Heckerling Institute on Estate Planning 2020

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A KEY ESTATE PLANNING GUIDE

LawEasy

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Grantor Trusts - Fundamentals

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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.

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History of Grantor Trusts

- IRS was concerned about this and Treasury issued regulations saying that if certain powers were retained you would be treated as the deemed owner of the trust income. But this did not have sufficient force but that changed with enactment of 1954 Code which introduced grantor trust provisions of Section 671-679 provisions of the Code.
- Those rules are 65 years old.
- 671 trust income deduction and grantors are treated as substantial owners.
- 672 definitions and rules.
- 673 reversionary interests
- 674 power to control beneficial enjoyment
- 675 administrative powers.
- 676 power to revoke.
- 677 income for benefit of grantor.
- 678 person other than grantor treated as substantial owner.
- 679 foreign trusts having one or more US beneficiaries.

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History of Grantor Trusts

- **2020**. Federal income tax brackets are fewer and not as progressive.
  - Rates from 10% to 37%.
  - Much less progressive then 1954 rates.
- Separate rates for trusts.
  - Trusts have thin tax brackets. Once trust has $13,150 of income its in the 37% bracket, as compared to a single individual at $518,400.
  - Preferential rates for dividends and capital gains 23.8% bracket applies to trust after same $13,150 trust.
  - Wealthy people cannot create trust to save on income tax on tax rates.
  - If you have assets in trust for non-income tax reasons it may make sense to structure trust as grantor trust rules to avoid the non-grantor trust rates above.
  - So, the 1954 trusts trap is now an affirmative planning opportunity. Sections 671-679 give you a checklist for how you may want to structure a trust.

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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?

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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 won't 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 non-grantor 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.

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Non-Grantor Trusts and the Multiple Trust and Anti-Abuse Rules

- 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 **principal** purpose of avoiding Federal income tax. Regs defer to statute.
- If same grantor create trust for same beneficiaries and only creating multiple 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?
- 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.

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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.

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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 had 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 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.

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Powers that Will Not Create Grantor Trust Status

- Not-Grantor Trust, But Gross estate inclusion.
  - Testamentary power to control distributions.
  - 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 non-fiduciary 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. **Comment**: 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 **actually** 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.

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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.
- Madorin v. Commissioner, 84 T.C. 667 (1985) iinvolved 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 non-fiduciary 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 grantor 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.

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

- Swap power may be the magical power. Note that you can still engage in many of the same transactions without a swap power but need trustee approval and trustee owes fiduciary duty to the beneficiaries not the settlor.
- Be aware of lurking danger of swap powers.
- High basis asset swapped into grantor trust for low basis assets to get step up. Risks exist! What if valuation is wrong. That might result in a gift if the value of what is swapped out is too small.
- Consider incorporating a Wandry clause in the transfer documentation consummating the swap. Use a Wandry clause to swap value for value. I am transferring $3M worth of property versus $3M worth of fractional interests in real estate, as an example. If the IRS challenges the valuation then the interests in property are adjusted accordingly. This is because it was an exchange of value not an exchange of assets.
- **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 beneficiaries.

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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?
- 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 grantor 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.”
- **Comment**: Different Crummey powers in non-reciprocal SLATs.

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Life Insurance and Grantor Trust Status and Estate Inclusion Considerations

- 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).
- 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 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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Life Insurance and Grantor Trust Status and Estate Inclusion Considerations

- 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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Tax Reimbursement Clause

- A key benefit of a grantor trust is that when income is taxed to grantor, it is a huge estate tax savings.
- But, clients often do not like writing the check for taxes.
- Some grantor trusts have tax reimbursement clauses for trustee to pay grantor back for income tax paid. Does that work without creating adverse tax results?
- Rev. Rul 2004-64
  - Grantor's payment of tax on trust income is not a gift to the beneficiaries (or the trust).
  - Discretionary tax reimbursement clause does not cause gross estate inclusion and is not a deemed gift from the beneficiary's (assuming no understanding that the trustee will exercise discretion in grantor's favor).
  - Mandatory tax reimburse clause does cause gross estate inclusion under Sec. 2036(a)(1).

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Tax Reimbursement Clause

- Don't get into the habit of regularly reimbursing the grantor as that defeats the point of the grantor trust status. If paying the trust's tax is not a gift it is functionally like making tax free contributions to the trust, why eliminate that? It is generally better for the grantor to pay the tax. In some states it might present a creditor issue if under state law if the grantor can get reimbursement that might give creditors access to the trust. DE statute expressly provides, for example, that a tax reimbursement clause does not give creditors the right to reach the trust assets.
- **Comment**: Recent CA malpractice case.
- **Comment**: Case where father sued son to get tax reimbursement added.

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Toggling Grantor Trust Status

- Toggling Grantor trust status on and off.
  - Loan power can do this.
  - Grantors would love a switch to turn off or on grantor trust status for every transaction.
- How can I turn on grantor trust status?
  - Springing powers. Have trust become grantor on a certain date or upon the occurrence of a certain event. Caution as that is difficult to predict or to draft.
  - Power conferred by trust protector - discretion to give a grantor trust power to the grantor when they wish to.
  - Actual loans to grantor/grantor's spouse.
  - Decanting – distribute trust to new trust that is a grantor trust. There is some concern or question on this. Is this ability to turn on grantor trust status through decanting violate decanting statute that requires alignment of interests before and after the decanting. There is no definitive consensus.

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Toggling Grantor Trust Status

- Turning off grantor trust status off.
  - Grantor can renounce power.
  - Trustee can cede power to add charitable beneficiary, etc.
  - Decant into a non-grantor trust.
  - This should be feasible to give up a power without making a gift.

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Note Sale to Grantor Trust

- 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.
- 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.
- **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?

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Note Sale to Grantor Trust

- Do you disclose installment sale on a gift tax return?
  - The technical answer is no but some practitioners do advise their clients to report a no-gift transaction on a gift tax return to start the statute of limitations on any valuation issue on the transaction. In most instances the asset is a difficult to value asset. If you file a gift tax return disclosing non-gift transaction it starts the 3-year statute of limitations. Others do not disclose.
- What happens if grantor dies before note is repaid?
  - What is the tax consequence if grantor dies in year 7 of a 9-year note?
- The trust is no longer a grantor trust.
  - There is no longer a deemed owner. The trust is no longer a grantor trust and absent a provision in the trust that might make someone else a 678 like owner the trust becomes a non-grantor “standard” irrevocable trust.
  - Is loss of grantor trust status a gain recognition event? Is it now a sale between a non-grantor trust.
  - If it is a gain where is it reported?

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Note Sale to Grantor Trust

- ….The trust is no longer a grantor trust.
  - Some say difference between principal value of note and adjusted basis of property that was sold should be reported as gain on decedent’s final income tax return.
  - Sale even if one occurred happed at death so does not belong on decadent's final 1040.
  - Chief counsel memorandum suggests conversion from grantor to non-grantor trust is not automatically a taxable event.
  - Does it get reported on the estate’s income tax return? No it should not be on 1041 as that captures sales made by estate and it was not IRD either so it should not be reported.
  - So there is a gap in finding an adequate return to report this on and IRS seems to say conversion of grantor to non-grantor trust is a non-event, there is no gain event.
  - So it is probably not a taxable event.
  - But, subsequent payments on note will be taxable.

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Note Sale to Grantor Trust

- What is the trust's income tax basis in the property purchased in the transaction?
- 1) Cost basis.
- 2) Sec. 1012 says except as otherwise provided, basis of property is cost to acquire property. A now non-grantor trust has acquired property. What did trust pay? $10M promissory note so under Crane and Tufts cases when you incur legal obligation that gives your basis so basis is $10M.
- 3) Stepped up basis. To get a step up in basis property must pass from a decedent. Sec. 1014(b)2-9 don't apply. The only one that might possibly apply is 1014(b)(1) that says transfer from decedent. When grantor trust becomes non-grantor trust that is a constructive transfer from the decedent to the trust. There is no guidance that confirms that this happens. This is a minority position. Few commentators believe that there is step up.

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Note Sale to Grantor Trust

- 4) Carryover basis.
  - Section 1015(a) says if you make a gift of property you take carryover basis except for loss purposes.
  - Section 1015(b) carryover basis in gift transaction but in case of non-gift transfers in trust there is a carryover basis. The installment sale transaction at death if you say it's a deal between a trust and a grantor trust it is still a sale for full money's worth so that is a non-gift transfer in trust then the correct answer is 1015(b) then the trust takes the same basis in property that the grantor has.

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Current Developments

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GST Allocations to Old Transfers

- 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?
- 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 gift in 2017 of $10M and only had $5M GST? Can you now allocate GST and when is it effective? Consider doing it like a late GST allocation. Some believe it can relate back to the date of gift other suggest the first of the year the allocation is made.
- **Comment**: This is a huge opportunity especially for smaller clients.

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Wealth Tax

- Not clear what to do to plan for a tax the nature of which you do not know.
- Goal is to break up large concentrations of wealth and fund progressive projects. The estate tax alone is not sufficient to accomplish this.
- Issue - The Constitution prohibits Federal government from imposing direct taxes unless proportioned among the states by population.
- A direct tax e.g. is a real estate tax. Indirect taxes are voluntary, e.g. things you don't have to do, like a transfer or transaction tax.
- Will a wealth tax pass Constitutional muster? Not clear.
- **Speaker believes proposals are serious since other tax changes have not curbed wealth concentration**.
- A 2% wealth tax if you have 2% return on investments you have nothing left.
- Valuation issues. Several countries have enacted wealth taxes and repealed them.

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199A Final Regs

- QBI 20% deduction for income from a flow through entity.
- What if have taxable income over threshold amount there are restrictions.
- DNI carries out QBI under the final Regs (had not done so under proposed Regs).
- Final regulations under Section 643(f) with anti-avoidance provisions with respect to the use of multiple nongrantor trusts.
- Reg. §1.199A-6(d)(3) requires that a nongrantor trust or estate conducting a trade or business allocate QBI, expenses properly allocable to the trade or business, W-2 wages, and UBIA of qualified property among the trust or estate and its beneficiaries. The allocation is based on the ratio that the distributable net income (DNI) distributed or deemed distributed to each beneficiary bears to the trust's or estate's total DNI for the taxable year. Any DNI not distributed is allocated to the nongrantor trust or estate itself.
- Sections 199A and 643(f) – Qualified Business Income Deduction: T.D. 9847, Rev. Proc. 2019-11, Notice 2019-7, REG-134652-18.

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Anti-Clawback Regulations

- 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 said it was reserving comment and will make further consideration. So be careful of using this kind of strategy.
- Reg, §20.2010-1(c), T.D. 9884 (Nov. 22, 2019), 84 FED. REG. 64995 (Nov. 26, 2019).

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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 1's descendants, naming Child 1 as trustee
- Trustee wishes to buy a life insurance on the joint lives of Child 1 and Spouse, 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 life, (ii) add independent Insurance Trustee with sole authority over 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.
- IRS ruled 2042 would not apply.
- 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.

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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 rate 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 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 – Pending Merger

- Grantor was Chairman of the Board of public company and gave shares to GRAT.
- Does donor have to consider impact of anticipated merger. Grantor knew discussions of merger were ongoing. Or can you use mean between high and low value?
- FMV is hypothetical willing buyer would pay to hypothetical willing seller even if actual facts are not known. Reasonable knowledge of relevant facts would include merger so to ignore the fact of the pending merger would be wrong.
- Note that federal securities laws would prevent Chairman from telling anyone of possible merger.
- Recommendation use a GRAT not a note sale so you have a valuation adjustment mechanism.
- Concern is that a public market is premised on everyone knowing everything.

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Valuation – Pending Merger

- Conclusion of CCA: "*Under the fair market value standard as articulated in §25.2512-1, the hypothetical willing buyer and willing seller, as of Date 1, would be reasonably informed during the course of negotiations over the purchase and sale of Shares and would have knowledge of all relevant facts, including the pending merger. Indeed, to ignore the facts and circumstances of the pending merger would undermine the basic tenets of fair market value and yield a baseless valuation.*"
- Chief Counsel Advice 201939002 (issued May 28, 2019; released Sept. 27, 2019).
- **Comment**: Consider when client wants ING before sale of company. How far forward has the transaction progressed? Has the gain already been earned in the high tax state?

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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.

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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 self-dealing 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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GST Allocation on Form 709

- Gift to trust made and intent was to allocate GST exemption (automatic allocation rules may have allocated).
- The problem was that the taxpayer's gift tax return first opted out of the automatic allocation then intended to attach an affirmative notice of allocation but forgot to do so. Do NOT opt out then allocate. Instead opt in.
- The IRS was gracious and found that the taxpayer substantially complied with the requirements for allocating GST exemption to an indirect skip trust, despite failure to include a notice of allocation. This was based on the return and the language in the trust.
- Letter Ruling 201936001 (issued May 6, 2019; released Sept. 6, 2019).

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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).

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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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Trust as Alter Ego

- Father created irrevocable trust for children and transferred rental real estate. IRS sued trustee to recover taxes father owed. Trustee moved to dismiss the trusts because they, not father, owned trust was not liable for father's tax obligations.
- Court refused to dismiss trust as defendant because IRS may establish that father was true owner of the trust property.
- Bad facts:
  - Father pays individually both the municipal taxes and utility bills.
  - Father receives rental income indirectly
  - Father receives his mail at the address of the trust's property.
- If the trusts were father's nominees or alter egos, the tax liens could be attached to the trust assets.

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Trust as Alter Ego

- Factors to consider in nominee argument include:
  - Whether trust as nominee paid adequate consideration for property.
  - Whether the property was placed in the nominee's name in anticipation of a suit while the taxpayer continued to control the property.
  - The relationship between the taxpayer and the nominee.
  - Failure to record the conveyance.
  - Taxpayer's continued enjoyment of the benefits of the property.
- United States v. Hovnanian, 2019 WL 1233082, 123 AFTR 2d 2019-1106 (D. N.J. March 18, 2019).
- **Comment**: How many taxpayers ignore trust formalities?

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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.
- How 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.
- **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 taint 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.
- **Residence of trustees.** The residence of individual trustees is a crucial factor. In the Kaestner 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?

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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 state. If this taint exists, are alternative arrangements available?
- **Location of investments.** The trust should not have any direct investments in the taxing state.

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Spendthrift Clause and Change of Situs

- Case involved a trust administration situs that was moved from a creditor-friendly jurisdiction, CA, to one that is less so, SD.
- Did the spendthrift clause prevail over a court order to pay child support?
- This was a third-party trust. Beneficiary name was Cleopatra. She got divorced. CA ordered her to pay child support and to do so out of the trust.
- Many states have statutes limiting effect of spendthrift provisions especially for child support.
- Cleopatra had authority to change situs of trust and she changed to South Dakota. SD law was different and provided no authority to pay child support.
- There was a valid judgement in CA. Did SD have to respect it? SD Supreme Court cited a case saying that there is a limit on the full faith and credit clause.
- As to issues on the time, manner and method of enforcement, you look to forum state law i.e. SD not CA. under SD law could not enforce. SD spendthrift law expressly stated not to follow Restatement 3rd of trusts and spendthrift wins against child support clause. Note that SD is unusual in that most states would respect the child support order.

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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.

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

- What about basis planning. We should all speak to our clients about basis. Is that conversation now part of the standard of care?
- Many engagement letters are too broad and generic and don't address.
- ***Stevenson v. Stanyer***, 2019 WL 2895378 (Wash. Ct. App. Div. 3 2019).
- **Comment**: Take a broad holistic approach or don't take the client. Many clients don't want to spend the money on planning elements they don't see as necessary yet they may still hold the professional responsible at a later date. Also, try to tailor the engagement letter to the circumstances and document what is and is not being done in communications to the client.

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Proper Documentation Essential

- Taxpayers often get cheap about involving the right professionals in their planning and often take the easy way out. Caveat Emptor.
- Dad instructed the accountant for the company and the family to make annual exclusion gifts from him to each of the children every year of interest in a family company. The accountant, instead of insisting that the client have corporate counsel handle the matter, "made" the gifts for many years by reflecting the changes in ownership on the federal and state Form K-1s each year.
- Years later dad wanted corporation to make a donation. Kids said no and that dad did not have the votes to do it. Dad said show me the stock certificates. There were none. Gifts were made by mere change on K-1s.

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Proper Documentation Essential

- Lawyer for kids said every year when dad presented tax return that was the equivalent of a constructive delivery of shares as those K-1s reported who owned the interests.
- The Virginia Supreme Court, affirming the trial court, held that without delivery of the stock certificates there was no relinquishment by Mr. Knop of his interest in the company.
- Knop v. Knop, 830 S.E.2d 723 (Va. 2019).
- **Comment**: So the intended gifts by K-1s were NOT sufficient nor complete. Clients who try to save a few dollars on proper implementation and documentation may loose out.

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Changing Residence: Tax and Legal Considerations

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Laws and Rights Vary By State

- Who can serve as executor? In FL must be relative. In other states not.
- Publicity rights.
  - NY does not have any post-death right to publicity.
  - CA does.
  - Robin Williams left publicity rights to charity with a requirement that they not be exploited for 25 years. But will that qualify for a charitable contribution deduction?
  - Prince could not control post-death publicity rights under MN law.
- Where you live determines medical decisions.
  - Assisted suicide permitted in about 9 states.
  - Pain relief/drugs use vary by state
- Arbitration.
  - In FL you can mandate.
  - In most states you cannot.

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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 but only state in which tangible 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 ½ of community property and presumption that ½ 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 kept 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 ½ 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.

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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?
- 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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Dual Domicile Risk

- Costly risk getting taxed as a person with two domiciles.
- Landmark case on this – Dorrence.
- Taxpayer worked for Campbell Soup company. He bought out Campbell heirs. He came up with idea of condensed soup. He was held to be a resident by both NJ and PA. Found to have domicile in both states so income all intangible property could be subject to tax in both states.
- Each state could impose its own estate tax.
- Some states, e.g. NY and CT, have a compact which are permitted by state laws to compromise. States might get together and impose highest of two taxes and divide it. But they are not required to do so.
- Dorrance, 309 Pa. 151, 163 A. 303, cert. denied, 287 U.S. 660 (1932).

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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 state consider moving non-compensation income into an ING trust. This can be done even if a resident of a high tax state.
  - NY 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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Ethics Issues and The Modern Family

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Competent Representation

- Duty of competent representation of clients. Rule 1.1 attorney must be competent. What does that mean? We should anticipate issues clients will be dealing with or they could arise in planning for long-term trusts.
- Technology issues, Alexa, social media are all concerns to address.
- Attorney must ask whether he is competent to address issues of changing families. Even if lawyer has different view of choices client makes, still needs to be aware of how those choices impact the documents and planning being put into place.
- Should be culturally aware. Consider moral and religious beliefs, way of behavior etc. that is what a culture entails. Culture is not always apparent. It is good business and good risk management to understand the cultural issues that are part of the client's family relationships, lifestyle, etc.
- Cultural competence is a concept planners need to embrace.
- Clients share with planners matters they may not share with anyone else. We are in a position to anticipate problems that could grow into more significant issues.

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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.

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LGBTQ Considerations

- Q = queer. Term reclaimed form a pejorative phrase in 1980s and refers to people who don't want to be identified as LGBT.
- Ask client how they want to be referred to.
- Non-binary may want to be referred to by name or as "they".
- 4.5% of US population identifies as LGBTQ. That is not the extent of the population. 8% of millennials identify this way but only 3.9% gen X and only 1% of prior generations. That reflects societal norms.
- Approximately .6% identifies as transgender. That is about 2 million transgender individuals in the US. Number is likely higher.
- Definition of descendants as biological or adopted children may not be a viable definition for these clients.
- Do not use language like:
  - Sexual preference
  - Homosexual, instead use LGBTQ or gay.
- Don't say LGBTQ lifestyle – just use lifestyle.

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LGBTQ Drafting Considerations

- Health care provisions in trusts, etc.
  - Include in definitions of medical expenses that trustee can pay for: adoption, gender confirmation surgery, travel related to those procedures…..
- Code Sec 213(d) includes general confirmation surgery as a medical expense so it is not a taxable gift.
- Adoption is not included under Code Sec. 213 so it may be necessary to expressly provide for it as a permissible stated expense.
- Consider successor in interest provisions for individuals in case that individual changes name and/or gender.
- Committed, non-married couples using artificial reproductive technology to build a family should be sure to formalize parentage by adoption or through a parenting agreement.

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Powell – Estate Inclusion and Practical Steps

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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.
- 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 and 2036

- Estate of Powell v. Commissioner, 148 T.C. 392 (2017).
- In Powell the Tax Court determined that the retained right of a 99% limited partner ("LP"), acting **in conjunction with** the 1% general partners ("GP") to vote to dissolve the partnership constituted the right to designate beneficiaries within the meaning of Sec. 2036(a)(2).
- Sec. 2036(a):
- *General rule. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—*
- *the possession or enjoyment of, or the right to the income from, the property, or*
- *the right, either alone or* ***in conjunction with*** *any person, to designate the persons who shall possess or enjoy the property or the income therefrom.*

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2038

- Bona fide sale exception.
- 3-year look back rule.
- Regulatory exception to deal with state laws that settlor in conjunction with beneficiaries could get together to revoke. Reg 20.2038-1(a)(2) if all interested parties consent to transaction and action adds nothing to rights under state law, will disregard as 2038 power. No similar rule under 2036 (i.e. no reg) but may be similar.
- Wall Case.
  - 1993 tax case. If you could remove and replace trustee power of trustee could be attributed to you.
  - The rule did not apply if removed for cause.
  - Estate of Helen Wall v. Commissioner, 101 T.C. 300 (1993).

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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, **in conjunction with** others, could dissolve so that equated to right to determine who possessed partnership property. Previously LP 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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What to Do Post-Powell

- Don't make a revocable transfer.
  - If incompetent involved in transfer, see what trust and durable power of attorney permit.
  - If make gifts in trust if POA limits to only descendants how do you draft a final takers clause? POA could address that by saying: "If I have no decedents then to heirs at law charity, etc."
  - Coordinate power of attorney and revocable trust.
  - When drafting powers of attorney client may be comfortable with agent paying bills but not making gifts so could have a committee or even separate power of attorney dealing with gifting.
- How do you avoid powers that could create 2036(a)(2) problem?
  - Could create Class A shares and Class B shares. Class A are full voting shares. Class B cannot amend partnership agreement provisions that are inappropriate (e.g. re: dissolution), or vote for dissolution. Give mom only Class B shares.

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What to Do Post-Powell

- How do you avoid powers that could create 2036(a)(2) problem?....
  - Create voting and non-voting shares and don't give mom voting shares.
  - Fiduciary duties should be considered for managers/GPs of LLC/FLP.
  - Have co-managers and only permit other (i.e. non-donor) manager or a special manager to hold those powers.
  - Consider a self-settled trust to hold LLC/FLP interests even if it is formed in a non-DAPT state it won't protect from creditors but may create fiduciary duties.
  - Beef up entity duties to show respect for other members and partners.
  - Have meetings and conference calls and document them. Differentiate entity being more than just an investment entity, and make it look more like a business.
  - Give it all away so no retained interest. May have 2704 deemed gift on release of power to liquidate entity.

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S Corporation Traps for the Unwary

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QSST

- 1 beneficiary or multiple beneficiaries with separate shares.
- Beneficiary must get all income from trust. It can be a discretionary distribution standard but must push out all Fiduciary Accounting Income ("FAI"). This is not the K-1 income but rather FAI. This is essentially distributions from the S corporation to the trust.
- QTIP is a good example of a QSST.
- Can a GRAT be a QSST? It's a wholly owned grantor trust so no need to worry about QSST status. But in a QSST the beneficiary not the grantor would pay the tax. A GRAT is not eligible because if the grantor survives the term of the trust all assets pass to beneficiary and that violates rules of a QSST.
- Beneficiary must make the election (rationale is beneficiary is paying the tax). Must make election within 2.5 months of getting stock.
- Beneficiary is treated as direct owner of QSST S corporation interest and K-1 is issued to the beneficiary.
- QSST is treated as two separate trusts: QSST portion = S corporation portion and non-S portion of the QSST.

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QSST

- Can limit income by limiting distributions/dividends from the S corporation.
- Can make dividends in kind. Cannot pay as IOU.
- QSST can have successive income beneficiaries and anyone can refuse to consent to QSST election and S election is terminated.
- Before transferring S corporation stock to QSST to be sure no provisions are incompatible with QSST provisions
  - Example multiple Crummey power holders as a Crummey power is a power to vest corpus in those beneficiaries but QSST rules require only the one beneficiary can benefit.
  - Power of Appointment during lifetime of beneficiary is not permitted.
  - S corporation language even if no S corporation to create "pocket" S corporation trust is worthwhile as it gives trustee right to create a sub-trust

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ESBT

- If cannot live with QSST use an ESBT, or convert to an ESBT.
- ESBT can have multiple beneficiaries, powers of appointment, trustee can control election as the trustee makes the election.
- Requirements include – the potential current beneficiaries (not remainder or contingent beneficiaries) must be individuals, estates, charities, starting 1/1/18 non-resident aliens (NRAs). Regs permit toggling. Each share of a trust can make its own election so some shares could be QSSTs and some can be ESBTs.
- Can only toggle only once every 36 months and both trustee and beneficiary must sign election.
- ESBT pays income tax on all K-1 items flowing to the trust.
- Sec. 641 lists deductions including state and local taxes, administrative expenses and the 199A QBI deduction.
- Tax is calculated at a flat 37% maximum rate on ordinary income and maximum capital gain rate.
- ESBTs do not get a distribution deduction.

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Death of S Corporation Shareholder

- what happens when S corporation Shareholder dies?
  - Stock in S corporation gets step up in outside basis just like a partnership. But a partnership can make a 754 election, the S corporation cannot.
  - If there is an asset sale of the S corporation there will be a large capital gains tax.
  - If gains are large enough, e.g. entire business sold, consider liquidating S Corporation in same year as sale. If liquidate in year of sale they should get capital loss to offset the gain on the sale of assets. If these happen in different years you cannot offset them.
- Distributions and redemptions from S corporations.
  - If S corporation had formerly been a C corporation different rules might apply.
  - If have accumulated earnings and profits (retained earnings while was a C corporation) AEP = need to look out for AEP as it has negative tax consequences.

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Dynastic Trust Planning

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Introduction

- Designing long term trusts.
  - Be wary of picking a trust without adequate information.
  - Avoid the commoditization of trusts.
- Trustee appointment and removal provisions.
  - Discretionary, best interests, HEMS, etc. but whatever you do a trustee will interpret it and that is critical.
  - The interpretations of the trustee are more important then the provisions in the instrument.
  - Need flexibility for all that will occur.
- Consider hierarchy of terms e.g. if you appoint someone now that supersedes whoever you named years ago. You might permit the higher/earlier named trustee to change the designations of those following them in the instrument, etc.

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Format for Trustees

- You can divide trustee functions to different persons. You can name one person to control distributions, another to control investments, etc.
- You can slice and dice distributions trustee up.
  - You can have a HEMS distribution trustee who can be a beneficiary.
  - You might have a discretionary trustee who has to be independent.
- You can name an administrative trustee to keep records, do accountings, file tax returns, etc. and relieve the other trustees of the administrative burdens.
  - Administrative trustee can provide nexus to a particular state.
- Consider special trustees with specific roles, e.g. to vote stock. This could be a directed trust with a directed trustee.
- Have system for appointing successor directed trustees.

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Investment Director

- Investment trustees. Many clients do not realize that they can be able to manage investments, with caveats. The Old Colony case said administrative powers don't cause inclusion. Willard case investment management doesn't cause estate inclusion.
- "*Grantor as Investment Trustee or Investment Advisor: The Supreme Court held in Old Colony Trust Company v. U.S., 423 F.2d 601 (1st Cir. 1970), that no aggregation of purely administrative powers will render the trust property includable in the estate. Also in Estate of Willard V. King v. Commissioner, 37 T.C. 973 (1962), the Tax Court held that the decedent's powers to manage the trust's investments did not allow him to control the beneficial enjoyment of trust property under IRC Section 2036(a)(2), because such powers were exercised in good faith and subject to fiduciary duties. Nor did such powers over the enjoyment of the property rise to the power to alter, amend or revoke under IRC Section 2038. This holding, which had been reached in several other decisions (although the Service has not acquiesced), was confirmed by the Supreme Court in United States v. Byrum.*"

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Exclusions

- Don't permit grantor or any trustee to have investment authority over insurance policies on their life.
- 2036(b)(2) no authority to vote stock in a controlled corporation.
- Partnerships.
  - Powell.
  - If you can amend partnership agreement or dissolve partnership under 2036(a)(2) can cause estate inclusion if taxpayer in conjunction with others can do these acts. So can manage bonds and stock but not make dissolution decisions.

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Pot and Spray rusts

- E.g. one trust for three kids. Serves a limited role.
- You don't need separate trusts while ILIT owns a single insurance policy.
- If you transfer a residence you can use an LLC but might be easier to have in one trust.
- Kids generally do not live in harmony.
- As kids get older and develop their own lives dividing up make sense.
- Give trustee to divide trusts early or distribute down to sub-trusts early. Consider building that into the trust documents.
  - Comment: Why not just give trust protector a power to do this.
- Advancement clause.
  - If give child A dollars for a house what about the other children? What about giving trustee the authority to treat a distribution as an advancement. This avoids unfairness and give trustee ability to make it equal, but not have to count ever dollar equally.
  - Should you exclude health care payments from advancement?

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Lifestyle and Incentive Trusts

- What does "religiously observant" mean in any particular faith? Who will monitor that?
- Graduating from college – what will that mean in 50 years? Opportunities arise and many Billionaires did not finish college.
- Drug and alcohol testing.
- Putting these provisions in a trust instrument will not fix parental 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.

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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 included? 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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Silent Trusts

- Good or bad?
- If trust is silent and prohibits informing beneficiaries is that a good result?
- May have a designated representative get notice in the interim.
- What if child gets check or K-1 with income but cannot explain?
- How can they know of powers of appointment?
- If the trust is not GST exempt it may have substantial impact on their estate plan.
- **Comment**: Consider purpose of trust. If non-reciprocal SLATs are intended for using exemption and asset protection but are parent's retirement plan silent trust provisions are different then for a trust intended solely for heirs. Consider in context of 2020 planning.

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Duty to Disclose

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Duty to Disclose

- Revocable trust.
  - In re Abbott, 890 N.W.2d 469 (Neb. 2017).
  - Sec 603 of UTC may not get information while trust is revocable: "rights of beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to the settlor."
  - Permitted case under Sec. 706 for removal of trustee which has a broader standing provision then Sec. 603.
  - **Comment**: Consider using a trust protector with specified powers, especially to protect an aging or infirm client.
- Does beneficiary get redacted version or full trust?
  - Trustees often initially send redacted version claiming the rest is 'private.'
  - Isn't it better to make full disclosure?

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Duty to Disclose

- Trust with restrictions on disclosure to beneficiaries.
  - May be time or age related.
  - Other duties of trustee including to duty act in good faith and in best interest of beneficiaries are not modified. This creates tension between restrictions on disclosure and other duties. HO 8
- Drafting considerations: Trust may provide that no information should be disclosed to particular beneficiary while under age 30 but same trust gives power of withdrawal or power of appointment at age 25. That is bad drafting. What if trustee dies and power to appoint new trustee falls to that beneficiary but he's under age 30? In that situation you have an affirmative duty to advise the beneficiaries. This is a duty of loyalty question.

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Books and Records

- Trustee must respond reasonable requests by beneficiaries with reports or an accounting.
- If trustee fails to keep proper accounts all matters are resolved against the trustee. The burden of proof is on the trustee.
- No details on what adequate books and records are.
- In non-controversial cases just send quarterly statements and perhaps tax returns. UTC adopts that idea and recognizes it by saying it is not a duty to account they use phrase "report" so it can take any number of forms. **Comment**: Note "reports" not a full blown accounting. Copies of a brokerage statement and tax return may suffice as "reports."
- UTC doesn't define what is adequate and complete. This remains a matter of state law-common law determined by the courts based on history of case law.
- Even if trust says no duty disclose must still administer trust according to its terms.

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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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UTC Concepts Concerning Reporting to Beneficiaries

- "Spineless settlor" – no beneficiary can receive reports while settlor or settlor's spouse is alive.
  - **Comment**: – Speaker is wrong. What if SLAT Is really your retirement account?
- Beneficiary is entitled to information necessary to enforce his rights under trust or to prevent a breach of trust. Courts have framed this as "are limitations so great or the courts are being deprived of mechanisms to enforce the trust. If that is the case its then against public policy."

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Grantor and Non-Grantor Trusts

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Conventional Uses of Grantor Trusts

- Grantor trust status for a trust to pass outside the estate.
  - Grantor pays tax on taxable income of the trust so trust gets tax free growth. This is a potential for a massive wealth sift.
  - Rev. Rul. 2004-64 IRS conceded that payment of income tax of trust is not a gift for gift tax purposes.
- Tax free swap of assets.
  - With limited exceptions property acquired from a decedent obtains a fresh FMV basis at death. This is a tax free step up.
  - 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.
  - Since grantor trust does not have separate identity for income tax purposes the swap transaction does not cause gain to be recognized.
  - 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).

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Conventional Uses of Grantor Trusts

- Tax free freeze transaction.
  - Grantor sells assets to a grantor trust.
  - Sale is ignored for income tax purposes.
  - If for adequate consideration it is not a gift.
  - By entering into this transaction wealth can be shifted over to the grantor trust for the next generation, e.g. assets sold at a discount.
  - If sold at deferred purchase price with low interest loan and appreciation in assets exceeds that interest hurdle, then additional wealth is passed on to the beneficiaries of the trust.
- How does grantor find money for income taxes?
  - Grantor could borrow money for paying income taxes from grantor trust.
  - If borrow from grantor trust and die with obligation to grantor trust potential tax implications.

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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.
  - 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.

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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 is called **BDIT** = beneficiary defective inheritor's trust.
  - **QSST** by election of beneficiary can be treated a owned by the beneficiary if trust meets certain requirements and owns S corporation stock. If so, beneficiary can be elected to be treated as owner of S corporation stock.

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Beneficiary Deemed Owned Trust - Lending

- Suppose trust beneficiary wants to borrow cash from trust and beneficiary and trust don't want to pay/receive interest
  - If give interest free loan 7872 provides that if interest free loan is made interest income will be imputed (and could be a gift tax consequence but not between trust and beneficiary).
  - Treatment of beneficiary loans under 7872 are not clear. There is a list of loans that 7872 specifically applies to but trust to beneficiary loan is not listed so its not clear. IRS could argue that this loan is a tax avoidance loan.
  - As to this portion of the trust beneficiary has the right to withdraw all income you have solved the problem.

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Beneficiary Deemed Owned Trust – Address NY/NJ Trust Income Tax

- NY and NJ state income tax rules.
  - NY and NJ rules say that if trust created by domiciliary it is a resident trust and it may pay state income tax.
  - Exception if 1) no trustee living in NY/NJ, 2) no source income in NY/NJ; and 3) no property in NY/NJ.
  - Investment advisers often put funds in private equity and hedge funds which are pass through entities and hard to tell which income is state source income. Even if a trivial amount of NY/NJ income is received then all of the trust income will be taxed.
- If modify trust so beneficiary can withdraw each year all NY/NJ source income then that portion of trust income is not trust income and will be taxed directly to the beneficiary.
- **Comment**: Should this be used as a savings clause in many trusts?

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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 non-grantor 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.
- 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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Non-Grantor Trusts – State Income Tax

- Use of Property Approach:
  - Let beneficiary use valuable trust assets. If beneficiary given $1M to buy home triggers state income tax. Instead trust buys home and lets beneficiary live their tax free.
  - Beneficiary use of property not treated as distribution
  - Trustee only has legal title and its owned by beneficiary so no imputed income on beneficiary's own property.
  - DNI rules don't create gross income they just divide it.
  - 643(e) a distribution of property other than cash
  - Little tax risk in letting beneficiary use assets.

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Non-Grantor Trust Other Income Tax Planning Benefits

- Progressive tax structure – non-grantor trusts distribute to shift income.
- 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.

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Question and Answer Panel

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Electronic Wills

- How do you contemplate electronic wills and remote notarization?
- Theory is you are doing the same thing you do now just electronically. Attorney's obligations to assure the client is not unduly influenced, has capacity etc. are not altered.
- **Comment** – Consider book by Malcolm Gladwell regarding truth: Talking to Strangers: What We Should Know about the People We Don't Know.

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678 Trusts

- 678 is trumped by true grantor rules 671-677. So trust with swap power with be grantor as to settlor not beneficiary. Crummey powers will be held in abeyance as long as swap power exists.
- What if swap power exists for 5 years and Crummey powers during that time then swap power is released. What happens to the status of the trust with respect to the Crummey power holder? You have the right to withdraw say 5% each year so IRS position is that person with 678 power becomes owner of 5% in year 1 then 5% (not cumulative but a fraction), in year 2, then 5% in year 3 etc. Is this held in abeyance until swap power lapses? No its just trumped by swap power. So if all contributions within 5/5 power it would be wholly grantor as to beneficiary in year 5 when the trumping swap power is turned off.
- You might worry whether the swap power is not truly a non-fiduciary power.

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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.

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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 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.
- **Comment**: Example file 8971 showing assets passing into QTIP. 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.

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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.

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Cameron Cleopatra Case – More Thoughts - 2

- Personal jurisdiction over trustee was discussed in another case.
  - Kloiber v. Kloiber dynasty trust Kentucky 2014 case.
  - KY court dismissed corporate trustee from DE on grounds that KY court had no personal jurisdiction over trust.
  - If you have an institutional trustee that is a N.A. = national association as trustee there may be jurisdiction anywhere.
  - If have only DE trust company there may be no personal jurisdiction outside DE.
  - Matter of Daniel Kloiber Dynasty Trust, 2014 WL 3924309 (Del. Chan., Unpublished, Aug. 6, 2014). Full opinion at http://goo.gl/UFF0r8
- 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.
- Would this apply to exemption statutes for the forum state? Would seem to be covered.

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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.

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Cameron Cleopatra Case – More Thoughts - 4

- **Comment**: Consider implication of above comment to non-DAPT jurisdiction resident establishing DAPT in DAPT jurisdiction. Consider implications to nexus and what you should have in a DAPT jurisdiction. Perhaps bifurcate investment 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 Exempt GST Trust fbo Cleopatra Cameron, created under the Cameron Family Trust, dated Dec. 20, 1996, as amended., 2019 S.D. 35

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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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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?

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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?

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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?

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Gift to Includable Trust to Secure Exemption is Risky - 1

- Client wants to lock in the large exemption before the election but is really not willing to part with sufficient assets. Is there a way to accomplish these seemingly disparate goals? Yes, but its risky.
- Client gifts asst to a trust but retains the right to trust income for life. The gift is complete and uses exemption but it also violates Sec. 2702 so it will be included in the client’s estate. The client did use the enhanced exemption before sunset/2020 election.
- Is it a completed gift? Yes, if grantor cannot unilaterally withdraw assets out of the trust. If trustee has discretion to distribute out of trust that is OK.
- $11M comes back into estate under 2036.
- 2001 estate tax calculation section – if gift is made you include assets in estate but you do not also include value of gift in estate tax calculation, so you only bring $11M back once.
- Anti-clawback regulation says your exclusion is what is available at death or the gift exclusion used which in this example was $11M, so this preserves the $11M exclusion and you have no gift or estate tax.

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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 anti-abuse 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.

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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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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.

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QTIP Planning - 2

- **Comment**: Divide trust before transactions to endeavor to insulate portions of QTIP not involved in the transactions from a 2519 challenge. Also, consider in Kite that the deferred annuity effectively prevented the surviving spouse from receiving any income for 10 years. How would that contrast with a note sale that would have generated interest income for 10 years? Kite facts were extreme.
- Kite was a Tax Court memo
- Many commentators believe that there a lot of questions about the case.
- Another issue if you have HEMS standard can you make these distributions?
- Estate Lilian Halpern TCM 95-352 different situation.
- Estate of Herford on point TCM 2008-278 distributions to beneficiary per HEMS standards and transferred for private annuity not excluded from gross estate merely because ascertainable standard.
- Estate of Hartzel TCM 94-576. Standards broader then just a HEMS.
- 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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Grantor and non-grantor trust considerations

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BDOTs - 1

- BDOTs - Grantor trust created by giving beneficiary power to withdraw income.
- Under UTC if the beneficiary has a power that is only exercisable with consent of the trustee, its still a power of withdrawal, but for state law purposes creditors should not be able to reach the trust assets.
- Why create BDOT?
  - To get lower tax brackets of beneficiary. Shift income to beneficiary without making distributions. Under normal non-grantor trust rules the trustee has to make actual distributions for DNI to flow out income to a beneficiary. Under 678 no need to.
  - Capital gains on sale of home owned by the trust.
  - Sec. 179 expensing is now a $1M deduction. 179(d)(4) of Code trust gets -0- 179 deduction. Cure this with BDOT.
  - No tracing requirement for charitable donations. IRC Sec. 681.
  - ESBT cannot get a distribution deduction. Note that 678 grantor trust rules trump ESBT rules.

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BDOTs - 2

- Why create a BDOT ……
  - 199A deduction may be enhanced if it can be claimed by the beneficiary.
  - GST trust leveraged by having beneficiary pay income tax on the GST exempt trust so trust assets grow unencumbered by income tax.
  - Shift income upstream with BDOT. Set up trust on which parents pay income tax on trust.
- Include a trust protector power to bestow a power of withdrawal on a beneficiary to turn the trust into a BDOT if that is desired at a later date.

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Leveraged Asset Techniques With Grantor Trust And BDOTs - Conversion

- Add a mandatory conversion feature to the notes resulting from a note sale transaction. This could have the notes converted automatically on death into non-managing interests in the entity sold to get a basis step up on death as the conversion feature would automatically pull the equity back into the estate and extinguish the notes that are not conducive to a step up. **Comment:** Does this raise “string” issues?
- The IRS attacks the value of notes received when sell to a grantor trust on the theory of the notes not equaling the value of the assets sold to the trust. The IRS argues that principal of note does not have a value equal to face value because there is so much leverage. Although the IRS has not done well with this argument, might a convertibility feature help negate this argument? If the note is convertible might deflect such an argument? **Comment:** Does this raise “string” issues?
- Classic note sale transaction. Father dies prematurely. Note is still outstanding. Have springing BDOT right in surviving spouse so she can withdraw net taxable income on husband’s death. Dad bequeaths note to surviving spouse. Use of BDOT principals. **Comment:** Does this really result in merger to extinguish?

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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.

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Charitable Planning With Non-grantor Trusts

- Individuals get charitable 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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INGs - 1

- Intentionally structuring trust as non-grantor trust, like a incomplete non-grantor trust = ING. If incomplete gift included in grantor's estate. But, the ING is not just for state income tax planning.
- INGs are a unique in structure. Trustee is usually independent corporate trustee in a DAPT state. How do you get distributions out? Settlor retains certain powers including a LPOA limited to HEMS and a testamentary LPOA to make gift incomplete. Distributions are made by a distributions committee comprised of adverse parties = beneficiaries of trust. Can make distributions by majority consent with consent of settlor or if unanimous without settlor's consent. Settlor may not be a beneficiary but may be a permissible appointed. Best practice is to use DAPT state but legally do not have to.
- When design ING committee follow existing PLRs and administrate it correctly.
- Rev Proc 2020-3 on no ruling list includes certain ING trusts. They were getting at ruling if you don't have committee structure composed only of beneficiaries.

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INGs - 2

- Possible benefits.
  - State income tax savings on non-source income is biggest savings. If in founder state that taxes based on state formed there it will be difficult.
  - 642(c) charitable deductions may be better then a Sec. 170 individual deduction. The non-grantor trust might qualify for a state income tax deduction when individuals are not permitted a state level income tax deduction for
  - 453A has a cap.
  - 1202 has a cap.
  - 199A has an income threshold.
- Sec. 672(a) to be adverse must have a substantial interest that would be adversely affected.
- SLAT is typically a grantor trust. Exception is if spouse can only get distribution with consent of an adverse party. Could use committee or just adverse party.

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Secure Act and BDOTs

- Some solutions in reaction to planning for Secure Act.
- 95% of cases will be stuck with 10-year rule. Problem is a real problem because if you want lower tax brackets you want to distribute out of trust but that ruins the asset protection and other benefits of the trust. But if keep it in trust will be taxed at the highest rate, NIIT, etc.
- BDOT provide a solution to this dilemma.
- $1M IRA and $3M estate. All assets payable to a trust. IRA you will pay say 10% a year. No RMD under Secure Act 10-year rule. Want to take something out to avoid highest tax bracket in year 10. If give beneficiaries right to pull out income that will pull income out to them but that leaves most of income (other than say income distributed to beneficiary to pay income tax) stays in the trust.
- CRT plan – leave IRA to CRT to get longer stretch but lack of longevity risk if die early goes to charity, inflexible, etc.
- Consider have 20-year CRT and have BDOT as beneficiary of CRT. Must still have some charitable intention.

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Material Participation

- Parent founder of family business is an active participant of business, but all children do not actively participate. Assume business organized as pass through entity. For those not actively participating two adverse consequences. Losses are suspended as 469 passive activity losses and income will be subject to NIIT 3.8% tax for non-actively participating children. For those children could have business interests held for their benefit and set up trust so it may be considered to materially participate. Perhaps a trusted employee of the business.
- Aragona case Tax Court said hours spent by employee as an employee count as time spent as trustee. Test to determine whether trust materially participates can be met. Note that the IRS has not agreed to this. There is a guidance project on this issue.
- What if distributions are to be made from trust? What result is desired? Outcome is uncertain. If beneficiary has unused passive losses can you pass out business income that is treated as passive income? Will distribution from a materially participating trust to a non-participating beneficiary change character of that income to passive?

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Changing Residence Tax And Legal Considerations

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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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How to Change Domicile

- How does client change domicile to a new state?
  - Must prove by clear and convincing evidence.
  - Need to do all mechanical items, but that is not enough.
  - Spend more time in new state. Days not in new state of domicile relate back to old state of domicile. Need to establish roots on the ground for 2-3 years before new state will be attributed non-old state days. Spending a significantly greater portion of each year in the new (or established) domicile state
  - Acquiring a more substantial home in the new (or established) domicile state.
  - Disposing of any home in the former domicile (or non- domicile) state and renting (not buying) another home in the former domicile state and, if possible, renting for only part of the year.
  - Registering and voting in the new (or established) domicile state.
  - Executing and filing a declaration of domicile with the appropriate office in the new (or established) domicile state.

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How to Change Domicile

- Revoking any declaration of domicile made in any other state.
- Filing all tax forms at the IRS service center for the new (or established) domicile state.
- Filing a final (so marked) resident tax return in the former domicile state (and city, if applicable).
- Signing a new Will (and other documents) declaring the new (or established) domicile.
- Paying all taxes as a resident of the new (or established) domicile state.
- Registering cars, boats, etc. in the new (or established) domicile state.
- Acquiring a driver's license in the new (or established) domicile state and surrendering any issued in other states.
- Obtaining non-resident license privileges (e.g., fishing license) in non-domicile states.
- Resigning from, or changing to non-resident status for, clubs, churches, etc. in non-domicile states.

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How to Change Domicile

- Changing all documents, subscriptions, passport, listings (e.g., in Who's Who) etc. to reflect the new (or established) domicile state
- Relocating personal belongings and family pets
- – See In re Blatt, DTA No. 826504 (N.Y. Div. of Tax Appeals Feb. 2, 2017)
- Taking all other steps to show that the center of his or her activities has been changed to the new (or is established in the) domicile state.
- Get new address on passport.
- Relocate personal belongings. Where is your heart? Items near and dear.
- Its always about the money. The state just wants the income tax.

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Prepare for the Audit

- Put together the war chest of factors.
  - Utility record for homes.
  - Credit card statements.
  - Telephone bills.
  - Driver's license.
  - Where they want to the doctor.
  - Where haircuts done.
  - Nails done.
  - Dog grooming.

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Secure Act

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Introduction

- Stretch IRA is gone for all but a few clients.
  - Where the law says a designated beneficiary = DB can withdraw over life expectancy we changed that to 10 years.
  - But some beneficiaries should still get a life expectancy payout so added 5 categories of eligible designated beneficiaries = EDBs.
    - Surviving spouse.
    - Minor child of participant.
    - Disabled individual.
    - Chronically ill individual.
    - Someone not more than 10 years younger then the participant.
  - EDBs receive a life expectancy payout except for the minor child it only extends to age of majority and in all cases on death of the EDB the 10 year rule kicks in so next beneficiary in line cannot use what is left of life expectancy.
- Conduit trust and see through accumulation trusts same just not same benefit.

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Categories Under Pre- and Post-Secure Act

- 3 categories/classes under old system:
  - Non-designated beneficiary e.g. an estate, charity or non-see through trust. They get 5-year rule if participant dies before starting RMDs and what's left of life expectancy if started.
  - See through trust.
  - Surviving spouse got life expectancy with special ways to compute life expectancy and a delay in starting.
- 3 new tiers:
  - Non-designated beneficiary e.g. an estate, charity or non-see through trust. They get 5-year rule if participant dies before starting RMDs and what's left of life expectancy if started if died after starting distributions.
  - DBs - See through trust etc. but only get 10-year rule.
  - EDBs get some variation of life expectancy.

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What Do You Say to New Clients?

- IRA – tax is in there just deferred. You can pay it during your lifetime, or your beneficiaries will have to pay it after you die and in most cases that will be over 10-years.
- Only one guaranteed way to eliminate tax – name a charity as beneficiary.
- If name spouse as beneficiary, she can roll over into her IRA and keep deferral going for rest of her life. The 10-year payout only kicks in after second death. Spousal rollover not changed by Secure Act.
- If spouse is a spendthrift can leave to trust for spouse and benefits will be paid out over life expectancy but you would not be deferring taxes to later death as would pay out over your life expectancy. To get this result per Reg all distributions that come out of plan must be forthwith paid out to the surviving spouse so all distributions during lifetime are conduit-ed out to the surviving spouse and she is considered sole beneficiary of the trust and the retirement plan. Spouse gets EDB treatment by being named as sole beneficiary or as a beneficiary of conduit trust.

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What Do You Say to New Clients?

- Could be see through accumulation trust. Under rules conduit trusts are guaranteed to qualify as DB but accumulation trust is not guaranteed. If you pay to spouse and on death to kids that qualifies as see through accumulation trust. Spouse gets income but other distributions could be accumulated. So, it's not a see-through trust and spouse is not sole beneficiary so she does not get benefit of surviving spouse like recalculation of life expectancy.

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What Do You Say to Existing Clients?

- Some clients not affected, e.g. leaving all retirement benefits to charity or who don't have significant assets.
- Most dramatically affected clients:
  - Clients who decided entire plan for retirement benefits around stretch for grandchildren need "emergency surgery." That option is not available post-Secure as best deal grandchild can get is a 10-year payout as the grandchild does not qualify as a minor child-EDB. Need a different plan.
  - Conduit trusts still works but may only have 10-year payout = take it all out by end of 10th year after death unless EDB. This is probably not what the client had in mind when created conduit. Planned for long life expectancy payout so it would have been dribbled out. Now nothing has to be paid during the 10 year rule and all as lump sum by end of 10th year. That gives 11 taxable years maximum over which you can spread out the payments.
- Secure Act used 5 year rule of old law and just substituted 10 years.
- Age 70.5 changed to 72 in all places but one QCDs from IRA remains 70.5 (income exclusion for QCDs limited if you make IRA contribution after 70.5).

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

- 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 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 trust 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 10th 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 10th 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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Eligible Designated Beneficiaries = EDBs - Minor

- Minor child of participant.
  - Sounds like a feel good exception but more complex then it appears and not as helpful as it sounds.
  - It is for minor child of participant only not for any other minor.
  - Lasts only until minor attains age of majority then flips to 10 year payout.
  - Age 18 is age of majority in many states, but…in defining "attains majority" Secure references 401(a)(9) which is an obscure ERISA rule. It says "attains majority" means state law age of majority, but if the minor individual has not completed a specified course of education it continues until he completes a specified course of education, but not beyond age 26. No one is quite sure what this means.
  - If minor has become disabled before age of majority, minority status continues if child is disabled.

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Eligible Designated Beneficiaries = EDBs - Minor

- Minor child of participant…..
  - Also, under existing Regs for person to be sole beneficiary of plan you have to name them outright or get benefits through a conduit trust so if you have multiple minor children you would need multiple conduit trusts. Is it worth it?
  - 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 die 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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Eligible Designated Beneficiaries = EDBs - Others

- Surviving spouse discussed above.
  - Name spouse or trust for spouse as above to get life expectancy payout.
- If you are not disabled on death of participant and you become disabled later, it's too late. Test is only at date of death.
- Disabled and chronically ill.
  - Disabled defined by statute.
  - Chronically ill defined by different statutory section.
  - These exceptions are important for planning for disabled and chronically ill beneficiaries.
  - Special rule about trusts. Accumulation trusts for sole benefit of the disabled or chronically ill individual will qualify for the life expectancy payout. This language seems to confirm that for any other beneficiary you need a conduit trust to qualify for the life expectancy payout (e.g. spouse).
- Less then 10-year younger beneficiary, e.g. a sibling. Get a life expectancy payout and then the 10-year rule kicks in when that EDB dies.

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GST Tax Considerations for Non-GST Exempt Trusts

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Taxable Terminations - 1

- Taxable termination: It is a termination of an interest in a trust (or trust arrangement, e.g. life estate remainder) and that termination doesn't trigger gift or estate tax. If child had GPOA its an estate tax event, not a taxable termination.
- Separate Shares: Sec. 2612 special rule if there is a trust with separate shares. Example: 3 beneficiaries of a trust paying income to 3 children in equal shares, a taxable termination would occur as to only that third if one child dies and that deceased child's share passes to her surviving issue.
- Only one GST tax is triggered. **Comment**: Consider Jonathan Blattmachr' s idea idea of generation jumping).
- Valuation.
  - Assumption is that it is FMV of property but only guidance is the instructions to Form 706.
  - Section 2701, 2702 don't apply.
  - 2703 applies.

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Taxable Terminations - 2

- Valuation….
  - 2704(a) doesn't apply.
  - 2704 (b) disregarded restrictions do apply.
  - Can use 2032 alternative valuation date in limited circumstance.
- Code permits deductions "similar to section 2053". No regulations on this but some guidance in Forms, trustee fees, appraisal fees, Robertson case addresses. Robertson v. United States, 97 A.F.T.R..2d 2006-589.
- Tax rate on taxable termination is the top estate and gift tax rate at the time of the termination, multiplied by inclusion ratio of the trust involved.
- How does taxable termination affect basis? If GST taxable termination occurs as a result of a death of an individual there should be an adjustment in basis but in generally there is no basis adjustment on taxable termination. If there is unrealized appreciation in property you get an increase in basis for GST tax attributable to that under principles similar to Sec. 1015.

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Taxable Terminations - 3

- Payment of GST Tax on Taxable Termination.
  - Trustee pays GST tax out of property and reports on Form 706-T. Tax is due 4/15.
  - Trustee might get help paying tax 6161(a)(1) Commissioner can allow six-month extension to pay tax for reasonable cause to pay and this applies to GST tax.
  - 10-year deferral under 6161(a)(2)(B) allowed on showing of undue hardship annual extensions up to 10 years with interest that should be available for GST tax due as a result of the death of an individual.
  - Sec. 6166 deferred payment not available for taxable terminations.
  - If do a 303 redemption you can include GST tax due in the notional amount of redemption for capital gain.

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Taxable Distributions - 1

- Taxable Distribution: This is a distribution (1) from a trust, (2) that is not exempt from GST tax, (3) to a skip person, (4) that is not a taxable termination, and (5) that is also not a gift/estate tax event.
- Example: A non-exempt pot-trust for all descendants, and trustee makes distribution to grandchild (child alive and move down rule has not applied).
- Decanting: Decanting distribution from one trust to another trust? Whether there is a taxable distribution depends on whether the appointee (recipient) trust to which the old trust is appointed into is a skip person. If all beneficiaries are skip persons (GC or more remote descendants) that will be a taxable distribution.
- Med/Ed: Distributions for medical or educational expenses that qualify for Sec. 2503(e) are technically distributions but they are not taxable as they are deemed to have an inclusion ratio of zero when made.
- Loan: What if the trustee makes a loan to a trust beneficiary? Is a loan a taxable distribution? Unclear as there are no Regs. Look to income tax rules by analogy. Lots of law on what is a distribution for income tax purposes, but does that apply to GST? In foreign trust area a below market loan is treated as a

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Taxable Distributions - 2

- Loan: What if the trustee makes a loan to a trust beneficiary? Is a loan a taxable distribution? Unclear as there are no Regs. Look to income tax rules by analogy. Lots of law on what is a distribution for income tax purposes, but does that apply to GST? In foreign trust area a below market loan is treated as a distribution. In the income tax context, it determines who pays income tax not whether there is an income tax payable so that is different.
- What if beneficiary skip person uses trust property? Beneficiary can use property without rent. But what if a non-exempt trust lets a skip person use property. Is that a distribution for purposes of GST tax? There is law on rent free use of property could be subject to gift tax, i.e., forgone rent is a gift. In the foreign non-grantor trust if beneficiary uses property it is a distribution and the DNI gets drawn out to the beneficiary. Result is unclear.
- Tax is paid by transferee who receives distribution. There no guidance other than Robertson case as to how to determine value. For GST tax in taxable distribution look at what transferee received.
- If trustee pays tax that constitutes an additional taxable distribution.
- Taxable distributions trigger the filing of two separate IRS Forms, Form 706-GS(D-1) and Form 706-GS(D).

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How to Address GST Non-Exempt Trust - 1

- Transferor.
  - If alive can make a late allocation of remaining GST exemption. Example: If client created non-exempt trust in say 1990s when exemption was $1M and now $11.58M can allocate late exemption and perhaps enough to make trust exempt.
  - Make late allocation on gift tax return effective date return is filed.
  - Client could allocate exemption at end of ETIP like a GRAT or QTIP. Effective date of allocation is date ETIP ends but don't have to file until following April 15.
  - Sec. 2632(d) allows late allocation that is retroactive. Example parent created pot trust for descendants no GST allocated not exempt. Child dies before parent. 2632(d) allows the transferor if alive to make late allocation of GST exemption to that trust on transferor's gift tax return for year of death and retroactively allocate GST exemption.
- Beneficiaries.
  - Appoint to charity if have LPOA.
  - Perhaps exercise power to appoint to non-skip persons to avoid GST i.e.

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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 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.

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How to Address GST Non-Exempt Trust - 3

- Trustee the legal holder of property ultimately subject to tax.
  - Distribute trust assets to non-skip persons.
  - Make medical/educational distributions to skip persons.
  - Let beneficiaries use property rent free (avoids/defers taxable distribution).
  - Use a decanting power or power to add beneficiaries to postpone the GST tax.
  - 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).
  - Severances to use discount planning. Watch business purpose and fiduciary duties.
  - Trustees of non-exempt trusts can freeze those trusts by selling assets to a exempt trust.
  - Freeze transactions may be possible in limited ways.

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Elder abuse Versus Independence

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Elder Abuse

- Large gender gap for aged. General population is 97 men per 100 woman. By age 85 2 woman alive per each man. Many woman are alone and are living alone. For those 65+ who are not institutionalized 20% of men live alone but 35% of woman live alone. Almost 50% woman 75+ live alone versus only 27% of men.
- Will older person be given the freedom to do as they wish or will we presume they are mad?
- Individuals with highest median net worth is the 75+ age cohort.
- They bear more responsibility for managing their own wealth. In the past wealth was regulated more by retirement plans and Social Security. They generally had a specified monthly amount. But todays retirees are relying increasingly on defined contribution plans, 401ks etc. and they not the governing or employers decide how to invest and spend.
- These nest eggs can be preyed upon by perpetrators.
- Aging clients need to protect themselves from fraudsters.

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Elder Abuse

- Trait of being trusting. The older we get the more trusting we become.
- Older woman face increased threats. Typical victim of elder abuse 70-89, white, female, cognitively impaired, etc. 2/3rds of victims are woman. Isolated woman are most likely the victim.
- Elder financial abuse can be as small as pilfering e.g. care taker keeping change from shopping, to forged legal documents, or documents the elder person is manipulated into signing.
- $36B in loss a year due to elder financial abuse and that may be the tip of the ice berg as only 1 in 14 are reported.
- 34% of financial abuse is by family members, friends but another study say 57% is by family members.
- Many fear remedies for abuse is worse. Abuser may institutionalize victim, have guardian appointed, etc. and that victim will lose more freedoms.

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Private Foundations That Outlived Usefulness

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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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Issues that Suggest Private Foundation Should be Evaluated-2

- Administrative and operational burdens. Meeting federal and state regulatory requirements strains resources:
  - Accounting and auditing.
  - Legal counsel to address governance practice.
  - Chapter 42 tax regime that regulates transactions with foundation insiders, excess holdings, etc.
  - Taxable expenditure rules.
  - Many administrative burdens may fall to board members.
  - Excise tax on net investment income.
- 2/3rds of foundations have less than $1M median is $500,000 so burdens can outweigh benefits.

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What Can be Done?

- Substantial time and effort should be spent to develop and train board members.
- Move members on/off board.
- Add outside/independent directors.
- Conflict of interest policy. Address self-dealing and conflicts. If all directors same family all may be conflicted. May need disinterested director to make decision on conflict issues.
- Some foundations put in place alternate procedure to get disinterested advice. Example if all directors have conflict appoint independent committee to make recommendation as to that transaction.
- Board commitment form. Useful to let board members know what their responsibilities are.
- Dispute resolution consultants may help.
- Get assistance with mediation and arbitration but may keep foundation out of litigation.

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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.
- 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.
- Easiest approach is transfer assets subject to donor's restrictions if not have to have restrictions released by donor or a court.

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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 guidance IRS has provided.

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Termination to DAF - 1

- Useful alternative to PF.
- Allows family to remain involved in supporting grant making without administrative burdens.
- Using one or more DAFs can be an "ideal" solution.
- Sponsor charity assumes responsibilities for investments, grants, etc. and donor family remains involved without the burdens of governance and management.
- Foundation can be terminated, and assets assigned to several DAFs with each having different advisers. This can permit founder's permission to continue.
- Can name DAF so family legacy can continue.
- DAF provides better charitable contribution limits for donors.
- If board wants to convert to DAF identify key criteria to select DAF e.g. support for international causes.
- Can transfer funds to DAF without 507 tax.

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Termination to DAF - 2

- Foundation will automatically be terminated if transfers all assets to DAF with no notice required to IRS.
- What if transfer to DAF but subject to use restrictions. To qualify as good 507 termination cannot be subject to any material restrictions. "Material" is a facts and circumstances analysis. Since DAF would have ultimate authority over the assets the analysis turns on whether assets can be held and administered by the DAF sponsor consistent with the donor restrictions.
- Some state regulators have been suspicious about terminations with payments to DAF.

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Family Governance

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Family Governance

- Research shows same statistics – 70% of families fail at transferring wealth past 2nd generation.
- 97% of multi-generational wealth transfers fail in three generations.
- 80% of money gone within 50 years of founder's death.
- 61% families say legacy planning is important.
- Shirt sleeves to shirt sleeves.
- Families are less connected.
- Are they making group decisions together? Need to recognize that there is a problem.
- 25% of failures is unprepared heirs. Less than 3% for failure is due to investments or planning failures.

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Family Governance

- 80-90% of wealthy families are first generational wealth.
- As wealth grows get away from hardship and gain moderate wealth and there is less interdependence and more independence. Dinner table conversations are more social and not consequential. 14-year old's in a family like this had no idea how to buy a car.
- Money doesn't cause the problems but allows the problems. High percentage of kids feel guilt or embarrassment by wealth that they have. Feelings of separation. How do you help these children/families in the middle environment. Children often don't develop sense of self and remain dependent. Children raised in these environments 2- 5x more likely to have anxiety, addictions, etc.
- Want to help families move to lower right quadrant where they get back to place of interdependence. This is voluntarily not by necessity. Join family.
- Solution: Must have family meetings or will fail. A family meeting is about the family not the money.

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IRAs and Charitable Giving

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IRAs and Charitable Giving

- Charitable Remainder Trust = CRT and IRAs.
  - Not a solution for all. Does provide way to meet both personal goals with human beneficiaries and charitable goals. If you don't care about charity and are just seeking to beat Secure Act CRTs are not really a great solution.
  - Provides life payout for a human. There can be multiple people as beneficiaries. Can be for a term of years (instead of life) up to 20-years (term not exceeding 20-years).
  - Payout must be a fixed dollar amount or a fixed percentage, minimum of 5% and maximum of 50%. Must state percentage or dollar figure up front.
  - IRS has issued a sample CRT form. No creative writing use the form and follow the Regs.

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IRAs and Charitable Giving

- Example.
  - Want to benefit aunt age 85. Since older than plan holder she can get life expectancy payout. But life tables are only 7 years to cash it out.
  - Instead leave to CRT that gives elderly aunt 5% payout. IRA passes to CRT tax free. CRT is tax exempt. CRT pays old aunt $50,000 = 5% x $1M IRA.
  - If investment return on CRT is below 5% her payout will diminish. She gets a payment every year. No worries about minimum distributions.
  - Get a deduction for the present value actuarial value of charitable remainder.
  - Value of remainder must meet 10% remainder rule.
  - Good way to provide life income to older person.
  - How does older person get taxed? CRTs have a unique system. The CRT itself is tax exempt. But every dollar of income is classified by tier:
    - Ordinary income; Capital gain; Muni bond; Return of principal.

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IRAs and Charitable Giving

- If client has beneficiary and wants beneficiary to get staggered payment and has some charitable intent a CRT is good to look at.
  - Since cannot stretch out payment with IRA could give adult child a CRT that gives lifetime payout.
- IRA saving/planning device.
  - You can say beneficiary will get the 5% payout or the actual net income of the CRT being trust accounting income. NICRUT.
  - If beneficiary doesn't get 5% for several years you can give a make up payment to make up for the lean years. NIMCRUT.
  - Trust accounting income can be planned so if you don't want life income beneficiary to get income for a period you can put CRT assets into FLP that doesn't pay income for that period.
- QCDs.
  - Lifetime gifts from IRA to charity with Secure twists.
  - Idea is transfer money directly from IRA to a qualifying charity and that amount is not taxed as distribution to plan holder on plan holder's income tax return. It also satisfies RMD requirement.

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Qualified Charitable Distributions = QCDs

- Lifetime gifts from IRA to charity with Secure twists.
- Idea is transfer money directly from IRA to a qualifying charity and that amount is not taxed as distribution to plan holder on plan holder's income tax return. It also satisfies RMD requirement.
- RMD start date has been increased by Secure to 72 from 70.5.
- Prior to Secure if over 70.5 could not contribute to traditional IRA. Secure eliminated this.
- Cannot give QCD to DAF (but on death you can leave same plan to a DAF).
- Maximum $100,000/year.
- IRA plan does not have to report that the distribution went to charity so taxpayer/plan holder has to address this on Form 1040.
- Gift to charity is subject to all of the same requirements of a regular donation including getting a receipt from the charity. You also cannot get anything back in exchange for the donation from the IRA.

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Practice Management

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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.
  - 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.

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Estate Practice Management – Billing Rates; Expenses; Training

- Billing Rates.
  - After recession rates went down.
  - Doesn't matter what rate is matters what you collect.
  - Law firm industry is not great at realization and estate planners are among the worst.
  - Rate growth perhaps 2-3% over 11 years.
- Expenses.
  - Expenses when down during the recession because we cut and slashed expenses and after recession expenses increased.
  - Biggest expense for law firms is talent. There is not a lot of young people coming in. Largest law firms have raised salaries to $190,000 which is a problem for rest of industry.
  - How are you training younger lawyers and CPAs to prepare returns when there are so few?
  - As a young associate may have in past worked on a dozen or more 706s in a year. Who can do that now?

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Steps to Consider

- Billing rates.
  - Clio study shows lawyers rarely increase hourly rates.
  - How do you determine hourly rates? If just attaching 3% increase that is wrong.
  - Your rate needs to be based on what market will pay not what you want to charge.
  - Why do I have one billing rate? The rate should depend on the work you are doing.
    - Estate and trust administration rate. Compliance work is less valuable then Brainiac work on highly complex transactions.
    - Hourly for some documents or flat fee.
    - Estate planning rate.
    - Cutting edge work – tax planning rate.

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Conclusion

Wrap Up

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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.

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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.
- Concern when someone has the right to withdraw but doesn't do it. Is the non-withdrawal a gift by the beneficiary to the trust?
- A withdrawal right 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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Spousal Grantor Trust

- Sell entity/assets to trust for note and freeze value. But client wants to enjoy growth of assets.
- Spousal grantor trust addresses this issue. The spouse of the seller will create the trust for the selling spouse and that trust will acquire the entity/property for a note so client has it both ways. They have installment note but they are also a beneficiary of the buying trust and may have LPOA. Gives incomplete gift trust defense to sale.
- Fly in the ointment what if the spouse who is grantor dies first and note is outstanding? A shift in the identity of the obligor may be an income tax realization event.
- PLRs in corporate area where entity changes from disregarded to regarded. Does that cause a realization event? Its only tax status of obligor that has changed not property law owner.
- Non-recourse debt may obviate problem as it won't matter who the obligor is.
- Speaker had client who opted not to use technique because of concerns. But the above may provide a solution.

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DAPT

- A non-resident of a DAPT state can use statutory scheme of a DAPT state to successfully set up a DAPT.
- You have to pay attention to the formulation and design of the trust to the different state limitations on fraudulent transfers.
- Do you need a resident trustee and what is role of trust protector?
- Beware of potential issues and conflicts between DAPT jurisdiction and home state non-DAPT laws where client is domiciled.
- A growing list of states enacting Uniform Voidable Transfers Act with Sec. 10 that has problematic language and commentators worried about when a non-DAPT resident can set up a DAPT in a DAPT jurisdiction.

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GST Non-Exempt Trusts

- How might we eliminate, defer or avoid transfer tax on non-exempt trust.
- Never elect out of automatic allocation rather elect into automatic allocation. The advice use to be the opposite. This was advice 10 years ago. Became clear IRS was confused by that approach so advice has shifted. So only elect in as you can always unwind that election in a future year. Definitions of GST trust are imperfect so you should elect in to make sure GST exempt.
- Vesting – can vest interest without giving it to them. Come to end of lives in being +21 years don't give property its just estate tax includible.
- If state law permits, consider DE tax trap. Some state laws won't allow.
- Can you amend trusts to grant general power of appointment? Many statutes permit this. If you have non-exempt trust you go in and grant beneficiary GPOA
- Late allocations work. You may not have had extra GST exemption when set up old trust, but you can go back and use $11.58M exemption remaining.
- Freezing transactions – consider Chapter 14. If try preferred partnership freeze between trusts will treat as owned by highest beneficiaries.
- Use installment sale between non-exempt trust and a grantor trust.

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Powell Case and FLPs

- Powell was a bad fact case and if you read write up by Blattmachr and Powell-proofing instruments consider that a bona-fide sale is your "get out of jail free card."
- Purchaser must have independent assets. 10% is Lore. Dallas case in notice of deficiency fact of 10% seed gift IRS respected it as debt.
- Porter/ Loomis-Price – what happens in litigation. You need to have real and significant independent non-tax reasons to form entity.
- Concern with Powell -- do you look through partnership and have distribution and liquidation powers in hands of independent people? The problem is that you can make irrevocable provisions but an entity agreement under state law owners can get together and take out firewall.
- So, transfer interests in the FLP or other entity into a trust and in the trust instrument provide that the trustees cannot change provisions in governing entity documents and that the trustees cannot decant away that provision.

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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 disclosure.
- Entitlement to information may be the entitlement to an accounting. Many forms try to waive duty to account. Consider being more articulate and differentiate providing information versus an accounting.

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