Happy New Year to all Section members! It appears that 2018 will be a dynamic year for all of us beginning with the new federal tax law, “Tax Cuts and Jobs Act,” signed by the President into law on Dec. 22, 2017 that kicked in on Jan. 1, 2018 and the new Power of Attorney Act, N.C.G.S. Chapter 32C.

Our winter Section Council meeting was held via conference call due to “snowmageddon” on Jan. 17, 2018. Our Section authorized two additional scholarships for Continuing Legal Education (CLE) held in Feb. 2018 for the Basics of Will Drafting and Estate Administration classes. These scholarships are new and in addition to the scholarships that will be offered for our Annual Meeting held in July 2018. Be on the lookout for the scholarship information for the Annual Meeting to be held at Kiawah Island, July 26 through 28, 2018.

The Ad Hoc Committee continues to plan and coordinate all issues related to the Annual Meeting and CLE at Kiawah. Our sponsors are amazing and continue to surprise us annually with their dedication to the Annual Meeting. The committee’s goal is to increase the quality of the breakfast offerings. We are working with the NCBA CLE department to make this happen. We also are focused on keeping our tuition low and continuing to amaze our members with quality of the CLE and the other events.

The Legislative Committee members are furiously drafting legislation for the 2018 Short

In what has been heralded by one side of the political aisle as an extraordinary opportunity to fix a broken tax system and criticized by the other as a hastened effort that only added to its complexity and the benefits provided to special interest groups, Congress passed what is informally known as The Tax Cuts and Jobs Act (the "Act") on Dec. 20, 2017, and the President officially made it the most impactful tax legislation reforming the Internal Revenue Code (the “Code” or “IRC”) enacted in over 30 years on Dec. 22, 2017. As estate and tax planners, regardless of where any personal views fall as to the propriety and ultimate efficacy of the Act to achieve its intended purpose, the reality is that we now face the task of advising individual clients how best to handle their personal affairs in a tax-efficient manner going forward under the Act. This article attempts to identify significant items of note for individual taxpayers and provide some observations on the Act’s impact on estate and tax planning as we move ahead.

Preliminary Considerations

Before delving into the substance of the Act, however, it is important to note certain principles that advisors should keep in mind when evaluating its details and the effect it will have on taxpayers.

The Byrd Rule and Continuing Political Uncertainty

The end of 2017 witnessed a feverish back-and-forth between the House of Representatives and Senate, with bills introduced by both houses ushered through committees and votes on their respective floors at an unprecedented pace. In the end, the terms of the Senate bill largely prevailed because of the more stringent requirements imposed upon it by the so-called “Byrd Rule,” which requires that legislation be revenue-neutral if it is not to be passed by a supermajority of 60 votes. This limitation was relaxed somewhat by a Senate budget resolution passed to allow for any tax reform to cost up to $1.5 trillion based on a “scoring” of its costs and “revenue raisers,” but even with that additional flexibility, Republicans in Congress still had to choose the portions of their tax reform agenda to prioritize at the expense of others.

The political rhetoric surrounding the Act promised tax breaks for both individuals and businesses alike, but in an effort to shore up sufficient room within these Senate budgetary constraints and allow the Act to be passed by the only politically feasible option of a simple majority, many of the individual tax breaks are made temporary—generally sunsetting back to their current forms after 2025—while most of the tax breaks afforded to businesses are made permanent, with a notable

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exception being the new Code Section 199A deduction for 20% of certain business income generated by pass-through entities, which also sunsets after 2025. Republicans have deflected criticism for this distinction, and the implied favoritism of businesses over individual Americans, by responding that the individual taxpayer benefits would almost assuredly be extended by a future Congress. For purposes of this article, focused on taxes imposed on individuals, the provisions of the Act described can be assumed to be applicable only for taxable years beginning after Dec. 31, 2017 and before Jan. 1, 2026.

In any event, the scheduled sunset dates have to be accounted for in adapting to changes brought about by the Act. Any or all of the reforms under the Act could fail to be extended, if they are to sunset, or even be repealed earlier by a future Congress, especially in light of the partisan nature of the legislation and the general political atmosphere. Only time will tell, but in the interim taxpayers and advisors should understand that any tax planning done in response to the Act may need to be reevaluated, altered, or, at the most extreme, reversed based on changes in political winds. The most effective tax planning, therefore, will involve measures a taxpayer can live with even if the tax benefits from the planning change, for one reason or another, in the future.

Forthcoming Technical Amendments and Regulations

The speed with which the Act was drafted and passed left much to be desired in its clarity and details in some places. In other places, the Act simply places responsibility on Treasury to issue clarifying Regulations, which could take some time, if the past is any indication and especially in light of the funding challenges facing the Internal Revenue Service. No matter what, the terms of the Act in some cases will prove frustrating to taxpayers and advisors who value the comfort of certainty.

An additional layer of complexity is added with technical corrections to the Act that will be required, as those will not fall within the confines of budgetary legislation in the Senate and therefore will require a supermajority vote. Given the current political climate between Republicans and Democrats, any legislation could easily fall victim to partisanship and be stalled by Congressional Democrats. Taxpayers and advisors are therefore faced with the additional challenge of navigating certain portions of the Act, based on the best available information to them at the time, to deal with what appears will be ongoing uncertainty for quite some time.

Inflation Adjustments

Adjustments for inflation are now generally being calculated using the Chained Consumer Price Index (CPI) for All Urban Consumers (C-CPI-U) (“chained CPI”) in place of regular CPI adjustments, and this is made permanent regardless of whether it is applied to tax brackets, exemption amounts, or deductions that otherwise sunset. The key difference between a chained CPI calculation and the regular CPI calculation no longer used is that chained CPI accounts for changes in a consumer’s habits as a result of rising prices in certain goods and resulting substitutions the consumer may make. This manner in which adjustments to inflation are now calculated means that inflation is determined to move more slowly and, as a consequence, base amounts included in the Act subject to adjustment will also increase more slowly than they would under the prior adjustments. The net effect, therefore, is that in many cases taxpayers, whose income presumably will appreciate at rates faster than the rate of the chained CPI adjustments, will “creep” into higher tax brackets and exemption amounts and slowly become phased out from, or subject to limitations on, benefits they might be entitled to at the outset of the Act. References in this article to inflation adjustments can be assumed to use this methodology, unless otherwise indicated. Note, however, that certain inflation adjustments which are retroactive to a date prior to the advent of chained CPI under the Act are adjusted using standard CPI for the period between the beginning date for the base amount and the date on which chained CPI adjustments begin under the Act.

Individual Income Tax Brackets, Personal Exemptions, Standard Deductions, and Child Care Credits

As a starting point, individual taxpayers are now subject to seven income tax brackets for ordinary income ranging from a 10% rate up to a 37% rate for income exceeding $600,000 for married taxpayers (assumed for this article to be married taxpayers filing joint returns) and $500,000 for unmarried taxpayers (assumed to be taxpayers who are not surviving spouses or filing with head of household status). IRC § 1(j). The brackets are as follows for taxable income of married and unmarried taxpayers:

<table>
<thead>
<tr>
<th>Income Level</th>
<th>Married Brackets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income not over $19,050</td>
<td>10% of income</td>
</tr>
<tr>
<td>Income over $19,050 but not over $77,400</td>
<td>$1,905 plus 12% of the excess over $19,050</td>
</tr>
<tr>
<td>Income over $77,400 but not over $165,000</td>
<td>$8,907 plus 22% of the excess over $77,400</td>
</tr>
<tr>
<td>Income over $165,000 but not over $315,000</td>
<td>$28,179 plus 24% of the excess over $165,000</td>
</tr>
<tr>
<td>Income over $315,000 but not over $400,000</td>
<td>$64,179 plus 32% of the excess over $315,000</td>
</tr>
<tr>
<td>Income over $400,000 but not over $600,000</td>
<td>$91,379 plus 35% of the excess over $400,000</td>
</tr>
<tr>
<td>Income over $600,000</td>
<td>$161,379 plus 37% of the excess over $600,000</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Income Level</th>
<th>Unmarried Brackets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income not over $9,525</td>
<td>10% of income</td>
</tr>
<tr>
<td>Income over $9,525 but not over $38,700</td>
<td>$952.50 plus 12% of the excess over $9,525</td>
</tr>
<tr>
<td>Income over $38,700 but not over $82,500</td>
<td>$4,453.50 plus 22% of the excess over $38,700</td>
</tr>
<tr>
<td>Income over $82,500 but not over $157,500</td>
<td>$14,089.50 plus 24% of the excess over $82,500</td>
</tr>
<tr>
<td>Income over $157,500 but not over $200,000</td>
<td>$32,089.50 plus 32% of the excess over $157,500</td>
</tr>
<tr>
<td>Income over $200,000 but not over $500,000</td>
<td>$45,689.50 plus 35% of the excess over $200,000</td>
</tr>
<tr>
<td>Income over $500,000</td>
<td>$150,689.50 plus 37% of the excess over $500,000</td>
</tr>
</tbody>
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This generally results in more compressed tax brackets, a corresponding drop in the effective tax rate imposed on individual taxpayers, and the “marriage penalty” becoming relevant only for married taxpayers falling in the highest bracket. With some very minor modifications to a few bracket levels, the long-term capital gains brackets and the resulting rates applicable for qualified dividends otherwise remain the same. IRC §§ 1(j)(5); 1(h)(11)(A). All individual income tax brackets under the Act, as well as the permanent brackets returning after the sunset, are to be adjusted for inflation. IRC §§ 1(j)(3)(B); -(f)(2)(A).

Individual taxpayers will be entitled to a standard deduction of $24,000 for married taxpayers and $12,000 for unmarried taxpayers, in each case also adjusted for inflation. IRC § 63(c)(7). Individual taxpayers will no longer be able to deduct personal exemptions for themselves and their dependents, but the child tax credit, although not adjusted for inflation, is doubled to $2,000 per child, includes $500 for certain other dependents, and has higher thresholds for a phase-out at $400,000 for a married taxpayer and $200,000 for an unmarried taxpayer. IRC §§ 151(d)(5); 24(h)(2); -(3); -(4)(A).

The “kiddie tax,” applying to any child under the age of 18 or with “earned income” of less than half of what is necessary for the child’s support and who is either the age of 19 or a student under the age of 24, is also modified so that unearned income of a child above a nominal threshold is taxed at rates commensurate with the rates applicable to trusts and estates, resulting in that income being subject to a higher effective rate than would otherwise be applicable to the child’s parents under prior law. IRC §§ 1(g)(2)(A); -(j)(4).

The Net Investment Income Tax (NIIT), imposing a 3.8% surtax on net investment income, remains in place. The threshold amounts for the tax to begin at $250,000 for married couples and $200,000 for single taxpayers also remain the same.

Income Tax Deductions

Aside from lower income tax rates, most taxpayers will experience the largest effect on their tax liabilities as the result of changes to their ability to take itemized deductions from expenses for which they have become accustomed to receiving a tax benefit. This and other changes under the Act will encourage taxpayers to alter their personal affairs going forward.

Miscellaneous Itemized Deductions

As a tradeoff to the higher standard deduction, miscellaneous itemized deductions previously subject to a floor of 2% of adjusted gross income are suspended, meaning that a multitude of expenses previously relied upon by many taxpayers to offset their income no longer provide a tax benefit, although one item of note is that the miscellaneous itemized deduction for estate tax paid on income in respect of a decedent (IRD) is not subject to the 2% floor and, therefore, not suspended. IRC § 67(g). Consistent with the suspension of miscellaneous itemized deductions subject to the 2% floor, the Pease limitation applicable to higher income taxpayers, causing the phase-out of certain deductions above certain income thresholds, is also suspended. IRC § 68(f).

State and Local Tax Deductions

The limitation imposed on deductions for state and local taxes (SALT) in the form of property, sales, and income taxes has become one of the most controversial and publicized aspects of the Act because of its disproportionate effect on residents of certain states over others. A taxpayer’s deductions for state and local taxes not attributable to a trade or business or the production of income are now capped at $10,000 for both married and unmarried taxpayers, with that limitation not adjusted for inflation. IRC § 164(b)(6).

After passage of the Act, many states experienced a rush of residents attempting to pay 2018 property taxes prior to 2017 year-end in an effort to be able to deduct those amounts on their 2017 returns. The IRS, in response, issued guidance in the form of IR-2017-210 distinguishing between 2018 property taxes which had been assessed as of the time of payment, in which case the deduction would be allowed, and those which had not yet been assessed, in which case the deduction for prepayment would be disallowed. Advisors quickly began to identify inconsistencies between the advisory and the plain terms of the statute, however, so the deductibility of any such payments remains unclear. Certain states are exploring alternate means of taxation that would be less detrimental to its residents, such as a tax on employers for wages paid, which would be deductible as a business expense, or a charitable contribution to the state, able to be deducted by a resident, followed by the issuance of a state income tax credit. States have also considered bringing legal challenges to the constitutionality of the Act’s effect on state income taxes.

Mortgage Interest Deduction

The mortgage interest deduction is modified so that interest may only be deducted on new indebtedness secured by a personal residence of up to $750,000 for a married taxpayer and $375,000 for an unmarried taxpayer (down from $1,000,000 and $500,000, respectively), with interest on existing indebtedness for the purchase of a personal residence on or before Dec. 15, 2017 (or as a result of a binding contract in effect at that time that meets certain other requirements) being allowed as a deduction under the previous higher limitations. IRC § 163(h)(3)(F)(i) (II)–(IV). Deductions for interest paid on a home equity line of credit (HELOC) are now disallowed except in the case of HELOC loans used to acquire, construct, or substantially improve a residence. IRC §§ 163(h)(3)(B); -(F)(i)(I).

Charitable Deduction

With the significantly increased standard deduction reducing the number of taxpayers who itemize deductions and, therefore, benefit from taking a charitable deduction, those impacted taxpayers may be discouraged from making charitable contributions. However, the ability to make large cash charitable contributions to qualifying organizations, including public charities, has improved by raising the limit of cash contributions able to be deducted in a single year to 60%, as compared to 50% previously, of a taxpayer’s adjusted gross income. IRC § 170(b)(1)(G). Any contribution which becomes subject to the limitation and therefore is not deductible in a particular year must be carried forward up to 5 years and be applied against the taxpayer’s adjusted gross income limitation in each succeeding year. IRC § 170(b)(1)(G)(ii).

Alimony Payments

Payments of alimony are disallowed as a deduction to the payor and, as a result, no longer reportable as income to the payee,
for divorce or separation instruments entered into after Dec. 31, 2018 or any preexisting divorce or separation agreements modified after that time if the modification expressly provides that the new rules are to apply. § 11051 of the Act. Relatedly, the payee no longer must consider alimony payments as compensation for purposes of retirement account contribution deductions. § 11051(b)(5)(C) of the Act (striking the third sentence of IRC § 219(f)(1)).

Other Deductions of Note

In addition to the deductions discussed above in more detail, there are also changes to the adjusted gross income floor applicable to the deduction available for medical expenses under IRC Section 213 (reduced from 10% to 7.5% for 2017 and 2018), the ability to deduct personal casualty losses under IRC Section 165(h) (limited to losses from federally declared disasters from 2018 to 2025), the exclusion available for qualified moving expense reimbursement under IRC Section 132(a)(6) (suspended from 2018 to 2025 except in the case of armed service members), and the ability to deduct moving expenses under IRC Section 217(a) (suspended from 2018 to 2025).

Roth Contributions and Recharacterizations

A Roth recharacterization, whereby a traditional individual retirement account (IRA) is converted into a Roth IRA and, depending upon the performance of the assets in the converted account, recharacterized back to a traditional IRA if the assets underperform, is no longer allowed, although the IRS has indicated that conversions entered into in 2017 may still be recharacterized within the permissible period. IRC § 408A(d)(6)(B)(iii).

A regular contribution to a Roth IRA can still, however, be recharacterized to a traditional IRA. Based on indications included in the Conference Committee Report to the Act, a “backdoor” Roth IRA contribution is also now sanctioned after previous uncertainty as to whether it could be challenged under the step transaction doctrine.

529 Accounts and ABLE Accounts

529 accounts, which allow for funds to be invested on a tax-free basis so long as they are ultimately used to pay for qualified education expenses for eligible post-secondary educational institutions, can now, in addition, be used to fund expenses for tuition of up to $10,000 per year at elementary and secondary schools. IRC §§ 529(c)(7); -(e)(3)(A). ABLE accounts created for a disabled beneficiary, which previously could only receive contributions in a single year from one or more donors in the aggregate amount of the gift tax annual exclusion then in effect, are now eligible for additional contributions above the annual exclusion amount to be made by the account beneficiary to the extent of his or her compensation for the year. IRC § 529A(b)(2)(B). A tax-free rollover may also be made from a 529 program account to an ABLE account, subject to the contribution limits in effect for the ABLE account and provided the beneficiary for both accounts is the same or a member of the same family, if the 529 account funds could be put to better use through an ABLE account for a disabled family member. IRC § 529(c)(3)(C)(III).

Individual Alternative Minimum Tax (AMT)

The alternative minimum tax (AMT) for individuals remains in effect, although it will be less relevant given the elimination of personal exemptions, the limitations imposed on deductions, and an increase in the exemption amounts for married taxpayers to $109,400 and for unmarried taxpayers to $70,300 and phaseouts of the exemptions now beginning at $1,000,000 and $500,000, respectively, and thereafter adjusted for inflation. IRC § 55(d)(4).

Gift, Estate, and Generation-Skipping Transfer (GST) Exemptions

In the gift, estate, and generation-skipping transfer (GST) tax arena, the basic exclusion amount for estates has been doubled to $10,000,000, with that amount adjusted for inflation from 2011, resulting in the same increase in the exclusion for gifts during a taxpayer’s lifetime and generation-skipping transfers. IRC § 2010(c)(3)(C). The inflation adjustment takes place using chained CPI starting in 2017. § 11002(d)(1)(CC) of the Act. While the inflation-adjusted amount for 2018 has not yet been officially set, calculations estimate it to be $11,180,000, the slight difference between this amount and double the amount of the 2018 exemption calculated under prior law being attributable to the use of chained CPI instead of a regular CPI adjustment. The annual gift tax exclusion is anticipated to be consistent with previous estimates at $15,000.

In light of the scheduled sunset of the exemption amounts down to their pre-Act schedules after 2025, Treasury is given the authority to issue “clawback” regulations as to the difference between the exemption amount when gifts were made during a taxpayer’s lifetime and the exemption amount in effect at his or her death. IRC § 2001(g)(2).

Planning Considerations

The possible avenues for tax and estate planning as a result of the Act are numerous and varied.

Existing estate plans should be evaluated to determine if changes are necessary as a result of the Act, for instance, because of the use of formula allocation clauses. An estate plan keyed off of the estate or GST tax exemption amounts that leaves unused exemption to one set of beneficiaries with the remainder to another might no longer be consistent with a taxpayer’s wishes. While formula clauses are necessary to avoid undesirable income tax consequences in many cases and provide flexibility to fluctuate with changing exemption amounts, the continued increase in the exemption amount—dramatically so, if considered relative to the much lower exemptions in effect in recent years—could cause, from failing to revisit an estate plan, a result much different from what a taxpayer would desire for his or her estate.

For example, a charitably inclined taxpayer might have desired to “zero-out” estate taxes by leaving his or her unused estate tax exemption amount to family members, with the remaining amount to pass to charity. The dramatic increase in the exemption amount, dependent upon the taxpayer’s net worth, might now result in the taxpayer’s family members receiving the entirety of the taxpayer’s estate, leaving the charity that the taxpayer also desired to benefit out of luck. Similar concerns could easily arise in a blended family context where a taxpayer has left the exemption amount to his or her children with the remaining amount taking advantage of the marital deduction by passing for the benefit of a second spouse. Or consider the possibility that a taxpayer may have planned to allocate or distribute assets using all of his or her GST tax exemption directly to grandchildren or, alternatively, among trusts to one or more children who themselves have children, so as to prevent a taxable termination upon the death of
a child, with an equalized amount of GST non-exempt assets passing to a child who is not anticipated to have children of his or her own, in which case a taxable termination is not a concern. It is not hard to imagine a client who has forgotten about his or her estate plan over the last decade and could now have very different dispositive objectives from what was roughly estimated at that time.

When it comes to tax planning, the Act has further solidified statements by commentators in recent years that the traditional unilateral focus on a single class of taxation is a thing of the past. Instead, tax planning for individual taxpayers will need to be increasingly customized to take into consideration benefits to be obtained both from gift, estate, and GST tax planning as well as income tax planning. Customized tax planning is especially important for taxpayers with “borderline” taxable estates (or the potential for growth in their net worth to result in taxable estates), both during the duration of the increased gift, estate, and GST tax exemptions and after the sunset, and could come in many forms.

Income Tax Planning

As a basic step for income tax planning, taxpayers will want to consider concentrating deductions in particular years, such as a large charitable contribution being made in a single year instead of being spread across multiple years, itemizing deductions in the year of the contribution and then using the increased standard deduction in other years.

As a more involved opportunity to reduce income tax liability, taxpayers negatively affected by deduction limitations imposed by the Act could consider using non-grantor trusts. While non-grantor trusts (i.e., trusts structured to be separately taxable from the grantor) are less advantageous for North Carolina residents than they might be for residents of other states because they currently cannot be sitused out-of-state to avoid North Carolina state income tax unless none of the trust beneficiaries reside in North Carolina, using non-grantor trusts to avoid the SALT limitations (combined, possibly, with the income limitations for the Code Section 199A pass-through deduction for certain business income) could prove to be useful. For a discussion of the Code Section 199A deduction and its application to non-grantor trusts, see “Business Tax Planning and Fiduciary Income Tax After Tax Reform” in this newsletter.

The economics of SALT deductions are not particularly impressive on a standalone basis, but if able to be leveraged over multiple trusts in an efficient manner, meaningful income tax savings could result. Assume, for example, a taxpayer has 4 children and 2 grandchildren. The taxpayer could create 6 separate non-grantor trusts for which each descendant is the primary beneficiary and transfer business interests to it which generate income subject to North Carolina state income tax. Assuming the taxpayer would also otherwise pay federal income tax on that income at the highest 37% rate and the North Carolina state income tax liability for each trust is at least $10,000, each trust would provide an additional $3,700 per year in tax savings solely from additional SALT deductions, for an annual total of $22,200. Additional savings would also result to the extent the business interests qualify for a deduction under Code Section 199A and now avoid the phase-out beginning at $157,500 of taxable income for unmarried taxpayers (including trusts) and $315,000 for married taxpayers, in the case of “specified service businesses,” or the phase-in of W-2 wages and depreciable property limitations, in the case of others. Alternatively, if no beneficiary is a North Carolina resident, it may be possible to structure trusts to avoid North Carolina state income tax. Of course, these calculations cannot be considered in a vacuum and would need to be evaluated relative to the transaction costs of creating and administering the trusts. If the taxpayer’s net worth would cause him or her to be subject to estate tax at death, it might also be more beneficial for any trust he or she creates to be a grantor trust, allowing the taxpayer to pay its income tax liability from his or her own funds.

At death, a taxpayer will also want to ensure that his or her remaining estate tax exemption is exhausted to the extent possible to cause a step-up in basis, which has been retained under the Act, for any built-in gain property included in his or her gross estate (also considering that built-in loss property would be stepped down at death). Pre-mortem planning for this purpose could involve swaps of assets from grantor trusts outside of the taxpayer’s estate if the taxpayer holds high-basis or built-in loss assets that would not benefit from a basis adjustment at the taxpayer’s death relative to low-basis assets owned by the trust. An independent Trustee of a trust might also be used to grant a general power of appointment to the taxpayer over built-in gain property to the extent of any remaining exemption. Use of exemption for a basis step-up might prove particularly effective with an older relative with a short life expectancy, whether through the grant of a general power of appointment in an existing trust or creation of a new trust with a general power of appointment such that property passes to the intended recipient at a higher stepped up basis after the relative’s death.

A taxpayer having excess exemption and who also has a limited power of appointment over trust property for his or her own benefit may consider whether exercising that power of appointment under his or her will could be beneficial to trigger the “Delaware tax trap” by creating a presently exercisable general power of appointment for another beneficiary, resulting in inclusion of the appointed property in the taxpayer’s estate under Code Section 2041(a)(3) and a basis step-up. The ability to exercise the Delaware tax trap involves significant uncertainty in many cases, including under North Carolina law, so this technique must be carefully evaluated based on the particular circumstances. The benefit to using the Delaware tax trap for a basis step-up, however, as opposed to granting a beneficiary of a trust a general power of appointment or distributing trust property to the beneficiary outright, is the beneficiary’s level of control over the exercise, the ability to avoid having to engage (and convince) an independent Trustee to act, possible creditor protection for the beneficiary, and the fact that an outright distribution or granting of a general power of appointment cannot be “undone” if circumstances change. Presumably the beneficiary, with the help of advisors, will also be able to determine best whether estate inclusion of the trust assets will be beneficial in the overall context of his or her estate plan.

Family entities such as family limited liability companies or family limited partnerships with interests that would be discounted from the underlying value of their assets in an estate at a taxpayer’s death might also be unwound or the terms of their governing documents amended so the includible property is no longer subject to a discount or, alternatively, low-basis property could be distributed to the taxpayer during lifetime in liquidation of his or her interest. In the closely-held business context, steps could be taken to address a taxpayer’s ownership of S corporation stock at death with there being no equivalent to a Code Section 754 election for S corporations as...
there is for partnerships causing an “inside basis” step-up upon the taxpayer's death. The result in the case of an S corporation might be a mismatch of gain and loss in that an S corporation selling assets piecemeal after a taxpayer's death will continue to recognize gain on those assets flowing through to its shareholders, and only upon liquidation of the deceased shareholder's stock (which did receive a basis step-up at the taxpayer's death) will the new owners of the stock be able to take advantage of a loss which results from a liquidation of stock with basis in excess of the underlying company assets. Low-basis assets might be distributed from the S corporation to the taxpayer or the S corporation otherwise restructured to address this issue.

Gift, Estate, and GST Tax Planning

Many taxpayers will want to proceed with traditional gift and estate tax planning separately or in conjunction with income tax planning, either because they are currently subject to the estate tax, even at the higher exemption amount, or in preparation for the eventual sunset of the increased exemption amount. This might involve gifts or sales to grantor trusts or non-reciprocal spousal lifetime access trusts (SLATs) for married taxpayers to avoid the regrets many taxpayers faced after planning in 2012 that left them without even indirect access to trust property. Depending on a taxpayer couple's net worth, and whether they are anticipated to remain subject to the estate tax at death, it may or may not make sense to structure SLATs either as grantor trusts, so that income tax payments can be made by each grantor (rather than the trust) without incurring gift tax, or as non-grantor trusts, to obtain income tax benefits. A previous sale to a grantor trust in exchange for a promissory note might be wound down by gifting assets to the trust to pay off the outstanding note principal.

There is, albeit unlikely in the views of many commentators, the possibility that a subsequent decrease in the gift tax exemption could involve some type of “clawback” provision for taxpayers who have used their excess exemption in the interim. If no clawback is to take place, planners might, closer to the effective date of the sunset, consider options to benefit a taxpayer from the exemption amount to be “lost.” If he or she is not willing or able at that time to make a completed gift, one approach may be to structure the transfer of a subordinate interest into trust and trigger the zero-valuation rules under Code Section 2701 intentionally to use the excess exemption, which is then credited back to the taxpayer at his or her death for estate tax purposes. In the interim, the taxpayer would be able to retain an interest with a preferred return to the subordinate interest involved in the deemed transfer for use during his or her lifetime.

Structuring Estate Plans

The technical tax aspect of estate planning will involve structuring a decedent's estate plan to allow for a balancing of income tax and estate tax benefits. This will supplant the use of traditional “A/B trust planning” in many cases in favor of added flexibility after the taxpayer's death, in the case of a married couple, to allow a basis step-up to occur at the death of both spouses.

For example, a married couple's estate plan might provide for assets to pass to a marital trust eligible for a QTIP election upon the death of the first spouse, which could be split into separate trusts to the extent desired to make only a partial QTIP election, having up to 15 months to make that determination. A portability election would be made to preserve the deceased spouse's unused exemption (DSUE) amount for the surviving spouse, and a reverse QTIP election would allow for the use of the deceased spouse's GST exemption over the marital trust assets. A disclaimer option, notwithstanding its own limitations, could also be added to reroute assets to a credit shelter trust to avoid a “leaky” non-QTIP marital trust providing for income payments to bring assets back into the surviving spouse's taxable estate, with the added benefit of facilitating trust funds more easily reaching the couple's descendants as beneficiaries of the credit shelter trust after the death of the first spouse (unlike a marital trust, which would only be for the direct benefit of the surviving spouse).

A “Clayton QTIP” structure might also be used, allowing an unrelated executor to choose what, if any, assets over which to make a QTIP election, causing those assets to be funded to a marital trust for the benefit of a surviving spouse to be included in the surviving spouse's estate and receive a second basis step-up upon the death of the surviving spouse. Any remaining assets would be separately funded to a credit shelter trust to make use of the deceased spouse's exclusion amount and prevent subsequent inclusion in the surviving spouse's estate.

Final Thought

Given the myriad changes, the coming years will prove challenging for tax and estate planners, but never more than before is there the opportunity for addressing a client's unique needs in a shift away from traditional planning techniques. While significant uncertainty remains as to the future of the reform brought about by the Act, taxpayers and advisors can work in tandem to make the best of the Act for our clients.

Thomas Cooper and Mark Horn are attorneys in the Charlotte, North Carolina, office of Moore & Van Allen PLLC.

SAVE THESE DATES:

Advanced Estate Planning CLE | May 18, 2018

Annual Meeting & CLE at Kiawah Island Resort | July 26-28