Leimberg Information Services, Inc.

Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2612

Date:22-Dec-17

Martin M. Shenkman, Jonathan G. Blattmachr and Joy Matak on the Tax Cuts and Jobs Act: Impact on Estate Planning and Ancillary Planning Areas

PUBLISHER'S NOTE:

LISI has provided members with:

- a first look overview of the new tax law in Estate Planning Newsletter 2609.
- charts on the distribution of tax savings at Estate Planning Newsletter 2610.
- an Editorial discussing the philosophy and underpinnings of the legislation at Estate Planning Newsletter 2611.
- commentaries on the estate tax aspects of the new law at Estate Planning Newsletter 2608.
- a commentary on the charitable deduction aspect of the law at Charitable Planning Newsletter 271.
- a discussion of some potential costs of the tax law at Income Tax Planning Newsletter 120,
- commentary on the pass-through deduction in Income Tax Planning Newsletter 121
- commentary on the life insurance provisions and the indirect effect on life insurance planning in Income Tax Planning Newsletter 122.

Now **LISI** is pleased to provide our members with an in-depth analysis by three of the brightest minds in practice today, **Martin M. Shenkman, Jonathan G. Blattmachr** and **Joy Matak**. But a word of caution: You can not read the following commentary without coming to several conclusions: First, you as a professional will face many uncertainties in the coming months and years as to how to best advise clients. Second, the law you read today will be interpreted and modified by the IRS since many rules and regulations will need to be promulgated. Third, your clients – except for the most sophisticated – are expecting simplicity – and many are certain to be disappointed and confused by the many decisions they will need to be making. And fourth, your need for keeping current with both emerging information and analysis will accelerate in importance.

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Joy Matak is a tax director at **CohnReznick** and **Co-Leader** of the Firm's **Trusts and Estates** practice. She has more than 18 years of experience as a wealth transfer strategist with an extensive background in providing tax services to multi-generational wealth families, owners of closely-held businesses, and high net-worth individuals and their trusts and estates. Joy provides clients with diverse wealth transfer strategy planning to accomplish estate planning and business succession goals. She also performs tax compliance including gift tax, estate tax, and income tax returns for trusts and estates, as well as consulting services related to generation skipping including transfer tax planning, asset protection, life insurance structuring, and post-mortem planning. Prior to joining CohnReznick, Joy was a senior tax manager at a Top 20 accounting firm. Early in her career, she was a principal in a Virginia-based law firm and also worked as a senior associate in the growing trusts and estates groups of one of the leading commercial law firms in New Jersey. Joy has spoken for the Greater Middlesex/Somerset Estate Planning Council and published articles for the *Hudson County Business Journal* and *Tax Management Estates, Gifts and Trusts Journal* on a variety of topics including wealth transfer strategies, income taxation of trusts and estates, and business succession planning.

Here is their commentary:

COMMENT:

Introduction

On Dec. 20, 2017, the House of Representatives passed as the and Senate had done a few days earlier passed legislation called the "Tax Cuts and Jobs Act". Although it has been delivered to President Trump, he likely will not sign it into law until the beginning of 2018 even though most of the provisions are effective for tax years beginning after December 31, 2017. In other words, the President and his party have been able to deliver sweeping provisions that affect almost every aspect of tax, estate and other planning, far more than what anyone anticipated, in just about 7 weeks! That truncated time frame no doubt will result in a myriad of implications and nuances to the final legislation that were either not considered adequately and which will leave practitioners faced with unanticipated complications.

Tax reform has created a number of practices and client-related recommendations that are worthy of immediate action, or at least, consideration, before year end. Many of these have received considerable media attention already (e.g. pre-paying certain expenses, or not). But the longer-term planning implications can be profound, even if not year-end sensitive.

Comprehensive Reform – but with expiration dates

Republicans have a slim 52-seat majority in the Senate. None of the Democrats in the Senate have signaled support for the Conference Agreement. As a result, the permanence of the Conference Agreement is limited because of the so-called *Byrd* provision which requires 60 votes (a filibuster-proof majority) to enact any law beyond 10 years. For this reason, many of the provisions in the Conference Agreement will "sunset" (nullified) after 2027.

Moreover, a detailed below, many of the changes directly affecting individuals will expire, on account of budget considerations, after 2025. Which provisions that are targeted to sunset, and those that are not, has important planning implications. These will be discussed below. But it is not only the sunsets that practitioners will have to grapple with in advising clients but also the potential for changes to the law by a future administration, a possibility that cannot be ignored, but which cannot be quantified.

Some of the changes to the tax code envisioned by the Conference Agreement could wreak havoc on decisions which have already been made by taxpayers while simultaneously making it difficult for those same taxpayers to determine how best to proceed. This issue is exacerbated by the fact that so many of the individual provisions in the Conference Agreement, as just indicated, are intended to be temporary. So, while the Conference Agreement presents significant transfer tax planning opportunities, individuals need to be wary that the uncertainty of the law could create unintended consequences and therefore planning should be done only with thoughtful guidance from qualified professionals.

Simplification Achieved?

Fuggedaboutit. As tax reform wound its way through the process, legislators seemed to drop altogether the stated goal of simplifying the tax code. The theatrical display of the President kissing a postcard during the rollout of the House proposal back in early November has long since faded from memory as reform morphed into a complex web of new constructs that will likely keep tax attorneys and accountants very busy for years to come. The Conference Agreement that will be delivered to the President's desk sets forth seven individual tax brackets, creates tax preferences and tax breaks, and appears to impose additional complexity for most higher earning and wealthier taxpayers.

The new rules on the income taxation of income from certain pass through entities appear to be incredibly complex, creating new concepts and planning implications. These rules might have a significant impact on how closely held business entities are structured, trust ownership of interests in those businesses, perhaps even when people choose to retire. However, it must be kept in mind that these changes are scheduled to expire and possibly could be changed by a change in the power structure in Washington, DC.

As another example, the elimination of the tax deduction for alimony for the payor on new divorce agreements executed after December 31, 2018, as well as not including alimony as income to the payee, appears on the surface to simplify tax planning and compliance. However, this provision could have dramatic impact on every divorce currently in process, and will change the landscape for all future divorces – but only until the provisions sunset in 2025 - in ways that may not be readily determined or determinable.

The tax implications of divorce agreements have been part of the complex negotiations between feuding spouses for a very long time. Many times, the ex-spouse who receives alimony has been able to negotiate an increased payment because the same will reduce the tax liability of the ex-spouse paying alimony. Will the elimination of the alimony tax deduction reduce the bargaining power of the ex-spouse receiving the alimony payments? The philosophy behind providing an above-the-line deduction to those paying alimony was that it made sense to shift the income tax liability to the payee spouse. After all, the income *is* being shifted; divorcing parties are not likely to share income with each other. Why are we changing this fundamental premise of divorce law? It has been speculated that, although payor spouses do claim a deduction in most cases for alimony paid, many payee spouses do not report the alimony payments in gross income as required by Section 71 of the Internal Revenue Code of 1986 as amended. (Section references are all to such Code unless otherwise noted.)

Since this provision sunsets as of the end of 2025, it is unclear what will happen after that point to all of the property settlement agreements that are executed while the alimony deduction was eliminated. Will there be an opportunity for the parties to get back to the negotiating table? What is the public policy in favor of disrupting matrimonial agreements this way? Will it create new issues that everyone must digest and evaluate on how property settlement components of a divorce need to be negotiated relative to alimony payments? How will judges synthesize the new dynamics when handling matrimonial cases?

Thus, every divorce agreement, prenuptial agreement and post-nuptial agreement ideally should address the consequences of the new law, be completed prior to the effective date of the new provision if that is preferable, and contemplate the possible change or sunset of the provision. The reality is that given the contentious nature of many of these agreements and the costs involved, that may not be practical. The results could be problematic for many.

Unfortunately, the wide-ranging implications to matrimonial agreements is but one of many traditional arrangements that could be disrupted by the tax law changes.

Will the Conference Agreement Cut Taxes?

Although President Trump referred to the Conference Agreement as the "Cut, Cut, Cut bill," it does not appear that the Conference Agreement will in fact provide a tax reduction for all taxpayers.

No doubt many taxpayers will have their tax bills lowered. But others, especially wealthier taxpayers, may not find that the results overall are favorable. Worse for some, the determination as to the tax impact will not be easy to evaluate. The impact might also be quite disparate. For example:

- The State and Local income, sales and property tax deductions (the "SALT deductions") will be limited to a combined $10,000 per year. For wealthy taxpayers, especially those with large homes and vacation homes in high tax states, this change could be quite costly. In contrast, a wealthy taxpayer in a low tax state may be affected to a much lower extent. This highlights a complexity of the new legislation – the impact will vary depending on the taxpayer's circumstances – including the state in which he/she lives.

- The Conference Agreement provides that the limitation on the SALT deductions would be effective for tax years beginning after December 31, 2016 in an effort to prevent taxpayers from prepaying their 2018 state and local taxes before the end of this year and then taking a deduction for the payment on their 2017 income tax returns. The limitation on the SALT deduction expires after 2025.

- The maximum tax rate is 37%, offering little or no savings for some wealthier taxpayers, and for others, a tax increase (e.g. based on the loss of deductions), especially when the many other changes in the Conference Agreement are factored into the analysis.

Those most likely to be hurt by the Conference Agreement are moderately wealthy taxpayers who live in high tax states but do not have estates large enough to benefit from the increased transfer tax exemption. These taxpayers currently benefit significantly from large SALT deductions on their federal income tax returns. They itemize their deductions in an amount greater than the doubled standard deduction contemplated by the Conference Agreement. By limiting the deduction for state and local income, real estate and sales tax to $10,000 in the aggregate, the Conference Agreement may cause a significant tax *increase* for these taxpayers (although that conclusion may also depend in part on the impact the AMT had on prior deductions).

There will be those in a "sweet spot" of net worth who might benefit significantly from the increase in the exemption. Those with very ultra-high net worth may not benefit in a significant way from what, relative to their estates, is an insignificant increase in the exemption, and who face loss of deductions. This is particularly so given that the current Act does not provide for the ultimate repeal of the federal estate tax. Again, the tax implications to wealthy taxpayers may in fact vary considerably depending on the circumstances.

How Will the Conference Agreement Really Affect Revenue?

The Conference Agreement will be passed and signed into law before a complete fiscal impact estimate can be issued. In any event, it appears questionable how provisions, such as the impact of the pass-through entity maximum tax rate, could be fiscally scored when the implications are so complex and uncertain. By way of example, the change resulting in the taxation of certain employee awards had been scored by the House version of the Conference Agreement to generate over $3 billion in 10 years. Is that realistic? Other estimates seem potentially unrealistic as well.

The increase in the transfer tax exemption has been scored as reducing revenues by $172.2 billion. It seems incredible that this change would be enacted given the other potential costs of the Conference Agreement and the fiscal and societal issues facing America now. There is no indication how this figure was estimated. Is this merely a tally of lost estate and gift taxes or does it also include a reasonable evaluation of the likely potentially significant decline in capital gains tax revenue? All but the very ultra-high net worth clients should be able to reduce paying capital gains tax by maximizing the wide range of basis maximization planning techniques practitioners have been discussing for the past several years. And that type of planning will no doubt accelerate as a result of the changes. If the capital gain tax loss is not realistically factored into the scoring, the impact of this change on the federal fisc over time will grow dramatically costlier.

The inflation adjustments in the tax laws appear to be modified to index for inflation using a so-called "chained CPI" instead of CPI to lessen future increases.

Another accommodation to the economic realities of the tax cut proposals, the political talk of tax reductions being retroactive to the beginning of 2017 has been dropped and most changes only take effect in 2018, some thereafter, and some with a sunset. This was to present the Conference Agreement as having less of a negative impact on the budget.

Do the Estate Tax Changes Really Help "Small" Business?

The rationale for the doubling of the federal estate tax exemption (not to mention the inflation kicker as well) was stated in the Summary to the House bill as follows: "By repealing the estate and generation-skipping taxes, a small business would no longer be penalized for growing to the point of being taxed upon the death of its owner, thus incentivizing the owner to continue to invest in more capital and hire more employees." Has any entrepreneur ever consciously not grown their business because of a perceived penalty of the estate tax impact on that business on their future death? The premise of this rationale is so questionable that the purported positive economic impact seems implausible. How can the phrase "small business" be used with figures of the magnitude of $10 million plus? The statement implies that "small businesses" are wiped out by the estate tax which ignores the current planning left in place, the ability to defer and spread out the payment of the federal estate tax under IRC Sec. 6166 and a range of other provisions. For some closely held businesses, the complexity of the new pass-through entity rules, and the complexity of other changes, may pose a far greater hardship then the estate tax ever did.

Displacement, Change, Uncertainty

Simplification is good. Few could argue with that. But dramatic changes to long-time tax laws that have been embedded in economic decision making for decades or more may have disruptive consequences that are difficult to evaluate, especially given the time frame the President has insisted upon to push through tax reform. Further, it seems incredible that our government would inflict sweeping changes upon all taxpayers using the budget reconciliation process which necessarily requires that many of these disruptions will be temporary.

The emasculation of the SALT deductions will have very different impact on taxpayers depending on their state of residence and circumstances. Lower income tax rates might make it difficult for states struggling from the SALT changes to raise funds in that manner as well. The result may be that some states will impose new taxes to offset the ripple effects of this change in federal tax law.

While that is hard to predict, perhaps more worrisome is the impact on the high tax states that may face a tax-driven exodus by their wealthy citizens, thereby eroding their fiscal tax base. Some of the states that may be affected are currently in questionable fiscal health. So might this change push them to even more precarious financial status? There appears to have been inadequate analysis of the possible implications of this. Many of the other changes in the Conference Agreement, even if simplifying in terms of the tax law, may prove disruptive to the industries affected, or the specific taxpayers.

Perhaps more alarming is that without an accurate fiscal score, there is no way to understand how these changes to the tax code (with its $1.5 trillion price tag) will really affect the U.S. economy. If the contemplated tax reform will not pay for itself (as many commentators fear), will the passage of the Conference Agreement lead to cuts to social safety nets such as Medicaid and Social Security? How will this new tax construct affect our already frayed and ailing health care system?

Disruption, change and uncertainty are not likely to prove boosts to the economy, although others point to the recent increases in the stock market as proof of the positive impact of the tax cuts. Practitioners will have to be careful not to draw general conclusions about the impact of the Conference Agreement as the implications to each client might vary significantly, but much of the impact may prove indirect and more difficult to ascertain.

Summary of the Transfer Tax Changes (and Not) of the Conference Agreement

- Whereas the House proposal contemplated permanent repeal of the estate and generation-skipping transfer (GST) taxes in 2024, the Conference Agreement contains no such repeal. Thus, ultra-high net worth taxpayers (with net worth defined relative to the new exemption amounts) should continue to aggressively plan. However, in light of the worries about future legislation changing the current tax cuts, even more moderate wealth taxpayers should seize on what might be a temporary increase in exemption amounts. Educating clients on the importance of planning in the latter category will be an important role for many advisers.

- The Conference Agreement doubles the estate and gift tax exemption for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026. This is accomplished by increasing the basic exclusion amount provided in section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011. Thus, the Federal estate, gift and GST tax exemption immediately increases by $5 million. The exact amount of the new exemption amount could be $11.2 million (or just under $11 million), depending upon how inflation adjustments are calculated. A married couple can transfer $22.4 million dollars gift, estate and GST tax free with the use of inter-vivos planning or portability. A mere .02% of taxpayers were liable to pay estate tax before the Conference Agreement. With the increase in the exemption, the percentage will be lower. Likely less than 1,000 estate tax returns will be filed per year with a tax due if the Conference Agreement becomes law.

- The Conference Agreement does not address specifically the GST exemption. But since the GST exemption is based on the basic exclusion amount (“BEA”), it too appears to be increased to the new higher doubled amount. The term “Generation-Skipping transfer” includes a taxable distribution, a taxable termination and a direct skip. With the exemption from GST tax doubled, for any trusts to which

GST exemption had not been previously allocated, late allocations may be feasible for more moderate wealth clients, or distributions could be made to “skip persons” from non-GST exempt trusts up to the new higher GST exemption amount without incurring a GST tax. For wealthier taxpayers, more judicious use of GST exemption in leveraged planning transactions generally similar to prior law planning will remain appropriate. IRC Sec. 2611.

- With the increased exemption to $11.2 million, practitioners should consider whether transfers should be made from any trusts to which GST exemption had not been allocated to take advantage of the additional exemption amount. To the extent that these transfers are made from trusts which had been previously funded, no additional transfer tax would be incurred.

- Future inflation adjustments will be based on the chained CPI which should slow the rate of increase of future increments. The base year has also been set at 2016.

- Assets held by the decedent at death appear to still obtain a stepped-up to date of death value as under current law. This will remain a cornerstone of planning for many.

<u>Transfer Tax Exemption</u>

The proposal changes the Basic Exclusion amount as set forth in IRC Sec. 2010(c)(3)(A) from $5 million to $10 million. The effect of this change is that the exclusion is deemed to have increased per IRC Sec. 2010(c)(B) each year by cost-of-living adjustments so that, assuming the law is enacted and becomes effective as of January 1, 2018, the Exclusion Amount appears that it will be $11,200,000, based on the following table:

Year:	Exclusion Amount Under Current Law:	Cost of Living Adjustments:	Deemed Exclusion Amounts under GOP Tax Plan:
2011	5,000,000.00		10,000,000.00

2012	5,120,000.00	2.400%	10,240,000.00
2013	5,250,000.00	2.539%	10,500,000.00
2014	5,340,000.00	1.714%	10,680,000.00
2015	5,430,000.00	1.685%	10,860,000.00
2016	5,450,000.00	0.368%	10,900,000.00
2017	5,490,000.00	0.734%	10,980,000.00
2018	5,600,000.00	2.004%	11,200,000.00

Transfer Tax Planning Overview

With the doubling of the exemption amounts, clients have an opportunity to accomplish significant gifting after the effective date of the Conference Agreement. Caution should be exercised by Connecticut residents who might face a state gift tax for transfers over $2 million. Making gifts will enable these clients to remove further assets from their taxable estates and exempt any future appreciation from transfer taxation. Further, with no assurance that a future administration could not lower the exemption amounts, planning should not be deferred for moderately wealthy clients who may benefit from the higher exemptions while available. Ultra-high net worth clients should use the new exemptions to leverage more robust wealth transfers.

While there was speculation as to whether there would be a claw back if there is a future change of excess exemption, that issue may have been resolved. The Conference Agreement provides: "(2) Modifications To Estate Tax Payable To Reflect Different Basic Exclusion Amounts.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between— ''(A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and ''(B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent." While the Regulations to be issued will hopefully clarify that claw back will not occur, practitioners might nonetheless caution clients making new exemption gifts of this possible risk. It is important to recognize that while the federal estate tax has been a political volley ball for decades, there has never yet been a reduction in exemption amounts once they have been raised. Nonetheless, the Conference Agreement raises the exemption so dramatically, and there have been many objections to the favoritism shown the wealthy, that it is unclear whether legislators might reduce them in future years, back to current levels, or perhaps even lower levels.

As a result, as to what level of wealth is appropriate to plan for will depend on a myriad of factors:

- Certainly, if asset protection or other non-estate tax benefits might alone be worthwhile, the new exemption should be used as soon as feasible.

- Those clients with estates over $10-12 million should consider using the new exemption. As the level of net worth increases, the incentive to proactively plan should increase.

- For large estates, the increased exemption should be used, likely in leveraged transactions to maximize the wealth transfers from the increased exemption. For example, if, as some commentators suggest, a 10:1 (others suggest a 9:1 and many disagree with this concept entirety) leverage is appropriate on a sale of assets to a trust an additional $10 million of exemption for a married couple might support a $100 million sale of assets to irrevocable trusts. Further, since the IRC Sec. 2704 Regulations have been withdrawn, that sale may be of discounted assets leveraging the wealth transfer upwards of perhaps $130 million of assets on the new exemption amount.

- For more moderate wealth clients who have previously consummated note sale transactions, consideration should be given to immediately funding additional gifts to the purchasing trusts to shore up the economics of those sale transactions. On those transactions, consideration might be given to evaluating the need for the existing guarantees. On much larger transactions, the additional trust “capital” might be supportive, but have no meaningful impact on guarantees. On smaller note sale transactions, that additional $5 million gift might be used to pay off a portion or all of a note, thereby eliminating the IRS IRC Sec. 2036 string argument as to the note.

- Powers of appointment and related planning should be evaluated. If, for example, a client created a trust and named a not-so-wealthy elderly relative to have a general power of appointment over the trust, or even more so if a client had considered such planning but did not proceed because of the size of the relative’s estate, the increased exemption available next year to that poorer relative might enable using a general power of appointment to obtain a large basis step-up on that relative’s demise for the client’s asset in that trust. This is precisely the type of basis planning that one wonders if those scoring the tax consequences to the federal fisc in the summary addressed. A better alternative may have been to grant a special power of appointment that could be exercised to trigger the so-called “Delaware Tax Trap”, thereby causing the property over which the power is so exercised to be included in the power holder’s gross estate. See, generally, Blattmachr & Pennell, “Using ‘Delaware Tax Trap’ to Avoid Generation-Skipping Taxes,” 68 *The Journal of Taxation* 242 (April1988).

- For lower wealth clients, existing documents and planning will have to be reviewed. Many clients in this wealth strata will be inclined to unravel prior planning under the premise of “Why do I need this now?” Practitioners will have to educate these clients as to the value of retaining (whether modified or otherwise) existing planning from a number of perspectives. Many estate planning steps provide asset protection benefits and the transfer tax changes do not minimize the need for that. For some clients if the planning is already in place the modest cost of continuing to maintain that planning may be insignificant relative to the cost of unraveling the planning then having to reconstruct it in the future if the law changes yet again (e.g. a reduction in the exemption amount by a future administration).

What clients might be willing to do with respect to planning, and how practitioners approach and advise different clients, will depend in part on how far client planning has progressed.

Modifying Estate Planning After the Conference Agreement

Apart from the tax issues, those who have not completed, or even started meaningful planning should nonetheless proceed with planning. Estate planning never should have been only about estate taxes. For most people, more wealth is dissipated from elder financial abuse, lawsuits, divorce, spendthrift heirs and other risks than from estate taxes. Properly crafted modern trusts can address all of these concerns and provide more flexibility no matter what results from the Conference Agreement.

Given that the tax laws are still in flux, the best course is to infuse flexibility into plans. By way of example, married clients should consider forming non-reciprocal, spousal lifetime access trusts ("SLATs") to which gifts or sales transfers might be made. Single clients might consider self-settled domestic asset protection trusts ("DAPTs") or hybrid DAPTs (a dynastic trust that has a mechanism to add the settlor back as a beneficiary so that the trust at inception is not a DAPT). Much of the regretted 2012 planning was a result of not providing the client/settlor with a means of reaching assets shifted in the late 2012 planning rush (before the anticipated decline in the exemption in 2013 which never occurred). In some ways planning in the post-Conference Agreement environment is similar. We have large exemptions, valuation discounts, the availability of grantor retained annuity trusts (GRATs), grantor trusts and other techniques. It is possible that in 2021 a new administration and a Congress with a different composition might successfully resurrect many of the Greenbook proposals made by the Obama administration. Thus, this may prove a valuable window of planning opportunity. But the lessons of 2012 should be remembered, and providing flexibility and access should be critical. At the high levels of the new exemptions this will be even more important than it was in 2012.

Example 1: Client began a plan to create two non-reciprocal SLATs in late 2016 out of concern about adverse tax changes but put the planning on hold considering the proposals to repeal the estate tax. The client should evaluate whether additional gifts may be made to these trusts after enactment of the Conference Agreement to take advantage of the higher exemption amounts. So long as the gifts contemplated to each trust are under the exemption amount, this planning might be viewed as having no downside gift tax risk, so there should be no reason not to complete the planning. The non-tax benefits of the structure, e.g. asset protection and divorce protection, etc., also remain. But depending on the client's relative wealth if those SLATs have not been completed perhaps additional flexibility to access assets may be infused into the draft documents. Perhaps the spouse can be given a limited power of appointment to appoint back to the settlor spouse and the trusts can be formed in a jurisdiction where this is permitted without causing estate tax inclusion.

Example 2*:* Client is quite concerned about malpractice suits. The estate includes significant holdings in an investment LLC and has a value of approximately $20 million. The client's attorney drafted non-reciprocal SLATs to which the clients contemplated gifts of discountable assets. Part of the motivation was asset protection planning. While the need to secure those discounts might appear academic considering the significant increase in exemption amounts, the clients will assuredly benefit from the asset protection benefits of the irrevocable trusts regardless of whether there are estate and gift tax benefits. If the plan has not yet been implemented the trusts might be modified to incorporate additional flexibility (for example, naming a non-fiduciary to add the grantors back as beneficiaries in the event of premature death of one spouse, etc.). If the client resides in a decoupled state (that is, a state with an independent estate or inheritance tax), perhaps the planning should continue unabated. Another option might be to amend and restate the LLC operating agreement negating discounts, although that might lessen the asset protection benefits of the LLC as an additional layer of protection. If the facts were different and there was only limited concern about malpractice or other claims, it might be feasible to liquidate the old LLC and contribute assets directly to the SLAT to avoid unnecessary discounts. It might be possible to modify the SLAT terms to create a non-grantor type trust if the clients reside in high tax states in light of the elimination of SALT deductions for state income taxes. See the discussion below.

Example 3*:* Client whose net worth is about $8 million owns a valuable building held in a limited liability company (LLC). Planning had begun and shifted $2 million worth of the LLC interests to irrevocable self-settled domestic asset protection trust ("DAPT") in 2016 in order to secure discounts before the anticipated 2704 Regulations were finalized, which is now academic. The client is quite old and infirm and is domiciled in a non-

DAPT decoupled state. Now that the repeal of the estate tax will not occur, the planning should be modified. Since the estate tax exemption has increased could be more than $11 million when the client passes – and since all the assets owned by the client at death will be eligible for a basis step-up – it might be advisable for the client to retain sufficient incidents of ownership such that the assets may be includable in his estate. Depending upon the risks of asset depletion, the practitioner may wish to consider whether it would be advisable to prepare an action by the trust protector now to move the situs and governing law of the trust to the client's non-DAPT home state in order to cause estate inclusion. If the client resides in a decoupled state there may still be advantages to further planning. The client might wish to evaluate a change in domicile to avoid that tax. For real estate, might a 1031 like-kind exchange with real estate in a different state enable the client to avoid the state estate tax? Exchanges of real estate only will continue to be permitted. But the planning discussion might also contemplate the possible reduction in the estate tax exemption by a future administration or the sunset of the increased exemption effective after 2025. Given the precarious health position of the client in this hypothetical, steps might be taken now to address this. For example, some portion of the LLC interests might be transferred to a revocable trust and a person granted the rights to revoke the client's interests in the trust to quickly consummate a completed gift if that becomes advisable.

Example 4: Client owns a large family business. The family is involved in a complex note sale (installment sale to a grantor trust) transaction that involves several tiers of transactions. Should the plan be abandoned? Not with repeal being abandoned. Safeguarding and preserving the family business is the major goal. Leaving stock in the family business exposed to possible transfer taxes, remarriage, creditor risks, etc. would not be prudent, nor would that be acceptable to the family. Stock that's held in an irrevocable trust that is not GST exempt might be better protected in a dynastic trust. To the extent that the transaction has progressed reasonably far down the planning continuum, it may be advantageous to have the family business stock shifted to the dynastic GST exempt trust. The family has no confidence that even with the Conference Agreement becoming law that the estate tax exemption increase will not be increased by a future administration. Of greater concern, is that a democratic administration in 2020 might revisit and the Obama Greenbook proposals or the October 12, 2017 Senate Committee on Finance report "Estate Tax Schemes: How

America’s Most Fortunate Hide Their Wealth, Flout Tax Laws, And Grow The Wealth Gap”.

Since we now know that repeal of the estate tax will not happen, the following planning remains worth considering:

- Annual exclusion gifts. But even with the exclusion increasing to $15,000/donee in 2018 the amount has become immaterial relative to the new larger exemptions so for many clients the cost and bother of annual gifts and Crummey powers when made through trusts, will simply no longer be worthwhile.

- Gifts of the exemption amounts including the increased (double) exemption the Conference Agreement will make available in 2018. As noted above, capitalizing on this increase while it is available may be a valuable planning step for many clients.

- Grantor retained annuity trusts (GRATs) which can have an automatic adjustment mechanism. But the calculus of when GRATs make sense will change. For many wealth clients that may have used GRAT extensively in their planning in the past, the larger exemption amounts will permit simpler one-time transfers to irrevocable trusts without the need for the leveraging GRATs provide. This will simplify planning as leakage of annuity payments back into the estate will prove unnecessary. For some clients, stopping a rolling GRAT plan in favor of a simpler completed gift to an irrevocable trust may prove more advantageous to simply remove assets from their estate.

- Note sales using defined value mechanisms. The type and application of the defined value mechanism should be considered for ultra-high net worth clients who fear a political backlash to the current administration and possible tax policy changes in the future. Note sales should be planned considering the IRS’s continued attack on such techniques. *True v. Comm’r*, Tax Court Docket Nos. 21896-16 and 21897-16 (petitions filed Oct. 11, 2016).

- New life insurance plans for most clients will differ. Life insurance may be more important for non-reciprocal SLATs (to protect against loss of income when one of the spouse's dies). Consider the new high exemptions and the sizable portion of client estates that can be gifted to SLATs. Life insurance to pay an estate tax will be less relevant for most clients, at least until the exemption drops back to a lower amount. Perhaps, some clients will view permanent life insurance as a ballast to the risk they may perceive in their stock portfolios given the price levels the equity markets have attained. While life insurance remains a useful income tax planning tool, growing value inside the tax favored envelope of the insurance policy, lower tax rates might dissuade some from pursuing this. However, other clients, may find that their combined federal and state tax bills are much larger and that insurance may be more valuable. It is difficult to make generalizations as to which clients will benefit given the varied impact the Conference Agreement will have on different taxpayers. Also, with respect to life insurance, the significant changes in corporate and individual taxes suggest that reviewing insurance funded buyout arrangements may be warranted as the assumptions underlying the plan when created may have changed.

- Additionally, with the increased exemption to $11.2 million, practitioners should consider whether transfers should be made from any trusts to which GST exemption had not been allocated to take advantage of the additional exemption amount. To the extent that these transfers are made from trusts which had been previously funded, no additional gift tax would be incurred, nor gift exemption incurred. To maximize the potential for taking advantage of the increased GST exemption, practitioners could consider allocating the increased GST exemption to these previously created non- exempt trusts or whether distributions may be made from non-exempt trusts to GST trusts. For taxpayers with estates of a size that there is no need to preserve the new GST exemption, it might be prudent to make late allocate of GST exemptions to existing trusts so that if a future administration rolls back the Conference Agreement's benefits, those trusts will already be exempt (barring some type of claw back). For larger estates, more sophisticated planning may be advisable to shift value from non-GST exempt trusts to GST exempt trusts. For example, a family member may create a new irrevocable trust that is "grantor" as to the existing non-GST exempt trust, funding that new trust using a portion of her new gift and GST exemption. That new trust might then engage in a transaction with the old non-GST exempt trust to shift value into a more optimal transfer tax structure.

<u>Example 5</u>: Client has a $25 million-dollar estate and has made no taxable gifts. She gifts $5 million of marketable securities to a self-settled trust in 2017, and plans to make another $5 million gift in 2018 if the Conference Agreement increased exemption becomes law. This is very low or no risk in terms of gift tax. There are no valuation issues, and the gift is below the client's exemption. The practitioner may wish to encourage the client to gift more to the trust to take advantage of the higher exemption. What if the Conference Agreement Act is repealed by a new administration in 2021? Might there be a claw back of amounts gifted?

<u>Example 6</u>: Clients have a $30 million-dollar estate, $10 million of which is comprised of an LLC that owns marketable securities and $10 million of which is a real estate LLC that owns commercial rental property. They have not made any prior taxable gifts. Wife gifts $5 million of discounted membership interests in the marketable securities LLC to a SLAT. Sixty days later, she sells $5 million of discounted interests to the SLAT. Is this likely to be minimal risk in terms of gift tax exposure. There are potential valuation issues so some type of valuation mechanism might be appropriate. But given the remaining exemption in 2018, a Wandry approach (by which the portion of the property transferred is determined by a formula described in terms of dollar amounts—see Wandry, 103 TCM 1472 (2012)) may be viewed as sufficient. Since the Conference Agreement's version of estate tax repeal does not include repeal of the gift tax, what will happen to these planning structures? If the client is audited and faces an audit adjustment, the gift tax exposure on that audit may have been for naught because if the client had waited, the repeal of the estate tax may have obviated the need for planning. Should this planning be pursued? Does a *Wandry* clause make the transaction lower risk? What if a different type of defined value mechanism were used instead? Does lowering the discount rates lower the risk profile of the plan? If the client is young enough it might be advantageous to fund non-reciprocal SLATs using non-discounted or conservatively discounted assets, use the new exemption amounts, and let the grantor trust "burn" (because the tax on trust income is payable by the grantor allowing the trust to grow income tax free) reduce the estate in future years. It will be more important to structure such trusts in a jurisdiction that permits tax reimbursement clauses since the magnitude of the wealth transfer is so large relative to the client's net worth. This same factor may make the importance of pre-transfer analysis and due diligence to mitigate against a fraudulent conveyance claim more important.

State Estate Tax Systems

What will the impact of the Conference Agreement be on different decoupled state estate tax systems? The combined impact of the state income tax issues and loss of SALT deductions could be devastating for taxpayers in high tax states. The state income tax rate could result in a significantly higher federal income tax paid as the result of the loss of the state income tax deduction. This tax increase could pressure wealthier people to move their residences to states without income tax and with lower property taxes. Might there be a migration to low/no income tax states?

What will this do to state budgets? It is noteworthy that high tax states such as New York, New Jersey and California are so-called "donor" states – that is to say, the taxpayers in these states contribute more in federal taxes than they receive in federal benefits because by and large, donor states use their own funds to provide benefits to their citizens. An exodus of wealthier taxpayers from these donor states could cause a dramatic shift in tax burdens and result in even higher taxes in these high tax states.

What is interplay of the Conference Agreement's $10 million inflation adjusted exemption and state estate tax systems? How will decoupled states react? What about the New York estate tax cliff? Under New York law, if an estate slightly exceeds the exemption amount, the exemption is lost and the entire tax is incurred on the entire estate. While a higher exemption amount would obviate the issue for many New Yorkers, the magnitude of the cliff will create an incredibly costly penalty for moderate wealth clients that only modestly exceed the exemption. In 2019, New York's exemption is slated to equal the federal estate tax exemption. Will New York match the doubled federal exemption or will New York be forced to amend its estate tax law to maintain its revenue base? How will other states react? Only about 14 states have an independent state estate tax. How will this affect them? What will states with estate tax systems do in light of the Conference Agreement doubled exemptions? Will they retain their estate taxes? Will it be cost-effective for states to retain an exemption amount that parallels the federal exemption – when the federal exemption increases with a $10 million inflation adjusted exemption amount? For non-decoupled states, will they feel an increased pressure to repeal their estate tax system if so few residents will be subject to tax? Of course, the increased Federal exemption is temporary only so that the state may only lose residents who anticipate dying before 2026.

Portability

With recent leniency provided by the IRS on filing late portability elections, will clients be willing to incur any cost to secure portability now that the exemption is doubling? In the future, will clients even be willing to listen to recommendations to file a federal estate tax return if the exemption is doubled? Certainly, fewer moderately wealthy clients may be willing to do so. For those clients affected, in the event that the estate tax is reinstated as expected, loss of portability from failure to file an estate tax return on the death of the first spouse can create greater estate tax on the death of the survivor, particularly if the federal exemption is returned to current levels.

Those taxpayers with portable exemptions from a prior deceased spouse might consider using those exemptions before a future administration may negatively affect them. This could take the form of using that DSUE to fund a DAPT. If a future administration negatively affects the portable exemption it will have already been used. By using a DAPT the client may not be prevented from accessing the wealth so transferred.

Non-Tax Estate Planning

More moderately wealthy clients may choose simplistic outright bequests if there’s no tax incentive. The term “moderate” may again be redefined relative to the new doubled exemption amounts. Practitioners will have to educate clients as to the obvious (to the practitioner, but not necessarily to the client) benefits of continued trust planning, such as divorce and asset protection benefits. In the absence of any transfer taxes, this may become the primary goal for many trust plans. With increased longevity, the likelihood of remarriage following the death of a prior spouse likely will increase. The need for trusts on the first death to protect those assets may be more important than many realize.

While trusts may afford tax planning opportunities by sprinkling income to whichever beneficiary is in the lowest income tax bracket, will the lower income tax brackets provided under the Conference Agreement reduce this benefit sufficiently enough to mitigate against this use of trusts? The distributions carry out income under the distributable net income rules of IRC Sections 651-652 and 661-662. Might it make more sense for trusts to make low interest-bearing loans to beneficiaries to repay mortgages loans to the extent the interest on which is no longer deductible under the new Act (taking into account that the interest will once again be deductible under the pre-Act levels when the provisions sunset)?

Business and Entity Income Tax and Planning Considerations

There are a host of changes made that affect corporations and other business entities, and therefore create business planning opportunities:

- The corporate tax rate is reduced to 21% from the current 35%. The difference between the maximum corporate and individual tax rate may be significant such that evaluating business structures may be advisable. Might C corporations may be more favorable to use than in the past? One important issue may be whether an S corporation should elect C corporation status or whether an entity taxed as a partnership (or proprietorship) should elect C corporation status.

- The corporate AMT is repealed.
- The optimal form of business may change for some clients.
- A sale of 50% or more of a partnership will not terminate the partnership.
- Expensing of otherwise depreciable assets other than buildings will be expanded significantly. The new rules are to be effective from September 28, 2017 to December 31, 2022. The $500,000 limitation on IRC Sec. 179 expensing would be increased to $1 million and the phase-out limitation for property placed in service exceeding $2 million would be increased to $2.5 million.
- The deduction for net interest expense would be limited to 30% of the business earnings after depreciation.
- Net operating losses ("NOLs") would be deductible only up to 80% of current taxable income, (it is 100% under current law). NOL

carryforwards would not expire but the Conference Agreement provides that the NOL may no longer be carried back.

- IRC Sec. 1031 like kind exchanges would be limited to transfers of real property. Is there a motive to preserve this for real estate developers despite the broad goal of simplification?
- Deductions for entertainment expenses will be disallowed, but the 50% limitation on deductions for meals would continue to apply.
- The Act imposes a three-year holding period in order for carried interest to qualify as a long-term capital asset.

Personal Service Entities and Pass Through Entities.

The House proposal had imposed harsh consequences upon owners of personal service entities and prevented those involved in the performance of services in fields such as law, accounting, health consulting, financial services or performing arts from enjoying the special business income tax rate. The Conference Agreement softens this approach by creating a new tax schema whereby the non-wage portion of pass-through income would be eligible for a 20% deduction up to 50% of the entity's W-2 wages with income exceeding $315,000 (married filing joint) or $157,500 (single).

Under the new Section 199A, the "deductible amount" for each trade or business will be the lesser of:

A. 20% of the taxpayer's qualified business income with respect to the taxpayer's qualified trade or business; or

B. The greater of: (i) 50% of the W-2 wages paid with respect to the qualified trade or business, or (ii) the sum of 25% of the W-2 wages with respect to the trade or business, plus 2.5% of the unadjusted basis of all qualified property, determined immediately after acquisition.

Wages are defined as remuneration for services performed by an employee. Sec. 3401.

Once the deductible amount of the taxpayer's earnings from the trade or business is determined, the Reconciliation Act provides for a deduction determined as follows:

1. The lesser of A. the taxpayer’s combined qualified business income; or B. an amount equal to 20% of the excess of i) the taxpayer’s taxable income for the taxable year, over ii) the sum of the taxpayer’s net capital gain plus the aggregate amount of the qualified cooperative dividends

PLUS

2. The lesser of A. 20% of the aggregate amount of the taxpayer’s qualified cooperative dividends, qualified REIT dividends and qualified publicly traded partnership income. for the taxable year or B. the taxpayer’s taxable income reduced by the net capital gain for the taxable year.

The deduction is further limited to the net of the taxpayer’s taxable income less the taxpayer’s net capital gain. Moreover, there are additional special rules which come into play in determining the deduction.

Although the Senate bill had precluded trusts and estates from benefiting from this change, the conference agreement provides that trusts and estates are eligible for the 20-percent deduction under the provision. Rules similar to the rules under present-law section 199 (as in effect on December 1, 2017) apply for apportioning between fiduciaries and beneficiaries any W-2 wages and unadjusted basis of qualified property under the limitation based on W-2 wages and capital.

Business owners (and others) will have to consider that C corporations will pay only a 21% tax. Even if the 79% left is paid out as a qualified dividend, taxed at 23.8%, the combined taxes will not be more than about 39%. So, some may well conclude that C corporation status is preferable to taxation through a pass through entities. But that is complicated by state and local taxes and by the fact that the entire Act may sunset after 2027 if even earlier by a change in control of the White House, Senate and House of Representatives before then.

This is not “simplification.” Will taxpayers will truly have enough time to understand the implications of these new rules before the deduction sunsets at the end of 2025?

Individual Income Tax Changes and Planning Considerations

Many deductions will be modified or eliminated.

- **Kiddie tax**. The "kiddie tax" will change by applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. (Earned income of a child covered by the kiddie tax provisions will continue to be taxed at the rates of unmarried single individuals.)

- **Standard deduction**. The standard deduction under current law is $12,700 for married taxpayers filing jointly, and $6,350 for single taxpayers. The Act will increase the standard deduction to $24,000 for married taxpayers filing jointly, and $12,000 for single taxpayers. While this change will simplify tax compliance for tens of millions of Americans, and lower their tax burdens, it will have wide ranging impact. Industries that have historically relied on itemized deductions to fuel their business models may be adversely affected. This might affect the housing industry, movers, charities, and more. Only the specifically identified deductions noted below will remain. Planning for taxpayers might potentially exceed these thresholds will change dramatically. Bunching deductions, by pushing deductions from year 1 into year 2, and in year 2 accelerating deductions from year 3 back into year 2, may enable taxpayers to periodically bunch deductions into a designated year to exceed the new higher threshold. This might entail bunching charitable deductions to a targeted year and funding a donor advised fund from which donations can be distributed in other years. Charitable remainder trusts might be more common. Planning discretionary medical expenses in that same targeted year will also facilitate exceeding the threshold.

- **Pease Limitation**. This rule had limited itemized to deductions to 3% of income over a threshold amount, or 80% of total deductions (known as the Pease Limitation). The Conference Bill repeals this, but it also eliminates many deductions so it may not have any impact on many. The overall limitation will not be as impactful given the other changes. Sec. 68. Some individuals in states without high income or property taxes could not get any benefit from charitable contributions by reason of this limitation. Those individuals may now get the full (or at least partial) benefit of charitable contributions.

- **<u>Personal exemptions</u>**. The personal exemption for a taxpayer, the taxpayer's spouse, and any dependents would be eliminated.

- **<u>Entertainment</u>**. Expenses for entertainment will not be deductible, except for certain meals which may be deductible up to 50%.

- **<u>Adoption</u>**. Whereas the House bill eliminated the deduction for adoption expenses, the Conference Agreement makes no mention of this deduction.

- **<u>Mortgage Interest</u>**. Home mortgage interest will continue to be deductible at a reduced level. Under current law, interest incurred on up to $1 million of mortgage debt is deductible, but under the Conference Agreement that amount will be reduced to $750,000. Additionally, only interest on acquisition debt may be deducted. How might this affect the value of clients in the home construction business? Might it enhance the value of clients owning rental apartment buildings? Might it prove more advantageous for trusts to own homes and permit beneficiaries to use them if both mortgage interest and property tax (see below) deductions are reduced substantially? Might there be a means to convert vacation homes into rental properties and thereby transform the deductibility of interest and taxes? Might more taxpayers in high tax states favor time shares or other arrangements that might be less costly because of these changes? With the restriction on home equity interest deductions taxpayers that have used home equity lines to finance other endeavors might evaluate repaying them depending on the rates and net cost. It may be feasible in some instances to use interest tracing rules to retain a deduction other than as a home equity line.

- **<u>SALT</u>**. The Act provides that taxpayers may take a deduction up to $10,000 for any combination of state and local taxes, sales tax, and/or property taxes paid. Otherwise, these taxes would only be deductible to the extent that they were paid in connection with carrying on a trade or business. The reduction in SALT taxes will have a very disparate and potentially profound impact. For example, this could have a significant and costly impact on wealthy taxpayers in high tax states that own multiple homes. What impact might this have on communities with high property taxes? Are there alternative options as noted above to restructure ownership to make taxes deductible? Will home office deductions become more common as taxpayers seek ways to qualify to deduct a portion of their property taxes? Will more vacation property owners seek to rent vacation homes to offset the increased net of tax cost of maintaining such properties? The restriction is effective January 1, 2017 to prevent the "abuse" of taxpayers paying state and local income taxes in late 2017 before due in 2018. Act Sec. 11042. Note that CPAs will have to be alert for what expenses are paid, when and which are deductible, and the impact on 2018 estimated taxes given all the myriad of changes and disparate late 2017 actions. While some advisers recommend consideration of "ING" trusts (discussed elsewhere) for moderate wealth clients seeking to take advantage of the new exemption amounts that may not be an optimal strategy.

- **Tax preparation**. Repeal of deduction for tax preparation expenses. Under the provision, an individual would not be allowed an itemized deduction for tax preparation expenses. The provision would be effective for tax years beginning after 2017. Under current law, these expenses are miscellaneous itemized deductions only deductible in excess of 2% of AGI, so few many taxpayers may not have received significant benefit in any event. This will likely result in taxpayers revisiting allocation of tax preparation fees as between business endeavors and personal returns preparation.

- **Medical expenses**. Though the House bill eliminated the medical expense deduction, the current Act reduces the threshold for deducting medical expenses to 7.5-percent for all taxpayers (down from 10%) for taxable years beginning after December 31, 2016 and ending before January 1, 2019. For these years, this threshold applies for purposes of the AMT in addition to the regular tax. Any elderly or disabled taxpayers considering or needing home improvements should make these modifications before January 1, 2019, in order to secure a tax deduction. This is more important than the general media discussions of accelerating deductions that may be eliminated because of the quantum of the costs to modify a home. In many instances, these costs can run from tens to hundreds of thousands of dollars. Additionally, taxpayers who might benefit from costly elective surgery not covered by insurance should all endeavor to plan before January 1, 2019. In future years, taxpayers will benefit from planning medical, charitable and other expenses to exceed the thresholds in periodic years.

- **Employee expenses**. The Conference Agreement eliminates the deduction for expenses attributable to the trade or business of being an employee. Employee/taxpayers should endeavor to take deductions in 2017 or there will be no deduction. Unreimbursed employee expenses had only deductible if they exceed 2% of AGI. For some employees with substantive expenses there will be a greater incentive to be an independent contract reporting on Schedule C so that expenses can be deducted. For taxpayers in high tax states this incentive will be enhanced by the loss of property tax deductions which also may be in part salvaged if a home-based business is reported. Employers might reevaluate expense reimbursement plans considering that employees may no longer obtain a deduction.

- **Personal casualty loss deduction**. The new law temporarily modifies (restricts) the deduction for personal casualty and theft losses. Under the provision, a taxpayer may claim a personal casualty loss (subject to the limitations described above) only if the loss was attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. The limitation does not apply with respect to losses incurred after December 31, 2025. The effective date is for losses incurred in taxable years beginning after December 31, 2017. Thus, theft and similar losses will no longer be deductible. Taxpayers might wish to reconsider the size of the deductible on their insurance since no tax benefit is likely to be available.

- **Retirement plans**. Although there had been discussion of restricting 401(k) plans, the Conference Agreement generally retains the current rules for 401(k) and other retirement plans. The one change in this area is more intended to close a loophole. Taxpayers who have converted regular IRAs to Roth IRAs in 2017 intending to reconsider this conversion after reviewing the level of appreciation or depreciation in the account at year-end had better do so before year end. Some taxpayers had converted regular IRAs to Roths and then invested aggressively in order to benefit from any gains (which are never subject to tax) by leaving them in the Roth, but then retroactively reversing the conversion if they incurred a loss inside the new Roth to avoid income taxes on some or all the converted amount. This strategy will no longer be feasible. The Act does permit recharacterization with respect to other contributions such as the conversion of a traditional Roth IRA to a Roth IRAs. For example, an individual may make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA.

- **Investing**. Though the House proposal had restricted the issuance of private activity bonds ("PABs"), the Conference Agreement does not change current law with respect to PABs. The net investment income tax ("NIIT") was to have been repealed but is not being repealed. This is the .9% tax on earned income, and the 3.8% tax on unearned income, applied to married taxpayers filing joint with income of more than $250,000, and single taxpayers with income of more than $200,0000. Tax advantages of carried interest do not appear to have been restricted under the Conference Agreement. The relative benefits of municipal bonds will be diminished as marginal tax rates for many taxpayers are reduced.

- **AMT**. While it would seem that using terms like "reform" or "simplify" would require elimination of the AMT, and despite all of the tough talk about eliminating AMT, the AMT will not, in fact, be repealed under the Conference Agreement. Instead, the AMT exemption will be increased to $109,400 (for Married Filing Joint taxpayers) and $70,300 (for single taxpayers). The thresholds for the phase-out of the AMT exemption were also increased to $500,000 for single files and $1 million for married joint filers.

Domicile

Clients have always evaluated the benefits of changing their domicile to lower tax jurisdictions. e.g. Florida, to avoid the estate tax in, for example, New York. The loss of the SALT deductions might accelerate this trend as the net income tax cost of remaining in a high tax state will be more significant every year. Practitioners will likely have more clients requesting guidance on tax and related planning to change domicile. Consider, in addition to the traditional steps necessary to sever the old domicile and establish a new one:

- Moving expenses may no longer be deductible (although many of the clients making such a move may not have qualified for a moving expense deduction under pre-Tax Reform law.
- Tax Reform may change the qualification period to obtain the home sale exclusion from 2 of 5 years to 5 of 8 years potentially making the cost of selling the old home more significant.
- New estate planning documents should be obtained signed in the new state of domicile and reciting the client's residency in that state.

Trust Income Tax Considerations

The Conference Agreement fixed the provision in the Senate version of tax reform that would have limited trusts and estates from taking the deductions permitted for the owners of pass-through entities. Specifically, the Conference Agreement permits trusts and estates to take the deduction similar to other owners of pass-through interests. The rules require apportionment between fiduciaries and beneficiaries of any W-2 wages and unadjusted basis of qualified property under the limitation based on W-2 wages and capital.

Trust tax brackets will be $2,550, $9,150 and last $12,500. The inflation adjustment begins after 2018. Estate or trust that would have reached the maximum tax bracket at $12,700 under current law but the Conference Agreement moves it back to $12,500 and no inflation adjustment until 2018. This is another nitpick that illustrates detailed small modifications to replace revenues affected by tax cuts.

The restriction or elimination of itemized deductions will affect trusts since trust taxation is based on the taxation of individuals. Thus, trust expenses that are miscellaneous itemized deductions would disappear similarly to those for individuals. Sec. 67(a). These restrictions, however, should not affect the deductions for costs which 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, such as trustee commissions, attorneys' fees, fees for accounting to a court or the beneficiaries, among others. IRC Sec. 67(e)(1). The deduction under Section 691(c) should remain, meaning that the income tax deduction for net Federal estate tax paid will be allowed. Deductions in a trust's final year for capital or operating losses appear to remain intact. IRC Sec. 642(h)(1).

How will the $10,000 cap on state and local taxes be applied to trusts? If a trust holds a personal use home, will the tax deduction be limited to $10,000? If a trust owns several homes will the result be the same $10,000 cap? What if a trust owning several different is divided into separate trusts. Will each resulting trust then have its own separate deduction?

Another variation in planning may occur because of the SALT changes. The doubled estate tax exemption and the costlier SALT situation may drive practitioners to thread a new trust tax needle. Most trust planning resulted, with one major exception, as generally relied upon the creation of grantor trusts. The taxation of trust income to the grantor was an effective tool to burn or reduce the client/grantor's estate, facilitate further tax oriented planning (e.g. swaps of trust assets for personal cash to obtain a basis step up on highly appreciated trust assets), etc. For wealthy clients (wealthy relative to the new exemption amounts) that planning may continue.

Some high earning clients used incomplete non-grantor ("ING"—see Blattmachr & Lipkind, "Fundamentals of DING Type Trusts." 26 Probate Practice Reporter 1 (April 2014)) trusts to shift income out of the reach of state tax authorities. These trusts were funded with incomplete gift transfers and were structured to avoid grantor trust status. The idea was that income, e.g. a large capital gain on the sale of stock, might be earned inside the ING and avoid high SALT in a high tax state. This technique had become so successful that New York enacted legislation to treat such trusts as grantor trusts subject to New York taxation.

However, for many clients with more moderate (relative to the new high exemption amounts) wealth, who reside in high tax states, a different variation of all the above planning might be preferable if feasible to achieve. These clients, perhaps in a wealth strata of $10-$40 million may be so wealthy that estate tax planning should continue because the higher doubled exemptions may be rolled back in the future. But these taxpayers may not be so very wealthy that they can afford to give up access to those trusts. Further, with the SALT deduction restrictions or elimination it may be prudent to shift investment income to a different low/no tax jurisdiction if feasible. Might these clients be able to structure completed gift (unlike the ING trusts), non-grantor (like the ING trusts) trusts to achieve both goals? To provide access to assets in such trusts might it be feasible to have the spouse as a named beneficiary, or the grantor (if in a jurisdiction that permits self-settled trusts) only to receive distributions with the consent of an adverse party to avoid grantor trust status? Would such trusts, if feasible from a federal income tax planning standpoint, be able to be planned around New York's anti-ING legislation and avoid grantor trust status for New York purposes?

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

Might a variation of the Beneficiary Defective Irrevocable Trust ("BDIT") be used in the above context? A BDIT is an irrevocable trust that is grantor for trust taxation purposes to the beneficiary not the settlor. For example, parent may set up a trust for child, and that trust could be crafted to avoid all incidence of grantor trust status to the parent/settlor, but include an annual demand or Crummey power making the trust grantor as to the child/beneficiary. If the parent lives in a high tax state and the child in a no tax state, might this shift income to a less SALTy environment to save SALT when they are no longer deductible?

For clients residing in low tax states more traditional grantor trust planning described earlier may be preferable.

Charitable Planning

Charitable contributions will continue to be deductible. However, the doubling of the standard deduction, for a single taxpayer to $12,000 and for a taxpayer who is married filing jointly to $24,000 would appear to eliminate the incremental tax benefit from donations since, for many taxpayers, there will be little advantage in itemizing deductions going forward. This is compounded by the many other restrictions on itemized deductions in the Conference Agreement which will make it more difficult for most taxpayers to exceed the standard deduction limit. This includes (a) limiting the total deduction for state and local income, real estate and sales tax to $10,000, (a) medical expenses may only be included as an itemized deduction to the extent that they exceed 7.5% of adjusted gross income, and (c) limiting mortgage interest deductions to acquisition debt on the first $750,000.

Thus, many taxpayers will simply not have itemized deductions that exceed the standard deduction and therefore will get no tax benefit for making any charitable contributions. For the drafters of tax reform, this is a feature and not a bug as it gets our tax code closer to "simple". But, at what cost? For taxpayers making less than $500,000 annually, the estimated annual average charitable contribution is about $3,700, based on IRS Statistics of Income. The result will be that few people will likely get a charitable contribution deduction after 2017 other than high income earners with substantial deductions in the categories that remain deductible. Will charities lose needed donations?

Here's a quick look at the relevant provisions related to charitable contributions in the Conference Agreement:

- The 50% of AGI (technically, the contribution base which is AGI determined without regard to any net loss carryback) limitation that applies for cash contributions to public charities and private operating foundations would be increased to 60% for cash gifts only. While this is a positive for very wealthy taxpayers who can afford to gift to such levels it is curious why this provision was added to the Conference Agreement. Currently donations are limited to 50% of AGI and can be 30% or 20% for other gifts.

- The provision would retain the 5-year carryover period to the extent that the contribution amount exceeds 60 percent of the donor's AGI.

- No charitable deduction shall be allowed for any amount described in paragraph 170(l)(2), generally, a payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.

- IRS Pronouncement gives amount of deduction for mileage, but for charity this was only 14 cents. While the House would have let this figure fluctuate like business travel expenses, a change charities have wanted for a while, the Conference Agreement did not include this change.

- Sec. 170 provides that if a donor makes a charitable contribution in excess of $250, no deduction is allowed unless the donor receives a contemporaneous acknowledgement from the done charity. There is an exception to this if done satisfies a reporting requirement. The Conference Agreement repeals this exception and therefore taxpayers must obtain a contemporaneous written acknowledgement to get a deduction. IRC Sec. 170(f)(8)(D).

For some taxpayers, the new paradigm of bunching deductions to targeted years may spur more growth in the use of charitable remainder trusts and donor advised funds in those selected years when the taxpayer wishes to exceed the standard deduction hurdle. Also, few taxpayers will benefit from a charitable contribution deduction on estate tax returns so it may be advantageous to prepay those bequests as advancements to the charities indicated. Care should be taken to receiving confirming documentation from the charity that the payment is an advancement to avoid an unintended duplication of donations.

Education Tax Considerations

The Conference Agreement upended many of the restrictions that had been imposed by the House proposal, retaining only the softer education tax provisions of the Senate bill, as follows:

- Section 529 plan distributions may be used to pay not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private or religious elementary or secondary school.

- The definition of higher education expenses was expanded to include certain expenses incurred in connection with home schooling, specifically: 1. Curriculum and curricular materials; 2. Books or instructional materials; 3. Online educational materials; 4. Tuition for tutoring or educational classes outside of the home (but only if the tutor is not related to the student); 5. Dual enrollment in an institution of higher education; and 6. Educational therapies for students with disabilities.

Residential Real Estate

There are a host of adverse changes that will impact residential real estate and vacation homes.

- The mortgage interest deduction will be severely limited. Taxpayers may continue to claim an itemized deduction for interest on acquisition indebtedness. For debt incurred after the effective date of December 15, 2017, the $1 million limitation would be reduced to $750,000. Since this provision is scheduled to sunset, for taxable years beginning after December 31, 2025, a taxpayer may treat up to $1 million of indebtedness as acquisition indebtedness – and deduct the interest thereon – regardless of when the indebtedness was incurred.

- The Conference Agreement suspends the deduction for interest on home equity indebtedness for taxable years after December 31, 2017. This suspension also ends for taxable years beginning after December 31, 2025.

- With the total aggregate amount of state and local income, sales and real estate taxes capped at $10,000, should a taxpayer engaged in a trade or business consider claiming a deduction for a home-based business to secure some portion of the property taxes? Might more taxpayers formalize home based businesses to address this and other limitations? The Conference Agreement provides: "The provision contains an exception to the above-stated rule. Under the provision a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for the aggregate of (i) State and local property taxes not paid or accrued in carrying on a trade or business, or an activity described in section 212, and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year." It is not clear that a single taxpayer would have the same $10,000 cap that a married couple would. If so, that would be a penalty for married taxpayers.

- Homeowners will continue to be able to exclude up to $500,000 of gain ($250,000 if single) from the sale of a qualified principal residence as under current law.

- In another blow to the housing industry (and moving and relocation businesses), the deduction for moving expenses is eliminated for the taxable years 2018 through 2025. However, during that suspension period, the provision retains the deduction for moving expenses related to those serving in the Armed Forces (or their spouses or dependents).

- A taxpayer may claim a deduction for personal casualty loss only if such loss was attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. The deduction for other personal casualty losses and theft is eliminated. While this is not limited to hurricane, flood, fire, theft and other losses on homes, it is likely that this change will be felt most acutely by those owning homes.

The larger macro implications of these and other changes on residential real estate are uncertain. For example, for ultra-wealthy taxpayers, these changes may be insignificant. For many Americans, they may be irrelevant. But for a large swath of what might be loosely referred to as moderately wealthy or wealthy Americans, these changes could have a substantial and unfair impact on the carrying costs of homes and vacation homes and perhaps undermine the values of those properties at the same time.

Matrimonial Matters

The Act includes several changes that could significantly impact matrimonial/divorce agreements. These provisions directly affecting divorce are in addition to the many indirect changes (e.g., impact on itemized deductions, SALT limits, etc. that may have a significant direct impact, positive or negative, on the ex-spouses):

- As previously discussed, alimony payments will not be deductible by the payor spouse, but will also not be included in income of the payee ex-spouse. The effective date indicates that this new rule will apply to any divorce or separation instrument as defined in IRC Sec. 71(b)(2) effective for any divorce or separation instrument executed after December 31, 2018, or for any divorce or separation instrument executed on or before December 31, 2018, and modified after that date, if the modification expressly provides that the amendments made by this section apply to such modification. Practitioners should consider adding a provision to any agreement in process that if the law is changed as provided in the Conference Agreement, the agreement can or must be renegotiated. It might, in some instances, be worth addressing the terms of the agreement with or without the change of the Conference Agreement. It is also important that if the Conference Agreement becomes law, both matrimonial practitioners and accountants should put all divorced clients paying or receiving alimony on notice that they can modify the agreement to bring it under the new law if that proves advantageous for them. Making all prior agreements under prior law able to be modified and brought under the new tax paradigm is anything but simplification.

- The personal exemption for dependents is eliminated under the Conference Agreement. What becomes of the divorce agreements where the parties expressly negotiated who would benefit from the exemptions? If the arrangement was to divide or split, or alternate each year the exemptions, then perhaps the economic impact is equal between the ex-spouses and simply a tax benefit lost. But what if one spouse negotiated the benefit? Is that a basis to revisit or adjust the agreement?

- As noted above, the qualified expenses under 529 plans will include elementary and high school education of up to $10,000 per year and includes both religious and home-based education. Will this undermine the intent of existing matrimonial settlement agreements that may have provided funding or confirmed balances in 529 plans for college which might now be dissipated for earlier education expense contrary to the parties' intent? The governing agreements should be reviewed to ascertain whether the agreement specified college only expenses be paid from an acknowledged 529 plan and whether that would suffice to restrict the ex-spouse account owner from using funds earlier.

Conclusion

Comprehensive tax reform whipped through the House of Representatives and the Senate at a record pace over these past seven weeks. The GOP appears set to pass the Conference Agreement and deliver it to President Trump in his Christmas stocking. While we know that the impact of the Conference Agreement will be far-reaching, it is not yet clear exactly how seismic a shift in tax policy this will ultimately be.

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

Martin Shenkman

Jonathan Blattmachr

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CITE AS: