Three attorneys from the Trusts & Estates department of Semanoff Ormsby Greenberg & Torchia, LLC attended the 53rd Annual Heckerling Institute on Estate Planning in Orlando, FL in January 2019. The Heckerling Institute is the nation's leading annual educational conference for estate planning professionals. This year's Institute was the largest to date, with over 3,400 registrants. We have summarized what we viewed to be the "top ten" takeaways from the Institute.

SOGT'S TOP TEN LIST FROM HECKERLING 2019

1. ANTI-CLAWBACK REGULATION - USE OF EXCLUSIONS FROM TAX

The amounts that individuals may transfer free of the federal gift, estate and generation-skipping transfer tax ("FGT," "FET" and "GSTT") were effectively doubled from their 2017 amounts in 2018 and further increased to $11.4 million per individual and to $22.8 million per married couple for 2019. While these increases have made the FGT/FET irrelevant for all but .2% of Americans, the exclusions are scheduled to revert to the inflation-adjusted 2017 level (anticipated to be $6.0/$12.0 million) in 2026 unless Congress and the President agree to change the current law. Because the FGT and FET are part of a unified system, individuals are free to make lifetime "taxable gifts" of the exclusion amount without paying any FGT. Lifetime taxable gifts reduce the exclusion available on death dollar-for-dollar. If the exclusion reverts to an amount which is less than the person's lifetime taxable gifts, can that excess be subjected to FET or "clawed back" upon his or her death? In Reg. 106706-18, the Treasury Department proposed guidance that there will be no such "claw back." In order to take advantage of the current, higher exclusion amounts, taxable gifts need to exceed the anticipated reversion amounts. This may be impractical for taxpayers who are unable or unwilling to make lifetime taxable gifts in excess of $6.0/$12.0 million.

While the Deceased Spouse Unused Exclusion or "DSUE" is "old news," the consensus view is that the unused amount will be based on the amount reported on the first spouse's FET Return between 2018 and 2026. The AICPA has requested that the finalized regulations clearly affirm this view. The IRS is likely to carefully review DSUE returns and the likelihood of such scrutiny reinforces the importance of obtaining good appraisals when filing those returns.

2. DISCLAIMERS

A disclaimer is a refusal to accept property that would pass by Will, right of survivorship, beneficiary designation or other means by a person entitled to receive the property. Upon such a disclaimer, the property will pass as if the disclaimant had predeceased the person making the transfer, and the disclaimant is treated as having never received the property for tax purposes. Disclaimers permit post-mortem planning which is often used to allocate assets between a surviving spouse and children, to account for changes in the tax law, to shift assets to a lower generation, and for charitable planning or other purposes.

A disclaimer is "qualified" for tax purposes if it is a written, irrevocable and unqualified refusal by a person to accept an interest in property, executed and delivered within nine months of the date on which the transferred interest was created or the date on which the disclaimant attains age 21. The disclaimant cannot accept any interest in the property or benefit from it, and the interest must pass without any direction on the disclaimant' s part. The predeceased ancestor rule for GSTT purposes does not apply in the case of disclaimers. An individual or fiduciary may disclaim assets or powers granted under the Will or trust, provided the fiduciary has the appropriate authority to do so under state law or in the governing document.

3. POWERS OF APPOINTMENT ("PoAs")

PoAs are granted in Wills, trust documents and sometimes even in deeds and allow a person who has a limited interest in the assets (e.g., the right to income or use, but not absolute ownership) to adjust the ultimate disposition of the assets. PoAs may be exercised during the power holder's lifetime, or more typically at the time of his or her death depending upon the terms of the document. PoAs are an effective way to allow the power holder to alter the ultimate recipients or the timing of their receipt of the interests subject to the power. There are numerous tax ramifications to the existence and exercise of these powers. If the right to alter the disposition of the assets is limited as to potential recipients or the timing of the ultimate distribution of the assets, the exercise of the PoA may not trigger the payment of FGT, FET or GSTT although the GSTT aspects can be quite complicated. Aside from "tweaking" inheritances to younger generation beneficiaries, creatively drafted PoAs can authorize the holder of the power to pass assets "upstream" to an ancestor who could become the "owner" of those assets for tax purposes. This strategy could be helpful where the ancestor's estate would not be subject to FET and might have unused exemptions from the GSTT. The draft Uniform Power of Appointment Act may, however, subject the appointive assets to the claims of the exercising power holder's creditors even if the power is not exercised. Professional associations are lobbying to avoid this result.

4. INTERNAL REVENUE CODE ("IRC") SECTION 199A

IRC section 199A allows a federal income tax ("FIT") deduction for individuals with qualified business interests, which will reduce the income tax on that business income to something closer to that of C corporations which are taxed as separate entities. Section 199A is available to non-corporate taxpayers (including individuals, trusts or estates) who or which have qualified business income ("QBI") from a partnership, LLC, S corporation or sole proprietorship. The tax deduction is limited or eliminated for high income tax payers who own a Specified Service Trade or Business ("SSTB"). The SSTB list includes services in health, law, accounting, athletics, performing arts and others. Notably, architects and engineers are not subject to that limitation.

Final regulations under section 199A were issued on January 18, 2019, by the Treasury Department. Unless extended, section 199A is only effective through the end of 2025. The use of the section 199A deduction may be a "red flag" on audit.

The section 199A deduction is taken on Line 9 of new form 1040 and software programs are now available to help determine if section 199A will benefit a taxpayer in a specific situation and the magnitude of any such benefit.

5. STEP-UP IN BASIS

When an individual dies owning assets with a fair market value ("FMV") in excess of their "basis" for FIT purposes, that property takes on a new or "adjusted basis" for that purpose equal to its FMV on the owner's date of death or applicable alternate valuation date. In a world where the FET is irrelevant to most Americans, the focus of planning has shifted to finding ways to obtain a "basis step-up" on death. Because assets held in most non-marital deduction trusts do not obtain a basis step-up, creative planners are looking for ways to obtain that step-up. One of those methods is "triggering the Delaware tax trap" for trust assets that are subject to a PoA. The implementation of the technique is highly technical and dependent on state law. If successful, assets held in long-term trusts may obtain a basis step-up by causing them to be included in the power holder's estate for FET purposes. To the extent the trust could be terminated and its assets included in the estate of the trust beneficiary for FET purposes, the same beneficial FIT effect can be obtained.

6. INDIVIDUAL RETIREMENT ACCOUNTS ("IRAs") AND QUALIFIED RETIREMENT PLANS ("QRPs")

IRAs and QRPs constitute a significant portion of many older individuals' net worth. A number of important concepts were discussed at Heckerling.

- When possible, it is almost always better to name flesh and blood individuals to be death beneficiaries of an IRA or QRP because the plan assets can be withdrawn over such a beneficiary's life expectancy. If a trust is named, it is easy to fall into a trap where the entire fund must be liquidated within five years with a consequent acceleration of the responsibility to pay income tax on the account assets. There are strict and complicated rules which must be observed to avoid that problem.

- An individual who has attained age 70½ may direct that up to $100,000 of an IRA (but not other QRPs) be paid directly to charity from an IRA. The distribution qualifies as a "Required Minimum Distribution" ("RMD"), reduces adjusted gross income, avoids the necessity of reporting a charitable deduction (which requires specific reporting on the tax return and might not save income tax because of higher personal exemptions) and can reduce taxes on Social Security for some taxpayers.

- Where an individual intends to leave an IRA (or QRP) to charity upon death, designating a Donor Advised Fund ("DAF") as the beneficiary may be better than naming multiple charities as direct beneficiaries. A DAF is created by the donor generally through a financial organization (e.g. Fidelity, Schwab, Vanguard, etc.) which will honor the DAF creator's requests as to the ultimate charitable beneficiaries. This option avoids difficulties with many IRA custodians which will not pay funds directly to a named charity on the IRA owner's death, but requires the charity to open an inherited IRA account and then take a distribution. It may be easier for the donor to create and name a DAF, and then to name the charity as a beneficiary of the DAF.

- If properly anticipated, an estate or trust can secure a charitable income tax deduction when income in respect of a decedent ("IRD") is donated to a charity. This planning option requires a directive in the decedent's Will requiring a distribution of its IRD to charity. In this situation the estate would be able to claim a FET charitable deduction on the Form 706 and an FIT deduction on Form 1041 for the IRD.

<u>Update:</u> Before the summer recess, House lawmakers approved the Setting Every Community Up for Retirement Enhancement ("SECURE") Act by a vote of 417-3. The

SECURE Act, currently stalled in the Senate, would significantly change retirement and estate planning by:

- Eliminating an age-based restriction (currently age 70 ½) on contributions to a regular IRA (there is no current age-based restriction on contributions to a Roth IRA);

- Increasing the age at which required minimum distributions (RMDs) from IRAs or defined contribution plans must begin from 70 ½ to 72;

- Eliminating current rules allowing non-spouse beneficiaries to "stretch" RMDs from an inherited IRA or defined contribution plan over their own lifetimes by requiring those beneficiaries to withdraw the full balance within ten years of the account owner's death, with some limited exceptions (separate bills proposed in the Senate would also reduce beneficiaries' ability to "stretch" withdrawals over their own lifetimes); and

- Permitting penalty-free early withdrawals of up to $5,000 penalty-free for expenses related to a "qualified birth or adoption."

7. STATE TAXATION OF TRUST INCOME

Two recent state court cases held that where a trust did not have minimum contacts with the state, the state could not tax the trust's income. In both cases, the Trustee and trust assets were located outside of the taxing state and income was not distributed to a beneficiary who resided in the taxing state. See Kimberly Rice Kaestner 1992 Family Trust v. North Carolina Dept. of Revenue, 814 S.E.2d 43 (N.C. June 8, 2018) and Fielding v. Comm. of Revenue, 2018 WL 3447690 (Minn. July 18, 2018). On January 11, 2019, the United States Supreme Court granted North Carolina's Writ of Certiorari in Kaestner. It is likely that North Carolina was emboldened by the U.S. Supreme Court's decision in South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (June 21, 2018), which upheld South Dakota's ability to impose its state sales taxon e-commerce transactions under the U.S. Constitution's Commerce Clause. Because the state courts' decisions in Kaestner and Fielding relied on the U.S. Constitution's Due Process Clause, the general view at Heckerling was that Wayfair will not be extended to trust taxation.

Update: On June 21, 2019, the U.S. Supreme Court, in a fact-specific, narrowly drawn ruling, issued a unanimous opinion in Kaestner. The Court held that North Carolina could not impose income tax on a non-resident trust, which had no resident trustee, where distributions to a North Carolina resident beneficiary were within the trustee's discretion and the trustee had made no distribution to the North Carolina resident beneficiary. In other words, the Court ruled that the North Carolina residency of a permissible beneficiary was in and of itself an insufficient connection to permit North Carolina to tax that non-resident trust.

8. QUALIFIED OPPORTUNITY ZONE ("QOZ")

Created by IRC sections 1400Z-1 and 1400Z-2, QOZs provide FIT benefits for investments in distressed communities as identified by the U.S. census tract. A qualified opportunity fund is a corporation or partnership that has at least 90% of its assets invested in QOZ property on two dates of each year.

Capital Gains earned on investments in a QOZ may be deferred and possibly excluded from tax altogether. Ten percent of the gain can be excluded if the opportunity fund investment is held for at least five years and that percentage increases over time. If the qualified opportunity fund is held for at least ten years, all of the gain accrued after the investment in the opportunity fund is excluded from taxation.

Amazon had planned to locate its new New York headquarters in a QOZ, although it backed away after criticism of the tax breaks and subsidies offered to the project.

9. INCOME TAX UPDATE FOR TRUSTS AND ESTATES

For tax years 2018 and 2019, trust or estate taxable income in excess of $12,500 and $12,750, respectively, is taxed at the highest marginal rate of 37% and subjected to the 3.8% Net Investment Income Tax. The Tax Cuts and Jobs Act ("TCJA") limits, or altogether eliminates, many deductions for individuals, trusts and estates. Miscellaneous itemized deductions subject to the 2% floor are no longer deductible, although IRC section 67(e)(1) deductions continue to be deductible for expenses incurred in the administration of an estate or a non-grantor trust that would not have been incurred if the property was not held in an estate or trust. The two year carryback rule for net operating losses no longer applies, and the deduction for state and local taxes is limited to $10,000. A trust may be entitled to the QBI deduction under IRC section199A.

10. THE CHANGING AMERICAN FAMILY RECENT STATISTICS / MODERN PLANNING

A new focus this year at Heckerling was the evolution of the American family. For example:

- The number of U.S. persons who are married has significantly decreased while the number of cohabitating individuals has increased 75% over the last ten years;
- Married households constitute fewer than 50% of all households;
- Religious affiliation has decreased; and
- A twenty year old is more likely to have a living grandmother today than a twenty year old was to have a living mother in 1900.

A University of Michigan health and retirement survey of 20,000 Americans age 50 and over notes that:

- 42% have no Will;
- 38% will die without a Will;
- 49% of respondents who have a step-child have no Will;
- 59% of respondents do not have a Will when there has been an emotional cutoff for a period of a year or more with an adult child; and
- 62% of respondents who are divorced do not have Wills.

This is not an exhaustive list and it remains important for clients to review their estate plans. If you have any questions, please contact Brian R. Price, Esq. at 215-887-0200 or bprice@sogtlaw.com or one of our many experienced trusts and estates attorneys at www.sogtlaw.com. We can assist you in reviewing your current plan or creating a plan with which you are comfortable and to fit your unique planning needs.