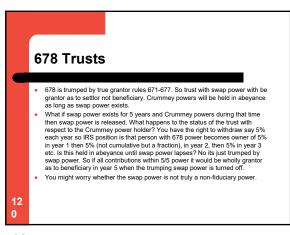
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## Non-Grantor Trust Other Income Tax Planning Benefits

- Progressive tax structure non-grantor trusts distribute to shift income.
- Progressive as audule = nonspanio toss busines to similar technic.
   Beneficiaries below threshold distributions to beneficiary NIIT can shift investment income from trust to beneficiary. Full time student under 24 may be subject to Kiddie Tax and taxed at parent's rate. That applies to income tax but not for NIIT purposes.
- 199A QBI deduction. HO 40. Watch anti-abuse rule that can cause even a single trust to be disregarded.
- Non-grantor trust is a separate taxpayer so per taxpayer benefits can be used. Shift income generating assets to non-grantor trust.
- SALT limited to \$10,000 trusts enjoy the same limitation as an individual so if create a trust can generate an additional \$10,000 SALT limit. Watch multiple trust rule.
- Qualified Small Business Stock. Exclusion of up to \$10M and perhaps more. Requirements of original issuance carry over to done of stock if received by gift so if non-grantor trust receives it by gift it creates the potential for an additional \$10M exclusion.







## **ILITs and Grantor Trust Status**

### Life insurance trusts and grantor status.

- Is it safe to use the power for a trust to use trust income to pay insurance premiums to make the trust a grantor trust? No, you should not do so. No, you would never intentionally use insurance as the sole mechanism to make a trust a grantor trust. •
- If you have life insurance and pay premiums PLR 8852003 no insurance in trust but income could have been used to pay premiums. •
- .
- Question in ruling was could you put S corporation in trust. PLR held yes. 2009 Tax Court Case Petter not squarely addressed but needed grantor trust for transfer and they got that through power to use income to pay life insurance • premiums.
- Comment: The above perspective should be used in planning new ILITs/trusts. It would undermines most old ILITs. Most practitioners have likely taken the position on old ILITs that the power to use trust income to pay premiums makes the ILIT a grantor trust.

121

12

## Form 8971 and Subsequent Transfers

- Form 8971 for subsequent transfers
- . Title of form says information regarding beneficiaries acquiring property from decedent. •
- Doesn't say anything about subsequent transferees. Proposed Reg. requires •
- blossin (say anyuming about subsequent transferees, inclused reg, requires filing for subsequent transfers. If take position on return contrary to proposed Reg you have to disclose. But where do you disclose if you aren't filing Form 8971?
- Speaker says proposed Reg is invalid and contrary to law.
- Spearer says proposed reg is invalid and contrary to law. **Comment:** Example file 89371 showing assets passing into CTIP. Then years later of QTIP contributes assets to FLP Prop. Reg. says you have to file Form 8971 again. It appears no one might be doing this. Panel acknowledged this. However, what's the pros/cons? Even if not required it is just the cost of filing versus the risk of not complying. Response of clients is often not to file. •

122

## Cameron Cleopatra Case – More Thoughts - 1

It's really a "Full Faith and Credit" case.

• Facts: July 2012 situs moved. Following that several 3 or 4 different corporate trustees. Issue was raised 5 years later so avoiding child support was not the motive for the move.

- CA judgment to pay child support from trust. Beneficiary moved the trust to SD. SD court said that matters of enforcement are issues for the forum state, i.e. for SD not CA. SD law says that the trustee does not have to pay child support out of a spendthrift trust.
- CA court is going to have hearing to hold SD trustee in contempt for not making payments out of trust. SD trustee defended on basis that CA court had no jurisdiction over them.
- We may get more law on issues of conflict of laws, etc. as this case progresses.

## Cameron Cleopatra Case – More Thoughts - 2

	•	Personal jurisdiction over trustee was discussed in another case.
		<ul> <li>Kloiber v. Kloiber dynasty trust Kentucky 2014 case.</li> </ul>
		<ul> <li>KY court dismissed corporate trustee from DE on grounds that KY court had no personal jurisdiction over trust.</li> </ul>
		<ul> <li>If you have an institutional trustee that is a N.A. = national association as trustee there may be jurisdiction anywhere.</li> </ul>
		<ul> <li>If have only DE trust company there may be no personal jurisdiction outside DE.</li> </ul>
		<ul> <li>Matter of Daniel Kloiber Dynasty Trust, 2014 WL 3924309 (Del. Chan., Unpublished, Aug. 6, 2014). Full opinion at <u>http://goo.gl/UFF0r8</u></li> </ul>
	•	If CA has personal jurisdiction over SD trustee then it, i.e., CA, would be the forum state, and the CA court would then apply CA law as to enforcement not SD law.
12 4	•	Would this apply to exemption statutes for the forum state? Would seem to be covered.

124

## Cameron Cleopatra Case – More Thoughts - 3 Changing situs in Cameron case. What effect on governing law? Does changing situs also change governing law? Look to the trust instrument first. Does the trust instrument say if change situs that will change governing law. Validity, construction and administration. If no specific language in trust agreement, then changing situs of trust may not change governing law as to validity (you cannot resurrect and invalid trust by moving it). As to construction there are cases going both ways under conflict of laws. As to administration it should shift to new situs where trust is moved to. Where is trust being administered? Example – trustees in multiple states, assets invested in a third state, etc. **Comment**: See the Kaestner case with trustee and asset administration in states outside and other than NC. If you have directed trustees administrative trustee is doing limited functions and has no liability other than willful misconduct so that trustee might be characterized as a mere custodian.

125

## Cameron Cleopatra Case – More Thoughts - 4

- Comment: Consider implication of above comment to non-DAPT jurisdiction comment consider implication of advectoring to independent of the parameters of the
- function and have trustee invest some of funds in DAPT jurisdiction. Should beneficiary have right to change situs of trust? If can change to state that would permit creditor to get to trust corpus. Creditor may say that the creditors stands in beneficiary's shoes and should be able to force that change to a creditor favorable jurisdiction. If a beneficiary as trustee has right to distribute to themselves that will be cut back to HEMS standard if not overridden by trust instrument. If beneficiary can move to state without HEMS standard will IRS argue HEMS is not applicable. So, do not give beneficiaries right to change situs. In the Matter of the Cleopatra Cameron Gift Trust, Dated May 26, 1998, & the Cameron Family Trust, dated Dec. 20, 1996, as amended., 2019 S.D. 35

## **Crummey Powers**

- Does a Trustee have to issue written Crummey powers?
- Written notice is not required.
- Turner case.
- TAM IRS issued is not authority.
- Comment: If the trust instrument requires notice, even if that notice is not required to make a gift qualify as a present interest for the annual gift tax exclusion, might that mandate in the trust (if the trust language in fact mandates it as some do) make it necessary for the trustee to give notice to meet the trustee's duties under the trust? Consider a written notice by beneficiaries waiving the requirement for annual notice. Also, consider the potential impact of the Democratic proposals of a \$20,000 cap on annual gifts per donor.

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12

## GST Bequest Not Considering 2017 (or even 2010) Increase in Exemption

- GST bequest under poorly drafted instrument: "maximum GST exempt amount to grandchildren, and balance to children."
- When will signed \$1M GST exemption, on testator's death GST exemption had increased to over \$11M.
- .
- Kids get nothing. No way to elect out of GST at death. You can opt out only for lifetime allocation. • Need to not use formulas that assume tax laws will stay static. Especially in smaller estates. What if we have a repeal of GST tax like 2010? Put floors and ceilings on formulas.
- Comment: What can you do about existing will with this type of issue? Ask court to reinterpret/reform governing instrument? Might a trust protector tax authority be of use? Disclaimers by grandchildren that might shift assets to children under final takers provision?

8

128

## Should You Get a PLR for an ING? Are PLRs advisable for ING trusts? As a general matter speaker rarely gets such a ruling. First from a practical perspective there is often not enough time to get a ruling between date of gift and sale of company. . There have been a lot of rulings on INGs and many PLRs have created a "cookbook" of criteria that is a pattern to follow. IRS said it won't rule unless you meet the criteria, so why not use them? So, unless you are doing something unusual why get a ruling? 12 9



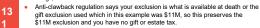
## Should You Report Charitable Gifts on Form 709?

- Most people do not report charitable gifts on returns. So you are not violating a standard of care.
- Conclusion there are unusual circumstances where you want to list all charitable gifts.
- If you have a "hairy" transaction you want to report all charitable gifts so you don't let the IRS have a basis to argue that the return was improper and that the statute of limitations does not toll.
- You could also face risk of a substantial omission of gifts and turn the 3-year statute into a 6-year statute of limitations.
- Comment: Why not report to make the return complete rather than pick and choose when it might be necessary? How hard is this to do anyway as you have all contributions for wealthier clients listed on 1040?

0 130

13





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## Gift to Includable Trust to Secure Exemption is Risky - 2

- This facilitated taking advantage of the window of opportunity.
- NYS Bar tax section said this is "too good" a thing and there should be an antiabuse rule.
- Do you think Treasury will promulgate Regs to prevent this abuse? Uncertain.
   Believe IRS is working on this project. Even if this gets on the priority guidance plan, we may not hear. IRS may just leave this as a "chilling" effect.
   Speaker referred to the above as a "ploy."
- If your client is not willing to do anything else you might try the above but explain the risks to the client.



## Can't Locate Final Appraisals or Final 709 - 1

- You're new counsel for a client and no one can locate a final appraisal or Form 709 for a prior year note sale transaction.
- Cash gifts made as seed gifts to irrevocable trust in year 1, followed by note sale in year 2.
- Client can only find draft 709 and draft appraisal, cannot find final return or final • appraisal. Uncertain if 709 was filed. .
- Ask IRS for transcript which will show if filed. .
- What does counsel do if appears that gift tax return was not filed? Contact appraiser that did draft and try to get a final appraisal, and use it as support that presumably no gift occurred as trust paid FMV. If appraiser cannot be located, or won't give a final report, you could rely on draft appraisal but that is problematic. Confirm trust paid FMV.

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## Can't Locate Final Appraisals or Final 709 - 2 If you believe a gift was made then you have to file a late filed gift tax return. If there is tax owed you have to pay tax, interest and penalties for failure to file over all the years, etc. Get tolling agreement from prior professionals. . Reasonable cause may be from reliance on professionals but need proof. Boyle case cannot delegate filing you have to follow up with tax advisers. File return and disclose sale and start statute. If no gift you might just not file, but then advise client that the statute of limitations will never run. Consider that on 706 has question 13.a. about trusts in existence. So, might you terminate trust and distribute out to existing beneficiaries to avoid having to answer that question. . If you decant it is the same trust and you should check the box as its misleading if not fraud. **Comment**: Others take the opposite view of this.

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4

## QTIP Planning - 1 Surviving spouse makes large gifts and sales from QTIP. Kite case impacts QTIP Planning. Sec. 2519 if distribution of qualifying income interest then that is treated as deemed distribution of all of the trust remainder interest which could be a huge gift and gift tax cost. .

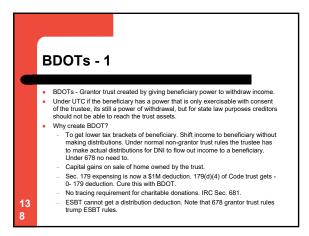
- Kite was quite complex. Assets into FLP then to spouse then sold to for a deferred annuity with no payments for 10 years. •
- The distribution of assets combined with the sale of the assets for the deferred . annuity constituted a deemed 2519 transfer.
- Dictum in the case that said mere termination of the QTIP alone is a Sec. 2519 transfer, but commentators say this is wrong.
- Contributions into LP but no finding that that was a deemed 2519 distribution.

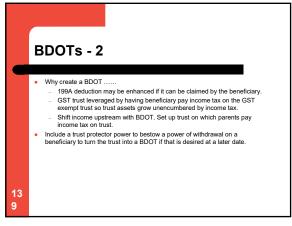
# <section-header><u<section-header><list-item><list-item><list-item> OTIP Planning - 2 • Origination of the transactions for a 2519 challenge. Also, consider in the deferred annuity effectively prevented the surviving spouse for a visual data contrast with a not esaw of the deferred annuity effectively prevented the surviving spouse for a visual data contrast with a not esaw of the deferred annuity effectively prevented the surviving spouse for a visual data contrast with a not esaw of the deferred annuity effectively prevented the surviving spouse for a visual data contrast with a not esaw of the visual data contrast with a not esaw of the visual data or a visual data contrast with a not esaw of the visual data or a visual data or a visual data contrast with a not esaw of the visual data or a visu

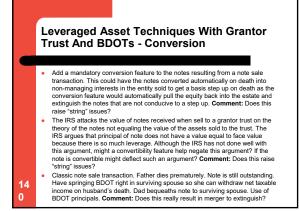
If HEMS standard might consider amending the trust to expand the standard.
 That might be a better approach but may have gift tax implications.

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## Leveraged Asset Techniques With Grantor Trust And BDOTs - State Income Tax Savings

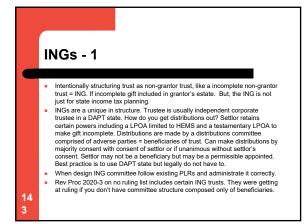
- Family in CA creates pot trust for 3 kids in CA.
- One child wants to go to TX. Lawyer suggests have pot trust with one exception, have TX beneficiary be able to withdraw all net taxable income? •
- . Have independent trustee or protector who can remove that power
- Maybe understanding is that TX kid withdraws that amount to pay federal income taxes.
- No other beneficiaries nor trust will pay income taxes in CA on this application of a BDOT.

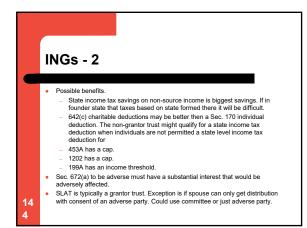
## Charitable Planning With Nongrantor Trusts

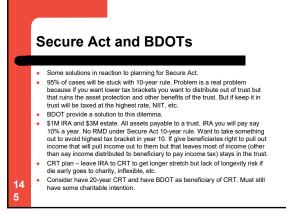
- Individuals get charitable deduction under Sec. 170.
- Introviousing get charinable deduction under Sec. 170. Trusts are subject to different set of rules under Sec. 642(c) for charitable contributions, except for trusts owning S corporation stock. Powerholder wants to appoint asset to charity. Trustee must show assets purchased with gross income or the deduction is limited.
- •
- If the client is the grantor and the grantor is alive then have the grantor purchase asset from trust for an unsecured loan. This makes the otherwise non-grantor trust a grantor trust as the Grantor becomes owner of that portion of trust because of unsecured loan under Sec. 675. •
- Interest is ignored for tax purposes. Client can then give appreciated trust assets to charity and can, if follows other rules, get a charitable contribution deduction personally (and carryforward excess for 5 years). If grantor is not alive separate trust into two parts and give beneficiary right to withdraw income making trust grantor as to beneficiary.

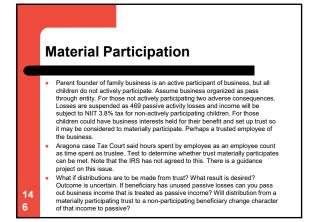
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## Domicile Considerations

### Migratory client moving from state to state.

 Many clients return as they age to be in high tax state they left to be near family. E.g. when spouse dies they may return home to family.
 Tax reduction.

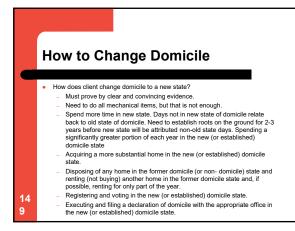
### State estate tax.

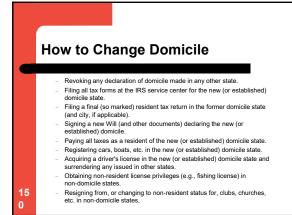
- If not resident in state only tangible and real property with situs in state is taxed only.
- Can we transmute tangible situs-ed assets into movable one and avoid state estate tax.
- Pass through entities don't always work. Need multipole owners, pay rent on house in LLC, etc.
- CT just passed unintelligible laws and may look through a pass-through entity.
- Leaving in-state property to a surviving spouse may not be sufficient to get 100% marital deduction.

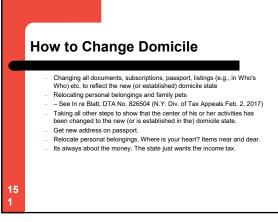
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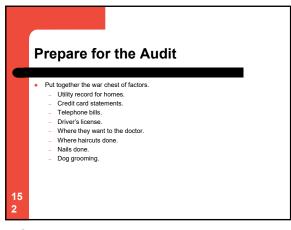
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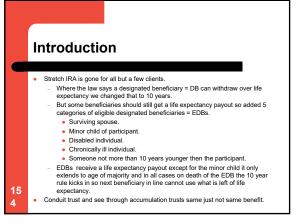


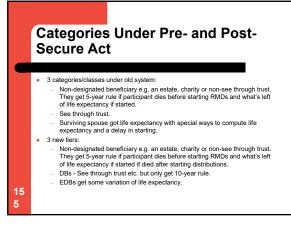


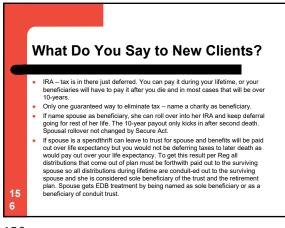


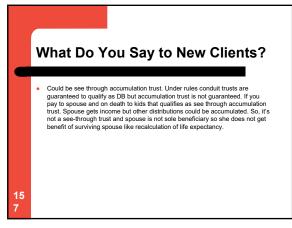


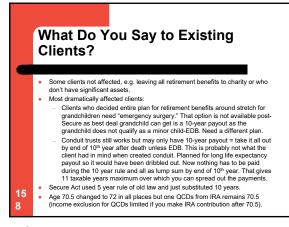




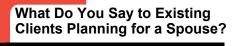








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Client who left benefits to spouse combination conduit QTIP works as before with one change that when spouse dies 10 year rule kicks in on surviving spouse's death.
 You could still get life expectancy payout by using a conduit trust for a surviving

 You could still get life expectancy payout by using a conduit trust for a surviving spouse. But that is not what client may want as that does not preserve money for children. If use conduit trust and surviving spouse lives to life expectancy the entire IRA would be distributed to spouse which is not what the client wanted as nothing will be left for the children (e.g. of a prior marriage). The accumulation trust will still give desired result, i.e. no change in estate plan but the tax result won't be as before

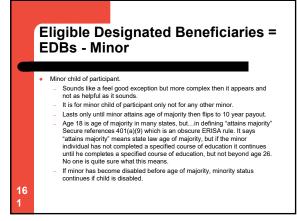
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## What Do You Say to Existing **Clients Planning for a Spouse?**

- Client in second marriage. Wanted to protect surviving spouse so under old rules left plan to see through accumulation trust. A classic QTIP trust that gave spouse income for life and on death remainder to children. That was a classic accumulation trust. Qualified as see through trust and DB. Under old rules that the second s Turst got life expectancy payout but under Secure Act it's a 10 year payout (10 years after decedent's death). Tax will be due in 10<sup>th</sup> year at high trust income tax rates. Income can still be paid out to surviving spouse over life expectancy and remainder held for children, but a substantial tax will be due in the 10<sup>th</sup> year.
- The Secure Act doesn't force termination of accumulation trust...it just does whatever terms of trust say. But because its an accumulation trust and not a conduit trust the plan must terminate in 10 years.
- Some client might keep existing plan under new Secure Act rules.

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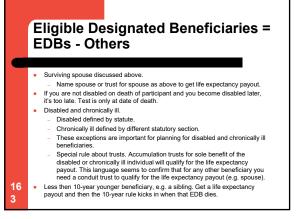


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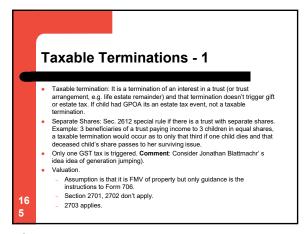


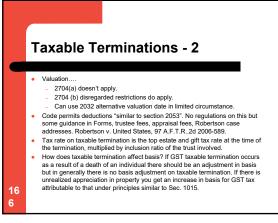
So, benefits have to be paid out by age 36. How useful is this exception? Few parents die while child is under 21 and its even rarer that both parents de before child is 21 and have significant retirement benefits. Better option may be to write trust for children that clients want and not focus on this minor child exception that is unlikely to ever happen.

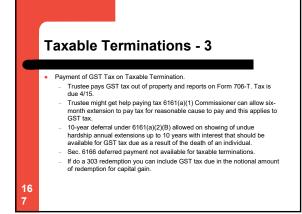
- If there is an issue of not enough money buy life insurance.

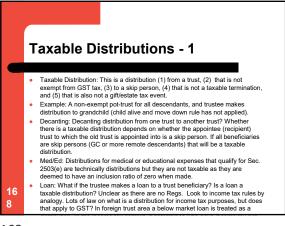


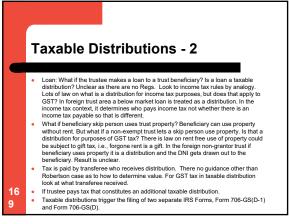


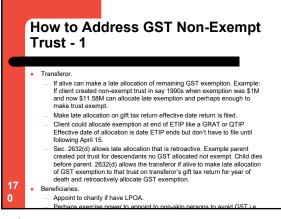












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## How to Address GST Non-Exempt Trust - 2

Beneficiaries.

Appoint to charity if have LPOA.

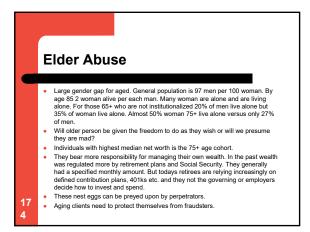
- Exercise power to appoint to non-skip persons to avoid GST i.e. push property out but that might undermine overall planning.
- Exercise power to lengthen trust to defer tax if within permissible period for
- Exercise power relighter that to derer day in winning permissione period for rule against perpetuities. Exercise LPOA to add additional non-skip persons and defer tax. But there are special rules. They must have substantial interest and cannot just be added to postpone GST tax.
- Beneficiary may be able to trigger gift or GST tax. E.g. release GPOA. If beneficiary has a LPOA that can postpone vesting of interest beyond initial perpetuities date it may trigger DE tax trap.

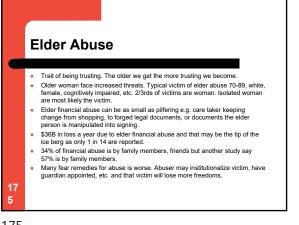
## How to Address GST Non-Exempt Trust - 3

	<ul> <li>Trustee the legal holder of property ultimately subject to tax.</li> </ul>
	<ul> <li>Distribute trust assets to non-skip persons.</li> </ul>
	<ul> <li>Make medical/educational distributions to skip persons.</li> </ul>
	<ul> <li>Let beneficiaries use property rent free (avoids/defers taxable distribution).</li> </ul>
	<ul> <li>Use a decanting power or power to add beneficiaries to postpone the GST tax.</li> </ul>
	<ul> <li>May have power to give non-skip person GPOA to attract estate tax instead of GST tax (but be careful of that person lives in a state with a state death tax).</li> </ul>
	<ul> <li>Severances to use discount planning. Watch business purpose and fiduciary duties.</li> </ul>
	<ul> <li>Trustees of non-exempt trusts can freeze those trusts by selling assets to a exempt trust.</li> </ul>
17	<ul> <li>Freeze transactions may be possible in limited ways.</li> </ul>
2	

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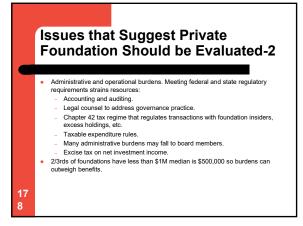




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## Issues that Suggest Private Foundation Should be Evaluated-1

- Internal disputes is a major cause of PF dissolution.
- Executive team, board, staff or any combination can have conflicts. Most toxic element is family.
- . Family dynamics and generational differences can make running PF difficult.
- Foundation may be used to provide income for one or more family members who need a job. Some family members can be excellent but some are not, can result in self dealing issues and family issues that some are employed and others are not. .
- Outside pressures can be a problem. Example: Board member's outside activities may adversely affect reputation.
- State AG investigation can close down (e.g. Trump foundation).





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## Termination

- Can split up and continue existing foundation.
- Can divide into and pay over to multiple foundations or DAFs.
- Governing documents should provide to comply to pick 501(c)(3) recipient.
   If made to other than a 501(c)(3) could be subject to penalty excise tax.
- In made to other main a bull(c)(3) could be subject to penalty excise tax.
   Consider restrictions in governing instrument, e.g. imitations on causes to support or investments.
- UMIFA may have to be considered.Consider restrictions in governing documents.
- Consider restrictions in governing documents.
   Easiest approach is transfer assets subject to donor's restrictions if not have to have restrictions released by donor or a court.

## **Voluntary Termination**

- Complex chapter 42 rules (no self dealing, etc.) must be addressed. Sec. 507 foundation must notify IRS and may face a termination tax.
- Sec. 507(a)(1) voluntary termination if notify IRS of intent to terminate status and pay termination tax that has not been abated.
- Option to transfer to one or more public charities.
  Must submit statement of intent to terminate foundation status and calculation
  - of 507 tax. Termination tax on lesser of:

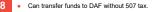
  - Tax benefit from termination, or Value of net assets of foundation.
- There are many exceptions for termination tax in Regs and IRS guidance. Because of complexity and ambiguity of Sec. 507 and Sec. 4940-4945 in past many PFs asked for PLRs. Now PLRs are generally unnecessary because of middane US has repride . guidance IRS has provided.

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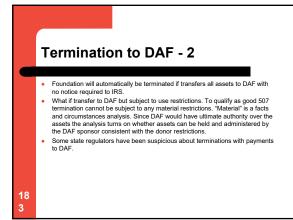
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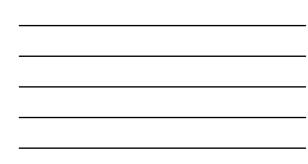


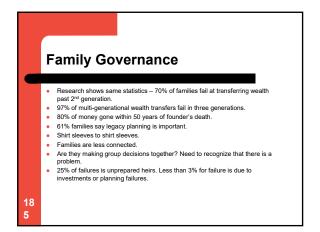
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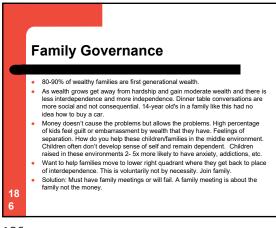






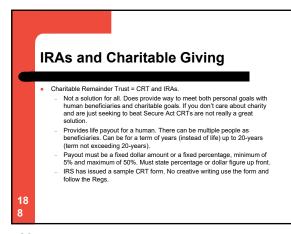


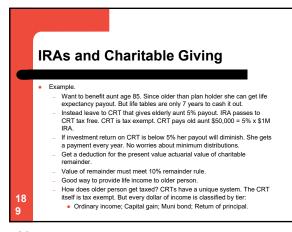


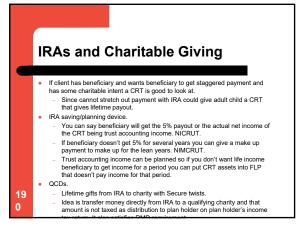


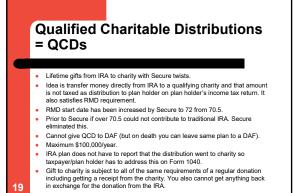










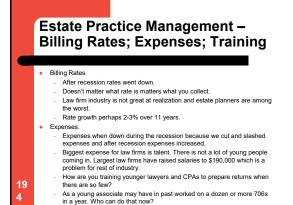


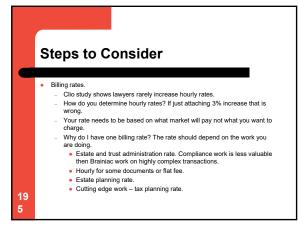


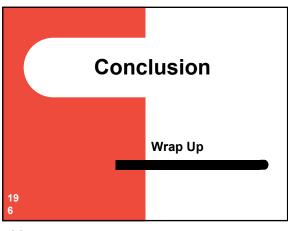
## Estate Practice Management – Estate Planning Services

Demand for estate planning services down 25% in 10 years. Went up in 2012 because of the fear of the exemption dropping from \$5M to \$1M and all were busy. • Went up in 2017 so wealthy clients doubled up in on gifts. Only 2 up years out of 11. Why is demand down 25%? . • See in number of estate tax returns filed: - 2000 – 108,322 706s filed and 52,000 were taxable estates. • 2012 - 9,412 estate tax returns filed and of those 3,738 were taxable estates. 2017 – most people had left behind great recession 12,711 estate tax returns filed and of those 5,185 had taxable estates. That doesn't reflect that in 2017 exemption doubled so going forward it will be even fewer. 19 2020 estimate fewer then 5% of returns filed in 2000 will be filed today.
 How many attorneys and CPAs does it take to file a few thousand estate tax returns? Not many. 3

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## Grantor Trusts

- Income tax leverage.
- Strategic uses of swap powers.
- Reverse if have loss asset you would get step down in basis so shift it into the grantor trust.
- Caution about swapping with notes. It does not work. I cannot buy asset from grantor trust with my own note as note will have tax basis of zero since note doesn't exist for income tax purposes, so you have gain when start paying note. Better to borrow from independent bank and use cash for swap. Get credit facilities set up.

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## Installment Obligation Outstanding At Death

- Death is not a realization event.
- If qualifies under 453(b) you would elect installment treatment as deemed sale occurs at moment grantor died.
- Death is not an income tax realization event.
- A CCA in 2009 addressed turning off grantor trust status. Chief Counsel agreed that turning off grantor trust status was not a realization event.
- Agree that there is carryover basis. Sec. 1015.
- Noted Blattmachr article suggesting that there is a basis step up.

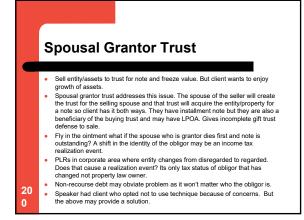
## BDOT

Income tax shifting to people in lower brackets.

- If you have discretionary non-grantor trust and distribute to beneficiary, it will carry out income through DNI. Purpose of BDOT is to shift income tax without requiring an actual payout.
   Shifts taxation of trust income to beneficiary without a mandatory payment.
- Shins taxation or trust income to beneficiary without a mandatory payment.
   Concern when someone has the right to withdraw but doesn't do it. Is the nonwithdrawal a gift by the beneficiary to the trust?
- A withdrawar d int by one beneficially to the user. A withdrawar light is same as income right under QTIP Regs so its not such a strange concept. But there are some words in the Regs that indicate that you have to be able to withdraw the corpus for the trust to be fully treated as fully grantor, e.g. to support sale transactions. Based on this speaker would not use a BDOT as recipient of an installment sale transaction.

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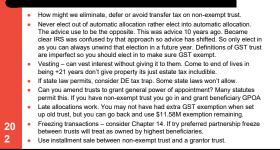
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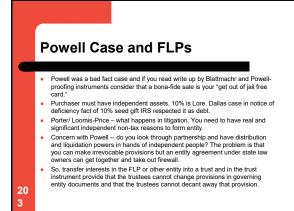
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## **GST Non-Exempt Trusts**



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# Trustee Disclosures to Beneficiaries

- If you are a fiduciary disclose disclose disclose.
  But what if settlor has settled trust in state that prohibits
- Entitlement to information may be the entitlement to an
- Enduement to information may be the enduement to an accounting. Many forms try to waive duty to account. Consider being more articulate and differentiate providing information versus an accounting.

