



Presented by:

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# 2017 Heckerling Highlights

January 2017



**BNY MELLON**  
WEALTH MANAGEMENT

# Portability – Fundamentals Session

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## Zaritsky prediction:

- Estate tax will be repealed by late 2017
  - Will have a 10 year phase-out
  - Estate tax resurrected in 2027
- Gift tax will not be repealed
  - Needed to prevent income shifting i.e. transfer to low bracket family member, sell, transfer back
  - With high estate, gift and GST exemption, income shifting can be done by most people now, so income shifting not that big a deal as in the past
- Need documents that say this is what will happen if there is an estate tax and this is what will happen if there is no estate tax

# Portability – Fundamentals Session

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## Reporting values

- If preparing estate tax return solely to elect portability or make allocation of GST exemption, don't have to report value of assets left to spouse or charity
- If preparing estate tax return for a taxable estate, valuation of assets left to spouse or charity is needed

# Portability – Fundamentals Session

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## Estate tax return not filed on time

- Estate below filing threshold – 9100 relief available.
- Estate over filing threshold – portability not available

# Portability – Fundamentals Session

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## Computing the DSUE amount

- If gift tax paid on a taxable gift, you do not have to adjust DSUE amount for the amount of the gift that generated a gift tax
- Example: H and W made \$3 million gift resulting in a \$2 million taxable gift when the gift tax exemption was \$1 million. H later dies when the estate tax exemption is \$5 million, leaving his entire estate to his W.
  - H's DSUE per the IRC is \$5 million less \$3 million = \$2 million DSUE
  - Regulations correct this and calculate the DSUE as follows: \$5 million less \$1 million used in making the \$3 million gift = \$4 million DSUE.
  - See Reg. 20.2010-2(c)(1)(ii)(B)

# Portability – Fundamentals Session

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**Can only use last deceased spouse's DSUE**

**If client remarries, consider funding an irrevocable trust with unused DSUE to safeguard losing DSUE if new spouse dies**

**If client wants access to funds, consider a self-settled DAPT**

- Uses DSUE and assets can be accessed by client

# Portability – Fundamentals Session

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## **NRA – taxed only on assets located in U.S.**

- Unified credit is \$13,000, the equivalent of a \$60,000 exemption
- The \$13,000 credit is not portable (unless treaty provides otherwise)

# Portability – Fundamentals Session

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## QDOT and portability

- Can't determine DSUE until surviving spouse dies or becomes a U.S. citizen
- Surviving spouse can't use DSUE to offset lifetime gifts (because you can't determine the DSUE until the surviving spouse dies or becomes a U.S. citizen)
- Can only use DSUE to offset the surviving spouse's estate tax



# Portability – Fundamentals Session

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## Rev. Rul. 2016-49 addresses the Rev. Rul. 2001-38 perceived problem

- Rev. Rul. 2001-38 issue not addressed in the portability regulations
- Rev. Rul. 2016-49 gives otherwise nontaxable estates the flexibility to elect portability and make a QTIP election
  - Sets forth procedures to disregard and treat as null and void a QTIP election in situations where the QTIP election wasn't otherwise necessary to reduce the estate tax liability to zero.
  - In estates where the executor made the portability election, the QTIP election will not be treated as void

# Portability – Fundamentals Session

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## Ways to use DSUE to get step-up in basis:

- Outright distribution
- GPOA
- Trigger Delaware tax trap
- Power of Appointment Support Trust (POAST)
  - G2 sets up trust with G1 as beneficiary and gives G1 GPOA
  - GPOA may be limited to unused exclusion or GST exemption
- Alaska, Tennessee, South Dakota community property trust

# Portability – Fundamentals Session

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## Consider portability in second marriage situations

- Treat as an asset subject to negotiation when drafting pre-nuptial agreement
- Agree that executor will make portability election and surviving spouse will pay tax compliance expenses

# Recent Developments - Part I – Section 2704 Prop. Regs.

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## Why discuss in light of potential estate tax repeal?

- Gift tax will remain so valuation is still important
- Possible capital gain tax on death so valuation is an issue

## Recent Developments - Part I – Section 2704 Prop. Regs.

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Good quote applicable to Section 2704:

“When a member of Congress  
can cite a Code section,  
you know there is a problem.”

# Recent Developments - Part I – Section 2704 Prop. Regs.

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## Fallout from Section 2704 proposed regs:

- Federal legislation introduced to defeat finalization of regs
  - Lapse at year end but already reintroduced in 2017
- IRS has received 10,000 comments on the proposed regs
  - Cathy Hughes has read only 400 of them
  - All comments will be reviewed

# Recent Developments - Part I – Section 2704 Prop. Regs.

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## What happened since Section 2704 regs issued in 1992:

- Court cases held that Section 2704(b) only applied for purposes of liquidating the *entire* entity, not an individual's interest. Kerr, Jones, Harper
- Non-family owner (e.g. charity) with nominal ownership nullified family control
- ULPA
- Proposed Section 2704 regs designed to put above into Section 2704

# Recent Developments - Part I – Section 2704 Prop. Regs.

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## Intent of Section 2704 proposed regulations

- Narrow regulatory exceptions
- Create new category – “disregarded restrictions”
  - Limit a restriction that limits an *individual’s* right to liquidate his/her interest
  - Disregarded restrictions should be ignored by appraisers in determining FMV
- Per Cathy Hughes, Section 2704 proposed regs not intended to eliminate all minority discounts – will be stated in final regs
- Per Cathy Hughes, the regs are not to be interpreted as requiring a deemed put right.
- Cathy Hughes says practitioners are reading the proposed regs too broadly



# Recent Developments - Part I – Section 2704 Prop. Regs.

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## Intent of Section 2704 proposed regulations

- Don't distinguish between operating and non-operating businesses

# Recent Developments - Part I – Section 2704 Prop. Regs.

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## Important compliance issue

- To get statute of limitations running under the adequate disclosure rules you must disclose that the position being taken on a return (e.g. valuation) is contrary to proposed regulations. §6501(c).
- Suggestion is to disclose a value in conflict with Section 2704 proposed regulations
  - If no adequate disclosure, S/L doesn't run
  - Problem for donee as well as donor because transferee liability S/L doesn't run until one year after statute runs as to donor. If no adequate disclosure and S/L doesn't run for donor, it never runs for the donee
  - Google "AICPA adequate disclosure 2704" to find suggested language.

# Recent Developments - Part I – Section 2704 Prop. Regs.

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**John Porter prediction – “won’t see Section 2704 regs finalized”**

# Recent Developments - Part I – Effect of Election

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## Republican blueprint:

- Fuel economic growth
- Simplify Internal Revenue Code
- Transform IRS to make it customer service focused

# Recent Developments - Part I – Effect of Election

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## Republican blueprint:

- Reduce income tax rates from 7 brackets down to 3
- Repeal AMT
- 25% tax rate for small business
- Mortgage and charitable deduction retained
- Expense capital expenditures but no deduction for excess interest expense
- NOL carried forward indefinitely but can only shelter up to 90% of taxable income
- Repeal Federal estate tax (but no mention of repeal of gift tax so it looks like the gift tax will remain)
  - Capital appreciation taxable at death
  - No deduction for gifts to taxpayer's foundation
- Incentives on retirement savings will remain

# Recent Developments - Part I – Effect of Election

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## Alternatives to current estate tax system

- Canadian system – no estate tax but income tax on disposition of asset e.g. sale or gift.
  - Carryover basis at death
  - Could have exemption e.g. Trump's \$10 million exemption
  - There is still a valuation issue
- Eliminate estate tax, no step-up in basis and depend on income tax
- Accessions tax
  - Beneficiary pays the tax
  - Add receipt to income and tax it
  - Key issues dealing with basis and valuation

# Recent Developments - Part I – Effect of Election

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## Aucutt prediction:

- Tax reform will happen by the Congressional August, 2017 recess via reconciliation
- If so, we'll know by May, 2017 what is going on
- Repeal of the Federal estate tax (which produces little revenue) will require political capital that the Republican leadership will want to spend elsewhere. Thus, estate tax will not be repealed.
- Caveat: Aucutt admitted that in the past all his predictions have been wrong. However, given his past erroneous predictions, his chance to be correct this time have increased.

# Recent Developments - Part I – Effect of Election

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**Could have estate tax repeal only to have it come back in 2 years or 4 years**

**Don't want to trigger gift tax given that estate tax may be repealed. Use techniques that don't generate gift tax**

- Thus, GRAT and sales to IDGT are good ideas.
- Use formula clauses, selling a dollar value of units as finally determined for federal gift tax purposes

**What is the most important thing??? Have flexibility in documents**

- For example, have flexible trust protector provision to allow change to cover future tax changes without the need for court intervention

**Bottom line: Nobody knows what will happen**



# Recent Developments - Part II - Basis Consistency

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**Enacted as part of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015**

**New §1014(f) – income tax basis limited to estate tax value**

- Use to determine gain or loss and depreciation

**§1014(f) only applies to property “whose inclusion in the decedent’s gross estate increased the liability for the tax imposed by chapter 11 ... on such estate.”**

**New §6035 – new basis information reporting requirement.**

- No exception similar to that under §1014(f) if estate tax liability is not increased

**Prop. Regs. issued in March, 2016**

# Recent Developments - Part II - Basis Consistency

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## **New §6035 – new basis information reporting requirement.**

### **Requirements:**

- If estate tax return required to be filed under §6018(a), the executor is required to report valuation information to both the recipients (i.e., “each person acquiring any interest in property included in the decedent’s gross estate”) and the IRS
- Does not apply if estate tax return is filed merely to elect portability and not otherwise required to file a return
- Statements must be furnished at the time prescribed in the regulations, but no later than 30 days after the return’s due date, including extensions (or 30 days after the return is filed, if earlier)
- If valuation adjustments are made after the statements are furnished, supplemental statements must be furnished within 30 days of the date of the adjustment

## Recent Developments - Part II - Basis Consistency

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**Caution:** the §6035 information reporting requirement isn't the same as the §1014(f) basis consistency requirement.

**Example:** Estate of decedent meets the filing requirements of §6018. There is no tax due because the estate tax marital deduction or charitable deduction reduces the estate tax to zero.

- §6035 information reporting is required because the filing requirements of §6018 are met
- §1014(f) basis consistency requirement doesn't apply because there is no increase in the estate tax

# Recent Developments - Part II - Basis Consistency

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## **Assets omitted from the estate tax return have a basis of zero**

- Cathy Hughes not sure how this will be resolved

## **§6035 reporting requirement doesn't apply to:**

- Cash
- IRD
- Tangibles not more than \$3,000
- Property sold

# Recent Developments - Part II - Basis Consistency

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## **Penalties for inconsistent reporting**

- §6662 amended to provide that the accuracy related penalties on underpayments under §6662 apply if a taxpayer reports a higher basis than the estate tax value basis that applies under §1014(f)

## **Penalties for failure to provide information returns and statements - §§6721 and 6722**

- Generally \$250 with a maximum penalty for all failures during a calendar year of \$3,000,000
- If failure to furnish the required information return or statement is “due to intentional disregard,” the penalty is \$500, or, if greater, “10 percent of the aggregate amount of the items required to be reported correctly.”

# Recent Developments - Part II - Basis Consistency

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## Effective Date for §1014(f) and §6035

- For returns filed after July 31, 2015
- Due date extended various times – regs confirmed June, 2016 due date for first returns
- Form 8971 – January, 2016 version
  - Final instructions issued October 13, 2016

## Issues:

- Executor may not know 30 days after the estate tax return is filed what assets will pass to particular estate beneficiaries.
- Safe bet – Executor furnishes the valuation information to every estate beneficiary about all estate assets except those receiving only specific bequests
- Must basis information be furnished to recipients of income in respect of a decedent that is not entitled to a basis step-up?
- Obviously, extended guidance needed from the IRS
- Subsequent transfers require reporting by beneficiary to IRS and new beneficiary

# Recent Developments - Part II – State Income Taxation of Trusts

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## **Bank of America, N.A., Trustee v. Commissioner of Revenue, 474 Mass. 702, (2016)**

- Deals with residence of corporate trustee
- Issue is taxation of accumulated income and capital gains
- Massachusetts SJC finds that a corporate trustee will be considered an “inhabitant” of Massachusetts if, upon evaluating the specific facts of each case the corporate trustee:
  - (1) maintains an established presence or place of business in the Commonwealth of Massachusetts for more than 183 days in the taxable year at issue and
  - (2) engages in material trust activities in the Commonwealth of Massachusetts related specifically to the trust or trusts whose tax liability is at issue.

# Recent Developments - Part II – IRS Priority Guidance Plan

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## Guidance IRS plans to issue by June 30:

- Basis of assets in grantor trusts at death – deals with trusts that are grantor trusts for income tax purposes but not included in the gross estate for estate tax purposes
- Valuation of promissory notes for transfer tax purposes
- Gift tax effect of defined value clauses
- Definition of “income” for support trusts under §682
- Deduction in decedent’s estate under §2053 for loan guarantees
- Security for estates electing §6166 treatment – will be complete re-write of regs
- Material participation of trusts and estates



## **Recent Developments - Part II – Woelbing case**

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**Sale of non-voting stock to IDGT, trust had over 10% seed capital, had defined value clause that adjusted number of shares sold based on final gift tax value**

**Settled Mr. Woelbing's case (Mrs. Woelbing's case still open), IRS conceded all penalties and taxes**

**IRS will continue to attack defined value clauses**

**IRS had chance to gut defined value clauses and passed in Woelbing**

**New case in Tax Court against defined value clauses – True v. Commissioner**

# Recent Developments - Part II – FLP cases

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## **Purdue, Holliday and Beyer**

**Issue is whether taxpayer had significant non-tax reasons to set up FLP**

**Case outcome dependent on facts and judge**

**One taxpayer win (Purdue) and two taxpayer losses (Holliday and Beyer)**

### **Reasons for losses:**

- **Lame reason for setting up FLP – no significant non-tax factors**
- **Step transaction – all steps performed together or close in time**
- **Retained interest**
- **Didn't follow formalities**

## **Recent Developments - Part II – Rev. Proc. 2016-49**

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**Addresses the Rev. Proc. 2001-38 issue – invalidates unnecessary QTIP election**

**Rev. Proc. 2016-49 supercedes Rev. Proc. 2001-38**

**Only time the IRS will disregard the QTIP election is when the executor asks it to disregard the QTIP election**

**Can only ask to have it disregarded is if you don't make the portability election**

## **Recent Developments - Part II – Morrissette v. Commissioner**

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### **Intergenerational split dollar life insurance case**

**Mom's revocable trust pays \$29.5 million premium on life insurance policies on sons' lives to fund a buy-sell agreement.**

**Mom's revocable trust had right to receive greater of premium or CSV back when insurance policy pays**

**Mom dies, estate values receivable at \$7.5 million.**

### **Issue is valuation of Mom's receivable**

- Use "economic benefit" regime (which would yield a lower estate tax value) or the "loan regime" (which would yield a higher estate tax value)
- Court grants partial summary judgment to estate and says the "economic benefit" regime is applicable but doesn't decide value

## Recent Developments - Part II – ING Trusts

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**Incomplete non-grantor trust – designed to save state income tax**

**Taxpayer in high tax state transfer assets to a non-grantor trust in a no tax state which is a separate taxpaying entity but is incomplete for gift tax purposes.**

**PLR 201642019 – IRS revokes PLR issued on this issue in 2014**

**PLR 201642019 said §673 applies – potential reversion worth more than 5% so trust is a grantor trust**

- Dealt with reversion if trustees resigned
- §673 has to be interpreted as if maximum power was exercised

## Recent Developments - Part II – GST Modification

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**IRS has suspended ruling on grandfathering of GST exemption where trust is modified**

**Reason: insufficient resources**

**Per Cathy Hughes, this is temporary**

# Recent Developments - Part II – Estate Tax Liens

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## **Procedure to obtain release of estate tax lien changed as of June 1, 2016 and authority to release of estate tax lien transferred from estate and gift tax division to collection division**

- The general estate tax lien arises under §6324(a) on all property includible in the decedent's estate for 10 years.
- The general estate tax lien does not have to be recorded – it is automatic.

## **All sales proceeds must be paid to the IRS or placed with a bonded escrow agent**

## **IRS has issued a revised Form 4422, Application for Certificate Discharging Property Subject to Estate Tax Lien**

**Planning idea: hold the real estate in a LLC – estate tax lien will be on the LLC membership interest (intangible property) and not the real estate.**

# Recent Developments - Part II – Closing Letter

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**Notice 2017-12 – transcript with Code 421 is the equivalent of a closing letter that you can take to probate court or state department of revenue**



## Recent Developments - Part II – Grantor Trusts

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**PLR 201633021 – trust can be grantor of another trust**

**Trust #1 had power to withdraw all income of Trust #2**

**Trust #1 taxed on income of Trust #2 regardless of whether Trust #1 took a distribution from Trust #2**

# Recent Developments - Part II – Charitable Contributions

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**Substantiation for income tax purposes important**

**Numerous cases denying individual income tax charitable deduction for failure to follow the substantiation rules**

**This is hot issue in the conservation easement area – failure to strictly follow the rules for conservation easements result in the loss of the income tax charitable deduction**

- Notice 2017-10 – listed transaction – after 2009 entering into a syndicated partnership involving a conservation easement that offers tax benefits worth more than 2.5 times the partner's investment

# Recent Developments - Part II – Charitable Contributions

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## **Rev. Proc. 2016-42 – IRS permits CRATs to avoid the risk of violating the probability of exhaustion test by a qualified contingency**

- Provides a mechanism by which individuals can create lifetime CRATs after August 8, 2016 despite the present low interest rate environment without violating the 5% probability of exhaustion test of Rev. Rul. 70-452.
- Requires adding a clause that creates a qualified contingency under which the trust terminates during the lifetime of the measuring life and distributes the assets to the charity, if paying the annuity amount would result in a reduction in the value of the trust corpus, when multiplied by a specified discount factor, below 10% of the value of the initial trust corpus, adjusted for inflation based on the §7520 interest rate on the date the trust was created.

# Recent Developments - Part II – Electronic Will

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## Florida Senate Bill S206

**Allow person to execute will online without a lawyer or witnesses. Witness can view execution by Skype or other webcam presence**

**VA, NH and NV also considering similar legislation**

# **Pennell – Placebo Planning**

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**Thinks Republicans will repeal estate and GST tax but will leave the Chapter 14 special valuation rules intact**

**How to pay for repeal – carryover basis or capital gain at death**

**Gift tax will remain to prevent income shifting**

**If we have a carry over basis, the best asset to invest in will be life insurance because of the income tax-free build up during life and the life insurance proceeds are received at death with no built in capital gains tax**

**Pennell thinks the best way to use a \$10 million exemption in a carryover basis regime is to use it against the assets you intend to sell first**

# McCaffrey - GRATs

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**GRATs are her favorite technique due to the ability transfer assets with no gift tax**

**GRAT is good for uncertain economic times because there is no risk of gift tax**

**GRAT is good in low interest rate environment because it is more likely the return will beat the §7520 rate**

## **Three keys for successful GRAT:**

- Drafting
- Funding
- Administration

# McCaffrey - GRATs

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## Drafting

- Comply with statutory rules
- Problem: timely payment not made
  - Solution: have clause that if payment not timely made a portion of the GRAT equal to the amount needed to be paid to the grantor will terminate and be paid to the grantor
- Problem: inadvertent additions
  - Solution: have clause that inadvertent addition comes out of the GRAT and is added to a new GRAT
- Problem: valuation risk – funded with hard to value assets
  - Solution: define annuity by formula – define annuity amount as the amount to reduce gift to zero

# McCaffrey - GRATs

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## Drafting

- Problem: mortality risk
  - Amount included in estate is annuity amount/§7520 rate at death
  - Solution: use short term GRATs
  - Solution: for married grantors, pay on death to trust that qualifies for the marital deduction
    - If annuity payments go to surviving spouse and remainder passes to someone else, terminable interest rule is violated. Want the interest to qualify for the marital deduction, Instead, have grantor retain power of appointment over remainder interest to extent included in gross estate and exercise in favor of surviving spouse and bequeath annuity interest to spouse as well. If a marital deduction trust is used, a clause is needed that says if spouse survives, trustee must pay all income to the spouse even if it exceeds the annuity amount.



# McCaffrey - GRATs

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## Funding

- Use multiple GRATs for multiple asset classes
- Fund with fractional interests to reduce the value of the gift
- Fund with leveraged assets e.g. put asset in LLC worth \$1 million and take back a \$900,000 note. Transfer LLC into GRAT. Annuity payments based on equity which may be covered by cash flow of entity
- Fund with preferred interest
  - Use high yield preferred interests

# McCaffrey - GRATs

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## Administration

- Make sure somebody is responsible for reviewing operation of GRAT from time to time
- If GRAT not performing well, have grantor buy back assets in GRAT
  - You can use a note
  - No income tax consequences since GRAT is a grantor trust
  - Re-GRAT because now the value of the asset is lower
- If GRAT does well, lock in appreciation
  - Purchase asset and substitute a note

# McCaffrey - GRATs

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## Administration

- How to protect GRAT from GST?
  - Avoid drafting so that on termination it goes to grantor's issue per stirpes – will be taxable termination
  - Shift identity of transferor to next generation
    - Give beneficiary a GPOA exercisable by will. If beneficiary exercises power in favor of a trust for her issue, transferor changes to beneficiary – 2 conflicting PLRs on this technique – IRS says beneficiary has exercised the power only to the extent of beneficiary's proportional interest in the trust
  - Sale by remainder beneficiary to a trust exempt from the GST tax
    - Not a taxable termination but merely a change in an investment in the GST exempt trust

# Hoyt – Retirement Plans

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## **Prediction – Senate will kill stretch IRA – limit payout to 5 years**

- Exceptions – stretch IRA still available for:
  - Surviving spouse
  - Disabled beneficiary
  - Minor child up to age 21
  - Someone within 10 years of IRA owner's age

## **New development on 60 day rollover – Rev. Proc. 2016-47**

- Can self-certify that late rollover is permissible
- Must meet one of 11 reasons
- Don't need to do expensive PLR

# Hoyt – Retirement Plans

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## **PLR 201623001 - Community property and IRA**

- Child named as beneficiary of IRA
- §408 says section must be applied without regard to community property laws
- Widow can't claim her community property interest and roll to a rollover IRA
- If child assigns to widow, treated as distribution to child

# Rothschild – Asset Protection

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## Asset protection techniques:

- Transfer assets to spouse
  - Divorce risk
- Transfer assets to irrevocable spendthrift trust
  - UTC §502(c) validates spendthrift clauses
- Transfer assets to DAPT
  - 16 states have DAPTs plus Michigan latter this year
- Transfer assets to support trust
  - Distributions can only be made for support
  - Only appropriate when grantor doesn't want to give trustee discretion
- Transfer assets to SLAT
  - Problem: spouses get divorced or beneficiary spouse dies
- Inter vivos QTIP
  - Some states (e.g. Florida) have enacted statute that inter vivos QTIP s not considered a self-settled trust

# Rothschild – Asset Protection

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## Suggestion in drafting asset protection trust

- Discretionary distributions
  - Say trustee “may” distribute, not “shall” distribute
  - Not subject to ascertainable standard
  - Avoid powers of withdrawal
  - Draft so that trustee can make distributions for the benefit of the beneficiary but not directly to the beneficiary
  - Make loans rather than distributions to beneficiary
  - Provide that attempted attachment by creditor eliminates beneficiary’s rights
- Independent trustee
- Multiple beneficiaries
  - Include beneficiary’s spouse – if beneficiary has creditor problems, can make discretionary distributions to beneficiary’s spouse
- Open class
- Long term trust
  - To avoid beneficiary getting an outright distribution on termination
  - Could acquire beneficiary’s assets e.g. home, business interest
- Give trustee power to remove beneficiary
- Give someone power of appointment to remove beneficiary as potential distributee

# Rothschild – Asset Protection

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## Other techniques:

- Tenancy by the entirety
  - Cannot be partitioned during marriage unless both spouses agree
  - Tenancy in common, community property and joint tenancy do not have asset protection features
  - Risk – death or divorce causes protection to be lost
- SPOA – not available to creditors
- GPOA – in most states until the power is exercised, it is not available to creditors
- Homestead – see state law for amount of exemption
- Qualified plans – not subject to creditor's claims – federal law governs
- IRA – state law governs



# Angkatavaich – Preferred Partnership Freezes

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**Preferred partnership is splitting an entity into different economic pieces - a preferred frozen interest and a common growth interest**

**This is a different variation of other freeze techniques like a GRAT or a sale to an IDGT**

**If Trump repeals the estate tax and imposes a capital gain at death, there is still a need for freeze planning to shift value away from the older generation's estate**

# **Wolven – Helping Trustees Avoid Pitfalls in Common Transactions**

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**Discussed following liability issued for trustee in the following areas”**

- Loans to beneficiaries
- Concentrated position
- Real estate

# Wolven – Helping Trustees Avoid Pitfalls in Common Transactions

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## Make loan to beneficiary rather than distribution

### Reason to make loan

- Beneficiary is income only beneficiary with no rights to principal and income goes down
- Don't want to upset other beneficiaries who are not getting a distribution
- Beneficiary might have taxable estate and distribution would increase his taxable estate
- Want beneficiary to have some skin in the game e.g. beneficiary wants distribution to buy a house or start a business so make him take a loan instead

# Wolven – Helping Trustees Avoid Pitfalls in Common Transactions

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## Loans are a trust investment

- Interest rate at AFR may be lower than market rate of return
- Must charge interest to avoid OID rules
- Does the trust allow a loan?
- Will loan cause a concentration of assets? Does trust allow concentrated position?
- When trust terminates can you charge the loan against the beneficiary's interest in the trust? Spendthrift clause may prevent the trustee from charging loan against the beneficiary's share
- What are the trust instrument's requirements to make a loan?
- Must loan be secured, how much interest should be charged, do you need UCC filing to protect trustee's interest?
- Will trustee be willing to enforce repayment? Can trustee seize the collateral?
- Make sure to document the loan especially the authority in the trust document to make the loan
- Have a default provision in the loan document i.e. what is a default and how do you cure a default

# Wolven – Helping Trustees Avoid Pitfalls in Common Transactions

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## Concentrated position

- A retention clause in the trust doesn't excuse the trustee from not monitoring the stock
- If you have a family business in a trust and there is an independent trustee with another person heading a family business, make sure the trustee can get information on the family business.
  - Otherwise person running the family business could keep the information on the family business to himself and not give it to the trustee
  - Consider allowing trustee to suspend distributions if information is not disclosed

# Wolven – Helping Trustees Avoid Pitfalls in Common Transactions

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## **Real estate**

- Seek expertise in managing real estate
- Develop a plan to manage the real estate

# Pennell and Cohen – Non-Tax Developments

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## Beneficiary's interest in revocable inter vivos trust

- UTC §603 says revocable trust is the functional equivalent of a will. Thus, while the settlor is alive, the trustee's duties run solely to the settlor and the non-settlor beneficiaries have no right to information about the trust or accountings.
- UTC §813 duty to inform and report to beneficiaries is suspended while the settlor is alive. Beneficiaries have no standing.

# Pennell and Cohen – Non-Tax Developments

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## **Binding arbitration provisions in contracts of long term care facilities**

- Department of Health and Human Services says these provisions are contracts of adhesion and will not be enforced
- Result: facility will forfeit Medicare and Medicaid benefits



# Pennell and Cohen – Non-Tax Developments

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## Elective share – what constitutes the “augmented estate”

- Beneficiary designations not included in “augmented estate”
- Can spouse share in appreciation of assets?
  - Depends on whether the elective share is defined as a pecuniary amount (entitled to interest only) or fractional amount (entitled to appreciation)

# **Bjorklund – U.S. Donations Abroad**

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**Discussion of how U.S. persons can structure gifts to foreign charities. Law in this area is 50 years old**

**General rule: for income tax purposes, a charitable deduction is only allowed for contributions to a U.S. charity. Estate tax rule is different**

- Avoid “conduit” organizations – organizations that simply give donation to a foreign charity
- Solution: “American Friends of” organizations – this is how you avoid “conduit” problem
- Canada, Mexico and Israel are the only countries that have a treaty with the U.S. with provisions dealing with a charitable deduction

**Issue: How can charitable contributions be made to foreign charities?**

# **Bjorklund – U.S. Donations Abroad**

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**Problem – if mistake made, donor loses charitable deduction and charity may lose exemption**

**Post 9/11 big changes in non-tax aspect of international charitable giving e.g. Patriot Act, Office of Foreign Asset Control (OFAC), Financial Action Task Force (FATF)**

**Charity Security Network (CSN) – formed to help charitable organizations share information and work with IRS and Financial Action Task Force. In November, 2016 helped get FATF to get charities off list to make wire transfers easier**

# Bjorklund – U.S. Donations Abroad

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## Two key revenue rulings issued in the 1960's

- Rev. Rul. 63-252
  - U.S. entity forms foreign subsidiary
- Rev. Rul. 66-79
  - Roadmap for international grant making
  - Also guideline for IRS audits

# Bjorklund – U.S. Donations Abroad

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## **Rev. Rul. 66-79 – Four requirements:**

- Control and discretion over donations coming in and going out by a U. S. board of directors
- Pre-approval by U.S. board of directors as being in furtherance of U.S. entity's purpose
- Retains right to withdraw funds and apply to different project
- Majority of board of directors must be U.S. citizens or residents

# Bjorklund – U.S. Donations Abroad

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## Funding procedures

- U.S. organizations should fund specific projects and not just send funds
- Not advisable to send funds for general operating support
  - Can't tell what the funds are being used for – may be used for terrorist support

# Bjorklund – U.S. Donations Abroad

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## **Earmarking funds – donor irrevocably earmarks funding for a particular purpose**

- May conflict with control by U.S. board of directors
- Solution: ask the “American Friends of” organization in writing whether a grant they intend to make for a project could be pre-approved before the donor makes the grant.

# Bjorklund – U.S. Donations Abroad

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## Suggestion

- Use an organization that already has the infrastructure to properly administer the requirements
- Use donor advised fund with worldwide network



# Bjorklund – U.S. Donations Abroad

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**Caution – may see foreign grant making curtailed under the Trump administration**

# Graham – Foreign Ownership of U.S. Assets

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**Review of U.S. estate and gift tax law as it applies to foreigners**

**Discussed importance of intake procedure for financial institutions due to Financial Action Task Force, Patriot Act, Bank Secrecy Act etc.**

- Must file transaction report if money laundering suspected but can't tip off account owner

**Pointed out that common law countries may have an estate tax (estate pays the tax) whereas civil law countries have an inheritance tax (beneficiary pays the tax)**

- If asset is located in a common law country which passes to a beneficiary in a civil law country, estate and beneficiary may both have to pay a tax on the same asset.

# Graham – Foreign Ownership of U.S. Assets

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**Discussed citizenship for estate tax and income tax purposes – test not the same**

**Income tax – substantial presence test – in U.S. for 183 days based on a look-back calculation**

**Estate tax – 2 prong test:**

- Time spent in U.S.
- Intent to remain in U.S. indefinitely

# Graham – Foreign Ownership of U.S. Assets

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## Estate tax

**U.S. resident - \$5,490,000 exemption**

**Non-U.S. resident - \$60,000 exemption (not inflation adjusted) but taxed only on U.S. situs asset**

- Real estate located in U.S.
- Stock in U.S. company – even if never come to U.S., a stock in a U.S. company is subject to federal estate tax
  - Financial institution will freeze asset until they get a transfer certificate
- Personal property located in U.S.

# Graham – Foreign Ownership of U.S. Assets

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## Gift tax

### **Intangibles are not U.S. situs assets**

- Planning opportunity: give stock away – if die with stock, will be subject to FET
- If gift made by foreign person to U.S. person, file Form 3520

### **Real estate located in U.S. subject to gift tax**

**\$14,000 annual exclusion**

**No lifetime exemption**

**\$149,000 exclusion for gift to NRA spouse**

## Recent Developments – Q & A

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**CCA 201651013 – trust modified by lower state court order giving beneficiary power of appointment and beneficiary appointed to charity – IRS says not entitled to §642(c) deduction as the modification is not part of the governing instrument**

- When beneficiary exercised power of appointment in favor of charity, IRS said it wasn't made "pursuant to the governing instrument"
- Amy Heller thinks the CCA is wrong as the power of appointment is part of the governing instrument

# Recent Developments – Q & A

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## **Basis consistency**

- Zero basis for asset omitted from estate tax return
- Punishing beneficiary for omission by the executor
- Beneficiary could have claim against the executor

# Recent Developments – Q & A

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## Notice 2017-12 - New procedure for release of federal estate tax lien

- New Form 4422
- Moved process for getting discharge from examining agent to collections division
- Issue arises in sale of real estate
- Must either have proceeds deposited with IRS or bonded escrow agent
- To get funds released you have to show a closing letter. Notice 2017-12 says account transcript with code 421 is a substitute for a closing letter
- Solution: put real estate in single member LLC – sell in LLC – the lien applies to the LLC not the real estate



# Concurrent Session – Managing Inherited Art

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**Estate of Newberger v. Commissioner – Tax Court recognized that appraisals with date of death FMV based on sale price from sales on dates other than the date of death need to be adjusted for changes in the art market**

**Allbritton v. United States - can you give art away and rent it back and keep it on the walls of your house?**

- IRS alleges corporate owned artwork in residences used by owner of corporation should be treated as distribution to owner of corporation.

# Concurrent Session – Managing Inherited Art

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## Sale and use tax issue

- New York investigation of art transactions regarding the sale and use tax compliance
- Investigating under the False Claims Act which allows state to look back 10 years

# Concurrent Session – Managing Inherited Art

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## Sale and use tax issue

- Fine art shippers – subject to NY sales tax because fine art shippers are not common carriers. They are the buyer's agents. When they come into NY to pick up art, they are subject to NY sales tax
- Planning tip: make sure sellers are arranging shipping and not the buyer
- Example: Art sold for \$142 million. If buyer accepted in New York, \$12 million sales tax. To avoid, buyer accepted outside of New York.
  - It is important to consider where art is accepted

# Concurrent Session – Managing Inherited Art

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## Considerations for donating art to museum

- Does donation align with mission of the museum
- Is the museum interest in the art
- Are there similar works
- Museum may ask for cash donation to support maintenance of the gift
- Recommend to board of trustees to accept/reject
- Restrictions on gifts is subject to negotiation
  - Museums are strict on restrictions – they don't want to accept work with restrictions unless it is a work they really want

# Concurrent Session – Managing Inherited Art

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## Tips on selling:

- Be informed collector and know value of what you have. Keep good records.
- Store in a way to ensure retention of value e.g. climate control
- Get a trusted advisor
- Sell private or at auction
- When you sell is just as important as where you sell
- Make sure you are not competing with other works when you sell
- Sell in year you also make charitable gift of art – can use charitable deduction to lower the capital gain tax due on the sale

# Concurrent Session – Managing Inherited Art

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## Reason valuation is important:

- Gift tax – establish value as of date of gift
- Collateral for loan – generally, maximum lenders will lend is 50% of FMV
- Family transfers
- Estate tax value
- FMV should include buyer's premium

# Concurrent Session – Managing Inherited Art

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## Executor's role:

- Inspect and understand what decedent has
- Guard against theft
- Get and secure records, old catalogues
- Check to see if art is stolen

# Concurrent Session – Managing Inherited Art

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## Surprising fact

- No tax reporting in the art market



# **Concurrent Session – Charitable Gifts of Business Interests**

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**Make gift of closely held business interest to a donor advised fund rather than a private foundation so you can get FMV deduction**

**Issue: does restricted stock constitute “qualified appreciated stock”? There are a number of PLR. Generally, must be able to sell stock.**

**Substantiation – if donor makes charitable gift to his own private foundation, he still must substantiate the gift i.e. send himself a contemporaneous written acknowledgement**

**Self-dealing rules of private foundations do not depend on the reasonableness of the transaction – they depend on the relationship of the parties i.e. whether the person is a “disqualified person”**

# Concurrent Session – Charitable Gifts of Business Interests

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## Charity wants exit strategy for gift of closely held business interest

- Usually done as a redemption. If charity has binding obligation to sell back to company, gain will be attributed to the donor
- In case of a public charity, they can redeem for a promissory note. However, a private foundation cannot redeem for a promissory note (self-dealing)

# Rothschild – Private Foundations

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**Outline and lecture are an excellent summary of the basic rules applicable to private foundations**

**To avoid the 2% excise tax on net investment income, give appreciated stock rather than cash to satisfy grants - avoid tax on gain**

**Doesn't make sense to accelerate grants to reduce excise tax on net investment income from 2% to 1%**

**Private foundation should maintain a list of “disqualified persons”**

# **Willms – Income and Transfer Tax Issues Every Fiduciary Should Know**

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**31 U.S.C. §3713 – executor’s personal liability for taxes**

**Notice of Fiduciary Relationship (Form 56), Request for Prompt Assessment (Form 4810), Request from Personal Liability (Form 5495)**

**Bosch case – IRS only required to follow decision of state’s highest court and only give “proper regard” to lower state courts**

**Review of basic rules of fiduciary income taxation**

– Expenses that benefit beneficiary are not a deductible administration expense e.g. selling estate’s collection of memorabilia for benefit of beneficiary who lived in one room subsidized apartment

**Gift tax issues in settlements**

– Redstone case provides roadmap for how to avoid taxable gift

# Nenno – State Income Taxation of Trusts

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**One or more factors used by states to justify state taxation of trust income:**

- Residence of grantor
- Residence of trustee
- Residence of beneficiary
- Place of administration

# Nenno – State Income Taxation of Trusts

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**New York will not tax the income of a trust where there are no New York trustees, no New York assets and no New York source income. N.Y. Comp. Codes R. & Regs. Tit. 20 §105.23(c).**

- \$1 of New York source income may cause the safe harbor to be inapplicable

# Nenno – State Income Taxation of Trusts

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## Recent changes to New York law regarding income taxation of trusts:

- Effective January 1, 2010, new and existing Nonresident Trusts must file informational returns. N.Y. TSB-A-11(4)l.
- For tax years beginning on or after January 1, 2014, an accumulation or “throwback tax” may now be imposed on certain distributions received by a New York resident beneficiary.
- ING trusts (an incomplete gift non-grantor trust created by a New York resident in another state to avoid New York state income tax without incurring federal gift tax liability) are exempted from the accumulation tax. However, for tax years beginning on or after January 1, 2014, an ING trust will be treated as a defective grantor trust for New York income tax purposes, taxable to the grantor, unless the trust was terminated prior to June 1, 2014.

# Concurrent Session – Estate Planning for Corporate Executives

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## §409A non-qualified deferred compensation plans

### Employee sanctions If rules not complied with:

- Income recognition
- Penalties 20%
- Interest



# Concurrent Session – Estate Planning for Corporate Executives

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## What is and is not covered by §409A:

- Restricted stock – NO - §83 governs
- Phantom stock plan – YES
- Non-qualified stock options – NO (if price is FMV at time of grant)
- Stock appreciation rights – NO (if price is FMV at time of grant)
- Split dollar – NO (non-equity split dollar), YES (equity split dollar)
- Carried interest – capital interest v. profits interest
- Restricted stock *units* - YES

# Concurrent Session – Estate Planning for Corporate Executives

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## Session discussed:

- §409A
  - Rev. Rul. 2017-3 – IRS will not rule on §409A
- Non-qualified stock options
- Split dollar life insurance – 2 regimes:
  - Economic benefit regime (most common)
  - Loan regime (less common)
- Carried interests
- §457 plans – deferred compensation for tax-exempt organizations
  - §457(b) plans exempt from §409A but §457(f) plans subject to §409A
- Private derivatives
- Application of securities laws to executive compensation
  - Focused in §16(b) – short swing profits

# Concurrent Session – Estate Planning for Corporate Executives

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## **§457A - 2017 recognition of pre-2009 deferred management or incentive fees earned by hedge fund managers of offshore funds**

- Consider the use of a grantor charitable lead trust to offset the recognition of income with an income tax charitable deduction

# Harrison – Wrap Up Session

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## Tax planning opportunities in the current environment:

- Grantor trust planning – most important
- GRATs are the number one strategy
  - Woelbing case settled in taxpayer’s favor
  - Caution: True case still being litigated in Tax Court
- Sales to IDGT
- §2701 preferred partnerships
- Shifting low basis assets
- Domicile planning to avoid state estate and state income taxes
- Charitable lead trusts

## Harrison – Wrap Up Session

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**Clients don't want or care how much a lawyer knows. They want to know how much you care.”**

Thank you!

# Disclosure Appendix

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