



# Selected Highlights of 2017 Tax Act and Estate Planning Considerations

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## Overview

**Passage of “Tax Cuts and Jobs Act” (2017 Tax Act or Reconciliation Act of 2017).** The Tax Cuts and Jobs Act passed the House on December 19, 2017 by a vote of 227-203 (with no Democratic votes and with 13 Republican members from California, North Carolina, New Jersey, and New York voting no). The Senate parliamentarian ruled that three provisions in the version passed by the House were “extraneous” to reconciliation (one of which was removing the short title, discussed in the following paragraph) and were removed in the bill that passed the Senate very early in the morning of December 20 by a straight party-line vote of 51-48 (Senator McCain was absent), forcing a House revote of the version passed by the Senate later that same morning. The President signed Public Law No. 115-97 (the “Act”) on December 22, 2017.

The short title “Tax Cuts and Jobs Act” was removed, but the Act sometimes is referred to informally by that former name. The official title is “To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.” Perhaps the Act will be known as the 2017 Tax Act or perhaps at the Reconciliation Act of 2017.

**Effective Date.** Most of the provisions are effective for taxable years beginning after 2017. Most of the provisions regarding individual tax reform (including the transfer tax provisions) are effective for taxable years from 2018-2025 (i.e., for 8 years). They sunset after that date in order to satisfy the “Byrd rule” so that the Act could be passed with just a majority vote in the Senate under the reconciliation process. The change to the “Chained CPI” indexing approach remains permanent, and generally the business tax reform measures are permanent.

**Simplification.** One of the stated purposes of tax reform was simplification, but many of the provisions add significant complexity. In particular, the various limitations and restrictions on the 20% deduction for pass-through entity qualified business income are very complicated.

**Revenue Impact.** The budget resolution that initiated the reconciliation process for approving the Act (with only a majority vote requirement in the Senate) authorized tax reform that would produce no more than \$1.5 trillion of deficits over the 10-year budget window authorized in the budget resolution. The Joint Committee on Taxation scored the bill as producing \$1.456 trillion of deficits over the 10-year period. It did not provide a “dynamic scoring” estimate taking into consideration economic gains that would result from the Act. The Tax Foundation (a “right-leaning” organization) estimates that the Act would add \$1.47 trillion to the deficit over 10 years, but \$448 billion after considering economic growth. The individual tax provisions of the Act generally sunset after 8 years; the Tax Foundation estimates that making all of the bill’s tax cuts permanent would have resulted in a deficit of \$2.7 trillion over 10 years, or \$1.4 trillion considering economic growth. Accordingly, the sunset provision saves \$1.23 trillion (\$2.7 - \$1.47 trillion) with a static projection, or \$950 billion (\$1.4 - .448 trillion) considering economic gains, and the trend of increasing deficits would have continued to expand in the following decade. Tax Foundation, *Preliminary Details and Analysis of the Tax Cuts and Jobs Act* (Dec. 2017). These estimates of the impact of the sunset provisions suggest that for Congress to remove the sunset provisions before 2026 could raise significant additional deficit concerns, increasing the cost of the Act **over just the following two years by almost \$1 trillion** (even considering economic growth), let alone going forward permanently. Accordingly, planning will need to take into consideration the significant possibility that the sunset of the individual provisions (including the transfer tax provisions) will occur.

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## Transfer Tax Issues

1. **Basic Exclusion Amount Doubled; Other Indexed Amounts.** The Act increases the basic exclusion amount provided in §2010(c)(3) from \$5 million to \$10 million (indexed for inflation occurring after 2011) for “estates of decedents dying, generation-skipping transfers, and gifts made” after 2017 and before 2026. The indexed amount for 2018 using the new “chained CPI” approach is not yet known. Dan Evans (Philadelphia, Pennsylvania) estimates that the basic exclusion amount for 2018 will be \$11.18 million and that the other previously announced indexed amounts for 2018 will remain the same under the chained CPI approach: annual gift tax exclusion – \$15,000; annual gift tax exclusion for non-citizen spouses – \$152,000; limitation on special use valuations – \$1,140,000; and “2% portion” under §6166 – \$1,520,000. Daniel Evans, *Summary of the Reconciliation Act of 2017*, (Dec. 25, 2017); <http://resources.evans-legal.com/?p=5316>.

The legislative history for the Act (the Joint Explanatory Statement of the Committee of Conference, referred to in this summary as the “Joint Explanatory Statement”) refers to this change as doubling the “estate and gift tax exemption,” but it also doubles the GST exemption because §2631(c) states that the GST exemption is “equal to the basic exclusion amount under section 2010(c).”

The sunset of the doubled basic exclusion amount raises the prospect of exclusions decreasing, and taxpayers being motivated to make transfers to take advantage of the larger exclusion amount, as in late 2012, but only significantly wealthy individuals are likely to be concerned with the gift tax exclusion amount decreasing to \$5 million (indexed).

2. **Regulations Will Address “Clawback.”** The Act amends §2001(g) to add a new §2001(g)(2) directing the Treasury to prescribe regulations as may be necessary or appropriate to address any difference in the basic exclusion amount at the time of a gift and at the time of death. This is to deal with the possibility of a “clawback” – i.e., a prior gift that was covered by the gift tax exclusion at the time of the gift might result in estate tax if the estate tax basic exclusion amount has decreased by the time of donor’s death, thus resulting in a “clawback” of the gift for *estate* tax purposes. This is the same issue that was a concern in 2012 when the possibility existed of the gift tax exclusion amount being reduced from \$5 million (indexed) to \$1 million. Most commentators thought there was unlikely to be a “clawback” in that situation; indeed, Congressional staffers had indicated in 2012 that clawback was not intended. For a further discussion of the clawback issue (and a related potential “reverse clawback” issue), see Item 5.c of the Current Developments and Hot Topics Summary (December 2012) found [here](#) and available at [www.Bessemer.com/advisor](http://www.Bessemer.com/advisor). See also James G. Blase, “Clawback Under New Tax Law” *Trusts & Estates* (Dec. 27, 2017); <http://www.wealthmanagement.com/estate-planning/clawback-under-new-tax-law>.
3. **No Estate Tax Repeal.** The House version of the Act would have repealed the application of the estate tax to decedents dying after 2024 (but would have left in place references to chapter 11 in §1014(b) for basis adjustment purposes at a decedent’s death). The House version would have left the gift tax in place, but with a reduction in the rate to 35% after 2024.

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## Individual Income Tax Issues

1. **Rate Brackets.** The Act preserves seven tax brackets, with a top rate of 37% for income starting at \$500,000 (indexed) for single individuals and heads of households and at \$600,000 (indexed) for married individuals filing joint returns. (The applicable income levels for the top rate bracket results in a “marriage penalty” of about \$8,000 for taxpayers in the top bracket.) The brackets are revised significantly. As an example, a married couple filing jointly with taxable income of \$700,000 would pay \$222,431 under pre-Act law and would pay \$198,379 under the Act (ignoring any applicable credits).

The top rate for trusts and estates applies to taxable income in excess of \$12,500 (indexed). (Under pre-Act law, the top rate bracket for trusts and estates would have applied to taxable income in excess of \$12,700 in 2018.) Interestingly, the top capital gains rate (23.8% including the tax on net investment income) applies to taxable income in excess of \$12,700 in 2018.

2. **Indexing Using “Chained CPI.”** A different measure of inflation will be used for indexing. The “chained CPI” approach would put more taxpayers in higher brackets over time than under the current indexing approach (and it continues to apply even after the tax changes for individuals sunset after 2025). The chained CPI approach uses the Department of Labor Chained Consumer Price Index for All Urban Consumers (“C-CPI-U”) rather than the “CPI-U” index that is used under pre-Act law. Values that are reset for 2018 are indexed with the chained CPI index in taxable years beginning after 2018. Unlike most of the other provisions applicable to individual taxpayers, changing to the chained CPI indexing approach does not sunset after 2025.

The IRS is expected to publish revised inflation adjustments for 2018 using the chained CPI index sometime in January or February, 2018.

3. **Standard Deduction and Personal Exemption.** The standard deduction is increased to a deduction of \$24,000 for married individuals, and the personal exemption is eliminated. The net result of these two changes will produce a modest tax savings for some (but not all) taxpayers. Under pre-Act law, in 2018 the standard deduction for married couples would have been \$13,000 and the personal exemption would have been \$4,150 so the combined standard deduction and personal exemptions for a married couple would have been \$13,000 + 4,150 + 4,150, or \$21,300 for a couple without children, or \$25,450 for a couple with one child.

Because of the increased standard deduction and the fact that many deductions for individuals are eliminated or limited (as discussed below), many taxpayers will use the standard deduction and will not realize any income tax benefits from charitable contributions, home mortgage interest payments, state and local tax payments, or other payments still qualifying as deductions to those who itemize deductions. Very importantly for business owners, as discussed above, the 20% deduction for qualified business income is allowed in addition to the standard deduction.

Taxpayers may consider “bunching” deductions into a particular year. For example, a taxpayer might make large charitable contributions in a single year to a donor advised fund, which can be implemented with very little expense or administrative inconvenience by creating an account with an established donor advised fund at a financial institution,

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community foundation, or other institutional sponsor. The account could be used to fund annual charitable contributions that the taxpayer would otherwise make in later years. The taxpayer could itemize deductions in the year in which the large payments are made, and use the increased standard deduction in other years.

The aged (age 65 and older) or blind deduction under §63(f) is not eliminated. The Joint Explanatory Statement describes the Senate version: “The additional standard deduction for the elderly and the blind is not changed by the provision,” and the Conference Agreement followed the Senate amendment. The aged or blind indexed deduction has previously been announced as being \$1,300 (\$1,600 for an unmarried person who is not a surviving spouse) for 2018.

4. **Kiddie Tax.** Under pre-Act law, the earned income of a child is taxed under the child’s single individual rates, but unearned income of a child who is subject to the Kiddie Tax (generally children with unearned income exceeding \$2,100 who are under age 18 and some children up to age 23 meeting certain requirements) is taxed at the parents’ rates if those rates are higher than the child’s rate. The Act continues but simplifies the Kiddie Tax by applying ordinary and capital gains rates applicable to trusts and estates, which often are higher than the parents’ rates, to the unearned income of the child. This change does not affect the ability of the child to take advantage of the \$200,000 threshold for protection from the 3.8% net investment income tax.
5. **Child Tax Credit.** The Act increases the child tax credit from \$1,000 for each qualifying child under age 17 to \$2,000 (not indexed) and the phase-out would not begin until income exceeds \$400,000 (not indexed) for married taxpayers filing jointly or \$200,000 (not indexed) for other taxpayers. The Act also increases the refundable portion of the credit.

The Act also allows a \$500 (not indexed) nonrefundable credit for qualifying dependents other than qualifying children.

No credit is allowed with respect to qualifying children unless the taxpayer provides the child’s Social Security number.

Because of the substantial increase in the child tax credit, families with multiple children may be among the most likely to realize significant income tax decreases under the Act. The expanded child tax credit provision has a very large revenue impact—projected at \$573.4 billion over ten years.

6. **Charitable Deduction.** The Act continues to provide that charitable contributions are deductible, with an increased limitation on cash contributions – i.e., 60% of the “contribution base” (generally AGI with a few modifications), up from 50%. The 80% deduction for contributions made for university athletic seating rights is eliminated. The exception from the substantiation requirement if the donee organization files a return that contains the same required information is repealed, effective for contributions made in taxable years beginning after 2016.
7. **Home Mortgage Interest Deduction.** Home mortgage interest for acquisition indebtedness of a residence that is incurred after December 15, 2017 is limited to the interest on \$750,000 (down from \$1 million) of debt. The \$750,000 limitation is not indexed. Pre-Act rules apply to acquisition indebtedness incurred prior to that date, and to

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refinancings of those loans not exceeding the refinanced indebtedness. No deduction is allowed for interest on home equity indebtedness (regardless when incurred) for 2018-2025 (after which time the individual provisions sunset, as discussed in Item 21 below).

8. **State and Local Taxes Deduction.** After considerable negotiation, the deduction for state and local income, sales, and property taxes (colloquially referred to as “SALT”) not related to a trade or business or a §212 activity is retained but limited to \$10,000 (not indexed) for joint filers and unmarried individuals and \$5,000 (not indexed) for a married individual filing a separate return (now representing another “marriage penalty” provision in the Code). This limitation may be significant for taxpayers living in high income tax states, and can be a factor in deciding where to establish (or whether to change) one’s domicile.

The \$10,000 limit on SALT deductions has led some states to consider implementing laws providing relief from state income tax to the extent of contributions to a specified charitable fund, in hopes that the taxpayer could deduct the full charitable contribution without any \$10,000 limitation. As an example, a taxpayer in Arizona may donate \$500 to a tax-exempt private school in Arizona and receive a dollar-for-dollar reduction in state income tax liability (up to a maximum of \$500) against the state income tax liability. While the \$500 reduction of state income tax liability might be viewed as a quid pro quo that should reduce the charitable deduction, some authority exists for permitting the full charitable deduction in similar situations. See Chief Counsel Advice 201105010.

Some jurisdictions informed taxpayers of the amount of property taxes that would be due for 2018, and the taxpayers prepaid those taxes in 2017, hoping they could deduct the full amount of those taxes without applying the \$10,000 limit that would apply if the taxes were paid in 2018. The IRS issued IR-2017-210 announcing that only property taxes assessed in 2017 and that are paid in 2017 could be deducted in 2017. Some commentators indicate that case law may nevertheless support a 2017 deduction for the 2018 property taxes that are paid in 2017 by a cash basis taxpayer. See Carol Cantrell, *Deducting 2018 Real Estate Property Taxes in 2017*, Leimberg Inc. Tax Pl. Newsletter #127 (January 10, 2018) (referring to Reg. §1.461-1(a)(1) permitting a cash basis taxpayer to deduct prepaid items, whether business or personal, as long as the expenditure does not create an asset having a useful life which extends “substantially beyond the close of the tax year,” which one case interpreted as a “one-year rule”).

This limitation might lead to some taxpayers having residences owned by various trusts for various beneficiaries, each of which would have its own \$10,000 limitation for the property tax deduction. See Item 20.c. below.

The SALT \$10,000 limitation does not apply to foreign income taxes or to real and personal *property* taxes paid “in carrying on a trade or business or an activity described in section 212” (i.e., investment activities), so should not apply to state and local *property* taxes reported on Schedule C (for a trade or business) or Schedule E (net income from rents and royalties).

The Joint Explanatory Statement in footnote 172 adds this explanation: “Additionally, taxes imposed at the entity level, such as a business tax imposed on pass-through entities, that are reflected in a partner’s or S corporation shareholder’s distributive or pro-rata share of income or loss on a Schedule K-1 (or similar form), will continue to reduce such partner’s or shareholder’s distribute or pro-rata share of income as under present law.” Accordingly, a



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franchise tax or other tax imposed on the entity reduces (without limit) the business income that flows through to the owner, but still the owner's state income tax on the business income is subject to the \$10,000 limit.

9. **Miscellaneous Itemized Deductions Not Deductible.** The Act adds new §67(g) as follows:

(g) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.—Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.

Section 67(a) provides that “miscellaneous itemized deductions” (described in §67(b)) may be deducted only to the extent they exceed 2% of adjusted gross income (AGI). Miscellaneous itemized deductions are all itemized deductions *other than* those specifically listed in §67(b); the excepted items (which are still deductible) include deductions for payment of interest, taxes, charitable contributions by individuals or trusts and estates, medical expenses, and estate tax attributable to income in respect of a decedent (under §691(c)).

The effect is that the Act, in very few words, eliminates many itemized deductions for taxable years beginning in 2018-2025. The Joint Explanatory Statement summarizes the present law by listing a large number of deductions treated as miscellaneous itemized deductions, and concluding that “taxpayers may not claim the above-listed items” as deductions during the suspension years. (The listed expenses include tax preparation expenses.)

The disallowance of many deductions for individuals may have an impact on state income taxes as well, because many states base their income tax calculation on the federal taxable income.

See Item 20.d below regarding the impact of this provision on the deductibility of the executor and trustee fees and other expenses of trusts and estates.

10. **Pease Limitation Eliminated.** The Pease limitation (reducing most itemized deductions by 3% of the amount by which AGI exceeds a threshold amount [\$313,800 in 2017 for married couples] but with a maximum reduction of 80%) is eliminated for 2018-2025. Eliminating the Pease limitation may have little impact for many taxpayers, however, in light of the elimination of most itemized deductions. Eliminating the Pease limitation can still be important for individual taxpayer itemizers who have substantial charitable or home mortgage interest deductions (as well as the SALT deduction, up to \$10,000).
11. **Qualified Business Income Deduction.** In connection with the decrease of the top corporate tax rate to 21%, a deduction is allowed for individual business owners of businesses operated in pass-through entities (sole proprietorships, partnerships, limited liability companies, or S corporations). The deduction under new §199A is included in the portions of the Act dealing with individuals, but the deduction is discussed in the Business Tax Matters section of this summary, below. The deduction will be a very significant deduction for some business owners.



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12. **Medical Expenses.** The Act retains the medical expense deduction and even expands the deduction for two years by reducing the threshold to 7.5% (rather than 10%) of AGI for 2017-2018.
  13. **Alimony; Repeal of §682.** Alimony payments will not be deductible and will not be income to the recipient. In addition, §682 is repealed; that section provided that if one spouse created a grantor trust for the benefit of the other spouse, following the divorce the trust income would not be taxed to the grantor-spouse under the grantor trust rules to the extent of any fiduciary accounting income that the donee-spouse is "entitled to receive." The repeal of §682 is particularly troublesome, in part because §672(e) treats a grantor as holding any power or interest held by an individual who was the spouse of the grantor at the time of the creation of such power or interest, so the ex-spouse's interest as a beneficiary will likely be sufficient to trigger grantor trust status under §677 even following the divorce.

The alimony and repeal of §682 provisions are effective for any divorce or separation instrument executed after December 31, 2018 and any divorce or separation instrument executed before that date but modified after that date if the modification expressly states that the amendments made by this section of the Act apply to such modification. This provision does not sunset after 2025.

This change will have a significant impact on the negotiation of divorce agreements. Many divorce agreements include agreements to pay alimony in order to take advantage of using the recipient spouse's lower income tax brackets. The inability to shift income tax responsibility for alimony payments or for the income of grantor trusts may have an impact on the negotiated amount of alimony. The Act may create an incentive for spouses who are contemplating divorce to complete the divorce before the end of 2018.

14. **Moving Expenses.** The deduction for moving expenses incurred in connection with starting a new job at least 50 miles farther from the taxpayer's former residence than the former workplace and the exclusion from income of moving expense reimbursements are eliminated for 2018-2025, except for members of the Armed Forces in certain circumstances.
15. **Alternative Minimum Tax.** The alternative minimum tax (AMT) is not eliminated for individuals, but the AMT exemption for individuals is increased from \$78,750 to \$109,400 (indexed) and the phase-out threshold is increased from \$150,000 to \$1,000,000 (indexed) for married taxpayers filing joint returns.
16. **Recharacterizing Roth IRAs.** Contributions to Roth IRAs are non-deductible (i.e., are made from after-tax income), but qualified distributions from Roth IRAs are not includible in the recipient's income. Traditional IRAs may be converted to Roth IRAs, and the amount converted is includible in the taxpayer's income as if a withdrawal had been made. Under pre-Act law, a Roth IRA that received a contribution or that resulted from a conversion of a traditional IRA could have been recharacterized as a traditional IRA before the due date for the individual's income tax return for that taxable year. For example, if assets in a Roth IRA decline in value after conversion from a traditional IRA, the Roth IRA could be recharacterized as a traditional IRA to avoid the income recognition from the conversion, and the recharacterized traditional IRA could again be converted to a Roth IRA at the lower values. The Act eliminates the recharacterization option for conversions (but not for contributions), effective for taxable years beginning after 2017 (and this provision does not sunset after 2025).

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17. **Expanded Application of 529 Accounts & ABLA Accounts.** For distributions after 2017, “qualified higher education expenses” will include tuition at public, private, or religious elementary or secondary schools, limited to \$10,000 per student during any taxable year. Under the Act, up to \$15,000 per year can be rolled over from a 529 account to an ABLA account for the same beneficiary or member of the same family. In addition, certain ABLA account beneficiaries will be able to make contributions from the account from earned income.
18. **Life Settlements of Life Insurance Policies.** For viatification (life settlements) of life insurance policies, the Act provides that the taxpayer’s basis in a life insurance policy is not reduced by the “cost of insurance” charges, reversing the IRS position announced in Rev. Rul. 2009-13. Reporting requirements are added for “reportable policy sales,” and none of the transfer for value exceptions apply to such sales. These provisions do not sunset after 2025.
19. **Eliminate Mandate for Health Insurance.** The Act eliminates the mandate for having qualifying health insurance beginning in 2019 (which is anticipated to save \$318-\$338 billion over 10 years because of reduced federal subsidies to low income persons who purchase coverage). The Congressional Budget Office and Joint Committee on Taxation project that this change will result in 13 million fewer people having health insurance by 2027 and will increase insurance premiums for many Americans by about 10%.
20. **Provisions Impacting Trusts and Estates.**
- a. **Tax Provisions for Individuals Generally Apply to Trusts.** Section 641(b) provides that “[t]he taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part.”
  - b. **Personal Exemption.** In lieu of the deduction for personal exemptions, an estate is allowed a deduction of \$600, a complex trust is allowed a deduction of \$100, and a simple trust (required to distribute all of its income currently) is allowed a deduction of \$300. An exception is made for a “qualified disability trust” which gets a deduction equal to the personal exemption of an individual. While the personal exemption for individuals is repealed, the Act adds new §642(b)(2)(C)(iii) to apply a deduction of \$4,150 (indexed) for qualified disability trusts for years in which the personal exemption for individuals is zero (i.e., 2018-2025). The \$600, \$100, and \$300 deduction amounts for estates and trusts other than qualified disability trusts are not changed by the Act.
  - c. **State and Local Taxes.** The \$10,000 limit on deducting state and local taxes under the Act applies to trusts (as made clear in footnote 171 of the Joint Explanatory Statement). This may create some incentive for creating multiple trusts, subject to the anti-abuse provisions for multiple trusts under §643(f), so that each separate trust would be entitled to its own \$10,000 limit on the SALT deduction. Having different beneficiaries or other terms of the separate trusts would be important for avoiding §643(f). Section 643(f) applies for trusts having substantially the same grantors and primary beneficiaries if the principal purpose of the trusts is to avoid income tax, but it applies “under regulations prescribed by the Secretary” and no such regulations have ever been issued. However, other tax or nontax reasons may exist for having a single trust.

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- d. **Executor or Trustee Fees and Other Miscellaneous Estate or Trust Expenses.** New §67(g) states that “[n]otwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.” Section 67(a) provides that “miscellaneous itemized deductions” (described in §67(b)) may be deducted but only to the extent they exceed 2% of adjusted gross income. Miscellaneous itemized deductions are all itemized deductions *other than* those specifically listed in §67(b), and executor and trustee fees are not listed in §67(b), so does new §67(g) preclude their deduction?

The answer is not clear. Executor and trustee fees and other miscellaneous estate/trust expenses are deductible under §67(e) to the extent that they satisfy the requirement of being expenses that “would not have been incurred if the property were not held in such trust or estate.”

Section 67 does not authorize deductions but limits deductions that would otherwise be allowed under other Code sections. New §67(g) says that miscellaneous itemized deductions are not allowed “notwithstanding §67(a),” but makes no reference to §67(e).

The specific reference to §67(a) but not §67(e) leaves the possible implication that miscellaneous itemized deductions could be allowed under §67(e). Section 67(e)(1) states (independently of §67(a)) that miscellaneous itemized deductions “shall be treated as allowable” in calculating an estate/trust’s AGI as long as the expenses are “paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate,” and §67(e)(2) makes clear that §67 does not limit the deductions for estates or trusts under §§642(b), 651, or 661.

Various arguments have been suggested to support the continued deductibility of miscellaneous deductions for estates and trusts notwithstanding §67(g). One argument is that superseding §67(e) would lead to illogical results. To say that new §67(g) supersedes §67(e) would suggest that it overrides not just §67(e)(1) but also §67(e)(2), which addresses §§642(b) (the deduction in lieu of personal exemption), 651, and 661. That would result in the illogical conclusion that §642(b) is overridden although other provisions of the Act provide expanded relief under §642(b), and would also mean that trusts and estates get no distribution deductions (which would completely overturn the basic premise of the income taxation of trusts and estates).

Additionally, the Joint Explanatory Statement describes the addition of §67(g) as suspending “all miscellaneous itemized deductions that are subject to the two-percent floor under present law.” Arguably, therefore, the intent was not to eliminate the deduction of items that were permitted under §67(e) because they are not “subject to the two-percent floor under present law.”

Another argument suggested by Steve Gorin (St. Louis) is that because the deductions are allowable in determining AGI (i.e., they are “above the line” deductions), they are not “itemized deductions” at all (and therefore not miscellaneous itemized deductions) because of §63(d)’s definition of itemized deductions:

Code §63(d) provides, “For purposes of this subtitle, the term ‘itemized deductions’ means the deductions allowable under this chapter other than (1) the deductions allowable in arriving at adjusted gross income, and (2) the deduction for personal exemptions provided by section 151.” So Code §67(e)(1) recharacterizes those expenses as above-the-line and not being itemized deductions at all.

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Not being itemized deductions any more, they are not subject to Code §67(a). When Code §67(e) says “for purposes of this section,” it is explaining that its recharacterization of expenses supersedes the definition in subsection (b) that otherwise would have applied to the expenses (described in Code §67(e)(1)) and that therefore these expenses are no longer subject to subsection (a).

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Nothing [in the Act or the Joint Explanatory Statement] suggests that Code §67(e)(1) has been directly or indirectly repealed as well.

Government officials have indicated that they are aware of this issue, and may issue guidance.

- e. **Excess Deductions or Losses at Termination of Estate or Trust.** Section 642(h)(1) provides that on the termination of an estate or trust, a net operating loss or capital loss carryover shall be allowed as a deduction to the beneficiaries succeeding to the property of the estate or trust. Capital losses are not itemized deductions, so new §67(g) should not impact them.

On the other hand, §642(h)(2) states that on the termination of an estate or trust any deductions for the last taxable year of the estate or trust (other than the deduction in lieu of personal exemptions and other than the charitable deduction) in excess of gross income for the year shall be allowed as a deduction to the beneficiaries succeeding to the property of the estate or trust. Those deductions are not mentioned in §67(b) and are miscellaneous itemized deductions, therefore their deduction is not allowed for 2018-2025 under new §67(g). Indeed the Joint Explanatory Statement specifically includes “[e]xcess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust” as one of the “above listed items” that cannot be claimed as a deduction under §67(g). The discussion about *estate/trust* deductions in paragraph d above does not apply, because these are deductions to the individual beneficiaries, not to the trust.

If the assets of an estate or trust pass to an individual and if the excess deductions are miscellaneous itemized deductions, the individual beneficiary would not be able to use those miscellaneous itemized deductions because of §67(g). If instead, the assets of the terminating estate or trust pass to another trust, can they be deducted by the recipient trust under §67(e)? Presumably not, because §67(e)(1) seems to refer to expenses incurred in the administration of the estate or trust claiming the deduction.

- f. **Alternative Minimum Tax.** The Act increases the AMT exemption for individuals, but not for trusts and estates. The exemption amounts for trusts and estates will likely be slightly lower than the previously announced amounts for 2018 because of the Act’s requirements to use chained CPI indexing.
- g. **Section 691(c) Deduction for Estate Taxes Attributable to Income in Respect of a Decedent.** New §67(g) does not suspend the §691(c) deduction for estate tax attributable to income in respect of a decedent because the §691(c) deduction is one of the items listed in §67(b) as *not* being a miscellaneous itemized deduction “for purposes of this section,” which would include new §67(g).

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#### h. **Electing Small Business Trusts.**

(1) **NRA as Permitted Potential Beneficiary.** The Act allows a nonresident alien (NRA) individual to be a potential current beneficiary of an electing small business trust (ESBT).

(2) **Charitable Deduction Allowed Under §170 Rather Than §642(c).** The charitable contributions deduction for trusts is governed by §642(c) rather than §170, which governs the charitable deduction for individuals. Several restrictions that apply under §642(c), but not under §170, are that the distribution must be made from gross income and pursuant to the terms of the governing instrument (and the governing instrument requirement has been applied strictly). In addition, no carryover of excess contributions is allowed for trusts. The Act provides that the charitable contribution deduction of an ESBT is determined by rules applicable to individuals under §170, not the rules applicable to trusts under §642(c), effective for taxable years beginning after 2017. This will be favorable in various respects for charitable contributions made by the portion of an ESBT holding S corporation stock. Eliminating the gross income requirement means that a charitable deduction would be available for gifts of property, the same as for individuals. The governing instrument requirement will no longer apply. Excess charitable deductions can be carried forward for five years. Possible negative effects of applying §170 rather than §642(c) to ESBTs are that the percentage limitations (but also the carryforward provisions) applicable to individuals will apply to charitable contributions made by the portion of an ESBT holding S corporation stock, and the substantiation requirements that apply to individuals under §170 will also be applicable to ESBTs, effective for taxable years beginning after 2017.

(3) **No Sunset.** The changes described above for ESBTs are permanent and do not sunset after 2025.

(4) **Section 199A Deduction.** ESBTs appear to qualify for the §199A deduction, as discussed in Item 2.c of the Business Tax Matters section of this summary, below.

21. **Sunset after 2025** – Almost all of the individual income tax changes will expire after 2025. This includes (among the many individual tax changes) the deduction for business income from pass-through entities, individual rate cuts, expanded child tax credit, expanded standard deduction, repeal of personal exemptions, and increases in the transfer tax exclusion amounts. A few (very few) of the individual income tax changes do not sunset after 2025, including the use of the chained CPI, which has the effect of moving taxpayers into higher brackets in future years as compared to the current indexing approach, alimony and §682 repeal, recharacterization of Roth IRA conversions, and the life insurance settlement provisions.

### **Business Tax Matters**

1. **Corporate Tax Rate.** The top corporate tax rate is 21% under the Act, effective beginning in 2018. This reduced top income tax rate applies to any entities that are subject to income taxation under Subchapter C.

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2. **Qualified Business Income from Pass-Through Entities.** A complicated provision in new §199A provides tax-favored treatment of business income from pass-through entities (sole proprietorships, partnerships, limited liability companies, or S corporations) that are not subject to taxation under Subchapter C and that will be taxed at the individual tax rates of the owners, which could be as high as 37%. The tax advantage under §199A reduces the wide discrepancy (21% vs. 37%) in the top rates at which business income would be taxed, depending on whether the business is taxed as a corporation or as a pass-through entity. Very generally (but with various limitations and exceptions), the §199A deduction results in a top rate of 29.6% (as discussed below) for the taxation of business income from pass-through entities. The provision is in the Subtitle A of the Act addressing individual tax reform (in particular in Section 11011 of the Act), but is included in the business tax portion of this summary.

a. **Overview of Deduction.** Way overly simplified –

**20% Deduction; Wage Limitation.** The Act allows a deduction equal to 20% of qualified business income from pass-through entities, limited to 50% of the taxpayer's pro rata share of the total W-2 wages paid by the business (including wages paid to the taxpayer). The Joint Explanatory Statement explains that the W-2 wages limitation is meant to "deter high-income taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20-percent deduction." The 20% deduction results in an effective top rate of  $(1 - 0.20) \times 37\%$ , or 29.6%.

- **Qualified Business Income.** Qualified business income is generally the net amount of income, gain, deduction, and loss from an active trade or business within the United States, but not including certain types of investment income (capital gains, dividends or interest unless the interest is allocable to a trade or business), and not including reasonable compensation paid to the taxpayer, any guaranteed payment under §707(c), or payment to a partner for services under §707(a). A net loss from a particular business in one year carries over to the next taxable year as a loss for that business.
- **"Real Estate Exception" to Wages Limitation.** The wages limitation was relaxed in the Conference Agreement by adding that the wage limitation is the greater of (a) 50% of W-2 wages, or (b) the sum of 25% of W-2 wages plus 2.5% of the unadjusted basis, immediately after acquisition, of all tangible property subject to depreciation (which could be very beneficial to real estate companies).
- **Specified Service Companies.** The deduction does not apply for specified service businesses in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any business where the principal asset is the reputation or skill of one or more of its employees (by reference to §1202(e)(3)(A)), except for engineering or architecture. This provision decreases the incentive of specified service businesses to pay low compensation income for the service-provider employees and claim that most of the income from the business is qualified business income entitled to the 20% deduction.



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- **Exceptions for Lower Income Taxpayers.** The 50% wage limitation (as modified by the “real estate” exception summarized above), and the specified service limitation do not apply if the taxpayer has taxable income below a threshold amount of \$315,000 (indexed) for married individuals filing jointly and \$157,500 (indexed) for other taxpayers, with a phase-out of the deduction for taxpayers over the next \$100,000/50,000 of taxable income. Even though the specified service business limitation may not apply for a particular taxpayer whose income is below the threshold, reasonable compensation concepts presumably still apply in determining what constitutes qualified business income (though that is not mentioned in the statute or Joint Explanatory Statement).
  - **REIT, Publicly Traded Partnership, Qualified Cooperative Dividends.** A straight 20% deduction generally applies to qualified REIT dividends, qualified publicly traded partnership income, and qualified cooperative dividends (subject to the overall limit described below of taxable income less net capital gains). In effect, the wage limitation does not apply to those types of income.
  - **Trusts and Estates.** The deduction is available to non-corporate taxpayers, including trusts and estates. (The Senate version would not have made the deduction available to trusts and estates.) In applying the wage limitation, W-2 income from entities owned by trusts and estates is apportioned between beneficiaries and the fiduciary under §199(d)(1)(B)(i), which has the effect of applying the rather complicated rules in Reg. §1.199-9(d)-(e).
  - **Overall Limit–Deduction Cannot Exceed Taxable Income Less Net Capital Gain.** The deduction cannot exceed taxable income reduced by the taxpayer’s net capital gain for the year. In effect, the 20% deduction cannot exceed the taxpayer’s ordinary and qualified dividend income.
  - **No Reduction of AGI; Deduction Available to Non-Itemizers.** The deduction reduces taxable income, but not AGI (so the deduction does not affect limitations throughout the Code based on AGI). The deduction is available to both itemizers and non-itemizers. (In other words, the deduction is available in addition to the standard deduction.)
- b. **A Little More Detail.** The details get *much more complicated*. Section 199A(a) describes generally the amount of the deduction, subject to a variety of definitions, modifications, special rules, and anti-abuse rules described in §199A(b)-(h). The Conference Agreement summarizes the deduction amount as follows:

The taxpayer’s deduction for qualified business income for the taxable year is equal to the sum of (a) the lesser of the combined qualified business income amount for the taxable year or an amount equal to 20 percent of the excess of taxpayer’s taxable income over any net capital gain and qualified cooperative dividends, plus (b) the lesser of 20 percent of qualified cooperative dividends and taxable income (reduced by net capital gain). This sum may not exceed the taxpayer’s taxable income for the taxable year (reduced by net capital gain). Under the provision, the 20-percent deduction with respect to qualified cooperative dividends is limited to taxable income (reduced by net capital gain) for the year. The combined qualified business income amount for the taxable



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year is the sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer and 20 percent of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. The deductible amount for each qualified trade or business is the lesser of (a) 20 percent of the taxpayer's qualified business income with respect to the trade or business, or (b) the greater of 50 percent of the W-2 wages with respect to the trade or business or the sum of 20 percent of the W-2 wages with respect to the trade or business and 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.

Got all that? (And that is a VERY simplified summary of the actual statute.) The headings of the subparagraphs of §199A provide an indication of the many detailed provisions in the statute: (b) Combined Qualified Business Income Amount; (c) Qualified Business Income, (d) Qualified Trade or Business; (e) Other Definitions; (f) Special Rules; (g) Deduction Allowed to Specified Agricultural or Horticultural Cooperatives; and (h) Anti-Abuse Rules. For a more detailed description of the detailed operation of §199A(a) with examples, see Samuel Donaldson, *Understanding the Tax Cuts and Jobs Act* (2018); Alan Gassman & Brandon Ketron, *Dymistifying the New Section 199A Deduction for Pass-Through Entities*, LEIMBERG INCOME TAX PLANNING NEWSLETTER #125 (January 4, 2018); Leimberg, Geeraerts, & Magner, *Tax Cuts and Jobs Act of 2017 – What Advisors Need to Know to Better Inform Their Clients*, LEIMBERG ESTATE PLANNING NEWSLETTER #2609 (December 16, 2017); Tony Netti, Tax Geek Tuesday: Making Sense of the New '20% Qualified Business Income Deduction,' Forbes (Dec. 6, 2017); <https://www.forbes.com/sites/anthonymitti/2017/12/26/tax-geek-tuesday-making-sense-of-the-new-20-qualified-business-income-deduction/#775b9e8e44fd>.

- c. **ESBTs Qualify for §199A Deduction.** The statute and legislative history do not specifically address the availability of the §199A deduction for ESBTs, but they presumably qualify for the deduction. Section 641(c) describes the manner in which the taxable income and the tax is determined for ESBTs, and §641(c)(2)(C) states that only certain items of income, loss, deduction, or credit may be considered in determining the tax for ESBTs, but the few allowed items include “[t]he items required to be taken into account under section 1366.” Section 1366 describes the pass-through of items to S corporation shareholders, which would include the pass-through of business income that would be reported on the Schedule K-1 from the S corporation.
  - d. **Revenue Impact.** The Joint Committee on Taxation projects that the deduction for business income from pass-through entities will cost \$414.4 billion over ten years, which suggests that the provision will present substantial planning and tax savings opportunities for taxpayers who can take advantage of the deduction.
3. **Increased Section 179 Expensing.** Under pre-Act law, taxpayers could generally deduct the cost of depreciable tangible personal property and certain real property purchased for use in a trade or business, but only up to \$500,000 (indexed) reduced by the cost of qualifying property placed in service during the year in excess of \$2 million (indexed). The balance of the cost is depreciated over an applicable period of years. The Act increases the allowed expensing levels to \$1 million, and the phase-out threshold amount is increased to \$2.5 million.

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4. **100% Expensing for Qualifying Business Assets.** Under pre-Act law, an additional first-year depreciation deduction is allowed equal to 50% of the adjusted basis of qualified property placed in service before 2020 (subject to various qualifications). The Act allows 100% expensing for qualified property (generally, depreciable assets other than buildings) that is acquired and placed in service after September 27, 2017 and before 2023 (before 2024 for “longer production period” property and certain aircraft), and extends the expensing to the acquisition of used as well as new property. A 20% per year phase-down of full expensing will apply for property placed in service after 2022 and before 2027.
  5. **Interest Deductions for Businesses.** Interest deductions for businesses with average annual gross receipts over \$25 million for the three prior years generally are limited under the Act to 30% of the corporation’s taxable income computed without regard to depreciation, amortization, or depletion deductions (“EBITDA”) or any deduction under new §199A for qualified business income of a pass-through entity for taxable years beginning after 2017 and before 2022, and for later taxable years computed without considering any deduction under §199A but after considering depreciation, amortization, or depletion (in effect “EBIT”). Disallowed interest can be carried forward indefinitely. Various complicated detailed rules and exceptions apply in determining the interest deduction limitation, but the limitation will be significant.
  6. **Corporate Alternative Minimum Tax Repealed.** The corporate alternative minimum tax is repealed. A planning implication is that one of the possible disadvantages of having corporate owned life insurance to fund an entity-purchase buy sell agreement will be removed, which could impact the decision of whether to use an entity-purchase or cross-purchase arrangement for corporate buy-sell agreements.
  7. **Like-Kind Exchanges Limited to Real Property.** Like-kind exchanges are permitted for property held for use in a trade or business or for investment. Under pre-Act law, like-kind exchanges are permitted for real or personal property. Under the Act, like-kind treatment will be limited to real property.
  8. **Entertainment Expenses.** No deduction will be allowed for expenses of a trade or business related to entertainment, amusement, or recreation activities or for membership dues to any club organized for business, pleasure, recreation, or other social purposes. The 50% limitation on deductions continues to apply for meals associated with operating the trade or business. The Joint Explanatory Statement gives this example: “(e.g., meals consumed by employees on work travel).”
  9. **Net Operating Losses.** Net operating losses (NOLs) are deductible only up to 80% of taxable income (determined without regard to the deduction). Under pre-Act law, they were fully deductible. NOLs cannot be carried back to prior years, as was permitted under pre-Act law, but indefinite carryforwards will continue to be allowed.
  10. **Qualified Stock Options.** Employees who receive stock options or restricted stock for the performance of services may defer recognition of income for up to five years upon exercise of the options (or earlier when the qualified stock becomes transferable or readily tradable on an established securities market). The special deferral provision does not apply to a 1% owner of a corporation, a CEO or CFO, any of the four highest compensated officers for any of the 10 preceding years, and family members of a 1% owner, CEO, or CFO.

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11. **Carried Interest.** A 3-year holding period will apply in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain. The 3-year holding period requirement applies notwithstanding the rules of §83 or whether a §83(b) election was made.
  12. **Deemed Partnership Termination.** A sale of 50% or more of the capital and profits of a partnership will no longer result in a technical termination of the partnership.
  10. **Repeal of §199 Deduction for Domestic Production Activities.** The deduction under §1999 for domestic production activities (which included the domestic manufacture of tangible personal property or computer software and energy generations from renewable energy projects) is repealed. The repeal is effective for C corporations after 2018 and for other businesses after 2017.

## Tax-Exempt Organizations

1. **UBTI Determined Separately For Each Activity.** New §512(a)(6) provides that the unrelated business taxable income (including for purposes of determining any NOL deduction) is determined separately for each trade or business activity. A deduction from one activity cannot offset the income from another activity in determining the organization's UBTI, but a loss from an activity in one year can offset the income from the same activity in another year. Under a special transition rule, NOLs that arise in taxable years beginning before 2018 that are carried over to a later year are not subject to this new limitation.
2. **Excise Tax for Certain Private Colleges and Universities.** A 1.4% of net investment income excise tax applies to private colleges and universities that have more than 500 students, assets of at least \$500,000 per full-time student, and 50% of tuition paying students located in the United States. This provision will apply to only a very limited number (approximately 27) of private colleges and universities.

## Estate Planning Considerations In Light of New Legislation and Inherent Uncertainty Arising From 2026 Sunset

1. **Déjà Vu on Steroids.** Planning alternatives that were considered in 2013 following the passage of ATRA, when the gift tax exclusion amount increased from \$1 million to \$5 million have resurfaced in light of the doubling of the gift tax exclusion. Indeed many of the detailed planning issues summarized in the Current Developments and Hot Topics Summary (December 2013) found [here](#) and available at [www.Bessemer.com](http://www.Bessemer.com) are highly relevant for 2018.
2. **Paradigm Shift.** The increased \$10 million (indexed) estate and gift tax basic exclusion amount for every individual means that estate and gift taxes are irrelevant for most clients. Concepts that have been central to the thought processes of estate planning professionals for their entire careers are no longer relevant for most clients – even for “moderately wealthy” clients (with assets of over several million dollars). For example, structuring trusts to qualify for the gift tax annual exclusion may be unnecessary for many clients who will *never* have any gift or estate tax concerns (though professional advisers must still advise them of the requirement to file gift tax returns reporting any taxable gifts that do not qualify

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for the annual exclusion). Structuring testamentary charitable trusts to qualify for the estate tax charitable deduction under §2055 will no longer be important for many clients. It is hard for “old dogs to learn new tricks,” and planners will constantly have to be sensitive to the major paradigm shift resulting from the Act.

3. **Small Percentage of Population Subject to Transfer Taxes.** Only about 1,800 of 2018 decedents will have to pay estate tax in 2018 (with an estate tax exclusion amount of about \$11.2 million), down from about 5,000 decedents in 2017 (with an estate tax exclusion amount of \$5.49 million). See Heather Long, *3,200 Wealthy Individuals Wouldn't Pay Estate Tax Next Year Under GOP Plan*, Washington Post (Nov. 5, 2017) (based on analysis of Joint Committee on Taxation). The \$10 million (indexed) gift tax exclusion amount also means that many individuals have no concern with lifetime gifts ever resulting in the payment of federal gift taxes. Wealthy clients still exist, though, and the wealthy are getting wealthier.
4. **Non-Resident Alien Individuals.** The exclusion amount has NOT increased for non-resident alien individuals (NRAs). The exclusion amount remains at \$60,000 (see §2102(b) (unified credit of \$13,000, which is the amount of tax on a \$60,000 estate)). Do not be lulled into thinking that federal estate tax concerns have vanished for NRAs because of the large increase in the exclusion amount that applies to citizens or residents of the United States.
5. **Cannot Ignore GST Tax; Allocation of Increased GST Exemption Amount.** Even low to moderate-wealth individuals cannot ignore the GST tax. Without proper allocation of the GST exemption (also \$10 million indexed), trusts created by clients generally will be subject to the GST tax at the death of the beneficiary unless the trust assets are included in the beneficiary's gross estate. Sometimes the allocation will occur by automatic allocation, but the planner must be sure that proper GST exemption allocation is made to long-term trusts (unless the trust assets will be included in the beneficiary's gross estate) even though the purpose of the trusts is not to save transfer taxes. The planner might specifically structure trusts that will not qualify for automatic allocation so that the assets will be included in a beneficiary's gross estate if the beneficiary dies before the termination of the trust, if the planner anticipates that the beneficiary will have sufficient estate tax exclusion amount to eliminate estate tax for the beneficiary even with the trust assets included in the estate (and the inclusion of those assets would also be helpful for basis adjustment purposes, as discussed in Item 9 below).

Grantors who have previously created irrevocable trusts that are not fully GST-exempt may want to allocate some of the increased GST exemption amount to the trust. Presumably this is permitted, but the increased estate and gift tax exclusion amount (which is also the GST exemption amount under §2631(c)) applies to “estates of decedents dying and gifts made after December 31, 2017,” and the mere allocation of GST exemption to an existing trust is neither of those things.

6. **Review Formula Clauses.** Review formula clauses in existing documents. For example, a classic bequest to a credit shelter trust of the maximum amount possible without incurring estate taxes may become a bequest of the entire estate if the decedent's estate is less than the \$10 million (indexed) basic exclusion amount. Confirm that is the client's intent. Having all of the estate pass to a credit shelter trust may also generate state estate taxes at

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the first spouse's death, as discussed in Item 7.j below. Planners may want to send letters to clients warning them that plans should be reviewed in light of the major impact that the substantial increase in the transfer tax exclusion amounts can have on estate plans.

Going forward, some plans may incorporate plans providing alternatives based on the size of the estate exclusion amount (e.g., whether the sunset occurs to decrease the exclusion amount to \$5 million indexed). Some clients may want to leave some specified amount to a credit shelter trust rather than relying on formulas.

7. **Testamentary Planning.** What testamentary planning approaches are preferred for couples with combined assets well under the approximately \$22 million estate tax exclusion amounts available to the spouses?

As an overview of general planning themes depending on the size of the estate of a married couple:

(1) Couples with assets under \$5.5 million – address whether assets will be left outright to the surviving spouse or in trust, and cause estate inclusion at the surviving spouse's subsequent death to receive a basis adjustment;

(2) Couples with assets over \$5.5 million but less than \$11 million – make use of the first decedent-spouse's exclusion amount with an outright gift with disclaimer planning or a QTIPable trust approach, creating flexibility through the manner in which the portability election is made (the portability election could create the possibility of using both spouses' exclusion amounts but allowing a basis adjustment of all of the estate assets at the second spouse's death); and

(3) Couples with assets over \$11 million – same as category 2 but also consider gifts using some of the increased gift exclusion amount to save estate tax in case the exclusion amount is subsequently reduced back to \$5.5 million and consider making transfers in a way that one of both spouses have potential access to some of the transferred assets for clients making large transfers.

These themes are addressed in more detail below. The alternatives begin with the simplest approaches, from a client perspective, but *not necessarily the preferred approaches*.

- a. **Outright-to-Spouse.** For clients who want simplicity and do not want to take advantage of the opportunities available with trust planning, the first decedent-spouse's assets could be left outright to the surviving spouse at the first spouse's death. Before employing this "maximum simplicity" approach, the planner should make sure that the client is aware of important planning opportunities that will be lost by not using trust protections for the surviving spouse. (The outright-to-spouse plan can also be disadvantageous in states with state estate taxes with exemptions low enough that the state estate tax might apply at the second spouse's death.)
- b. **Outright Bequest with Disclaimer to Trust.** The first decedent-spouse's assets could be left outright to the surviving spouse with a disclaimer provision causing the disclaimed assets to pass into a trust with the spouse (and perhaps others) as discretionary beneficiaries.

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Several significant disadvantages may result from relying on the disclaimer approach. The most important is that the spouse may refuse to disclaim assets (or may be incompetent or may die before disclaiming), even though a disclaimer would be appropriate based on the tax situation. Another significant disadvantage to the disclaimer approach is that the surviving spouse cannot retain a nontaxable power of appointment over disclaimed assets. Reg. §25.2518-2(e)(2) & §25.2518-2(e)(5)(Ex. 5). However, a family member other than the surviving spouse-disclaimant (such as the spouse's brother or sister) could have a power of appointment that could be exercised at the spouse's death (or earlier if that is desired). In addition, the risk exists that the surviving spouse inadvertently accepts benefits, making a disclaimer impossible. Also, under the laws of some states, disclaimers may not be recognized for fraudulent transfer purposes with respect to the disclaimant's creditors (*e.g.*, Fl. Stat. §739.402(d)) and will be treated as disallowed transfers for Medicaid qualification purposes.

In states with a state estate tax, the surviving spouse could disclaim an amount that would not be subject to state estate tax at the first decedent-spouse's death. This decision may be made in a more granular manner by disclaiming assets that either will be held for a very long time period after the surviving spouse's life expectancy, or that are not likely to have significant appreciation potential (again keeping in mind that the income tax cost of not getting a basis step-up at the second spouse's death may outweigh the potential state estate tax).

- c. **Make Clients Aware of Trust Advantages.** Planners should make sure that clients are aware of various advantages of trusts even if the client has no federal transfer tax concerns. Potential advantages that will be important to some clients are opportunities to provide for appropriate management of assets, to place appropriate limitations on how assets can be used for beneficiaries, to allow the settlor to lock-in who will receive trust assets at the termination of the trust, to protect trust assets from claims of the beneficiaries' creditors, and to protect trust assets from claims of divorcing spouses or ex-spouses of beneficiaries. In addition, trusts may result in significant state transfer tax or state income tax savings.

Trust structuring should incorporate planning for flexible provisions to react to future conditions. Powers of appointment are becoming increasingly popular for various reasons in facilitating future flexibility.

- d. **Direct Bequest to Discretionary Trust For Spouse (And Perhaps Others) For Combined Estate Under \$5 Million.** If the surviving spouse wants to take advantage of opportunities available with trusts, the first decedent-spouse's assets might be left directly to a trust permitting discretionary distributions to the surviving spouse (and perhaps other beneficiaries, as well). If the combined estate is under \$5 million, so that no estate tax will result at the second spouse's death even if the second spouse dies after the increased estate tax basic exclusion amount has sunset back to \$5 million (indexed), the trust could be designed to include any provisions desired by the clients, without the necessity of assuring that the trust qualifies for the estate tax marital deduction. A method for causing estate tax inclusion at the second spouse's death may be important to achieve a basis adjustment for the trust assets at the second spouse's death. (See Item 9 below.)



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- e. **Taking Advantage of First Decedent-Spouse's Exclusion Amount For Combined Estate Over \$5 Million.** For the couple with over \$5 million, being able to make use of the first decedent-spouse's estate exclusion may be important (if the second spouse dies after the time that the exclusion has declined back to \$5 million (indexed)). That can be accomplished either by leaving assets into a trust that can act as a traditional credit shelter trust or by making the portability election following the first spouse's death. If the portability approach is used, the assets should pass in a manner that qualifies for the marital deduction, or else little DSUE may be available for the surviving spouse even if the portability election is made.
- f. **Increased Importance of Portability.** If the first spouse dies before 2026 while the estate tax basic exclusion amount is still \$10 million (indexed), making the portability election should leave the surviving spouse with a DSUE of that full amount even if the basic exclusion amount later decreases in 2026. See Reg. §20.2010-2(c) (describing computation of DSUE amount).

Unless strong reasons exist to use credit shelter trusts in \$10 million and under estates, relying on portability to take advantage of the first spouse's estate exclusion amount is increasingly helpful. The decision of whether to create a bypass trust following the first spouse's death can be delayed until after the first spouse has died using a disclaimer approach (Item 7.b above) or using a QTIPable trust (Item 7.g below), so that the tax law situation at that time can be considered (*e.g.*, whether the exclusion amount has returned to or is still likely to return to \$5 million (indexed) in 2026).

A tax advantage of relying on portability rather than creating a bypass trust is that the surviving spouse has both spouses' exclusions to cover any estate taxes that might apply, but a basis step-up is achieved at both spouses' deaths.

Some of the factors for favoring the creation of a credit shelter trust at the first spouse's death include if there is (i) a likelihood or significant possibility of substantial appreciation of estate assets after the first spouse's death and the federal estate tax might apply to the surviving spouse's estate, (ii) a state estate tax, (iii) a younger client scenario (in which remarriage of the surviving spouse is likely), and (iv) a situation in which the couple wants to use trusts after the first spouse's death and wants to have both the surviving spouse and descendants as discretionary beneficiaries of the trust (although the surviving spouse may be able to receive trust distributions from a QTIP trust and make gifts to younger family members as desired in light of the increase gift tax exclusion amount). The credit shelter trust may also be advantageous for various reasons in blended family situations, as discussed in Item 8.d the Current Developments and Hot Topics Summary (December 2013) found [here](http://www.Bessemer.com/Advisor) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor).

If the QTIP approach is used in connection with portability, in light of the wide ranging factors that must be considered and the inherent uncertainties involved with the portability decision, documents should provide broad exculpation to the fiduciary who must make the QTIP election.



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- g. **Flexible QTIP Trust Approach.** A favored approach of many planners for testamentary planning will be the use of QTIP trusts, and the approach can be used for any size of estate if the clients want to use trust planning after the first spouse's death. [or if the transfer tax does not apply], which affords great flexibility). QTIP planning could use a single QTIP plan, or multiple QTIP trusts (for example, if a state estate tax applies with an exemption different than the federal estate tax exclusion amount, as discussed in Item 7.j below). An advantage of the single QTIP drafting approach is that the client (hopefully) can understand it, just realizing that it leaves a great deal of flexibility after the first spouse has died.

Portability would be used if a full QTIP election is made (and the first deceased spouse's GST exemption could be used by making a reverse QTIP election under §2652(a)(3)), and a bypass trust approach would be used if a partial QTIP election is made.

The trust could include a Clayton provision allowing more flexible terms if the QTIP election is not made, as discussed in the "Flexibilities" discussion below. Alternatively, the unelected QTIP trust could remain as a single-beneficiary mandatory income trust for the spouse. The amount of income paid to the spouse could be managed by the asset selection for the trust.

**Estates under \$5 Million.** The approach could be used for combined estates under \$5 million as a way of creating a trust that would be entitled to a basis adjustment at the surviving spouse's subsequent death—but an estate tax return would have to be filed following the first spouse's death to make the QTIP election, as discussed immediately below.

For estates that are small enough that an estate tax return would not be required at the first spouse's death, a disadvantage of the QTIP trust approach is that an estate tax return would have to be filed at the first spouse's death to make the QTIP election. Perhaps the trust could build in the possibility of causing the surviving spouse to have a testamentary general power of appointment at the surviving spouse's subsequent death, or to give the spouse a testamentary nontaxable power of appointment that could be exercised in a manner to trigger the Delaware tax trap, so the option would exist to avoid filing an estate tax return following the first spouse's death to make the QTIP election. In that case, while a basis adjustment would not apply at the second spouse's death because the trust is a QTIP trust (see §1014(b)(10)), it would apply for other reasons.

**Estates over \$5 Million.** This approach could also be helpful for combined estates in the \$5-\$10 million range because qualifying for the marital deduction is important for those estates, in case the surviving spouse dies after the basic exclusion amount has reverted to \$5 million (indexed).

**Flexibilities of QTIPable Trust Approach.** Even though the QTIP approach may seem more complicated to clients, in many ways, the QTIPable trust approach affords greater flexibilities.

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- The executor has up to 15 months to decide whether to make the QTIP election and over what portion of the trust.
  - The QTIP election could be made by a formula, thus providing a “savings clause” to assure that no estate tax would be paid at the first spouse’s death (if his or her assets are over the new \$10 million basic exclusion amount – or \$5 million exclusion amount after the increased exclusion amount has sunset).
  - If the QTIP election is made, the executor could make the “reverse-QTIP” election and allocate the decedent’s GST exemption to the trust.
  - If the state recognizes a “state only QTIP election,” having assets in the QTIP trust may make the planning easier to fully utilize the first spouse’s exclusion amount without paying any state estate taxes at the first spouse’s death.
  - Any unelected portion could pass to a standard bypass trust under a “Clayton” provision. Some planners believe that the surviving spouse should not be the executor making the QTIP election if there is a Clayton provision. The IRS might argue that if the spouse makes the election, the spouse makes a gift of some or all of the assets that would have been in the QTIP trust. Commentators generally believe that there *should* be no gift tax consequences; this should be no different than other post-death tax elections (such as where to deduct administrative expenses) that have a direct impact on the amount of assets that pass to the credit shelter trust and to the surviving spouse (or QTIP trust). However, if the surviving spouse is the executor making the Clayton election, uncertainty would exist for years concerning whether a gift results and whether that causes §2036 inclusion issues for some portion of the credit shelter trust. But keep in mind the paradigm shift resulting from the huge \$10 million exclusion amount. Many clients will have absolutely no risk of owing gift tax and may be unconcerned about potential gift risks of having the surviving spouse serve as the executor with a Clayton provision. A disadvantage of including a Clayton provision is that leaving the unelected portion in a trust with “QTIPable terms” (including a mandatory income interest for spouse as the exclusive beneficiary) would facilitate getting a “previously taxed property credit” under §2013 if the surviving spouse were to die shortly after the first spouse to die if the estate is large enough to have estate tax concerns. But many clients like being able to make transfers to children and the use distributions to the children for income-shifting purposes.
  - The surviving spouse can have a testamentary nontaxable power of appointment over the assets in the QTIP trust (or the Clayton bypass trust).
- h. **QTIPable Trust With Delayed Power of Withdrawal.** If the clients want to have the flexibilities afforded by using a QTIP trust (*e.g.*, to have 15 months to decide what QTIP election to make, to make a formula QTIP election, etc.) but still want the spouse to have an unlimited withdrawal power, consider creating a standard QTIP trust but including a delayed withdrawal power. The trust is a general power of appointment trust qualifying for the marital deduction only if the surviving spouse’s power of appointment exists immediately following the decedent’s death. Reg. §20.2056-5(a)(4) (“must be exercisable in all events”) & §20.2056-5(g)(1). For example, provide that the power of withdrawal arises sometime after estate tax filing date. Any limitations desired on the

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amount of the withdrawal right could be added (e.g., up to 20% each year). Professor Jeff Pennell suggests that this perhaps should be the default approach for QTIP trusts, to be removed if the clients don't want the provision. (Jeff observes that most attorneys trust their own spouses after they are dead but think their clients do not trust their spouses.)

- i. **Creative Flexible Approaches Using Both Disclaimers and QTIP Trusts.** For a discussion of creative flexible approaches using both disclaimers and QTIP trusts, see Item 5.i of the Estate Planning: Current Developments and Hot Topics Summary (December 2014) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor).
- j. **State Estate Tax Planning Issues.** For clients that may be subject to state estate taxes, various issues must be considered in addition to the planning considerations described above.
  - **State Exemption Amounts.** Seventeen states plus the District of Columbia have a state estate or inheritance tax. Various states are scheduled to adjust their state exemptions to the amount of the federal estate tax exclusion amount (Hawaii, Maine, and Washington, D.C. in 2018, Maryland in 2019, and Connecticut in 2020). New York will move its exemption amount to \$5 million (indexed) in 2019 (to match what the federal basic exclusion amount would have been under pre-Act law). States may not have contemplated an \$11.2 million basic exclusion amount, however, in adopting those provisions, and some states may back off from increasing their state exemptions to the federal basic exclusion amount. See Ashlea Ebeling, *Where Not to Die in 2018*, Forbes (Dec. 21, 2017). When the federal exclusion amount reverts back to \$5 million (indexed) after 2025, those state exemptions would adjust back to that amount as well.
  - **Formula State Exemption Bypass Trust, Balance Outright to Spouse.** Because disclaimers sometimes don't happen as a practical matter, the clients may want to mandate that the bypass trust will be funded with the state exemption amount at the first spouse's death.
  - **QTIP Trust Planning.** For clients subject to a state estate tax, flexible QTIP trust planning could result in (i) a "standard" QTIP trust for the excess over the federal basic exclusion amount, (ii) a QTIP trust effective only for state purposes (sometimes referred to as a "gap trust") for the amount in excess of the state exemption amount but less than the federal exclusion amount if the state allows a "state-only QTIP election" (which is allowed in 9 states) and (iii) a Clayton QTIP that has expanded into broader terms for up to the state exemption amount. This has the advantage of effectively having a federal bypass trust for an amount up to the full federal exclusion amount, but there is an obvious loss of distribution flexibility since all of the net income of a QTIP trust must be distributed annually to the surviving spouse, although the amount of net income that must be distributed could be managed, to a large degree, by the asset selection for the trust.
  - **Formula State Exemption Bypass Trust, Balance to QTIP Trust.** Some states (like New York and New Jersey) provide that the federal QTIP election (or nonelection) is binding for state estate tax purposes as well. Leaving the balance

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above the state exemption amount to a QTIP trust would have the advantage of using trust planning for non-tax purposes for all of the estate at the first spouse's death.

8. **Emphasis on Flexibility.** In light of the remaining inherent uncertainty regarding whether the basic exclusion amount will be reduced back to \$5 million (indexed) after 2025, building in flexibility to trust arrangements will be important, particularly for estates in the \$5-\$22 million range. Provisions included in trusts to avoid estate taxes may be unnecessary (and not desirable) for settlors or beneficiaries who have no estate tax concerns. Some of the ways of adding considerable flexibility are:
- using nontaxable powers of appointment;
  - providing broad distribution standards by independent trustees;
  - granting substitution powers to the settlor; and
  - providing special modification powers to trust protectors (see Item 3(h)(8)-(11) of the Current Developments and Hot Topics Summary (November 2017) found [here](#) and available at [www.Bessemer.com/advisor](http://www.Bessemer.com/advisor) for a more detailed discussion of powers and limitations that can be added for trust protectors to provide flexibility).
9. **Basis Adjustment Planning.** Planning to leave open the flexibility to cause trust assets to be included in the gross estate of a trust beneficiary if the beneficiary has excess estate exclusion will continue to be important to permit a basis adjustment at the beneficiary's death without generating any added estate tax. Indeed, incorporating planning for the flexibility to cause estate inclusion is more important than estate tax planning for most clients because most clients will not owe estate tax.
- a. **Basis Adjustment for Settlor.** A very flexible alternative to cause estate inclusion for the trust settlor would be to give an independent party the authority to grant a power to the settlor that would cause estate inclusion, such as a testamentary limited power of appointment, which would cause estate inclusion under §2038 and result in a basis adjustment under §1014(b)(9).

Does this work? Might the settlor be treated as having such a power even if never granted? The key issue is whether the decedent would be treated as having retained a §2036(a)(2) power to designate persons who could enjoy the property. No prearranged understanding should exist for the grant of such a power to defend against an argument that the decedent indirectly retained the power so that §2036(a)(2) could apply (because that section requires that the power be retained by the decedent at the time of the transfer). Reg. §20.2036-1(b)(3) provides that §2036 applies even if a power is merely exercisable in conjunction with other persons (whether or not adverse) and regardless of whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before his death. That arguably would apply to the permitted grant to the settlor of a limited power of appointment even if it was never actually granted.

That same provision is not included in the regulations under §2038. See Reg. §20.2038-1(b) ("However, section 2038 is not applicable to a power the exercise of which was subject to a contingency beyond the decedent's control which did not occur before his death... See, however, section 2036(a)(2) for the inclusion of property in the decedent's gross estate on account of such a power.")

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The court in *Estate of Skifter v. Commissioner*, 468 F.2d 699 (2d Cir. 1972), addressed a fact scenario in which the decedent had transferred a life insurance policy on his life to his wife who years later left the policy under her will to a trust for her daughter with the decedent as the trustee. The analysis analogized §2042 to §§2036 and 2038, and reasoned, in dictum, that §2036 would not apply because the power over the policy was not “retained by the grantor ... when he transferred it to another” (without addressing the potential application of Reg. §20.2036-1(b)(3)). The court reasoned that §2038 would not apply to a power conferred on the decedent “by someone else long after he had divested himself of all interest in the property subject to the power,” but suggested that §2038 would apply if the power were actually granted to the decedent and if the grant was pursuant to authority “that the decedent created at the time of transfer in someone else and that later devolved upon him before his death.” If the grantor authorized a third party to grant a limited power of appointment to the grantor, and the third party actually granted that power to the grantor, then §2038 would apply under this analysis.

Whether the settlor will be treated as having the power causing inclusion in the gross estate even if the limited power of appointment is never actually granted to the settlor by the third party is not clear. The regulation under §2036 is very broad and potentially applies to the situation, and the discussion in *Skifter* is dicta.

- b. **Basis Adjustment for Beneficiary.** Possible strategies to allow a basis adjustment at a trust beneficiary’s death include planning for the flexibility:
- to make distributions to the beneficiary (either pursuant to a wide discretionary distribution standard or under the exercise of a non-fiduciary nontaxable power of appointment);
  - to have someone grant a general power of appointment to the beneficiary (that possibly could be exercisable only with the consent of some other non-adverse party (but not the grantor); consider using broad exculpatory language for the person who can grant the power of appointment and consider providing that the powerholder has no duty to monitor whether a general power should be granted or possibly provide that the powerholder has no authority to grant a general power until requested by a family member to consider exercising his or her discretion to grant a general power); but query whether the grant of a general power of appointment by a third party is treated as holding a general power of appointment with the consent of a non-adverse party, which would treat the beneficiary as having a general power of appointment whether or not the third party actually grants it?;
  - to use a formula general power of appointment (see Item 10.m of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor));
  - to the extent that general powers of appointment are used for basis adjustment purposes, bear in mind that the existence of the general power may have creditor effects, but the actual exercise of a testamentary general power of appointment may be more likely to subject the assets to the decedent-beneficiary’s creditors than if the general power is not exercised (see Item 10.m of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor)); or

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- o to trigger the Delaware tax trap by the exercise of a nontaxable power of appointment to appoint the assets into a trust of which a beneficiary has a presently exercisable general power of appointment.

See Item 14 of the Current Developments and Hot Topics Summary (December 2016) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor) for a more detailed discussion of these strategies. The 2017 Heckerling materials regarding portability by Lester Law and Howard Zaritsky have outstanding forms for all of these alternatives (including formula general powers of appointment and exercising the Delaware tax trap). See generally Blattmachr & Rivlin, *Searching for Basis in Estate Planning: Less Tax for Heirs*, 41 EST. PLAN. 3 (August 2014).

- c. **Upstream Gifts.** Many parents of clients (or other individuals) will have no federal estate tax concerns, even if the parents live past 2025 when the exclusion amount returns to \$5 million (indexed). Gifts may be made to individuals who have no estate tax concerns in hopes of getting a basis increase at the individual's death, utilizing the individual's GST exemption, and taking steps to avoid §1014(e) in case the donor should die within one year of the gift. See Item 10.h below. If the taxpayer is concerned about using his or her gift exclusion to fund the upstream gift, consider using a GRAT that pours over the GRAT remainder to an upstream trust.

10. **Transfer and Freeze Planning.** Transfer and freeze planning can (i) assist in shifting wealth to save estate tax for clients with assets in excess of the basic exclusion amount, (ii) provide creditor protection planning, (iii) assist in moving assets downstream during life, which is becoming more important as people have longer life expectancies and inheritances are long-delayed, and (iv) provide income shifting by transferring wealth to family members who may be in lower income tax brackets. The most obvious non-tax advantage of making gifts is to allow donees to enjoy the gift assets currently.

- a. **Window of Opportunity.** The gift tax exclusion amount will sunset back to about \$5.5 million in 2026 (unless changed by Congress prior to 2026). Gifts making use of the doubled gift tax exclusion amount are available for eight years through 2025.

Gifts utilizing the \$11 million exclusion amount can reduce federal estate tax if the donor dies after the basic exclusion amount has been reduced to \$5 million (indexed), assuming clawback does not apply. As an extremely unrealistic example to illustrate the point, a couple with \$20 million of assets may have about \$10 million of assets subject to estate taxes if they die after the exclusion amount has been reduced to \$5 million (ignoring indexing of the exclusion amounts), resulting in \$4 million of estate tax. The \$4 million of estate tax could be avoided entirely by making \$20 million of gifts utilizing each of the spouses' \$10 million (indexed) gift tax exclusion amounts. (Of course, in that circumstance, the grantor would want to take steps to be potential recipient of at least some portion of the transferred amounts, as explored in Item 10.f below.)

- b. **Cushion Effect.** Perhaps the most important advantage of the increased gift tax exclusion amount for many individuals will be the "cushion" effect – the ability to make gifts in excess of \$5 million, but considerably less than \$11 million, with a high degree of comfort that a gift tax audit will not cause gift tax to be imposed (perhaps even for assets whose values are very uncertain). Clients who have been reluctant to implement



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transfer planning strategies in the past because of fear of the possible assessment of a current gift tax will be much more comfortable making transfers with cushion effect of the \$11 million gift tax exclusion amount.

- c. **Decreased Emphasis on Defined Value Transfers.** Because of the substantial cushion effect of the very large gift tax exclusion amount, clients making transfers significantly less than the full exclusion amount will have much less incentive to add to gift transactions the complexities of defined value transfers.
- d. **Specific Gift Opportunities.**
- Gifts to Dynasty trust to utilize \$10 million (indexed) GST exemption (or making a late allocation of GST exemption to previously created trusts if the donor does not want to make further gifts);
  - Forgiveness of outstanding loans to children;
  - Gifts to grantor trusts, and leveraging grantor trusts with loans or sales from the grantor;
  - Equalizing gifts to children or grandchildren;
  - Gifts to save state estate taxes (very few states treat gifts as reducing estate exemption amounts, even for gifts made within three years of death in gross estates);
  - GRATs (GRATs will continue to be advantageous even with the \$10 million (indexed) gift tax exclusion amount);
  - Life insurance transfers (including the ability to “roll out” of split dollar arrangements);
  - Deemed §2519 transfers from QTIP trusts (for an outstanding detailed discussion of planning by a surviving spouse with QTIP trusts, see Read Moore, Neil Kawashima & Joy Miyasaki, Estate Planning for QTIP Trust Assets, 44th U. MIAMI HECKERLING INST. ON EST. PLAN. ch. 12 ¶ 1202.3 (2010));

These specific gift strategies are discussed in more detail in Item 5.o-aa of the 2012 Heckerling Musings and Other Current Developments Summary found [here](#) and available at [www.Bessemer.com/advisor](http://www.Bessemer.com/advisor).

- e. **Trust Sales.** For mega-wealthy clients, trust sales can be magnified on (super steroids) using the increased gift tax exclusion amount. Using a rule of thumb of having 10% equity to support a sale to a trust, spouses could fund grantor trusts with \$22 million of assets and sell nine times that, or almost \$200 million of assets to the trusts in return for notes bearing interest at the AFR (although the IRS may question if that interest rate is sufficient).

For a pre-existing sale to grantor trust transactions, additional gifts could be made to the trust if needed to bolster the equity value of the trust (and to reduce the necessity of relying on guarantees) to support the bona fides of the sale transaction, and to reduce the



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risk of a §2036 attack against the grantor's retained interest via the note from the trust. In several recent cases, the IRS has taken the position that §2036 applies to sales to grantor trust transactions. For some previously completed sales transactions, gift to trusts may be sufficient to repay the notes entirely (or the notes could be forgiven) to remove any §2036 risk, at least if the repayment/forgiveness occurs at least three years prior to the grantor's death. Avoiding the risk of a protracted audit and litigation over the §2036 issue could be a significant perceived advantage.

f. **Transfers with Possible Continued Benefit for Grantor or Grantor's Spouse.**

Couples with \$22 million of gift tax exclusion amount may significantly reduce their potential estate tax liability by making gifts to utilize the increased exclusion amount, particularly if either or both spouses die after 2025 when the estate exclusion amount is scheduled to decline to \$5 million (indexed). But the couples making such large transfers will likely want some kind of potential access to or potential cash flow from the transferred funds.

Planning alternatives for providing some benefit or continued payments to the grantor and/or the grantor's spouse include:

- Spousal limited access trust ("SLAT") and/or exercise by beneficiaries of nontaxable powers of appointment (discussed in more detail in Item 10.g below);
- "Non-reciprocal" trusts;
- Self-settled trusts established in asset protection jurisdictions (and the more conservative approach may be to allow a third party to appoint assets to the settlor under a non-fiduciary power of appointment rather than including the settlor as a discretionary beneficiary under fiduciary standards);
- Transferring residence to trust or co-tenancies between grantor/spouse of grantor and trust;
- Preferred partnership freeze;
- Payment of management fees to the grantor;
- Inter vivos QTIPable trust; and
- Retained income gift trust.

Possible alternatives that do not shift value to the transferor but at least provide possible cash flow or a way to access specific trust assets include:

- Borrowing of trust funds by grantor;
- Sale for a note or annuity rather than making a gift of the full amount to be transferred, resulting in continued cash flow to the transferor; and
- "Reverse grantor trust" transaction in which the donor purchases (including through the exercise of a substitution power) or borrows assets gifted to trust.

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Each of these alternatives is discussed in more detail in Items 14-24 of the Current Developments and Hot Topics Summary (December 2013) found [here](#) and available at [www.Bessemer.com](http://www.Bessemer.com).

- g. **SLATs.** One spouse funds an irrevocable discretionary “spousal lifetime access trust” (SLAT) for the other spouse and perhaps descendants. Assets in the trust avoid estate inclusion in the donor’s estate if the donor’s estate is large enough to have estate tax concerns. Both spouses may create “non-reciprocal” trusts that have sufficient differences to avoid the reciprocal trust doctrine. Assets are available for the settlor-client’s spouse (and possibly even for the settlor-client if the spouse predeceased the client) in a manner that is excluded from the estate for federal and state estate tax purposes.

The original settlor could even become a discretionary beneficiary if the spouse predeceases as long as the settlor’s creditors could not reach the trust assets under applicable state law, which could occur if DAPT laws apply to the trust or if state spendthrift trust law specifically protects against the settlor’s creditors in the “surviving settlor” scenario. *E.g.*, TEX. PROP. CODE §§112.035(d)(2) (settlor becomes beneficiary under exercise of power of appointment by a third party), 112.035(g)(1) (marital trust after death of settlor’s spouse), 112.035(g)(2) (any irrevocable trust after death of settlor’s spouse), 112.035(g)(3) (reciprocal trusts for spouses). Accordingly, even couples in non-DAPT states may nevertheless be able to transfer substantial assets (up to \$22 million using reciprocal/non-reciprocal trusts) to trusts that may benefit one of the spouses that may be protected from the creditor claims of both spouses.

In addition to avoiding estate inclusion, the trust also provides protection against creditors, elder financial abuse, and identity theft. Over time, the trust can accumulate to significant values (because it is a grantor trust, the client will pay income taxes on the trust income out of other assets) and can provide a source of funding for retirement years. (As with any inter-spousal transfers, clients should be aware of potential implications of the transfers on divorce.)

To maximize the creditor protection feature of SLATS (i) the trustee should have the ability to sprinkle distributions among various beneficiaries, (ii) at least one independent trustee should consent to distributions, (iii) any named trust protector should be someone other than the settlor, and (iv) the trustee should be authorized to permit beneficiaries to use assets (rather than having to make distributions for them to enjoy benefits of the trust).

For a detailed discussion of SLATs and “non-reciprocal” SLATs, see Items 16-17 of the Current Developments and Hot Topics Summary (December 2013) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor).

- h. **Upstream Gifts or Other Gifts to Moderate Wealth Individuals; §1014(e).** Many parents of clients will have no federal estate tax concerns, even if the parents live past 2025 when the exclusion amount returns to \$5 million (indexed). While the gift tax exclusion amount is \$10 million (indexed), a client may give/sell assets to a grantor trust for a third party (such as a modest-wealth parent of the client) who will have a

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testamentary general power of appointment in the trust. At the parent's death, the inclusion of the assets in his or her estate may generate no estate taxes but the assets would receive a basis adjustment (although issues could arise under §1014(e) if the parent dies within a year of when the client creates the trust), and the parent could allocate his or her GST exemption to the assets. The assets might pass by default into a trust for the client's benefit but that would not be in the client's estate for estate tax purposes. For a detailed discussion of this planning alternative, see Item 7.c of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/advisor](http://www.Bessemer.com/advisor).

If the client wants to use an upstream transfer but does not want to use the client's gift tax exclusion amount in doing so, a GRAT could be used with the remainder interest passing to an upstream trust for the client's parents.

Similarly, gifts may be made to other individuals who have no estate tax concerns in hopes of getting a basis increase at the individual's death, and taking steps to avoid §1014(e) in case the donor should die within one year of the gift (for example, by having the assets pass into a discretionary trust for the original donor's benefit rather than passing outright to the original donor, *cf.* PLR 90036036). For a detailed discussion of planning issues surrounding §1014(e), see Item 8.c of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/advisor](http://www.Bessemer.com/advisor).

- i. **Report Transactions on Gift Tax Returns With Adequate Disclosure.** Many planners encourage clients to file gift tax returns to report gift or non-gift transactions to start the statute of limitations. Otherwise, the possibility of owing gift tax on an old transaction is always present. The historic rate for auditing gift tax returns is about 1%, and this rate has not been rising in recent years (although more gift tax returns may be reviewed in the future as the number of taxable estates decreases).

In order to start the statute of limitations, the return must meet the adequate disclosure requirements of Reg. §301-6501(c)-1(f). *See e.g.*, Field Attorney Advice 20152201F (requirements not satisfied); PLR 201523003 (adequate disclosure can foreclose later attacks on issues other than valuation such as whether a split gift election was properly made). For a detailed discussion of the background and planning issues around the adequate disclosure rules see Item 20 of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor).

11. **Be Very Careful Before Making Lifetime Gifts of Low Basis Assets.** The estate tax savings of gifts are offset by the loss of a basis step-up if the client dies no longer owning the donated property. For example, for a client that has previously fully used available exclusion amounts, a gift of a \$1 million asset with a zero basis would have to appreciate to approximately \$2,470,000 (to a value that is 247% of the current value) in order for the estate tax savings on the future appreciation (\$1,469,135 x 40%) to start to offset the loss of basis step-up (\$2,469,135 x 23.8% for high bracket taxpayers). The required appreciation will be even more if state income taxes also apply on the capital gains.
12. **Avoiding Funding Bypass Trust.** Countless situations will arise in which a spouse dies with a traditional formula bequest in a will that has not been reviewed in years that creates a bypass trust when the couple has no federal estate tax concerns at the surviving spouse's subsequent death. Creating the bypass trust will create administrative complexity that the

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surviving spouse may want to avoid and, perhaps more importantly, will eliminate any basis step-up for trust assets at the surviving spouse's death (because he or she would not own the trust assets). For various planning strategies, see Item 6.c of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor).

13. **Revised Charitable Planning Paradigms.** Because no necessity would exist for an estate tax charitable deduction if the estate tax will not apply because of the increased basic exclusion amount, a new paradigm would apply to charitable dispositions at death for decedents with assets under the increased basic exclusion amount who are likely to die before sunset occurs in 2026.
  - In a family with unified goals about charitable transfers, consider making bequests to individual family members and allowing them to make lifetime gifts to the same desired charities, giving the individuals an income tax deduction. Alternatively, the desired amount of charitable bequest could be funded out of mandatory annual distributions from a trust over various years, structured so that the §642(c) charitable deduction would offset taxable income of the trust.
  - Charitable bequests to trusts would no longer have to be in the form of a qualified interest. Assets could be left to a trust providing that all income would be paid to charity, which would allow the trust to receive a §642(c) income tax deduction, thus, reducing the trust's DNI to zero, meaning that trust distributions to others would not carry out income to them.
14. **State Tax Planning; Domicile.** State estate and income tax planning will continue to be important. Domicile planning (to eliminate or reduce contacts with high-tax states) can be significant to minimize state taxes and may be especially important in light of the Act's limiting the SALT deduction to only \$10,000 per year.
15. **Selection of Entity and Business Restructuring.** The Act raises new factors in the selection of entity decision for businesses and may lead to business restructuring efforts to make maximum use of the new §199A deduction for qualified business income. These issues include whether the entity should be structured as a C corporation (to take advantage of the lower tax rate on current income, but realizing that a subsequent dividend tax applies as dividends are withdrawn by shareholders), and whether a business in a "specified service" industry taxed as a pass-through entity should be divided so that a separate firm would provide ancillary administrative support (such as secretarial services, accounting, document management, information technology support, etc.) that would charge the "specified service" company for its support services, hoping that the business income of the support entity would qualify for the §199A deduction.
16. **Income Shifting.** The increased gift tax exclusion amount may afford the practical ability for some clients to fund non-grantor trusts for income shifting purposes. To the extent that the grantor wished to be a discretionary beneficiary of the trust, the general structure of an ING-type trust could be used (except it would be a completed gift trust), or a SLAT could be structured with ING-type provisions. *E.g.*, IRS Letter Rulings 201744006-008 (examples of the many rulings that have addressed "DING" trusts).

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17. **Undoing Prior Planning.** If the estate tax had been repealed, some clients may have wanted to undo prior planning that was implemented to avoid the estate tax. That will be less significant in light of the fact that the doubling of the basic exclusion amount only lasts eight years. See Item 6.I of the Current Developments and Hot Topics Summary (December 2016) found [here](#) and Item 6 of the Current Developments and Hot Topics Summary (December 2015) found [here](#) and available at [www.Bessemer.com/Advisor](http://www.Bessemer.com/Advisor) for a discussion of possible issues about undoing prior planning.)

18. **Many Planning Issues beyond Federal Estate Tax Planning.** Remember all the many things that estate planners do beyond planning for the federal estate tax. Following the passage of ATRA, Lou Mezzullo, President of the American College of Trust and Estate Counsel, sent a letter to ACTEC Fellows reminding them of the many services that professionals provide to clients other than federal transfer tax planning. He provides the following list, not meant to be exhaustive, of some of those items (quoted with his permission).

1. Planning for the disposition of the client's assets at his or her death.
2. Asset protection planning.
3. Planning for disability and incompetency.
4. Business succession planning (without the estate tax to blame for failure of a business).
5. Planning for marital and other dissolutions.
6. Charitable giving (for its own sake, and because income tax considerations will still be relevant and techniques, such as lifetime charitable remainder trusts to facilitate diversification, would not be affected at all).
7. Life insurance planning (other than to provide funds to pay taxes).
8. Fiduciary litigation (enhanced because more to fight over).
9. Retirement planning.
10. Planning to pay state death taxes (in many states).
11. Planning to avoid or minimize gift taxes (and client desires to gift more than the \$5 million (indexed) basic exclusion amount for gift tax purposes).
12. Using business entities to accomplish nontax objectives.
13. Planning for children with disabilities.
14. Planning for spendthrift children.
15. Planning for clients with real estate in more than one state, including ownership, asset protection, state income taxation, spousal rights, and probate issues (in addition to state estate tax).

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16. Planning for clients who are U.S. citizens or resident aliens who own property in other countries.
  17. Planning for nonresident aliens with assets in the U.S. or who plan to move to the U.S.
  18. Planning for citizens who intend to change their citizenship.
  19. Planning for possible decrease in the estate, gift, and GST tax exemptions and/or increase in the transfer tax rates.
  20. Planning to pay education expenses, including contributing to I.R.C. §529 plans.
  21. Planning to deal with non-tax regulatory issues, such as the Patriot Act, HIPAA, and charitable governance reform.
  22. Identifying guardians for minor children, if and when needed.

All of these issues (and various other non-tax issues) would still be important for clients.

19. **Keep Perspective.** Michael Graham (Dallas, Texas) reminds planners of the importance of estate planning beyond saving estate taxes, pointing out that planners assist broadly in the “transporting” of capital from one generation to the next.

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**Michael observes:**

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I continue to maintain that not a single less person will die needing at least a Will, not a single less person will have, or be married to, children from a prior marriage. There will continue to be children of great promise and children faced with great challenges. The fact that my lovely wife June would not need to worry about the marital deduction any more doesn't mean she would give everything outright to me at her death. She knows me too well after 47 years of marriage.

Even now, the truth is that for most of our planning, divorce is more likely than death. I did an Ethics presentation for the annual NAELA meeting this year on representing H and W. The statistics are that 70% of second marriages in which there are children from a prior marriage will end in divorce within 5.5 years. Think about that. Even now, we are drafting in anticipation of divorce, not death.

We are not the railroad unless we treat ourselves as such. We are transportation. We assist in transporting capital from one generation to the next.

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