"Sweeping Changes You Need to Know About the Tax Cuts and Jobs Act"

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INCOME TAX CONSEQUENCES OF THE TAX CUTS AND JOBS ACT

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Tax Cuts and Jobs Act (the "Act"), enacted December 22, 2017.

II. Changes Primarily Affecting Individual Taxpayers

1. Tax Rates

    a. Ordinary Income Tax Rates – Code § 1(i); Act § 11001

        i. The Act retains seven rate brackets, but changes five of the rates, including the top rate. Furthermore, the Act changes the thresholds for each bracket. The new rates are below.

2017	Act
10%	10%
15%	12%
25%	22%
28%	24%
33%	32%
35%	35%
39.6%	37%

        ii. The top marginal rate applies to taxable income above $500,000 (up from $418,400) for single taxpayers and head of household filers and $600,000 (up from $470,700) for married individuals filing joint returns and surviving spouses.

    b. Capital Gain Tax Rates – Code § 1(j)(5)(A); Act § 11001(a)

        i. The capital gains tax rates of 0%, 15%, and 20% remain unchanged. However, the income levels at which the different rates apply are now indexed using Chained CPI-U, which is discussed in detail below.

c. Kiddie Tax – Code § 1(j)(4); Act § 11001(a)

i. The “kiddie tax” provisions continue to apply to a child if: (1) the child has not reached the age of 19 by the close of the tax year, or the child is a full-time student under the age of 24, and either of the child's parents is alive at such time; (2) the child's unearned income exceeds $2,100; and (3) the child does not file a joint return..

ii. The Act simplifies the kiddie tax by applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child without consideration of the child’s parents or other siblings. As was the situation prior to the Act, earned income continues to be taxed according to an unmarried taxpayers’ brackets and rates. However, net unearned income is taxed according to the tax schedule for trusts and estates.

d. AMT – Code § 55(d)(4); Act § 12003(a)

i. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act increases the AMT exemption and exemption phase-out amounts for individuals as follows:

	2017		**Act**	
	Exemption	**Phase-out**	**Exemption**	**Phase-out**
Single	$54,300	$120,700	$70,300	$500,000
MFJ & SS	84,500	160,900	109,400	1,000,000
MFS	42,250	80,450	54,700	500,000

ii. All of these amounts will be indexed for inflation after 2018 under the Chained CPI method.

2. Deductions/Exemptions

a. Standard Deduction – Code § 63(c)(7); Act § 11021(a)

i. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation in tax years beginning after 2018. No changes are made to the current-law additional standard deduction for the elderly and blind.

ii. All of these amounts will be indexed for inflation after 2018 under the Chained CPI method.

b. Personal Exemption – Code § 151(d); Act § 11041(a)

i. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for personal exemptions is reduced to zero.

c. Home Mortgage Interest and Home Equity Loan Interest – Code § 163(h)(3)(F); Act § 11043(a)

i. Prior to the Act, qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations. Qualified residence interest is interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence.

ii. Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which is secured by such residence. The maximum amount treated as acquisition indebtedness is $1 million ($500,000 in the case of a married person filing a separate return). Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness but only to the extent of the amount (and term) of the refinanced indebtedness.

iii. Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence. The amount of home equity indebtedness may not exceed $100,000 ($50,000 in the case of a married individual filing a separate return) and may not exceed the fair market value of the residence reduced by the acquisition indebtedness.

iv. Thus, the aggregate limitation on the total amount of a taxpayer's acquisition indebtedness and home equity indebtedness with respect to a taxpayer's principal residence and a second residence that may give rise to deductible interest is $1,100,000 ($550,000, for married persons filing a separate return).

v. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, Code § 163(h)(3) reduces the limits on qualifying acquisition debt to $750,000 ($375,000 for a married taxpayer filing separately). However, for acquisition debt incurred before Dec. 15, 2017, the prior limit applies. The higher prior limit also applies to debt arising from refinancing acquisition debt incurred prior to Dec. 15, 2017, to the extent the debt resulting from the refinancing does not exceed the original debt amount.

vi. The Act eliminates the deduction for interest on home equity debt. Code § 163(h)(3)(F)(i)(I).

vii. There is an exception to the Dec. 15, 2017 date, the binding contract exception, which provides that a taxpayer who entered into a binding written contract prior to Dec. 15, 2017 that was to close on the purchase of a principal residence before Jan. 1, 2018, and who actually purchases such residence before Apr. 1, 2018, shall be considered to incur acquisition indebtedness prior to Dec. 15, 2017.

d. <u>State and Local Tax Deduction – Code § 164(b)(6); Act § 11042</u>

i. Prior to the Act, individuals were permitted a deduction under Code § 164 for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business. These taxes include:

a) State and local real and foreign, real property taxes

b) State and local personal property taxes; and

c) State, local, and foreign income, war profits, and excess profits taxes.

ii. At the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes.

iii. Property taxes may be allowed as a deduction in computing adjusted gross income if incurred in connection with property used in a trade or business; otherwise they are an itemized deduction. In the case of State and local income taxes, the deduction is an itemized deduction notwithstanding that the tax may be imposed on profits from a trade or business.

iv. For tax years beginning after Dec. 31, 2017 and ending before Jan. 1, 2026, Code § 164 is modified to limit the amount of such taxes that an individual may deduct. Taxpayers may no longer deduct foreign real property taxes. In addition, the remaining taxes may be deducted in an amount up to $10,000 ($5,000 in the case of a married person filing a separate return).

v. These limitations do not apply to amounts paid or accrued in carrying on a trade or business described in Code § 212.

e. <u>Miscellaneous Itemized Deductions – Code § 67(g); Act § 11045</u>

i. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act suspends all miscellaneous itemized deductions subject to the two-percent floor. A non-exhaustive list of such deductions includes:

a) Business bad debt of an employee;

b) Business liability insurance premiums;

c) Damages paid to a former employer for breach of an employment contract;

d) Depreciation on a computer a taxpayer's employer requires him to use in his work;

e) Dues to a chamber of commerce if membership helps the taxpayer perform his job;

f) Dues to professional societies;

g) Educator expenses – excluding the above the line deduction;

h) Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;

i) Job search expenses in the taxpayer's present occupation;

j) Laboratory breakage fees;

k) Legal fees related to the taxpayer's job;

l) Licenses and regulatory fees;

m) Malpractice insurance premiums;

n) Medical examinations required by an employer;

o) Occupational taxes;

p) Passport fees for a business trip;

q) Repayment of an income aid payment received under an employer's plan;

r) Research expenses of a college professor;

s) Rural mail carriers' vehicle expenses;

t) Subscriptions to professional journals and trade magazines related to the taxpayer's work;

u) Tools and supplies used in the taxpayer's work;

v) Purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;

w) Union dues and expenses;

x) Work clothes and uniforms if required and not suitable for everyday use; and

y) Work-related education.

f. Medical Expenses – Code § 213(f); Act § 11027(a)

   i. For tax years beginning after Dec. 31, 2016 and ending before Jan. 1, 2019, the threshold for deducting medical expenses shall be 7.5-percent for all taxpayers. Thereafter, the threshold will be 10 percent.

g. Casualty and Theft Losses – Code § 165(h)(5); Act § 11044

   i. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, new Code § 165(h)(5) suspends the itemized deduction for casualty and theft losses except for losses attributable to a federally declared disaster. However, where a taxpayer has personal casualty gains, the loss suspension doesn't apply to the extent that such loss doesn't exceed the gain.

h. Moving Expenses – Code §§ 132(g), 3401(a)(15), 3121(a)(11), 3306(b)(9) and 217; Act §§11048 and 11049

   i. Exclusion. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Code § 132(g) exclusion for qualified moving expense reimbursements is suspended, except for certain military personnel.

   ii. Deduction. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Code § 217 deduction for moving expenses is suspended, except for certain military personnel.

i. Charitable Contributions – Code §§ 170(b)(1)(G) and 170(l); Act §§ 11023, 13705, and 13704

   i. Contribution limits. For contributions made in tax years beginning after Dec. 31, 2017, the 50% limitation under Code § 170(b) for cash contributions to public charities and certain private foundations (Code § 170(b)(1)(A) organizations) is increased to 60%. Contributions exceeding the 60% limitation are carried forward and deducted for five (5) years.

   ii. College Sports Seating Rights. The Act modifies Code § 170(l) for contributions made in tax years beginning after Dec. 31, 2017, by denying a charitable deduction for any payment to an institution of higher education and the tax payer receives, directly or indirectly) the right to purchase tickets or seating at an athletic event.

j. Overall Limitation on Itemized Deductions – Code § 68(f); Act § 11046

   i. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act suspends the Code § 68 overall limitation on itemized deductions that applied to taxpayers whose adjusted gross income exceeded specified thresholds. The itemized deductions of such taxpayers were reduced by

3% of the amount by which AGI exceeded the applicable threshold, but the reduction could not exceed 80% of the total itemized deductions, and certain items were exempt from the limitation.

k. Gambling Losses – Code § 165(d); Act § 11050

i. Prior to the Act, Code § 165(d) provided that "losses from wagering transaction" were allowed as a deduction only to the extent of the gains during the taxable year from such transactions. Case law permitted taxpayers to deduct amounts connected to wagering (*e.g.*, transportation, admission fees) regardless of wagering winnings.

ii. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the limitation on wagering losses under Code § 165(d) is modified to provide that "losses from wagering transactions" includes any deduction otherwise allowable that is incurred in carrying on and wagering transaction. Wagering losses and expenses thus will be limited to wagering winnings.

l. Alimony – Code §§ 61(a)(8), 71(a) and 215(a); Act § 11051

i. Prior to the Act, alimony and separate maintenance payments are deductible by the payor spouse and includible in income by the recipient spouse. Child support payments are not treated as alimony.

ii. The Act strikes Code § 215 thereby eliminating the deduction for alimony for the payer under agreements. Furthermore, the Act eliminates Code § 61(a)(8) which causes alimony to not be considered income to the recipient.

iii. The Act, but not the Code, provides that the current rules continue to apply to already-existing divorces and separations, as well as divorces and separations that are executed by Dec. 31, 2018. However, taxpayers have the option to have the new rules under the Act apply to modifications of agreements that are entered into after Dec. 31, 2018 if the modification expressly provides that the Act rules are to apply.

3. Child and Family Tax Credit – Code § 24(h); Act § 11022(1)

a. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act increases the child tax credit to $2,000 per qualifying child. The credit is further modified to temporarily provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children. The maximum amount refundable may not exceed $1,400 per qualifying child.

b. The Act modifies the adjusted gross income phase-out thresholds. The credit begins to phase out for taxpayers with adjusted gross income in excess of $400,000 (in the case of married taxpayers filing a joint return) and $200,000 (for all other taxpayers). These phase-out thresholds are not indexed for inflation.

4. Repeal of Affordable Care Act Individual Mandate – Code § 5000A(c); Act § 11081

a. For months beginning after Dec. 31, 2018, the amount of the individual shared responsibility payment is reduced to zero.

5. Income

a. Discharged Student Loans – Code § 108(f); Act § 11031

i. Gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.

ii. The Act expands the exception for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, for certain student loans that are discharged on account of death or total and permanent disability of the student. Loans eligible for the exclusion under the provision are loans made by:

a) the United States (or an instrumentality or agency thereof),

b) a state (or any political subdivision thereof),

c) certain tax-exempt public benefit corporations that control a state, county, or municipal hospital and whose employees have been deemed to be public employees under state law,

d) an educational organization that originally received the funds from which the loan was made from the United States, a state, or a tax-exempt public benefit corporation, or

e) private education loans (as defined in § 140(7) of the Consumer Protection Act).

iii. Additionally, the provision modifies the gross income exclusion for amounts received under the National Health Service Corps loan repayment program.

b. Deferral Election for Qualified Equity Grants – Code § 83(i); Act § 13603(a)

i. Code § 83 provides specific rules that apply to property, including employer stock, transferred to an employee in connection with the performance of services. These rules govern the amount and timing of income inclusion by the employee and the amount and timing of the employer's compensation deduction. Under these rules, an employee generally must recognize income in the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture.

ii. These rules do not apply to the grant of a nonqualified option on employer stock unless the option has a readily ascertainable fair market value. Instead, these rules apply to the transfer of employer stock by the employee on exercise of the option. That is, if the right to the stock is substantially vested on transfer (the time of exercise), income recognition applies for the taxable year of transfer. If the right to the stock is nonvested on transfer, the timing of income inclusion is determined under the rules applicable to the transfer of nonvested stock. In either case, the amount includible in income by the employee is the fair market value of the stock as of the required time of income inclusion, less the exercise price paid by the employee.

iii. Code § 83(b) election is generally not available to the grant of options. If upon the exercise of an option, nonvested stock is transferred to the employee, a Code § 83(b) election may be available.

iv. The Act created Code § 83(i) which permits a "qualified employee" to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to "qualified stock" transferred to the employee by the employer. An election to defer income inclusion ("Code § 83(i) election") with respect to qualified stock must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

v. If an employee makes a Code § 83(i) election, the income must be included in the employee's income for the taxable year that includes the earliest of:

    a) the first date the qualified stock becomes transferable;

    b) the date the employee first becomes an "excluded employee";

    c) the first date on which any stock of the employer becomes readily tradable on an established securities market;

    d) the date five years after the first date the employee's right to the stock becomes substantially vested; or

    e) the date on which the employee revokes the Code §83(i) deferral election.

vi. A Code § 83(i) election is made in a manner similar to the manner a Code § 83(b) election.

vii. Code § 83(i) does not apply to income with respect to nonvested stock that is includible as a result of a Code §83(b) election. Furthermore, Code § 83(i) expressly states that restricted stock units (RSUs) are not eligible for Code § 83(b) elections. Absent this provision, RSUs are nonqualified deferred compensation and therefore subject to the rules that apply to nonqualified deferred compensation.

viii. Under the provision, a qualified employee means an individual who is not an excluded employee and who agrees, in the Code § 83(i) election, to meet the requirements necessary to ensure the income tax withholding requirements of the employer corporation with respect to the qualified stock are met.

ix. An excluded employee with respect to a corporation is any individual

a) who was a one-percent owner of the corporation at any time during the ten (10) preceding calendar years;

b) who is, or has been at any prior time, the chief executive officer or chief financial officer of the corporation or an individual acting in either capacity,

c) who is a family member of an individual described in (1) or (2), or

d) who has been one of the four highest compensated officers of the corporation for any of the 10 preceding taxable years.

x. Qualified stock is any stock of a corporation if

a) an employee receives the stock in connection with the exercise of an option or in settlement of an RSU, and

b) the option or RSU was granted by the corporation to the employee in connection with the performance of services and in a year in which the corporation was an “eligible corporation”.

xi. Qualified stock does not include any stock if, at the time the employee’s right to the stock becomes substantially vested, the employee may sell the stock to, or otherwise receive cash in lieu of stock from, the corporation. Qualified stock does not include stock received in connection with other forms of equity compensation, including stock appreciation rights or restricted stock.

xii. A corporation is an eligible corporation with respect to a calendar year if

a) no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year, and

b) the corporation has a written plan under which, in the calendar year, not less than 80 percent of all employees who provide services to the corporation in the United States (or any U.S. possession) are granted stock options, or restricted stock units ("RSUs"), with the same rights and privileges to receive qualified stock.

xiii. For this purpose, in general, the determination of rights and privileges with respect to stock is determined in a similar manner as provided under the present-law ESPP rules. However, employees will not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, provided that the number of shares available to each employee is more than a de minimis amount. In addition, rights and privileges with respect to the exercise of a stock option are not treated for this purpose as the same as rights and privileges with respect to the settlement of an RSU.

xiv. For purposes of the provision, corporations that are members of the same controlled group are treated as one corporation.

6. Miscellaneous

a. Inflation Calculation – Code § 1(f); Act § 11002(a)

i. For tax years beginning after Dec. 31, 2017, dollar amounts that were previously indexed using Consumer Price Index for All Urban Consumers (CPI-U) will instead be indexed using Chained Consumer Price Index for All Urban Consumers (C-CPI-U).

ii. Indexed parameters in the Code switch from CPI-U indexing to CCPI-U indexing going forward in taxable years beginning after December 31, 2017. Therefore, in the case of any existing tax parameters that are not reset for 2018, the provision indexes parameters as if CPI-U applies through 2017 and C-CPI-U applies for years thereafter.

b. ABLE Accounts – Code §§ 25B, 529 and 529A; Act §§ 11024 and 11025

i. A qualified ABLE program is a tax-favored savings program established pursuant to Code § 529A to benefit disabled individuals and maintained by a State or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an "ABLE account"), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; and (3) the program must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations. Several changes were made to ABLE programs by the Act.

ii. The Act permits amounts from qualified tuition programs (also known as 529 accounts) to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 account, or a member of such designated beneficiary's family. Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year. Any amount rolled over that is in excess of this limitation shall be includible in the gross income of the distributee in a manner provided by Code § 72.

iii. The Act also increased the ABLE account contribution limits for tax years ending before January 1, 2026. Although the general overall limitation on contributions (the per-donee annual gift tax exclusion ($14,000 for 2017)) remains the same, the limitation is temporarily increased with respect to contributions made by the designated beneficiary of the ABLE account. Code § 529A(b)(2)(B) provides that after the overall limitation on contributions is reached, an ABLE account's designated beneficiary may contribute an additional amount, up to the lesser of (a) the Federal poverty line for a one-person household; or (b) the individual's compensation for the taxable year. Additionally, the provision temporarily allows a designated beneficiary of an ABLE account to claim the saver's credit provided in Code § 25B for contributions made to their own ABLE account.

c. <u>Section 529 Plans – Code §529(c)(7); Act § 11032(a)</u>

i. For distributions made after Dec. 31, 2017, the definition of "qualified higher education expense" is expanded by new Code § 529(c)(7) to include tuition at an elementary or secondary public, private, or religious school, up to a $10,000 limit per tax year.

III. <u>Changes Affecting Businesses</u>

1. <u>Reductions in Corporate Tax Rates</u>.

a. Effective for all tax years of a C corporation beginning after 12/31/17, all corporate taxable income will be subject to tax at a flat 21% rate.

b. Previously, under Code § 11(b), corporations were taxed at a rate of (i) 15% on taxable income between $0 - $50,000; (ii) 25% on taxable income between

$50,001 - $75,000; (iii) 34% on taxable income between $75,001 - $10,000,000; and (iv) 35% on taxable income in excess of $10,000,000.

c. Unlike most of the other changes under the Act, this change is permanent.

2. <u>Other Changes Applicable to C Corporations</u>.

a. <u>Reduction in Dividends Received Deductions</u>. The dividends received deduction for C corporations will be reduced from current levels of 80% and 70% to 65% and 50%.

b. <u>Repeal of Corporate AMT</u>. The new Act repeals the corporate alternative minimum tax.

c. <u>Impact of NOL Limitations</u>. The new NOL limitations imposed under the Act (discussed below) will prevent NOLs arising in tax years beginning after 12/31/17 from being carried back to prior years when C corporation marginal rates were as high as 35%, but may now be carried forward indefinitely.

3. <u>QBI Deduction; Choice of Entity</u>. Effective January 1, 2018, the Tax Act enacts new Code § 199A which generally provides a deduction of 20% of the "Qualified Business Income" ("QBI") from an S corporation, partnership, LLC (taxed as a partnership) or a sole proprietorship. Although new Code § 199A also provides rules for dividends from qualified real estate investment trusts, dividends from qualified cooperatives and income from publicly traded partnerships, this outline will focus on the deduction applicable for owners of S corporations, partnerships, LLCs and sole proprietorships.

a. <u>The Deduction in General</u>. For taxable years beginning after December 31, 2017 and before January 1, 2026, taxpayers (including estates and trusts) other than corporations generally may deduct 20% of the QBI of an S corporation, partnership, LLC or a sole proprietorship **allocable** to such shareholder, partner, member or sole proprietor.

In order to obtain the full benefit of the deduction without being subject to the wage and capital limitations discussed below, the taxable income of the shareholder, partner, member or sole proprietor must be less than $157,500 or less than $315,000 in the case of a married taxpayer filing jointly (the "Threshold Amounts"). Consequently, a taxpayer receiving the full benefit of the deduction would see a reduction in such taxpayer's top marginal tax rate on QBI to 29.6% (37% top marginal individual tax rate x 20% = 7.4% deduction; 37% - 7.4% = 29.6%).

<u>Example #1</u>: <u>Sole Proprietor (Single-Member LLC) In a Qualified Trade or Business with Taxable Income Less than Threshold Amount</u>. Assume A is the sole owner of a qualified trade or business through a single-member disregarded LLC. The business has no employees and no substantial fixed assets. The QBI from the business is $200,000 and A's wife has taxable income of $100,000 so that their combined taxable income is $300,000.

Because the taxable income of the taxpayer is below the Threshold Amount of $315,000 for married individuals filing jointly, A's deduction will be equal to $40,000 (20% x $200,000 of QBI).

b. Qualified Business Income. The term "QBI" generally means the net amount of "qualified items of income, gain, deduction and loss" with respect to any "qualified trade or business" of the taxpayer. Qualified items of income, gain, deduction and loss mean items of income, gain, deduction and loss to the extent such items are effectively connected with the conduct of a trade or business within the United States. In other words, QBI only includes domestic income and not foreign income. However, in the case of a taxpayer who otherwise has QBI from sources within the commonwealth of Puerto Rico, provided all of the income is taxable, the taxpayer's income from Puerto Rico will be included in determining the individual's QBI.

i. Definition of "Trade or Business" Code § 199A leaves open what constitutes a "trade or business" for purposes of determining the deduction. There are a number of different interpretations of what constitutes a trade or business under the Code, with the highest standard being that of a Code § 162 trade or business. In order for an activity to achieve that standard, the business must be regular, continuous and substantial. Hopefully, there will be further guidance on what constitutes a "trade or business" for purposes of the new Code § 199A deduction, or be prepared for substantial litigation over this issue. For example, would the ownership of a single piece of commercial real estate rented out on a triple net lease basis qualify as a "trade or business" for purposes of the Code § 199A QBI deduction?

ii. Investment Related Income Excluded from QBI. Qualified items also do not include investment-related income, deductions or loss. Specifically, qualified items do not include, among other things, short-term capital gain or loss, long-term capital gain or loss, dividend income or interest income.

iii. Reasonable Compensation and Guaranteed Payments Excluded from QBI Additionally, QBI does not include any amount paid by an S corporation that is treated as reasonable compensation to the taxpayer, nor does it include any guaranteed payments made by a partnership to a partner for services rendered with respect to the trade or business or any other amounts paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services.

a) Where a qualifying trade or business does not have depreciable property or any wages other than those paid to the owner or owners of the business, a determination should be made on the amount of Form W-2 compensation to be paid to the owner so that the W-2 limit is not zero, while at the same time leaving some QBI on which to apply the 20% since any reasonable compensation will reduce QBI.

b) The formula for obtaining the maximum deduction is 20% (y - x) equal to 50% of x, where y is the income prior to the payment of wages and x is the amount of W-2 wages. Consequently, approximately 28.57% of income should be paid as wages in order to maximize the deduction. For example, assume $1,000,000 of QBI, with the same taxable income and no wages paid to employees other than shareholders (and no significant qualified property). If the qualifying trade or business is formed as an S corporation and wages are paid to the taxpayer, approximately 28.57% of the QBI should be paid as income to the shareholder in order to maximize the deduction, as this would result in a deduction of approximately $142,850 ($1,000,000 of QBI minus $285,700 W-2 wages to S corporation shareholder results in $714,300 of QBI x 20% = $142,860, while the W-2 wage limitation would be equal to 50% of $285,700, or $142,850). <u>Keep in mind that this formula is applicable only to an S corporation that has no employees other than the Shareholders</u>.

iv. <u>Qualified Trade or Business</u>. As will be discussed in more detail below, a qualified trade or business means a trade or business <u>other than</u> a "specified service trade or business" and <u>other than</u> the trade or business of being an employee.

v. <u>Mechanics of Deduction</u>. The deduction reduces a taxpayer's taxable income but not his or her adjusted gross income (i.e., it is a "below the line" deduction). However, the deduction is available whether you itemize deductions or take the standard deduction.

vi. <u>Carryover of Loss to Reduce QBI in Subsequent Taxable Year</u>. Under Code § 199A(c)(2), if the net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount will be treated as a loss from a qualified trade or business in the succeeding taxable year. Consequently, it appears that even if such loss is used in computing taxable income in Year 1, when you get to Year 2, that QBI loss carries over and reduces the QBI for Year 2 solely for purposes of computing the 20% of QBI deduction. Additionally, under Code § 172(d)(8), if a taxpayer has a Code § 199A deduction in a year in which such taxpayer has a net operating loss, the taxpayer's net operating loss does <u>not</u> include the Code § 199A deduction.

c. Limitation(s) Based on W-2 Wages and Capital. For businesses other than a "specified service trade or business" (which will be discussed below), and for which the taxpayer's taxable income exceeds $207,500 ($157,500 + $50,000 phase-in amount), or $415,000 ($315,000 + $100,000 phase-in amount) if married filing jointly, the deducible amount for each qualified trade or business carried on by the S corporation, partnership, LLC or sole proprietorship is the **lesser of** (1) 20% of the taxpayer's allocable share of QBI with respect to the qualified trade or business; or (2) the **greater of** (a) the taxpayer's allocable share of 50% of the W-2 wages with respect to the qualified trade or business, or (b) the taxpayer's allocable share of the sum of 25% of the W-2 wages with respect to the qualified trade or business, plus 2.5% of the unadjusted basis immediately after acquisition of all "qualified property" (the "wage and capital limitations").

i. W-2 Wages. W-2 wages are wages paid to an employee, including any elective deferrals into a Code § 401(k)-type vehicle or other deferred compensation. W-2 wages do not include, however, things like payments to an independent contractor or management fees. This definition raises issues for employees employed by an affiliated management company that leases the employees to an operating business or businesses. The question is whether wages paid by the management company can be taken into account with respect to each qualified trade or business even though it is operated in a separate taxable entity (such as the grouping of activities permitted under the passive activity loss rules of Code § 469). Additionally, because a partner is not an "employee" of the partnership under Rev. Rul. 69-184, 1969-1 C.B. 256, and a sole proprietor is not an "employee" of the sole proprietorship, neither guaranteed payments made to a partner nor any other payments made to a partner or a sole proprietor appear to qualify as W-2 wages (which can either be advantageous or disadvantageous depending upon the circumstances).

a) Code § 199A(b)(4) specifically defines W-2 wages by reference to Code §§ 6051(a)(3) and (8). This mirrors, in part, the language in Code § 199(b) as it existed prior to the Tax Act relating to the Domestic Production Activities Deduction. Guidance on wage issues had been issued under prior Code § 199 in Rev. Proc. 2006-22, 2006-1 C.B. 1033 and in the Code § 199 Regulations. Revenue Procedure 2006-22 provided three safe harbors for determining the definition of wages for purposes of old Code § 199: (1) the "Modified Box Method" which uses the lesser of Box 1 or Box 5 of the Form W-2; (2) the "Modified Box 1 Method" which adds a modified Box 1 amount subtracting amounts not subject to federal income tax withholding, added to the deferrals reported in Box 12; and (3) the "Tracking Method" where the amounts subject to federal income tax withholding are tracked, deferrals are added, and other modifications made. Again, however, Revenue Procedure 2006-22 and the prior regulations issued under Code § 199 are not direct authority for Code § 199A, but may provide some insight as to how similar wage determination issues will be interpreted.

b) Code § 199A wages do not include any amount which is not properly included in a return filed with the Social Security Administration on or before the sixtieth (60^{th}) day after the due date, including extensions, for such return. Consequently, good compliance with reporting rules is necessary to get credit for the maximum amount of W-2 wages.

ii. Allocable Share. If there is more than one owner of the pass-through entity, it must be kept in mind that the owners are only entitled to their "allocable share" of QBI, W-2 wages and unadjusted basis of qualified property. For an S corporation, a shareholder's allocable share will be equal to his or her percentage ownership of the stock of the S corporation. For partnerships, where special allocations may be made under Code § 704(b), a partner's allocable share of QBI and of W-2 wages will be equal to the amount of ordinary income of the qualifying trade or business allocated to such partner by the partnership.

iii. Qualified Property. For purposes of Code § 199A, "qualified property" means tangible property of a character subject to depreciation that is held by, and available for use in, the qualified trade or business at the close of the taxable year, which is used in the production of QBI sometime during the taxable year, and for which the depreciable period has not expired before the close of the taxable year. The depreciable period with respect to qualified property of a taxpayer means the period beginning on the date the property is first placed in service by the taxpayer and ending on the **later** of (a) the date ten years after such date; or (b) the last day of the full year in the asset's normal depreciation period. Again, with respect to a shareholder of an S corporation, such shareholder's "allocable share" of the unadjusted basis of qualified property will be equal to his or her percentage ownership in the stock of the S corporation. However, with respect to partners of a partnership (including LLCs taxed as partnerships), the partner's allocable share of the unadjusted basis of qualified property will be equal to the percentage of depreciation allocated to such partner by the partnership.

Example #2. LLC Taxed as a Partnership in a Qualified Trade or Business with Income in Excess of Threshold Amount Plus Phase-In Amounts. A is a 30% owner of an LLC which has QBI of $3,000,000. The LLC paid wages of $1,000,000 and the LLC's unadjusted basis in qualified property is $200,000.

A's deduction will be equal to the lesser of:

1.	*Total QBI*	*Allocable Share (30%)*	*20% Deduction*
	$3,000,000	*$900,000*	*$180,000*
	and the greater of:		
2(a)	*Total W-2 Wages*	*Allocable Share (30%)*	*50% Limitation*
	$1,000,000	*$300,000*	*$150,000*
	or		
2(b)	*Total W-2 Wages*	*Allocable Share (30%)*	*25% Limitation*
	$1,000,000	*$300,000*	*$75,000*
	plus		
	Unadjusted Basis	*Allocable Share (30%)*	*2.5% Limitation*
	$200,000	*$60,000*	*$1,500*
	TOTAL		*$76,500*

Thus, A is entitled to a deduction of $150,000.

d. Phase-In of Wage and Capital Limitations. For taxpayers having taxable income between $157,500 and $207,500 ($157,500 plus $50,000), or with respect to married individuals filing jointly having taxable income between $315,000 and $415,000 ($315,000 plus $100,000), the wage and capital limitations are phased in. Specifically, if the wage and capital limit is less than 20% of the taxpayer's QBI with respect to the qualified trade or business, the taxpayer's deductible amount is determined by reducing 20% of QBI by the same proportion of the difference between 20% of the QBI and the wage and capital limit as the excess of the taxable income of the taxpayer over the threshold amount bears to $50,000 ($100,000 in the case of a joint return). Once the taxpayer has $207,500 of taxable income, or $415,000 of taxable income in the case of a married individual filing a joint return, the wage and capital limitations apply fully to the taxpayer.

Example #3: S Corporation In a Qualified Trade or Business with Taxable Income Within the Phase-In Range.

A and B are married. A's allocable share of the QBI of an S corporation is $300,000. A's allocable share of the W-2 wages paid by the S corporation is $40,000. A's allocable share of the unadjusted basis of the qualified property is $100,000. B earns wages from her job of $85,000 so that their taxable income is $385,000.

Step 1: Determine what would A's deduction have been if the wage and labor limitation did not apply. 20% of $300,000 = $60,000.

Step 2: Determine A's "Excess Amount" by looking at the difference between $60,000 and the amount which would be deductible if wage and capital limitations applied in full. Greater of:

1. *50% of $40,000 = $20,000; or*

2. *(25% of $40,000) plus (2.5% of $100,000) = $12,500.*

A's Excess Benefit is $40,000 ($60,000 - $20,000).

Step 3: Figure Percentage of Taxable Income of A over Threshold Amount:

$385,000
<$315,000>

$70,000 /$100,000 = 70%

Step 4: A loses 70% of $40,000 Excess Benefit or $28,000

A is therefore entitled to a deduction of:

20% of QBI	*$60,000*
Reduction of $40,000 Benefit	*<$28,000>*
	$32,000

e. Specified Service Trade or Business. Code § 199A defines a "specified service trade or business" as any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees who are owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. It should be noted that engineering and architecture services are specifically excluded from the definition of a specified service trade or business. Because a specified service trade or business includes both "consulting" and "any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees who are owners," there will be a great deal of uncertainty as to whether certain businesses are a specified service trade or business, and thus expect a substantial amount of litigation to ensue on this issue.

i. Deduction Allowed for Specified Service Trade or Business if Taxable Income Less than Threshold Amounts. Even though a specified service trade or business is not a qualified trade or business, such business will nevertheless be eligible for the 20% of QBI deduction provided that the taxpayer's taxable income is less than the Threshold Amounts of $315,000 in the case of married individuals filing joint returns and $157,500 for all other taxpayers.

<u>Example #4: Specified Service Trade or Business with Taxable Income Below Threshold Amount</u>.

A is a partner in a law firm. A is married and has total taxable income of $300,000 with his wife. A's allocable share of the QBI of the law firm is $250,000, his allocable share of W-2 wages of the law firm is $60,000 and his allocable share of the unadjusted basis of the qualified property of the law firm is $40,000.

Even though A derives his income form a specified service trade or business, he will receive a deduction of $50,000 ($250,000 x 20%). Because A's taxable income is below the Threshold Amount of $315,000, the wage and labor limitation won't apply (the <u>greater</u> of $30,000 (50% of $60,000) or $16,000 (25% of $60,000 plus 2.5% of $40,000).

ii. <u>Phase-Out of Deduction For Specified Service Trades or Businesses</u>. The ability to take the deduction for 20% of QBI for a specified service trade or business is phased out for a taxpayer having taxable income between $315,000 and $415,000 in the case of married individuals filing joint returns, and between $157,500 and $207,500 for all other taxpayers. Specifically, for a taxpayer with taxable income within the phase-out range, the taxpayer takes into account only the "applicable percentage" of qualified items of income, gain, deduction or loss, and of allowable W-2 wages. The "applicable percentage" with respect to any taxable year is 100% reduced by the percentage equal to the ratio of the excess of the taxable income of the taxpayer over the threshold amount bears to $50,000 (or $100,000 in the case of a joint return).

<u>Example #5</u>: <u>Specified Service Trade or Business with Taxable Income Within the Phase-In (or Phase-Out) Range</u>. A (a lawyer) and B are married. A's allocable share of the QBI of the law firm (an S corporation) is $300,000. A's allocable share of wages paid by the law firm is $40,000. A's allocable share of the unadjusted basis of the law firm's qualified property is $100,000. B earns wages of $85,000 so that their taxable income is $385,000.

<u>Step 1</u>: Determine what would A's deduction have been if the wage and labor limitation did not apply at all. 20% of $300,000 = $60,000.

Step 2: Determine how much of A's $100,000 "phase-in" threshold has been exceeded:

$385,000
<$315,000>

$70,000 /$100,000 = 70%

Step 3: Determine A's "Applicable Percentage" by subtracting 70% from 100% = 30%.

QBI	*Applicable Percentage (30%)*
$300,000	*$90,000*
W-2 Wages	*Applicable Percentage (30%)*
$40,000	*$12,000*
Unadjusted Basis	*Applicable Percentage (30%)*
$100,000	*$30,000*

Step 4: Determine A's deduction using the "Applicable Percentage" numbers: equal to the lesser of:

1. *20% of QBI of $90,000 = $18,000; or*

2. *the greater of:*

    (a) 50% of $12,000 = $6,000; or

    (b) 25% of $12,000 plus 2.5% of $30,000 = $3,750.

Step 5: Determine the excess of the deduction allowed to A if W-2 limitation did not apply over amount deductible if wage limitation fully phased-in: $18,000 - $6,000 = $12,000.

Step 6: Determine Percentage of Taxable Income of A over Threshold Amount:

$385,000
<$315,000>

$70,000 /$100,000 = 70%

Step 7: A loses 70% of $12,000 benefit or $8,400:

A is therefore entitled to a deduction of:

20% of QBI	*$18,000*
Reduction of $12,000 Benefit	*<8,400>*
Total Deduction	*$9,600*

iii. No Deduction Allowed if Specified Service Trade or Business and Taxable Income Exceeds Threshold Amount Plus Phase-In. The deduction for 20% of QBI is not available at all for shareholders, partners, members or sole proprietors of a specified service trade or business whose taxable income is $207,500 or above, or in the case of married individuals filing a joint return, $415,000 or above.

Example #6: Specified Trade or Business with Taxable Income over Threshold Plus Phase-In (Phase-Out) Range.

A is a partner in a law firm. A is married and has taxable income of $1,000,000. A's allocable share of income of the law firm is $700,000, his allocable share of the W-2 wages of the law firm is $200,000 and his share of the unadjusted basis of qualified property is $100,000.

A is entitled to no deduction at all because the law firm is a specified service trade or business and A's taxable income exceeds $415,000. A is completely "phased-out" of any deduction.

If, on the other hand, the business had been a qualified trade or business, A's deduction would be equal to the lesser of:

1. *20% of $700,000 = $140,000; or*

2. *the greater of:*

   (a) 50% x $200,000 = $100,000, or

   (b) 25% x $200,000 plus 2.5% x $100,000 = $52,500.

A would therefore be entitled to a deduction of $100,000 if the business had not been a specified service trade or business.

f. Overall Limitation**.** In addition to the other limitations described above, the maximum amount of deduction available under new Code § 199A (for all of a taxpayer's qualified trades or businesses) cannot exceed 20% of the excess of the taxpayer's taxable income less any capital gain for the taxable year.

Example #7: *Taxable Income Limitation Applies*. *A is married and has $100,000 of QBI. A has $200,000 of long-term capital gains, $30,000 of wages, and $50,000 of itemized deductions, resulting in taxable income of $280,000. A's deduction is limited to the lesser of:*

1. *20% of QBI of $100,000 = $20,000; or*

2. *20% of ($280,000 taxable income less $200,000 of capital gain) = $16,000.*

g. Recap of Rules for Qualified Trades or Businesses. In the case of a qualified trade or business other than a specified service trade or business, if the shareholder's, partner's, member's or sole proprietor's taxable income is less than the threshold amount ($157,500 or $315,000), such owner will generally be entitled to deduct 20% of his allocable share of the QBI from an S corporation, partnership, LLC or sole proprietorship. In the event that the taxable income of such shareholder, partner, member or sole proprietor is over the full phased-in amount ($207,500 or $415,000), the deduction is equal to the **lesser of** (1) 20% of the taxpayer's allocable share of QBI from the S corporation, partnership, LLC or sole proprietorship; or (2) the **greater of** (a) the taxpayer's allocable share of 50% of the W-2 wages of the qualified trade or business; or (b) the taxpayer's allocable share of 25% of the W-2 wages of the qualified trade or business plus 2.5% of the unadjusted basis of the qualified property used in such trade or business.

h. Recap of Rules for Specified Trades or Businesses. In the case of a specified service trade or business, provided the taxable income of the shareholder, partner, member or sole proprietor is less than the threshold amounts ($157,500 or $315,000), his or her deduction should be equal to 20% of such taxpayer's allocable share of the QBI of the S corporation, partnership, LLC or sole proprietorship. However, in the event that the taxable income of the shareholder, partner, member or sole proprietor is over $415,000 for married individuals filing joint returns, or $207,500 for all other taxpayers, no deduction will be allowed for such taxpayer.

i. Observations. Clearly, the rules for the new deduction available to owners of S corporations, partnerships, LLCs and sole proprietorships are extremely complex (and certainly did not simplify the Code), especially where the taxpayer's taxable income exceeds the threshold amounts ($157,500 or $315,000) discussed above. These new rules can result in different (and presumably unintended) results between S corporations, partnerships and sole proprietorships having the same amount of income, and thus may affect the taxpayer's choice of entity decisions. These different results are the result of two factors.

j. S Corporations and Unreasonably Low Compensation. In Rev. Rul. 59-221, 1959-1 C.B. 225, the IRS found that an S corporation's income does not constitute earnings for purposes of the self-employment tax. Additionally, Code § 1402(a)(2) specifically excludes from the definition of net earnings from self-employment dividends on shares of stock issued by corporation. Consequently, neither a shareholder's distributive share of income passed through from the S corporation under Code § 1366 nor any S corporation distributions actually received by the shareholder from the S corporation constitute net earnings from self-employment subject to the self-employment tax.

Because wages paid to shareholder-employees of an S corporation are subject to social security taxes while S corporation distributions are not, shareholder-employees have an opportunity for significant tax savings by withdrawing funds from the S corporation in the form of distributions rather than wages. As a result of this strategy, the IRS has been successful in re-characterizing S corporation distributions as wages subject to social security taxes where it determines that unreasonably low compensation has been paid to the shareholder-employee of the S corporation. See the following:

a) Rev. Rul. 74-44, 1974-1 C.B. 287, Rev. Rul. 71-86, 1971-1 C.B. 285 and Rev. Rul. 73-361, 1973-2 C.B. 331.

b) Radtke v. United States, 895 F.2d 1196 (7th Cir. 1990).

c) Spicer Accounting, Inc. v. United States, 918 F.2d 90 (9th Cir. 1990).

d) Esser, PC v. United States, 750 F. Supp. 421(D. Ariz. 1990).

e) Cave v. Commissioner, 476 F. App'x 424 (5th Cir. 2012), *aff'g per curiam*, T.C. Memo 2011-48.

f) Watson P.C. v. United States, 668 F.3d 1008 (8th Cir. 2012), a*ff'g* 757 F. Supp. 2d 877 (S.D. Iowa 2010).

g) Herbert v. Commissioner, T.C. Summ. Op. 2012-124.

h) Scan McClary Ltd., Inc. v. Commissioner, T.C. Summ. Op. 2013-62.

i) Glass Blocks Unlimited v. Commissioner, T.C. Memo 2013-180.

j) IRS Fact Sheet FS-2008-25.

This reclassification risk applicable to S corporations, does not apply, however, to partnerships or sole proprietorships (at least under current law).

k. W-2 Wages Cannot be Paid to Partners of a Partnership or Sole Proprietors. As discussed above, unlike S corporations which pay W-2 wages to their shareholder-employees, W-2 wages cannot be paid to a partner of a partnership or to a sole proprietor, which can lead to the wage limitation being equal to zero where the qualified trade or business has no outside employees.

Example #8: High Income Qualified Trade or Business with No Outside Employees. Assume that a qualified trade or business generates $600,000 of QBI and that the $600,000 is also A's taxable income.

1. *Sole Proprietorship. Because a sole proprietor cannot pay himself a salary, and because A's taxable income is over the Threshold Amount as fully phased-in, the W-2 limitation will apply and A's deduction will be equal to 50% of zero W-2 wages, or zero.*

2. *Partnership. Even if A pays himself a guaranteed payment of $150,000, that amount presumably will still not qualify as W-2 wages, so again the amount of the deduction would be equal to 50% of zero W-2 wages, or zero.*

3. *S Corporation. Since S corporation shareholders are required to pay themselves "reasonable compensation", assume A pays himself $150,000. In such case, A's deduction would be equal to the lesser of:*

   (a) 20% of $450,000 of QBI ($600,000 QBI - $150,000 salary) or $90,000.

   (b) 50% of $150,000 W-2 wages, or $75,000.

Example #9: Low Income Qualified Trade or Business With No Outside Employees.

Assume that A's business only generates $300,000 of QBI and that the $300,000 is also A's taxable income.

1. *Sole Proprietorship. Because A's taxable income is below $315,000, A will be entitled to a deduction of 20% of $300,000, or $60,000, because the wage limitations will not apply.*

2. *Partnership. Assuming no guaranteed payments are made by the partnership to A, A will likewise be entitled to a deduction equal to 20% of $300,000 or $60,000.*

3. *S Corporation. A still has to pay himself "reasonable compensation", so assume A pays himself $100,000. That will reduce A's share of QBI from $300,000 to $200,000, so that in this situation A's deduction would only be $40,000 (20% of $200,0000).*

It is doubtful that Congress actually intended to have the Code § 199A deduction be different depending on the type of entity the taxpayer is using where such entities are producing identical income. It is possible that a "reasonable compensation" standard could be applied to partnerships and sole proprietorships the same as for S corporations (with such amounts being treated as W-2 wages) so that businesses having the same income would receive the same deduction under Code § 199A. However, until further guidance is issued in the form of a technical corrections bill or possibly guidance from the IRS, the plain language of new Code § 199A seems to create these anomalous results.

A possible "work around" for this issue in the case of a partnership would be to form a tiered partnership structure, so that the lower-tiered partnership would be owned by an upper-tiered partnership, and the lower-tiered partnership could then pay wages to partners of the upper-tiered partnership. While such a structure may work, the IRS has expressed doubt to a similar type arrangement utilizing a disregarded entity to enable a partner to be treated as an employee for withholding purposes. Under the purported structure, a partnership creates a wholly-owned entity that is disregarded for federal income tax purposes, and has the partners of the partnership become employees of the disregarded entity, which for employment tax purposes, is treated as the employer having its own employer identification number and subject to W-2 withholding. On June 13, 2014, Curtis Wilson, IRS Associate Chief Counsel (Pass-Throughs and Special Industries) stated that the IRS is looking at this issue but that if use of the disregarded entity works, "it makes it pretty easy to get around what would otherwise be the general rule, and so … we think it's a stretch."

l. Effect of Tax Act on Choice of Entity**.** As a result of the reduced corporate tax rate for C corporations to a flat 21%, as well as the deduction for 20% of QBI of pass-through entities and sole proprietorships, choice of entity and structuring considerations may be affected, especially where the entity is not planning on distributing available cash to its owners.

m. Double Tax Imposed on C Corporations. Although C corporations will continue to be subject to the so-called "double-tax" on their earnings, once at the corporate level and again at the shareholder level when the earnings of the corporation are distributed to its shareholders, the maximum combined double-tax rate will be reduced significantly from 48% (or 50.47% if the Net Investment Income tax is applicable), to 36.8% (or 39.8% if the Net Investment Income Tax is applicable). This should be contrasted to a top marginal tax rate of 37% on the income of a pass-through entity or sole proprietorship even if the taxpayer derives no benefit whatsoever from the deduction available under Code § 199A, or a top marginal tax rate of 29.6% on the QBI of a pass-through entity or sole proprietorship where the taxpayer receives the full benefit of Code § 199A without being subject to the wage and capital limitations. To the extent that a C corporation is not distributing its earnings, however, consideration also must be given to the possible application of reasonable compensation arguments, the accumulated earning tax under Code § 531 or the personal holding company tax under Code § 541.

i. Reasonable Compensation. Although traditionally unreasonable compensation arguments have been applied in the C corporation context to re-characterize unreasonably high compensation paid to shareholder-employees as dividends subject to double tax, it is possible that the IRS will apply unreasonably low compensation arguments (that have been applied in the S corporation area) to C corporations where the C corporation is retaining earnings taxed at the 21% flat tax rate and not paying any (or unreasonably low) compensation to its shareholder-employees, which would be taxed at a maximum marginal tax rate of 37% and also be subject to FICA taxes.

ii. Accumulated Earnings Tax. S corporations and other pass-through entities are not subject to the Accumulated Earnings Tax imposed under Code § 531.

a) General. The accumulated earnings tax is a penalty tax imposed upon C corporations that accumulate earnings in excess of the reasonable needs of the business, rather than pay them out to shareholders, with the purpose of avoiding taxes at the shareholders level.

b) Tax Base. The accumulated earnings tax applies to accumulated taxable income at a tax rate of 20%. Accumulated taxable income is the corporation's taxable income, subject to certain adjustments (as provided in Code § 535(b)), reduced by: (A) the dividends-paid deduction, if any, and (B) the accumulated earnings credit.[1] The adjustments, as provided in Code § 535(b), include: (A) income taxes accrued to the corporation for the year; (B) corporate charitable contributions over the 10% deduction limit under Code § 170(b)(2); (C) the corporation's capital losses disallowed under Section 1211; and (D) the corporation's net capital gain for the year. The accumulated earnings credit is an amount that starts at $250,000 but could be higher if justified by the reasonable business needs of the corporation. In other words, the accumulated earnings credit is designed to allow corporations to retain at least $250,000 and as much of earnings as is supported by the reasonable needs of the business.[2] The minimum accumulated earnings credit is determined annually as the excess of $250,000 over the corporation's accumulated earnings at the end of the preceding tax year.[3] Thus, if a corporation had no prior

[1] Code § 531(a).
[2] Code § 535(c).
[3] Code § 535(c)(2).

years' accumulated earnings, the current year's minimum accumulated earnings credit would be $250,000. If the corporation's prior year accumulated earnings were $100,000, however, the minimum credit would be $150,000 ($250,000 minus $100,000). Note that corporations performing services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting may claim a minimum accumulated earnings credit of only the excess of $150,000 over accumulated earnings at the end of the preceding tax year.

c) Reasonable Business Needs. As mentioned above, there are two basic elements that must be present in order for the accumulated earnings tax to apply. First, there must be an accumulation of earnings beyond the reasonable needs of the business. Second, the earnings had to have been accumulated for the purpose of avoiding shareholder level taxes. Thus, a corporation is generally able to avoid the accumulated earnings tax if it can demonstrate that it retained the earnings for its reasonable business needs. Whether particular grounds indicate that earnings have been accumulated for reasonable business needs or beyond depends on the specific circumstances.[4] Generally, an accumulation of earnings is excessive if it is more than what "a prudent businessman would consider appropriate for the present business purposes and for the reasonably anticipated future needs of the business."[5] In addition, the retained earnings must be directly connected with the needs of the corporation and must be for bona fide business purposes. The "business" of a corporation includes not only that which it has previously carried on but also any line of business it may undertake.[6]

d) Tax Avoidance Purpose. Even if a corporation has accumulated earnings beyond its reasonable needs, the earnings must have been retained for the purpose of avoiding taxes at the shareholder level in order for the accumulated earnings tax to apply. Note, however, that unreasonable accumulations create a presumption of a tax-avoidance purpose, rebuttable by the corporation.[7] Tax avoidance needs only be one of the purposes, not the sole

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[4] Treas. Reg. § 1.537-2(a).

[5] Treas. Reg. § 1.537-1(a).

[6] Treas. Reg. § 1.537-3(a). *See also* Treas. Reg. § 1.537-2(b) for examples of specific grounds for accumulations most frequently encountered in reasonable business needs cases.

[7] Code § 533(a).

or dominating purpose, of the accumulation.[8] Although the Code does not specify the person or persons whose purpose is relevant in determining liability for the accumulated earnings tax, it is presumably the purpose of those who control the corporation, through stock ownership or otherwise, that is key. The following factors are among those considered in determining whether a corporation's retention of earnings was motivated by a tax-avoidance purpose:

(i) Dealings between the corporation and its shareholders, including loans and advances to shareholders and expenditures of corporate funds for the shareholders' personal benefit (rather than paying dividends).[9]

(ii) Investing undistributed earnings in assets having no reasonable connection to the corporation's business.[10]

(iii) A dividend history demonstrating that shareholder taxes were avoided by the corporation's failure to make distributions.[11]

(iv) Corporate loans to friends or relatives of shareholders, as well as to other corporations owned directly or indirectly by the shareholders.[12]

e) Exceptions. The accumulated earnings tax imposed under Code § 531 does not apply to a personal holding company within the meaning of Code § 542, a foreign personal holding company within the meaning of Code § 552, a corporation exempt from tax under Subchapter F, and a passive foreign investment company within the meaning of Code § 1296.[13]

iii. Personal Holding Company Tax. S corporations and other pass-through entities are not subject to the Personal Holding Company Tax imposed under Code § 541.

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8 *U.S. v. Donruss Co.***,** 393 US 297 (1969).
9 *See* Internal Revenue Manual 4.10.13.2.2 (03/16/2015).
10 Id.
11 Id.
12 Treas. Reg. § 1.537-2(c).
13 Code § 532(b).

a) General. A closely held corporation whose income is largely of investment character may be a personal holding company (PHC), in which case a penalty tax is imposed on the "personal holding company income" if not distributed. The personal holding company tax is designed to prevent corporations from accumulating earnings rather than distributing the earnings as taxable dividends. The personal holding company tax is equal to 20% of the undistributed personal holding company income.

b) Definition. A corporation is a personal holding company if: (i) at least 60% of its adjusted ordinary gross income (as defined in Code § 543(b)(2)) for a taxable year is personal holding company income, and (ii) at any time during the last half of the taxable year, more than 50% in value of the corporation's stock is owned, directly or indirectly, by or for not more than five individuals.[14]

c) PHC Income. Personal holding company income generally includes dividends, interest, royalties (including mineral, oil and gas royalties and copyright royalties), annuities, rents, produced film rents, compensation for use of corporate property by shareholders, personal service contract income, and income from estates and trusts.[15] In general, undistributed personal holding company income means "taxable income" (as adjusted by the items set forth in Code § 545(b)), less the dividends paid deduction (as defined in Code § 561).[16] Adjustments to taxable income generally include negative adjustments for federal income taxes, certain net operating losses, and net capital gains less the attributable taxes.

n. Taxation of Gain Upon Sale of Assets of Corporation. The maximum marginal combined rate for a C corporation selling its assets is the same as the maximum double tax on earnings of a C corporation which are distributed to its shareholders (36.8% or 39.8% if the 3.8% Net Investment Tax is applicable). This should be contrasted with the sale of assets by an S corporation, partnership or LLC taxed as a partnership, or a sole proprietorship, where typically the bulk of the sales price is allocated to capital assets (such as goodwill), so that the maximum marginal rate to which the gain on the sale of the assets will be subject will either be 20% (the maximum capital gains tax), or, if the taxpayer does not materially participate in the trade or business carried on by the entity, 23.8% with the addition of the Net Investment Tax.

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[14] Code § 542(a).
[15] Code § 543(a).
[16] Code § 545(a).

o. The Cost of "Escaping" C Corporation Status. There has already been substantial discussion that a number of S corporations, LLCs and sole proprietorships may convert to C corporation status as a result of the flat 21% tax rate imposed on C corporations. However, the owners of C corporations may not be able to "escape" the shareholder-level tax because of reasonable compensation arguments, the accumulated earnings tax or the personal holding company tax, as discussed above. Additionally, in the event Congress subsequently raises the corporate tax rate (although deemed a "permanent change"), taxpayers may find themselves "trapped" in C status. Once in the C corporation regime, there are number of "prohibitions" and "toll charges" on entities that want to convert back from a C corporation to a pass through entity or sole proprietorship.

If a C corporation converts to a partnership or a sole proprietorship, the conversion will be treated as a taxable liquidation. Where an S corporation has revoked its S election to become a C corporation, Code § 1362(g) generally prohibits the corporation from reelecting S status for a period of five years. Even where a C corporation is allowed to convert to S corporation status, a number of unfavorable rules may apply to the S corporation which has converted from C corporation status, including the application of the LIFO recapture tax under Code § 1363(d), the imposition of the tax on excess passive investment income imposed under Code § 1375 for S corporations having subchapter C earnings and profits, the possible termination of the corporation's S election (where it has excess passive investment income and subchapter C earnings and profits for three consecutive taxable years) under Code § 1362(d), the less favorable distribution rules applicable to S corporations having subchapter C earnings and profits versus S corporations having no subchapter C corporation earnings and profits and the possible loss of net operating losses under Code § 172. Most importantly, the so-called built in gains tax under Code § 1374 is imposed on C corporations which have converted to S corporation status (which effectively imposes a double tax to the extent of any built-in gain of such corporation at the time of conversation), if the assets of the corporation are sold or otherwise disposed of within the five (5) year period following the corporation's conversion to S status. This can be especially disadvantageous for a cash-basis taxpayer having accounts receivable converting from C to S status where the collection of such accounts receivable following conversion to S status will be treated as built-in gain subject to the built-in gains tax.

p. Conclusion. As discussed above, the rules applicable to the 20% of QBI Deduction for pass-throughs and sole proprietorships are complex and should be carefully considered in the selection of the type of entity to use, as well as whether employees versus independent contractors should be used in the business and whether employees can be in a separate management company.

Also, great thought should be given before a business decides to convert from a pass-through entity to a C corporation due to the difficulty in getting out of "C" corporation status, and the "toll charges" imposed on converting from "C" corporation status.

Unless you have a crystal ball predicting future revenues, payroll, equipment purchases and the timing of the sale of the business, it is going to be very hard to recommend that a business convert to "C" corporation status. Obviously, one of the biggest factors as to whether a "C" corporation makes sense at all is how much of the earnings you are planning to distribute to the shareholders. If you frequently take profits out of your business or imagine selling your business in the foreseeable future, it makes the most sense to stay a pass-through entity or sole proprietorship.

Don't act impulsively. Just take a deep breath, relax and carefully review your options with your accountant and tax attorney.

4. <u>Modification of Interest Expense Deductions</u>.

a. The Act limits the deduction for net interest expenses for every business (whether corporate or other) in a taxable year to (i) the business interest income of such business for such taxable year; (ii) 30% of adjusted taxable income of such business for such taxable year; plus (iii) the taxpayer's floor plan financing interest for such taxable year. Taxpayers whose average annual gross receipts for the preceding three taxable years are less than $25,000,000 are exempt from this limitation.

i. Adjusted taxable income is defined as the taxable income of a taxpayer –

a) Computed without regard to:

(i) Any item of income, gain, deduction or loss which is not properly allocable to a trade or business;

(ii) Any business interest or business interest income;

(iii) The amount of any net operating loss under Code § 172;

(iv) The amount of any deduction allowed under Code § 199A; and

(v) In the case of taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization or depletion.

b) Computed with such other adjustments as provided by the Secretary.

ii. Business interest means any interest paid or accrued or indebtedness properly allocable to a trade or business, but does not include investment interest under Code § 163(d)(3).

iii. Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business, but does not include investment interest under Code § 163(d)(3).

b. The amount of business interest not allowed as a deduction as a result of the aforementioned limitation is treated as business interest paid or accrued in the following tax year, and may be carried forward indefinitely.

c. The general carryforward rule (above) does not apply to partnerships.

i. The amount of any business interest not allowed as a deduction to a partnership as a result of the 30% limitation is not treated as business interest paid or accrued by the partnership in the succeeding taxable year. Rather, it is treated as <u>excess business interest</u> which is allocated to each partner in the same manner as the non-separately stated taxable income or loss of the partnership.

ii. If a partner is allocated any excess business interest from a partnership in any taxable year, such excess business interest is treated as business interest paid or accrued by the partner in the next succeeding taxable year in which the partner is allocated <u>excess taxable income</u> from such partnership, but only to the extent of such excess taxable income. Any portion of such excess business interest remaining after the application of the rule in the preceding sentence shall, subject to the limitations of the rule in the preceding sentence, be treated as business interest paid or accrued in succeeding taxable years.

iii. Excess taxable income is the amount that bears the same ratio to the partnership's adjusted taxable income as (i) the excess of (1) 30% of the partnership's adjusted taxable income over (2) the amount by which the partnership's business interest, reduced by any floor plan financing interest, exceeds its business interest income of the partnership, bears to (ii) 30% of the partnership's adjusted taxable income.

d. <u>Special Rules for Partnerships and S Corporations</u>.

i. Each partner's adjusted taxable income is determined without regard to such partner's distributive share of any of the partnership's items of income, gain, deduction or loss.

ii. Each partner's adjusted taxable income is increased by the partner's distributive share of the partnership's excess taxable income.

iii. A partner's distributive share of partnership excess taxable income is determined in the same manner as the partner's distributive share of the partnership's non-separately stated taxable income or loss.

iv. Rule similar to these apply to S corporations and their shareholders.

e. In the case of a taxpayer that is a corporation or other form of entity, this limitation is applied at the entity level.

f. Certain types of trades or businesses, including, among others, the trade or business of performing services as an employee, an electing real property trade or business and an electing farming business, are excluded from the definition of a trade or business for purposes of Code § 163(j).

5. Modification of Bonus Depreciation.

a. The Act allows 100% bonus depreciation under Code § 168(k) for qualified property placed in service between 9/27/17 and before 1/1/23. This bonus depreciation will be reduced to 80% if the qualified property is placed in service between 1/1/23 and 12/31/23; 60% if placed in service between 1/1/24 and 12/31/24; 40% if placed in service between 1/1/25 and 12/31/25; and 20% if placed in service between 1/1/26 and 12/31/26.

i. Prior to the Act, property (other than certain types of property having a longer production period and certain types of aircraft) had to be placed in service prior to January 1, 2020. Now, property (other than certain types of property having a longer production period and certain types of aircraft) must be placed in service prior to January 1, 2027.

b. The Act also modified the requirement that, in order to qualify for bonus depreciation, the original use of the property must begin with the taxpayer. Now, under Code § 168(k)(2)(A)(ii), property whose original use does not begin with the taxpayer (used property) may constitute qualified property subject to bonus depreciation if such property:

i. Was not used by the taxpayer at any time prior to acquisition;

ii. Was not acquired from certain related persons;

iii. Was not acquired from another component member of a controlled group; and

iv. Was not acquired in a transaction in which the basis of such property was determined by reference to the adjusted basis of such property in the hands of the person from whom it was acquired or under Code Section 1014.

6. Modification of Expensing.

a. Code § 179 allows a taxpayer to treat the cost of any Code § 179 property as an expense which is not chargeable to capital account, allowing such cost to be deducted for the taxable year in which such Code § 179 property is placed in service.

b. Prior to the Act, the aggregate cost which could be taken into account under Code § 179 was $500,000. The Act increased this limitation to $1,000,000.

c. Prior to the Act, the $500,000 limitation (which is now a $1,000,000 limitation) was reduced (not below zero) dollar for dollar by the amount by which the cost of Code § 179 property placed in service during such taxable year exceeded $2,000,000. The Act increased the $2,000,000 threshold to $2,500,000.

d. For taxable years beginning after 2018, the $500,000 limitation and $2,500,000 threshold are increased by multiplying such amounts by the cost-of-living adjustment under Code § 1(f)(3).

e. The Act also expanded the types of real property that qualify as Code § 179 property ("qualified real property").

   i. Prior to the Act, in order to constitute qualified real property, such real property had to constitute qualified (i) leasehold improvement property, (ii) qualified restaurant property or (iii) qualified retail improvement property.

   ii. Qualified real property under Code § 179 adopts the concept of "qualified improvement property," which completely replaces the three categories above.

      a) Qualified improvement property is defined as any improvement to an interior portion of a building (subject to certain exceptions below) which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service. Qualified improvement property is a significant expansion of the types of property that qualify, as compared to qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property.

      b) However, qualified improvement property does not include improvements for which the expenditure is attributable to:

         (vi) The enlargement of the building;

         (vii) Any elevator or escalator; or

         (viii) The internal structural framework of the building.

   iii. The Act further expanded the definition of qualified real property by including the following improvements to nonresidential real property placed in service after the date such property was first placed in service:

      a) Roofs;

b) Heating, ventilation and air-conditioning property;

c) Fire protection and alarm systems; and

d) Security systems.

7. <u>Modification of Net Operating Loss ("NOL") Deduction</u>.

a. Prior to the Act, an NOL was generally first carried back two years and then carried forward twenty years. Under the Act, any NOL arising for tax years beginning after 12/31/17 may be carried forward indefinitely but, in most cases, may not be carried back.

b. Prior to the Act, NOLs were not subject to a limitation based on taxable income. Under the Act, the amount of taxable income a taxpayer can offset with an NOL carry-forward in any taxable year will be limited to 80% of taxable income (determined before deducting the NOL) to the extent the losses comprising such NOL arose in taxable years beginning after 12/31/17.

8. <u>Limitation on Excess Business Losses</u>.

a. For taxable years beginning after 12/31/17 and before 1/1/26, the Act added new Code § 461(*l*), which limits excess business losses of non-corporate taxpayers. Excess business losses are defined as the excess of –

i. The aggregate deductions of the taxpayer for the taxable year which are attributable to trades or businesses of such taxpayer; over

a) The sum of –

(i) The aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses; plus

(ii) $250,000 (or $500,000 in the case of taxpayers filing a joint return).

b. For taxable years beginning after 2018, the $250,000 (or $500,000, in the case of taxpayers filing a joint return) amount above is increased by multiplying such amount by the cost-of-living adjustment under Code § 1(f)(3).

c. For partnerships and S corporations, this limitation is applied at the partner or shareholder level.

d. Losses which are disallowed under Code § 461(*l*) are treated as NOLs and are carried forward indefinitely.

e. Code § 461(*l*) is applied after the application of Code § 469, relating to passive activity losses.

9. New Restrictions Imposed on Section 1031 Exchanges. Code § 1031 and its predecessor provisions under the Internal Revenue Codes of 1939 and 1954, as well as various Revenue Acts dating back to 1921, enabled a taxpayer who transferred qualifying property held by him for productive use in a trade or business or for investment in exchange for qualifying replacement property to be held by him for such purposes, to defer all or a portion of his gain on the exchange. Although the dollar volume of these exchanges each year has been primarily attributable to real property exchanges, Code § 1031 was also widely used for exchanges of many types of both tangible and some intangible personal properties such as fleets of leased vehicles, aircraft and business equipment.

The Act amended Code § 1031 to limit its applicability solely to real property. Although this change is relatively straight-forward, there are still questions with respect to the scope of its applicability. For example, if a taxpayer holds real property with respect to which it has previously done a cost segregation study and has identified a variety of items as tangible personal properties eligible for a more rapid write-off for depreciation purposes, will these items, most of which are treated as "real property" under applicable state law, be eligible for deferral under newly amended Code §1031?

The changes to Code § 1031 will apply to exchanges completed after 12/31/17, subject to certain transition rules for exchanges commenced but not completed prior to that date.

10. Changes Under the Act to Partnerships and LLCs Treated as Partnerships. The Act made a number of changes affecting entities that are treated as partnerships for federal income tax purposes, including LLCs (other than LLCs that filed elections to be treated as corporations). The most important of these changes relates to the pass-through of the deduction for qualified business income discussed in Part III. 1. above. This portion of the outline will discuss additional changes affecting tax partnerships not addressed in other parts of this outline.

a. Carried Interests. Carried interests, which are also known as profits interests, are partnership interests issued to a person in exchange for services. These interests have been used for many years to recognize and reward "sweat equity". If structured properly in compliance with existing IRS guidance (Rev. Proc. 93-27 and Rev. Proc. 2001-43), the issuance of a profits interest is not taxable to the recipient partner and, as the corollary to that rule, the issuing partnership will be precluded from claiming a deduction with respect to the grant of such interest to the service partner. The rules governing the initial issuance of a profits interest were not affected by the Act.

In recent years, private equity funds and hedge funds that often manage millions of dollars of portfolio investments for investors have utilized these carried interests as a means of compensating fund managers. Since these funds manage assets, most of which are capital assets, these fund managers effectively receive compensation taxed at long term capital gains rates for their services. This has raised the ire of many politicians and others in recent years.

The Act has added new Code § 1061 which provides that any gains recognized by the holder of certain types of carried interests that would otherwise be treated as long term capital gains, will instead be treated as short term capital gains taxed at rates applicable to ordinary income unless the assets that generated such gains were held in excess of three years (as contrasted with the normal one year plus one day minimum holding period for eligibility for long term capital gain treatment).

The language set forth in new Code § 1061 limits its applicability primarily to carried interests issued by partnerships that manage portfolio assets, which include stock and securities, commodities, real estate held for rental or for investment purposes, and cash or cash equivalents.

New Code § 1061 specifically exempts certain otherwise includible carried interests from its provisions. The primary exemption is for a carried interest that is held by a "corporation". Query: does the term "corporation" include an S corporation? An S corporation is a corporation under state law and is otherwise treated under the Code as a corporation except to the extent otherwise provided in Subchapter S of the Code. Unfortunately, this issue cannot be resolved until further guidance becomes available.

b. <u>Repeal of Technical Termination Rule</u>. Under prior law, if sales or exchanges of partnership interests representing 50% or more of the total interests in both partnership capital and partnership profits were completed within any 12-month period, the partnership was deemed to have terminated under Code § 708(b)(1)(B). The results of such a termination included: (i) the taxable year of the partnership closed, usually resulting in a short taxable year that required the filing of an additional return; (ii) any partnership elections that were in place prior to the termination ceased to apply to the partnership; and (iii) all partnership depreciation recovery periods were restarted.

The Act has repealed Code § 708(b)(1)(B), effective for all transfers of partnership interests that take place after 12/31/17. As a result of this repeal, the only event that can cause the termination of a partnership for federal income tax purposes is if "…no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership…" Code §708(b)(1)(A).

c. <u>New Rules Applicable to Mandatory Basis Adjustments Upon Sales or Exchanges of Partnership Interests</u>. Code § 743(a) provides that no change will be made to the tax basis of partnership property upon a sale or exchange of a partnership interest, or upon a transfer of a partnership interest by reason of the death of a partner, unless either: (i) the partnership had an election in place under Code § 754 for the partnership taxable year in which the transfer occurred, or (ii) the partnership had a substantial built-in loss immediately after the transfer. The existence of a substantial built-in loss resulted in a mandatory write sown of the partnership's tax basis in those assets with the built-in loss. Needless to say, a mandatory write-down of the tax basis of partnership assets caused by the existence of a substantial built-in loss is never popular with a partnership or its partners.

Under prior law, a partnership would be deemed to have a "substantial built-in loss" only if the partnership's cumulative tax basis in all of its properties exceeded the cumulative fair market value of all of its properties by more than $250,000. The Act has expanded the circumstances in which the partnership will be deemed to have a substantial built-in loss to also include a situation in which the transferee partner would be allocated a loss of more than $250,000 if the partnership sold all of its assets (in a hypothetical sale) for their current fair market values immediately following the transfer of such partnership interest to the transferee partner.

<u>Example</u>: Partnership ABC, which has 3 partners, A, B and C, owns two assets as of 06/30/18: Asset #1 has a built-in gain of $1,000,000 and Asset #2 has a built-in loss of $900,000. Partnership ABC does not have a Code § 754 election in effect. Under ABC's partnership agreement, if Asset #1 is sold by the partnership, all of the gain attributable to Asset #1 must be allocated to partner A, and all profits or losses attributable to a sale of Asset #2 will be equally allocated (33 1/3% to each partner) among all of the partners. Under prior law, partnership ABC would not be treated as having a built-in loss if a partnership interest was sold because it had a net built-in <u>gain</u> of $100,000. However, under Code § 743(d), as amended by the Act, if partner B sells his entire partnership interest to a unrelated third party on 06/30/18 for its net fair market value of $33,333 the new transferee partner would be allocated a net loss of $300,000 if the partnership engaged in the hypothetical sale of all of its assets for their fair market values and allocated the profits and losses therefrom in accordance with ABC's partnership agreement because all of the gain on Asset #1 would be allocated solely to partner A, and of each of partners A, C and the new transferee partner would be allocated $300,000 of loss from this hypothetical sale of Asset #2. Thus, under Code §§ 743(a) and 743(d), as amended by the Act, partnership ABC will be required to write-down the tax basis of Asset #2 to its current fair market value as of 06/30/18.

d. <u>New Rule for Pass Through of Partnership Charitable Contribution Deductions</u>. As a general rule, a partner may only claim his or her allocable share of partnership losses and deductions to the extent of such partner's tax basis in his or her partnership interest under Code § 704(d). Under prior law, an exception to this outside basis limitation rule was available for a partner's allocable share of the partnership's charitable contribution deductions. Thus, if partner A had a tax basis in his or her partnership interest that had been reduced to $0.00 by previous allocations to partner A of partnership losses and/or by reason of partnership distributions, and if partner A is then allocated partnership charitable contribution deductions of $100, partner A would still have been able to claim the full $100 charitable contribution deduction because the basis limitation rules of Code § 704(d) did not apply.

The Act has now modified Code § 704(d) to provide that no charitable contribution deductions may be passed through to a partner if the partner does not have sufficient tax basis in his or her partnership interest to facilitate the pass through. This modification of Code § 704(d) by the Act is applicable to all taxable years of the partnership beginning after 12/31/17.

e. New Partnership Audit Rules are Now in Effect. Although not related to the Act, the new partnership audit rules enacted as part of the Bipartisan Budget Act of 2015 became effective for all partnerships for their taxable years beginning after 12/31/17. These new rules, which will generally govern all tax audits and tax controversies are dramatically different than the prior rules relating to partnership audits. These new partnership audit rules provide for an audit at the partnership level and the general rule is that once a partnership adjustment has been proposed by the IRS, any tax increases will be collected from the partnership and not from the partners. A new position that is referred to as a "partnership representative" has been created under these new partnership audit rules. The partnership representative will effectively become a "tax czar" with complete authority to bind the partnership to any and all settlement agreements with the IRS and will also have the sole authority to contest any proposed tax adjustments in court or otherwise. The new rules provide the opportunity to elect out of these new partnership audit provisions under certain circumstances and also provide for alternate methods of pushing partnership adjustments out to the partners.

Every partnership and LLC taxed as a partnership should have specially designed provisions included in its partnership agreement or operating agreement designed to comply with these new rules, including imposing restrictions on the party that is designated as the "partnership representative" to ensure that any decisions made by the partnership representative will have been approved in advance by either all or a majority in interest of the partners.

IV. Changes Affecting Tax-Exempt Organizations

1. Donors

a. Impact of Change in Standard Deduction – Code § 63(c); Act § 11021

Consider the potential impact on charitable giving that may result based on the increase in the standard deduction.

i. Charitable contributions remain deductible as itemized deductions.

ii. The increases in the standard deduction from 2017 levels are from $12,700 to $24,000 for married filing joint, from $9,350 to $18,000 for head of household, and from $6,350 to $12,000 for individuals.

iii. Also, consider impacts of lower top marginal rate, suspension of limitation on itemized deductions, increase in estate tax exemption.

b. Charitable Contribution Deduction Limitation – Code § 170(b)(1); Act § 11023

i. The deduction for contributions to a public charity (or the other organizations listed in Code § 170(b)(1)(A)), is limited to 50 percent of adjusted gross income (without regard to any NOL carryback) (AGI).

ii. This percentage limitation is increased to 60 percent of AGI for cash contributions to such organizations, with a five-year carryover.

c. "Contribution" for Athletic Seating Event Rights – Code § 170(l); Act § 13704

i. The partial deduction (80%) for amounts paid in exchange for college athletic event seating rights is repealed.

ii. In 2017, 80% was deductible. In 2018, no deduction for seating rights.

2. Exempt Organizations

a. Unrelated Trade or Business Income – Code § 512(a)(6) (new); Act § 13702

i. Exempt organizations must compute unrelated business taxable income separately for each unrelated trade or business.

ii. The new 21% corporate tax rate does not have any graduated rates, so net tax will be higher on lower taxable incomes. For example, if the unrelated business taxable income is $50,000, the graduated tax rates (15%) would have resulted in a tax of $7,500, whereas the flat tax rate of 21% results in a tax of $10,500.

iii. Net operating losses from prior years may be used to offset all unrelated business taxable income; net operating losses starting in 2018 shall apply only to the separate business that generated the loss.

b. Contemporaneous Written Acknowledgement by Donee Organization – Former Code § 170(f)(8)(D) (deleted); Act § 13705

i. Required in order to deduct contributions of $250 or more.

ii. The ability to substantiate based on the done organization's Form 990 has been eliminated.

c. Excise Tax on Large Endowments at Private Schools – Code § 4968 (new); Act § 13701

i. A 1.4% excise tax is imposed on net investment income of private college or university with at least 500 students (and more than 50% of the students in the United States), with investment assets of at least $500,000 per full time student.

ii. Net investment income is calculated using the regular rules for private foundations to determine the 2% (or 1%) excise tax on investment income of Section 4940(c).

iii. Exempt use assets are not included in the calculation.

iv. Net investment assets of related organizations (such as supporting organizations) are combined with the assets of the college or university.

d. Executive Compensation – Code § 4960 (new); Act § 13602

i. A 21% excise tax (based on the new corporate tax rate) is imposed on compensation paid by tax-exempt organizations in excess of $1,000,000 for a "covered employee."

ii. "Covered employee": five highest paid employees (current and prior years).

Excludes: amounts paid to licensed medical professionals (including veterinarians) for the performance of medical (or veterinary) services by such professional.

iii. Include compensation paid to the employee by a related organization (such as a supporting organization); reasonableness of the amount of compensation is not relevant.

iv. An "excess parachute payment" (defined as more than three times the employee's average salary for the prior five years, paid upon separation from employment) to a covered employee is also subject to the 21% excise tax.

e. Proposals NOT Adopted

i. Flat 1.4% excise tax on investment income of private foundations; the current 2% (or 1%) excise tax remains in effect.

ii. Johnson Amendment – remains in Section 501(c)(3); exempt organizations may not participate or intervene in a political campaign on behalf of (or in opposition to) a candidate for public office.

iii. Tax on royalty income from licensing trademarks; not adopted.

iv. Exception from private foundation excess business holdings tax for certain wholly-owned philanthropic businesses; not adopted.

v. Donor advised funds, additional reporting requirements; not adopted.

V. **Special Agricultural Provisions**

1. Relief for Florida Citrus Industry: Act § 13207

   a. For the past two (2) legislative sessions, the Florida delegation (and others) have advocated for an amendment to Code § 263A to provide relief for the citrus industry under the name of the Emergency Citrus Disease Response Act. The substance of those efforts are as follows.

   b. Code § 263A allows for expensing the costs of replanting, instead of capitalizing, where the original trees were lost or damaged due to freeze, disease, drought, pests, or other casualty. This benefit, however, was previously limited to the taxpayer who experienced the loss.

   c. The Act adds a provision to Code § 263A(d)(2) which liberalizes the ability to bring in new investors and still reaping the expensing benefit, provided that the original taxpayer retains an equity interest not less than 50% in the replanted citrus in the year the amounts were paid.

   d. In the alternate, the expensing benefit is now available to a new taxpayer who has purchased the entirety of the original taxpayer's interest in the affected land to the extent the replanting is on that same land.

   e. These benefits are available until December 22, 2027.

2. Depreciation

   a. Act § 13203: Machinery or equipment, other than grain bins, cotton ginning assets, fences, or other land improvements, the original use of which commences after December 31, 2017, shall be treated as 5-year property.

   b. Act § 13205: Any property held by an electing farming business with a recovery period of ten (10) years or more can use the alternate depreciation system provided under Code § 168(g).

      i. An affirmative election is necessary to take advantage of this provision, but the method for making this election is to be dictated by the Secretary in regulations to do not yet exist.

      ii. Election is irrevocable.

      iii. Making this election will also exempt the electing farming business from the limitations on the deductibility of business interest under Code § 163(j), as amended by Act § 13301.

c. Note: All depreciation provisions currently have limited relevance due to unlimited, immediate expensing allowed by the Act under Code § 168(k) for property placed in service prior to January 1, 2023.

3. Act § 13312: Code § 118 Nonshareholder Contributions to Capital

a. Code § 118 exempts any "contribution to capital of the taxpayer" by a nonshareholder from inclusion in gross income of the taxpayer.

b. Case law provides guidance as to what qualifies as a nonshareholder contribution to capital as follows: (1) the contribution must become a permanent part of working capital; (2) the contribution must not be compensation for specific quantifiable services; (3) the contribution must be bargained for; (4) the contribution must foreseeably benefit the corporation in an amount commensurate with its value; and (5) the contribution must ordinarily be employed to generate additional income.

c. Act § 13312, however, amends Code § 118 by specifically excluding from the meaning of "contribution to capital of the taxpayer" both contributions in aid of construction or any other contribution as a customer or potential customer and contributions by any governmental entity or civic group.

d. The amendment is to be effective for contributions made after December 22, 2017.

e. The Act provides an exception for contributions made after the effective date by a governmental entity which are made pursuant to a "master development plan" approved by the governmental entity prior to the effective date, however the meaning of this term is murky as it is not defined in the Act.

f. While this provision does not specifically apply to agriculture, many agricultural landowners consider entering into contracts with government entities that would be affected by this provision. Funds received under existing contracts with government entities (for example, a water management district) are now taxable where they were not previously so. This affects existing contracts and the willingness of taxpayers to enter into such contracts in the future.

4. Act § 11011: New Cooperative Advantages

a. New Code § 199A(g) provides for a deduction allowable to "specified agricultural or horticultural cooperative[s]" in the amount of the lesser of (i) 20% of the excess of the gross income of the cooperative less the qualified cooperative dividends paid during the taxable year for the taxable year or (ii) the greater of 50% of the W-2 wages of the cooperative with respect to its trade or business or the sum of 25% of the W-2 wages of the cooperative with respect to its trade or business plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property of the cooperative.

b. The deduction under new Code § 199A(a) is also calculated in a manner that takes qualified cooperative dividends into account.

c. Practical Impact

i. Because cooperative dividends are generally going to be equal to the farmer's share of the cooperative's gross income, a farmer selling entirely to a cooperative can take a 20% deduction out of a much bigger number, with the only limit being taxable income.

ii. This is an additional benefit that makes sales to cooperatives advantaged, although the precise calculus is complex and nuanced.

iii. The advantage to cooperatives over other farming companies has been the topic of much discussion and is reportedly set to be corrected in a glitch bill. That said, there are no specifics of what the fix might be at this time and any fix is miles of negotiation and procedure away.

5. Act § 11012: Limitations on Losses

a. Under previous law, § 461(j) provided for the disallowance of "excess farm loss" for non-corporate taxpayers receiving certain subsidies, subject to carryforward provisions.

b. While the Act eliminates the application of § 461(j) until January 1, 2026, this provision is replaced with another which, during that time period, disallows "excess business loss." An "excess business loss" is the excess of the taxpayer's aggregate deductions attributable to the taxpayer's trade or business over the sum of the taxpayer's aggregate gross income or gain for the tax year which is attributable to those trades or businesses plus $250,000 ($500,000 for a joint return), adjusted for inflation.

c. Practically, this new provision has a broader scope and the disallowance will encompass all of the farmers previously falling under § 461(j) and additional farmers who would not have fallen under that section as well.

6. Act § 13302: Net Operating Loss Carrybacks and Carryforwards

a. Prior to the Act, net operating losses could be carried back for two (2) years and carried forward for twenty (20) years. There was a special rule for farming losses allowing carryback for five (5) years.

b. While the Act does away with the general carryback rule, farming losses still allow for a carryback for two (2) years. Carryforward is unlimited.

c. A "farming loss" is the lesser of the amount that would be the net operating loss for the tax year if only income and deductions attributable to farming businesses are taken into account or the amount of the net operating loss for the tax year.

d. A taxpayer may elect to forego the carryback, but the election is irrevocable. The manner of the election is to be prescribed by the Secretary.

7. Act § 13102: Limitations on Cash Method Accounting

a. Prior to the Act, under Code § 448, C corporations and partnerships with C corporation partners could not use cash method accounting, except to the extent gross receipts did not exceed $5 million, on average, for the prior 3 taxable years.

b. While the rule of Code § 448 didn't apply to farming businesses, Code § 447 provided essentially the same general rule, but with a gross receipts test threshold of $1 million for all years since 1976. For family corporations, the threshold was $25 million.

c. The Act made the rule uniform. The gross receipts test, for farming businesses and otherwise, is now satisfied for any given taxable year if a corporation or partnership has average annual gross receipts do not exceed $25 million for the 3 taxable year period immediately preceding the taxable year in question.

IMPACT OF THE TAX CUTS AND JOBS ACT ON ESTATE PLANNING

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I. The Law Prior to the Tax Cuts and Jobs Act of 2017 (the "Act")

A. 2017 Law (Prior to the Act)

1. 40% top rate for estate, gift and GST taxes.

2. $5 million estate, gift and GST tax exemptions, indexed for inflation after 2011 ($5.49 million in 2017). Estate and gift tax exemptions are unified.

3. $14,000 gift tax annual exclusion.

4. Exemptions and tax brackets are indexed for inflation using the standard CPI.

5. Income tax rates for estates and trusts of 15%, 25%, 28%, 33% and 39.6%, with the top rate of 39.6% applying to taxable income in excess of $12,500.

6. Miscellaneous itemized deductions under Section 67 are deductible to the extent they exceed 2% of taxpayer's adjusted gross income (AGI).

7. Top rate of 20% for long term capital gains and qualified dividends for taxpayers in the 39.6% income tax bracket.

8. Transfer tax provisions and certain income tax provisions are permanent (unless changed by future legislation).

B. What 2018 Law Would Have Been Without the Act

1. 40% top rate for estate, gift and GST taxes.

2. $5 million estate, gift and GST tax exemptions, indexed for inflation after 2011 ($5.6 million in 2018). Estate and gift tax exemptions are unified.

3. $15,000 gift tax annual exclusion.

4. Exemptions and tax brackets are indexed for inflation using the standard CPI.

5. Income tax rates for estates and trusts of 15%, 25%, 28%, 33% and 39.6%, with the top rate of 39.6% applying to taxable income in excess of $12,700.

6. Miscellaneous itemized deductions under Section 67 are deductible to the extent they exceed 2% of taxpayer's adjusted gross income (AGI).

7. Top rate of 20% for long term capital gains and qualified dividends for taxpayers in the 39.6% income tax bracket.

8. Transfer tax provisions and certain income tax provisions are permanent (unless changed by future legislation).

II. Key Estate Planning Provisions of the Act

A. Transfer Tax Provisions

1. Maintains a 40% top rate for estate, gift and GST taxes.

2. $10 million estate, gift and GST tax exemptions, indexed for inflation after 2011 (projected to be $11.18 million in 2018) for estates of decedents dying, and gifts made, after 2017 and before 2026. Estate and gift tax exemptions are unified.

3. Gift tax annual exclusion amount is yet to be determined, but projected to be $15,000.

4. Exemptions and tax brackets are indexed for inflation using the Chained CPI instead of the standard CPI, which results in slightly slower growth in exemptions and rate brackets.

5. Maintains the portability of unused estate tax exemption between spouses. Unused GST tax exemptions still are not portable.

6. The increased exemptions "sunset" after 2025. Therefore, estate, gift and GST tax exemptions in 2026 would revert to an amount equal to $5 million indexed for inflation after 2011. Some have estimated that, assuming the sunset occurs, the exemptions in 2026 would be about $6.75 million per person.

7. “Clawback” becomes an issue because exemptions will be lower in 2026 (and subsequent years) than they were in 2018-2025. The phrase “clawback” refers to the possibility that taxpayers who make gifts between 2018-2025 to utilize their increased gift tax exemption may have to pay additional estate tax when they die if the estate tax exemption amount in effect at the time of their death (after 2025) is less than at the time the gift was made. In other words, there may be a “clawback” of the prior gift. As part of the Act, Congress amended Code § 2001(g) and directed Treasury to issue regulations addressing the effect of a reduction in exemptions.

8. Similar to the clawback issue is what happens with unused deceased spousal unused exemption (“DSUE”) if the surviving spouse has not used it by 2026 when the increased exemptions sunset.

B. Relevant Income Tax Provisions

1. Income tax rates for estates and trusts of 10%, 24%, 35% and 37%, with the top rate of 37% applying to taxable income in excess of $12,500 for 2018.

2. Top rate of 20% for long term capital gains and qualified dividends for taxpayers applies to income in excess of $12,700 in 2018. It is unclear why the top capital gains rate applies at $12,700 of taxable income, but the top income tax rate applies at $12,500 of taxable income.

3. Miscellaneous itemized deductions under Section 67 are disallowed for 2018-2025.

4. $10,000 limitation on deducting state and local taxes applies to estates and trusts, except to the extent such taxes consist of property taxes that are paid or accrued in carrying on a trade or business.

5. For life settlements of life insurance policies, the selling taxpayer’s basis in the policy is not reduced by the cost of insurance component, which reverses the IRS position in Rev. Rul. 2009-13. However, reporting requirements were added for “reportable policy sales” which is defined as the sale of a policy to someone who has no substantial family, business or financial relation with the insured apart from the acquisition of the policy. Further, none of the transfer for value exceptions under Code § 101 apply to reportable policy sales, thus resulting in ordinary income treatment for insurance proceeds paid out on death.

6. Electing Small Business Trusts (ESBTs)

   a. Nonresident aliens now qualify as “potential current beneficiaries.”

b. Charitable deduction for ESBTs is now determined under Code § 170 limitations rather than Code § 642(c) requirements. Previously under Code § 642(c), a charitable contribution was only deductible to the extent it was paid from gross income and required by the terms of the trust. Further, excess charitable contributions could not be carried over under prior law.

c. Sunset does not apply to ESBT changes.

7. Roth Recharacterizations

a. Under the Act, an individual may still make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA. An individual may also make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA (e.g., if an individual exceeded the $118,000 AGI threshold for a contribution to a Roth IRA, the individual would be permitted to recharacterize the contribution as having been made to a traditional IRA). However, under the Act, recharacterizations cannot be used to unwind a Roth conversion. In other words, once a traditional IRA is converted to a Roth IRA, the funds cannot be re-characterized back to a traditional IRA if the Roth IRA declines in value.

8. Alimony Payments are No Longer Deductible

a. Alimony payments made pursuant to a divorce or separation instrument *executed after December 31, 2018* will no longer be deductible by the payor spouse, nor will they be includible in the income of the payee spouse.

(1) This new rule of non-deductibility will also apply to a divorce or separation instrument executed on or before December 31, 2018 *if the instrument is modified or amended after such date to expressly provide that the new law shall apply.*

(2) In addition, Code § 682 is repealed for any divorce or separation instrument executed after December 31, 2018. Section 682 provided a mechanism for alimony to be satisfied through a trust arrangement. Specifically, Code § 682 provided that if one spouse created a grantor trust for the benefit of the other spouse, then following the divorce, the trust income would not be taxed to the grantor-spouse under the grantor trust rules to the extent of any fiduciary

accounting income that the donee-spouse is entitled to receive.

C. "Hot topics" in estate planning that were <u>not</u> included in the Act

1. Estate and gift tax repeal.

2. Modification of rules on valuation discounts

   a. Revise Code § 2704 to add additional category of applicable restrictions that would be disregarded in valuing transferred assets.

   b. In 2017, the IRS withdrew the proposed regulations that were issued in August 2016.

3. Limitations on Grantor Retained Annuity Trusts (GRATs)

   a. 10 year minimum term; maximum term of grantor's life expectancy plus 10 years.

   b. Value of remainder interest must be greater than zero.

   c. Annuity amount cannot decrease during GRAT term.

4. 90 year limitation on GST exemption

   a. On the 90th anniversary of the creation of the trust, the inclusion ratio would be increased to 1, effectively making all generation-skipping transfers from the trust thereafter subject to GST tax.

5. 5 year mandatory payout period for designated beneficiaries on retirement accounts.

6. Inclusion of grantor trusts in grantor's gross estate

   a. If a trust is a grantor trust, then (i) assets would be includible in grantor's gross estate for estate tax purposes, (ii) distributions from the trust would be treated as gifts and (iii) conversion to non-grantor trust status would be treated as a gift.

   b. Same rules would apply to 678 trusts if the deemed owner sells assets to the trust (which could be intended to limit the use of Beneficiary Defective Trusts (BDITs)).

III. Changes Affecting the Taxation of Estates and Trusts

A. Change in Income Tax Brackets and Rates of Estates and Trusts[1]

Bracket	**2017 Rate**	**2018 Rate**
Not over $2,550	15%	10%
$2,550 - $6,000 $6,000 - $9,150	$382.50 + 25% $1,245 + 28%	$255 + 24%
$9,150 - $12,500	$2,127 + 33%	$1,839 + 35%
Over $12,500	$3,232.50 + 39.6%	$3,011.50 + 37%

B. Suspension of Miscellaneous Itemized Deductions for Taxable Years Beginning in 2018 Through 2025[2]

1. The Act adds new Code § 67(g).

(g) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025. – Notwithstanding subsection [67](a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.

Section 67(a) provides that "miscellaneous itemized deductions" may be deducted only to the extent they exceed 2% of a taxpayer's adjusted gross income (AGI). Miscellaneous itemized deductions are all itemized deductions other than those specifically listed in Code § 67(b).

2. Itemized Deductions.

63(d) ITEMIZED DEDUCTIONS.— For purposes of this subtitle, the term "itemized deductions" means the *deductions* allowable under this chapter *other than*—

(1) *the deductions allowable in arriving at adjusted gross income [i.e. above the line deductions]*,
(2) the deduction for personal exemptions provided by section 151, and
(3) the deduction provided in section 199A.

3. *Exclusions From Miscellaneous Itemized Deductions.* The items listed in Code § 67(b) that often apply to estates and trust include deductions for

[1] Code § 1(j)(2)(E); Sec. 11001 of the Act.
[2] Sec. 11045 of the Act added new Code § 67(g).

payment of interest, taxes, charitable contributions, and estate tax attributable to income in respect of a decedent (under Code § 691(c)). While the items listed in Code § 67(b) still are deductible, the deductions for certain items are subject to limitations, some of which existed under prior law and some of which were added by the Act.

67(b) MISCELLANEOUS ITEMIZED DEDUCTIONS. — For purposes of this section, the term "***miscellaneous itemized deductions***" means the ***itemized deductions other than***—
(1) the deduction under section 163 (relating to *interest*),
(2) the deduction under section 164 (relating to *taxes*),
(3) the deduction under section 165(a) for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d),
(4) the deductions under section 170 (relating to charitable, etc., contributions and gifts) and section 642(c) (*relating to deduction for amounts paid or permanently set aside for a charitable purpose*),
(5) the deduction under section 213 (relating to medical, dental, etc., expenses),
(6) any deduction allowable for impairment-related work expenses,
(7) the deduction under section 691(c) (*relating to deduction for estate tax in case of income in respect of the decedent*),
(8) any deduction allowable in connection with personal property used in a short sale,
(9) the deduction under section 1341 (relating to computation of tax where taxpayer restores substantial amount held under claim of right),
(10) the deduction under section 72(b)(3) (relating to deduction where annuity payments cease before investment recovered),
(11) the deduction under section 171 (relating to deduction for amortizable bond premium), and
(12) the deduction under section 216 (relating to deductions in connection with cooperative housing corporations).

4. *Examples of Miscellaneous Itemized Deductions.* The Joint Explanatory Statement of the House and Senate Conference Committee provides the following list of items subject to the aggregate 2% floor under Code § 67(a) that may not be deducted for taxable years beginning in 2018-2025:

Expenses for the production or collection of income

-Appraisal fees for a casualty loss or charitable contribution;
-Casualty and theft losses from property used in performing services as an employee;
-Clerical help and office rent in caring for investments;
-Depreciation on home computers used for investments;
-*Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust [642(h)(2)];*
-Fees to collect interest and dividends;
-Hobby expenses, but generally not more than hobby income;
-Indirect miscellaneous deductions from pass-through entities;

-Investment fees and expenses;
-Loss on deposits in an insolvent or bankrupt financial institution;
-Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;
-Repayments of income;
-Safe deposit box rental fees, except for storing jewelry and other personal effects;
-Service charges on dividend reinvestment plans; and
-Trustee's fees for an IRA, if separately billed and paid.

Tax preparation expenses

Other miscellaneous itemized deductions subject to the two-percent floor

-Repayments of income received under a claim of right (only subject to the two percent floor if less than $3,000);
-Repayments of Social Security benefits; and
-The share of deductible investment expenses from pass-through entities.

C. Income Taxation of Estates and Trusts

1. *Tax Provisions for Individuals Generally Apply to Trusts.* Code § 641(b) provides, in part, that "[t]he taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part.

2. Deduction in Lieu of Personal Exemption

a. *Estates and Most Trusts.* In lieu of the deduction for personal exemption, under Code § 642(b) an estate is allowed a deduction of $600, a complex trust is allowed a deduction of $100, and a simple trust (required to distribute all of its income currently) is allowed a deduction of $300. These deductions in lieu of the personal exemption are not affected and are not indexed for inflation.

b. *Qualified Disability Trusts.* A "qualified disability trust" is allowed a deduction equal to the personal exemption of an individual. During the period the personal exemption for individuals is suspended (i.e., 2018-2025), Section 11041 of the Act adds new Code § 642(b)(2)(C)(iii) to allow a deduction of $4,150, indexed for inflation, for qualified disability trusts.

3. *Determination of Adjusted Gross Income of Estates and Trusts.* The adjusted gross income of the estate or trust is computed in the same manner as an individual, with two exceptions under Code § 67(e).

67(e) DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS.—For purposes of this section, the *adjusted gross income* of an estate or trust shall be *computed in the same manner as in the case of an individual, except that*—

(1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate, and
(2) the deductions allowable under sections 642(b), 651, and 661,

shall be treated as allowable in arriving at adjusted gross income [i.e., above the line deductions]. Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter to take into account the provisions of this section.

Are deductions under Code § 67(e) suspended by Code § 67(g)? The argument is that new Code § 67(g) states that "[n]otwithstanding subsection [67](a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31,2017, and before January 1, 2026." Miscellaneous itemized deductions are all itemized deductions other than those specifically listed in Code § 67(b), and executor and trustee fees and most other estate and trust administration expenses are not listed in Code § 67(b).

a. *Costs Incurred in Connection with the Administration of the Estate or Trust*. The deductions for costs paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate are not itemized deductions, because they are specifically allowed in arriving at adjusted gross income under Code § 67(e)(1), therefore, they are not itemized deductions and cannot be miscellaneous itemized deductions.

Executor and trustee fees and other estate and trust administration expenses are deductible under Code § 67(e) to the extent that they satisfy the requirement of being expenses that "would not have been incurred if the property were not held in such trust or estate." Deductions for administrations costs still must meet the existing requirements under *Knight v. Comm'r.*, 128 S.Ct. (2008) and Treas. Reg. § 1.67-4.

(1) The *Knight* Case. In *Knight*, a case involving investment advisory fees, the Supreme Court interpreted Code § 67(e)(1) to mean that fees incurred in connection with the administration of a trust were not miscellaneous itemized deductions subject to the 2% floor only to the extent they are not commonly or customarily incurred by individuals.

(2) *Treas. Reg. § 1.67-4.* Subsequent to the *Knight* case, the IRS promulgated regulations, which provide as follows:

(a) *In general*.— Section 67(e) provides an exception to the 2-percent floor on miscellaneous itemized deductions for costs that are paid or incurred in connection with the administration of an estate or a trust not described in § 1.67-2T(g)(1)(i) (a non-grantor trust) and that would not have been incurred if the property were not held in such estate or trust. A cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust, and commonly or customarily would be incurred by a hypothetical individual holding the same property.

(b) *"Commonly" or "Customarily" Incurred*

(1) *In general*.— In analyzing a cost to determine whether it commonly or customarily would be incurred by a hypothetical individual owning the same property, it is the type of product or service rendered to the estate or non-grantor trust in exchange for the cost, rather than the description of the cost of that product or service, that is determinative. In addition to the types of costs described as commonly or customarily incurred by individuals in paragraphs (b)(2), (3), (4), and (5) of this section, costs that are incurred commonly or customarily by individuals also include, for example, costs incurred in defense of a claim against the estate, the decedent, or the non-grantor trust that are unrelated to the existence, validity, or administration of the estate or trust.

(2) *Ownership costs*. — Ownership costs are costs that are chargeable to or incurred by an owner of property simply by reason of being the owner of the property. Thus, for purposes of section 67(e), ownership costs are commonly or customarily incurred by a hypothetical individual owner of such property. Such ownership costs include, but are not limited to, partnership costs deemed to be passed through to and reportable by a partner if these costs are defined as miscellaneous itemized deductions pursuant to section 67(b), condominium fees, insurance premiums, maintenance and lawn services, and automobile registration and insurance costs. Other expenses incurred merely by reason of the ownership of property may be fully deductible under other provisions of the Code, such as sections 62(a)(4), 162 [trade or business expenses], or 164(a) [taxes], which would not be miscellaneous itemized deductions subject to section 67(e).

(3) *Tax preparation fees*. — *<u>Costs relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor</u>*. The costs of preparing all other tax returns (for example, gift tax returns) are costs commonly and customarily incurred by individuals and thus are subject to the 2-percent floor.

(4) *Investment advisory fees*. — Fees for investment advice (including any related services that would be provided to any individual investor as part of an investment advisory fee) are incurred commonly or customarily by a hypothetical individual investor and therefore are subject to the 2-percent floor. However, *<u>certain incremental costs of investment advice beyond the amount that normally would be charged to an individual investor are not subject to the 2-percent floor</u>*. For this purpose, such an incremental cost is a special, additional charge that is added solely because the investment advice is rendered to a trust or estate rather than to an individual or attributable to an unusual investment objective or the need for a specialized balancing of the interests of various parties (beyond the usual balancing of the varying interests of current beneficiaries and remaindermen) such that a reasonable comparison with individual investors would be improper. *The portion of the investment advisory fees not subject to the 2-percent floor by reason of the preceding sentence is limited to the amount of those fees, if any, that exceeds the fees normally charged to an individual investor*.

(5) *Appraisal fees*. — *Appraisal fees incurred by an estate or a non-grantor trust to determine the fair market value of assets as of the decedent's date of death (or the alternate valuation date), to determine value for purposes of making distributions, or as otherwise required to properly prepare the estate's or trust's tax returns, or a generation-skipping transfer tax return, are not incurred commonly or customarily by an individual and thus are not subject to the 2-percent floor*. The cost of appraisals for other purposes (for example, insurance) is commonly or customarily incurred by individuals and is subject to the 2-percent floor.

(6) *Certain Fiduciary Expenses*. — *Certain other fiduciary expenses are not commonly or customarily incurred by individuals, and thus are not subject to the 2-percent floor. Such expenses include without limitation the following: probate court fees and costs; fiduciary bond premiums; legal publication costs of notices to creditors or heirs; the cost of certified copies of the decedent's death certificate; and costs related to fiduciary accounts*.

(c) *Bundled fees*

(1) *In general*.— If an estate or a non-grantor trust pays a single fee, commission, or other expense (such as a fiduciary's commission, attorney's fee, or accountant's fee) for both costs that are subject to the 2-percent floor and costs (in more than a de minimis amount) that are not, then, except to the extent provided otherwise by guidance published in the Internal Revenue Bulletin, the single fee, commission, or other expense (bundled fee) must be allocated, for purposes of computing the adjusted gross income of the estate or non-grantor trust in compliance with section 67(e), between the costs that are subject to the 2-percent floor and those that are not.

(2) *Exception*. — If a bundled fee is not computed on an hourly basis, only the portion of that fee that is attributable to investment advice is subject to the 2-percent floor; the remaining portion is not subject to that floor.

(3) *Expenses Not Subject to Allocation*. — Out-of-pocket expenses billed to the estate or non-grantor trust are treated as separate from the bundled fee. In addition, payments made from the bundled fee to third parties that would have been subject to the 2-percent floor if they had been paid directly by the estate or non-grantor trust are subject to the 2-percent floor, as are any fees or expenses separately assessed by the fiduciary or other payee of the bundled fee (in addition to the usual or basic bundled fee) for services rendered to the estate or non-grantor trust that are commonly or customarily incurred by an individual.

(4) *Reasonable Method*. — Any reasonable method may be used to allocate a bundled fee between those costs that are subject to the 2-percent floor and those costs that are not, including without limitation the allocation of a portion of a fiduciary commission that is a bundled fee to investment advice. Facts that may be considered in determining whether an allocation is reasonable include, but are not limited to, the percentage of the value of the corpus subject to investment advice, whether a third party advisor would have charged a comparable fee for similar advisory services, and the amount of the fiduciary's attention to the trust

or estate that is devoted to investment advice as compared to dealings with beneficiaries and distribution decisions and other fiduciary functions. The reasonable method standard does not apply to determine the portion of the bundled fee attributable to payments made to third parties for expenses subject to the 2-percent floor or to any other separately assessed expense commonly or customarily incurred by an individual, because those payments and expenses are readily identifiable without any discretion on the part of the fiduciary or return preparer.
(d) ***Effective/applicability date*. —** This section applies to taxable years beginning after December 31, 2014.

b. *Deductions Allowable Under Code Sections 642(b), 651, and 661.* To say that new Code § 67(g) suspends deductions Code § 67(e) would suggest that it suspends not only Code § 67(e)(1), but also Code § 67(e)(2), which addresses Code § 642(b) (the deduction in lieu of personal exemption), Code § 651 (distribution deduction for simple trusts), and Code § 661 (distribution deduction for complex trusts). If the argument is true, then it would result in the illogical conclusion that Code § 642(b) is overridden although another provision of the Act provide expanded relief under Code § 642(b)(2)(C) by increasing the deduction in lieu of a personal exemption for qualified disability trusts. It also would mean that trusts and estates would not be entitled to distribution deductions (which would completely overturn the basic premise of the income taxation of trusts and estates since 1954).

Moreover, Code § 67(e) states that the deductions described therein are deductible in arriving at adjusted gross income (i.e., above the line deductions) and, therefore are not itemized deductions under Code § 63(d)(1).

D. Excess Deductions or Losses at Termination of Estate or Trust. Code § 642(h) provides that on the termination of an estate or trust (1) a net operating loss or capital loss carryover and (2) deductions in excess of gross income shall be allowed as a deduction to the beneficiaries succeeding to the property of the estate or trust.

642(h) UNUSED LOSS CARRYOVERS AND EXCESS DEDUCTIONS ON TERMINATION AVAILABLE TO BENEFICIARIES. — If on the termination of an estate or trust, the estate or trust has—

(1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or
(2) for the last taxable year of the estate or trust deductions (other than the deductions allowed under subsections (b) [deduction in lieu of personal exemption] or (c) [charitable deduction]) in excess of gross income for such year,

then such carryover or such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary, to the beneficiaries succeeding to the property of the estate or trust.

A trust generally will be considered as having terminated when it has distributed all of the property it holds to the persons entitled to succeed to the property, except that the trust may retain a reasonable amount for the payment of unascertained or contingent liabilities and expenses. Treas. Reg. § 1.641(b)-3.

1. *Net operating Losses and Capital Loss Carryovers*. Net operating losses carryovers under Code § 172 and capital loss carryovers under Code § 1212 are not itemized deductions, rather they are reductions in arriving at the total income of the estate or trust before any deductions are taken. Beneficiaries succeeding to the property of the estate or trust will continue to be able to take these items into account in computing their income.

2. *Deductions in Excess of Gross Income in the Final Taxable Year*. Deductions in excess of gross income in the final taxable year of an estate or trust are itemized deductions because they are not deductible by the beneficiaries in arriving at their adjusted gross income. They are miscellaneous itemized deduction, because they are not listed as exceptions in Code § 67(b). Thus, Code § 67(g) prevents their deduction for taxable years beginning in 2018-2025.

   The Joint Explanatory Statement specifically includes "[e]xcess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust" in the list of deductions suspended by Code § 67(g).

3. Planning Considerations.

   a. *Timing of Termination.* Fiduciaries need to be cognizant of whether an estate or trust might have deductions in excess of gross income in determining the timing of payment of certain deductible expenses and termination of the estate or trust.

   b. *Professional Fees.* Attorneys and other professionals representing fiduciaries should bill separately for services rendered in respect to estates and related trusts and give careful consideration to which fees are property allocable to a terminating estate or trust and a continuing trust.

   c. *Decanting.* Fiduciaries need to be cognizant of whether an estate or trust might have deductions in excess of gross income in determining the timing of decanting a trust in situations in which the second trust will be a separate taxpayer and the decanting treated as a distribution from the first trust to the second trust; e.g., situations in which the first trust is decanted to a second trust funded by someone other than the settlor of the first trust.

E. Deduction for Estate Tax Attributable to Income In Respect of a Decedent. The deduction under Code § 691(c) for estate tax attributable to an item of income in respect of a decedent included in gross income by a taxpayer is not a miscellaneous itemized deduction and continues to be deductible, because it is listed as an exception in Code § 67(b)(7).

F. $10,000 Limitation on State and Local Taxes Applies to Estates and Trusts[3]

1. *SALT Deductions*. New Code § 164(b)(6) suspends the deduction for foreign real property taxes not incurred in a trade or business and limits the deduction for the aggregate amount of the following taxes not incurred in a trade or business to $10,000: (1) state and local real property taxes; (2) state and local personal property taxes; (3) state and local, and foreign, income, war profits and excess profits taxes; and (4) state and local sales tax. The taxes other than the foreign real property taxes are referred to as the state and local tax (SALT) deductions.

   The Joint Explanatory Statement confirms that the $10,000 SALT limitation applies to estates and trusts by virtue of Code § 641(b) (which provides that the taxable income of an estate or trust is computed in the same manner as an individual, except as otherwise provided) in footnote 171 on page 80.

2. *Planning Considerations.* There may be a benefit to creating multiple trusts, each of which would be subject to a separate $10,000 SALT deduction limit (as well as, a separate deduction in lieu of personal exemption and separate run up the income tax brackets). Care must be taken, however, to avoid the anti-abuse provisions for multiple trusts under Code § 643(f).

   643(f) TREATMENT OF MULTIPLE TRUSTS. — For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if—

   (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, *and*
   ***(2)** a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.*
   For purposes of the preceding sentence, a husband and wife shall be treated as 1 person.

   It is necessary for separate trusts to have different settlors, beneficiaries or terms, or not be established for income tax avoidance, in order to avoid Code § 643(f). *Boyce v. U.S.*, 190 F.Supp. 950 (5th Cir. 1961); PLR

[3] Sec. 11042 of the Act added new Code § 164(b)(6).

199912034. Although the provision regarding multiple trusts was added to the Code in 1984, no Regulations have been issued.

G. Alternative Minimum Tax Exemption and Phase-out Thresholds.[4] The Act increases the AMT exemptions and phase-out thresholds for individuals, but not for trusts and estates. Due to the change in the method of computing inflation adjustments, the AMT exemption amount and phase-out threshold for trusts and estates likely will be slightly lower than the amounts previously announced for 2018; i.e., $24,600 and $82,050, respectively.

H. Electing Small Business Trusts ("ESBT")

1. Non-*resident Alien can be a Potential Current Beneficiary of an ESBT.*[5] The Act amends the provision that provides that each potential current beneficiary of an ESBT shall be treated as a shareholder of an S Corporation to provide that it shall not apply in determining whether an S Corporation has a non-resident alien as a shareholder.

2. *Charitable Deduction of an ESBT Determined Under Code § 170 and No Longer Under Code § 642(c).*[6] The charitable contributions deduction for trusts is governed by Code § 642(c) rather than Code § 170, which governs the charitable deduction for individuals. Some restrictions that are imposed by Code § 642(c), but not by Code § 170 include: (1) distribution must be made from gross income (*Green v. U.S.*, 2018-1 U.S.T.C. ¶50,126 (10th Cir. 2018)) and pursuant to the terms of the governing instrument (CCA 201747005, August 14, 2017) and (2) no carryover of excess contributions is allowed for trusts. The Act provides that the charitable contribution deduction of the portion of an ESBT holding S Corporation stock is determined by the rules applicable to individuals under Code § 170, not the rules applicable to trusts under Code § 642(c), effective for taxable years beginning after 2017.

   a. *Potential Benefits.* Elimination of the requirement that charitable gifts must be made from gross income will allow charitable deductions for gifts of property, the same as for individuals. The governing instrument requirement will no longer apply. Excess charitable deductions can be carried forward for five years.

   b. *Potential Detriments.* The percentage limitations applicable to individuals will apply to charitable contributions made by the portion of an ESBT holding S Corporation stock. The substantiation requirements that apply to individuals under Code § 170 also will be applicable to charitable contributions from an ESBT.

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[4] Sec. 12003 of the Act left Code § 55(d)(1)(D) unchanged and added new Code § 55(d)(4)(A)(ii)(III).
[5] Section 13541 of the Act amended Code § 1361(c)(2)(B)(v).
[6] Sec.13542 of the Act added new Code § 641(c)(2)(E).

c. *No Sunset.* The changes described for ESBTs are permanent and do not sunset after 2025.

IV. Impact of the Act on Existing Estates and Trusts: What You Should Be Doing Now.

A. Review Structure of Revocable Trusts and Wills

1. Does the formula clause for estate and/or GST tax exemptions used in the Will or Trust of an individual or individual's spouse need to be revised?

a. Revocable trusts and wills often contain formula clauses that divide assets based upon the remaining estate or GST tax exemptions of the taxpayer at death. Given the drastic increase in exemptions, consider whether the formula clause still accomplishes the taxpayer's intent.

b. Example: Assume the settlor's revocable trust provides for an amount equal to the settlor's remaining estate tax exemption to pass to a family trust for the benefit of the settlor's surviving spouse and descendants, with the balance passing to a marital trust that is solely for the benefit of the surviving spouse. As a result of the Act, the amount passing to the marital trust just decreased by up to $5.6 million in 2018, which may eliminate a large portion or all of the marital trust that was intended to be left for the sole benefit of the surviving spouse. While the surviving spouse is still a beneficiary of the family trust, he or she may not like the idea of the children having an opinion on the distribution of funds that the spouse was planning to have sole authority over.

c. Example: Assume the settlor's revocable trust provides for a gift of the settlor's remaining GST exemption to trusts for grandchildren, with the balance distributable to the settlor's children in trust. As a result of the Act, the amount of the gift made in trust for grandchildren increases by approximately $5.6 million. This may or may not be consistent with the settlor's intent, especially if either (i) the settlor had used up most of his or her GST exemption during life and was only anticipating a small amount of remaining GST exemption to pass to his grandchildren, or (ii) the increased amount passing GST exempt to the grandchildren consumes most or all of the inheritance that was intended to pass as the non-exempt share to the children.

B. Review Existing Irrevocable Trusts

1. As a result of the increased estate tax exemptions under the Act, consider whether assets held in trust should be distributed to a beneficiary or the trust should be modified to cause inclusion in the beneficiary's gross

estate to obtain a basis step-up for appreciated assets (e.g., add a testamentary general power of appointment).

2. As a result of the increased GST tax exemptions under the Act, consider whether assets held in trust should be distributed to a beneficiary or the trust should be modified to cause inclusion in the beneficiary's gross estate so that the beneficiary can allocate additional GST tax exemption to assets transferring upon his or her death. It is possible that assets held in trust will incur a GST tax upon the death of a beneficiary which could have been avoided if the trust was modified to instead have the assets includible in the beneficiary's gross estate.

    a. Example: Assume $5 million of assets are held in a GST non-exempt irrevocable trust that provides for distributions to be made to or for the benefit of the settlor's child, C, and at C's death, the remaining assets shall be distributed outright to C's issue. Assume further that C dies having $6 million of his own assets.

        (1) At C's death, a generation-skipping transfer (i.e., a taxable termination) will occur.

        (2) Prior to the Act, if the trust was left "as is" then a GST tax at the rate of 40% would be due at C's death on the trust assets, but no estate tax would be due. Alternatively, if the trust was modified prior to C's death to be includible in C's gross estate then an estate tax at the rate of 40% would be due, but no GST tax would be due. Thus, the transfer tax liability upon C's death would be the same regardless of whether the irrevocable trust was left as is or modified.

        (3) Under the Act, a GST tax at the rate of 40% will still be due on the trust assets if the trust is left as is because C's increased GST exemption cannot be applied to the transfer since C was not the transferor of the assets. However, all estate and GST tax can be avoided by modifying the trust terms to have the assets includible in C's gross estate for estate tax purposes (thereby taking advantage of C's extra $5.6+ million of estate tax exemption). Further, once the assets are includible in C's gross estate, C becomes the transferor for GST purposes and can allocate his extra $5.6± million GST exemption to them.

3. Caution: When making the decision to modify trusts to cause inclusion of trust assets at the beneficiary's death for estate or GST purposes, consider that the exemptions are currently scheduled to decreased in 2026. Thus, this planning will not work if the beneficiary survives until the date that the exemptions decrease. For beneficiaries who are likely to survive the

sunset, it may be prudent to adopt a wait and see approach before implementing trust modifications to see if the sunset is likely to occur or if the increased exemptions are likely to be extended by future legislation. However, for trusts with aging or ailing beneficiaries who are unlikely to survive until the sunset (or possible earlier repeal) of the increased exemptions, it may not be prudent to wait to implement changes. The decision to distribute assets or modify a trust for the tax reasons described in 1 and 2 above becomes much easier if the beneficiary is virtually certain to die before the exemptions decrease.

4. Consider converting a grantor trust to a non-grantor trust

   a. Grantor trusts are trusts that are structured to shift the liability for the payment of tax on the trust income to the grantor rather than the trust. This is often used when the grantor's estate is large enough that the grantor will be subject to estate tax and the grantor wants to spend down his or her taxable assets for the benefit of the trust beneficiaries. With an additional estate tax exemption of approximately $11.18 million for a couple, it may no longer be necessary to spend the grantor's assets on the tax liability for trust income as a means to reduce estate tax. The grantor may prefer to turn off the grantor trust status of the trust (in order to shift the liability for the tax to the trust), at least until the increased exemptions sunset.

   b. Further, converting to a non-grantor trust will create a separate taxpayer that may expand the available deductions. For example, assume an individual pays $10,000 of property taxes on his or her personal residence and an irrevocable trust created by the individual pays $10,000 of state income taxes. If the trust is a grantor trust as to the individual, then the individual may only deduct $10,000 of $20,000 total taxes paid. If, however, the trust is a non-grantor trust, then each of the individual and the trust should be able to deduct $10,000 on their respective returns.

   c. Caution: Converting a grantor trust to a non-grantor trust may not be as simple as releasing a power of substitution or other Code § 675 power. Code § 674 can be difficult to overcome depending on the terms of the trust and who is serving as trustee.

   d. Caution: Converting a grantor trust to a non-grantor trust can also have income tax consequences because the conversion is effectively treated *for income tax purposes* as the grantor transferring assets to the trust at the moment of conversion. Rev. Rul. 77-402; Treas. Reg. § 1.1001-2(c), ex. 5.

C. Analyze the Tax Year Options for Current Estate Administrations

1. Estates have the option to elect a fiscal tax year in lieu of a calendar year.

2. The first tax year of an estate may be less than 12 months.

3. Fiscal year election is made on the first filed return, even if it's a late return. Tax years indicated on a Form SS-4 are not binding. Further, the filing for an automatic extension of time to file does not establish a tax year. Treas. Reg. § 1.441-1(c).

4. An election can be made pursuant to Code § 645 to treat a decedent's revocable trust as part of the estate for income tax purposes for a limited period of time following the decedent's death. This results in the trust having the same fiscal tax year as the estate instead of a calendar year. The election must be made by filing Form 8855 no later than the due date (including any extensions) for filing the Form 1041 for the estate for its first taxable year. There is no relief for a missed Code § 645 election.

5. Why is the selection of a tax year important?

   a. The new income tax rates under the Act apply only to taxable years *beginning after* December 31, 2017 *and before* January 1, 2026. Thus, the tax year selected will determine how long the pre-Act tax rules will continue to apply for decedents dying in 2017.

      (1) Example: Assume decedent dies on November 1, 2017 and the estate expects to receive a considerable amount of income beginning in January, such as from the sale of a business interest or receipt of taxable retirement account proceeds. If the personal representative selects the longest fiscal year possible, which means the first tax year ends October 31, 2018, then the income received by the estate from January 1, 2018 to October 31, 2018 will be subject to the pre-Act rates, including a top rate of 39.6%. However, if the personal representative instead elects to have the first tax year end December 31, 2017, then all of the income from January 1, 2018 through October 31, 2018 will instead be subject to the Act rates, which means a top rate of 37%.

      (2) NOTE: An estate or qualified revocable trust seeking to make an election to have a fiscal year ending 12/31/17 must file a return or extension of time to file a return by April 17, 2018. If a timely return is not filed, the fiscal year election can be made on the first filed return for the estate (even though the return is late), but a Code § 645 election cannot be made for the qualified revocable trust.

(3) Caution: Rate brackets are not the only consideration. One must also consider the potential impact of the other income tax changes under Act, such as the suspension of miscellaneous itemized deductions under Code § 67. If an estate is expected to have significant itemized deductions (e.g., investment advisory fees) then it may be better to elect a November 30, 2017 year-end for the first tax year in order to have the estate taxed under the pre-Act rules for December 2017 through November 2018.

D. Move Irrevocable Trusts to Florida (or another Jurisdiction without a State Fiduciary Income Tax)

1. With the new limitations imposed on deductions for state and local taxes, it just became more expensive to administer a trust in a state that imposes income tax on trusts.

2. States impose income tax on irrevocable trusts on a variety of bases, such as the residence of a trustee, the principal place of administration, and whether the trust was created by a resident. These strings often can be severed to eliminate the application of the state income tax, resulting in an immediate savings to the trust.

E. Higher Transfer Tax Exemptions Does Not Mean that Planning for Clients Has Become Less Important

1. Non-estate tax reasons for planning

a. Asset protection planning;

b. Planning for disability and incompetency of recipients;

c. Business succession planning;

d. Protection from divorce;

e. Charitable giving;

f. Avoidance of litigation (enhanced when there is more to fight over);

g. Planning to minimize state income or estate taxes (in many states);

h. Income tax basis planning;

i. Controlling/restricting the disposition of assets post-death;

j. Planning for spendthrift children; and

k. Planning for clients with real estate in multiple states, including ownership, asset protection, state income taxation, spousal rights, and probate issues.

2. At the recent Heckerling Institute on Estate Planning, it was reported that in a recent survey by Trusts and Estates Magazine, respondents said the top planning concerns of those surveyed were as follows:

a. 43% avoiding chaos and family discord;

b. 41% avoiding estate tax;

c. 36% protecting children from mismanagement;

d. 35% business succession planning; and

e. 22% asset protection.

V. Planning for 2018 and Beyond

A. Refresher on Portability

1. "Portability" means that the personal representative of a deceased spouse's estate may elect to transfer any unused estate tax exemption at the deceased spouse's death to the surviving spouse. The unused exemption is known as the "Deceased Spousal Unused Exclusion" amount or the "DSUE" amount.

2. Portability is intended to provide a married couple the opportunity to utilize the exemptions of both spouses even if the couple failed to plan prior to the death of the first spouse. For example, assume H has $22.36 million of assets in 2018 and W has $0. Without portability, if W died in 2018 (without any assets), W's $11.18 million exemption would be lost. When H later dies in 2018, estate tax would be due on the $11.18 million of assets in excess of H's $11.18 million estate tax exemption. With portability, no estate tax would be due upon H's death because H could add W's unused $11.18 million exemption to H's exemption, thus giving H a total exemption of $22.36 million.

3. Surviving spouse can use the DSUE of the deceased spouse to make gifts during the lifetime of the surviving spouse. Gifts by the surviving spouse use the DSUE amount first before using the surviving spouse's exclusion amount.

4. GST exemption is not portable. First spouse must use it or lose it.

5. The DSUE amount is not indexed for inflation (even though the surviving spouse's exemption is indexed for inflation).

6. The DSUE amount "ported" to a surviving spouse includes the DSUE amount the deceased spouse acquired upon the death of his or her prior spouse.

   a. Example −Assume Wife survives Husband 1 and Wife's applicable exclusion amount is $12 million (her $10 million basic exclusion amount plus $2 million DSUE from Husband 1). Wife remarries and then predeceases Husband 2. Wife made no taxable transfers and has a taxable estate of $3 million, which she leaves to children from her first marriage. An election is made on Wife's estate tax return to permit Husband 2 to use Wife's DSUE, which is $9 million (Wife's $12 million applicable exclusion amount less her $3 million taxable estate). Accordingly, Husband 2's applicable exclusion amount is increased by $9 million, i.e., the amount of Wife's DSUE.

7. *Addressing the Portability Election in your Documents.* Regardless of a client's wealth, it is important to draft provisions into your Wills, Trusts, Prenuptial Agreements and Postnuptial Agreements that address whether the portability election will be made, who will have the authority to decide whether to make a portability election, who will bear the costs associated with filing the portability election, etc.

   a. A will could designate whether the personal representative would be required or have the discretion to make or not make the portability election. An alternative is to require the executor to make the election if the spouse so requests, or perhaps to require that the executor make the election unless the spouse directs that the election not be made.

   b. The expense of preparing an estate tax return to make the portability election must be borne by someone. Even with the simplifications allowed by the temporary and proposed regulations of not having to list the values of each asset passing to the surviving spouse or charity, the expense in preparing the estate tax return to make the election still could be significant. The will can address whether the estate or surviving spouse would pay the expenses of making the election.

   c. If the expense, which is an estate transmission expense, is allocated to the share of the surviving spouse, it will reduce the marital deduction. As long as the expense is claimed as a deduction on the estate tax return, it will not affect the DSUE amount. If, however, the expense instead is claimed on the fiduciary income tax return, then to avoid the imposition of estate tax at the first death, the expense would have to be offset by the use of a portion of the deceased spouse's applicable exclusion amount, reducing the DSUE amount passing to the surviving spouse.

d. Providing for portability in a prenuptia1 / postnuptial agreement is important as well. The surviving spouse may not be the person responsible for making the portability decision. If portability is addressed in the prenuptia1 / postnuptial agreement, consider whether these provisions will permit the terms of a spouse's will or trust to override the terms of the prenuptia1 / postnuptial agreement with respect to portability.

B. Use of Portability vs. Credit Shelter Trust

1. *Portability Decision Is Complex* – The portability provisions may cause married clients to proceed with fairly simple "all to spouse" will planning, relying on portability to take advantage of both spouses' estate exemptions, rather than using more complicated trust planning. From the planner's perspective, this is a more complex decision involving a variety of factors.

a. Caution: The overarching concern with relying on portability under the new Act is that it is unclear what will happen to the DSUE when the Act sunsets and the increased exemptions revert to pre-Act levels. For example, if an individual dies in 2018 and his entire $11.18 million estate tax exemption is ported to the surviving spouse, what is the DSUE amount available to the surviving spouse if the surviving spouse dies in 2026? Will it be $11.18 million or will it be reduced in conjunction with the sunset? This is one area the IRS should be issuing guidance to clarify.

2. *Situations Favoring Portability* - Situations favoring an approach leaving all of the assets to the surviving spouse and relying on portability include:

a. A competent spouse who can manage assets;

b. Client's desire for simplicity and to avoid using trusts;

c. First marriage or no children existing from prior marriage of either spouse;

d. Clients who are more interested in obtaining a basis step up at death of surviving spouse rather than getting future appreciation out of their estate (although basis step up may still be available through trust planning described in Section C below);

e. Situations in which it is undesirable to retitle assets among spouses prior to death;

f. There is a residence or other assets (such as large retirement accounts) that would be difficult to administer in a trust;

g. Consumption of surviving spouse is expected to exceed growth rate of assets; and

h. Desirability of the surviving spouse to be able to use the DSUE to create a trust following the first spouse's death that would be a grantor trust as to the surviving spouse.

3. *Reasons for Using Trusts even with Portability* – There are various reasons for continuing to use credit shelter trusts at the first spouse's death and not rely on portability, including:

a. The DSUE is not indexed for inflation;

b. The DSUE from a predeceased spouse will be lost if the surviving spouse remarries and survives his or her next spouse;

c. Growth in the assets of a credit shelter trust are excluded from the gross estate of the surviving spouse;

(1) Example: Assume Wife dies in 2018 with a $11.18 million estate and that Husband has a $0 estate. If all assets are transferred from Wife for the benefit of Husband, what is the impact of relying on portability vs. using a credit shelter trust if the assets grow by 6% per year until Husband's death 7 years later in 2025? Assume Husband's exemption grows by 2.45% per year due to inflation. The DSUE is not indexed for inflation.

	Portability	Credit Shelter Trust
Starting Balance	$11,180,000 (W) + $11,180,000 (H) $22,360,000	$11,180,000
Balance at end of 7 years	$ 11,180,000 (DSUE) + $ 13,244,194 (H) $24,107,471	$16,810,586
Amount subject to estate tax	$16,810,586 gross estate -$24,107,471 exemption $0	$0
Estate tax (40%)	$0	$0

(2) Example: Same facts as example 1 above except Husband dies in 2038 and his estate tax exemption reverts back to the 2017 exemption level of $5,490,000. Assume Husband's exemption grows by 2.45% per year due to inflation. The DSUE is not indexed for inflation.

	Portability	Credit Shelter Trust
Starting Balance	$11,180,000 (W) + $11,180,000 (H) $22,360,000	$11,180,000
Balance at end of 20 years	$ 11,180,000 (DSUE) + $ 8,908,644 (H) $ 20,088,644	$35,855,755
Amount subject to estate tax	$35,855,755 gross estate -$20,088,644 exemption $ 15,767,131	$0
Estate tax (40%)	$6,306,852	$0

(3) Same facts as example 2 above except that the DSUE also reverts back to 2017 exemption levels. Assume Husband's exemption grows by 2.45% per year due to inflation. The DSUE is not indexed for inflation.

	Portability	Credit Shelter Trust
Starting Balance	$ 11,180,000 (W) + $ 5,490,000 (H) $ 16,670,000	$11,180,000
Balance at end of 20 years	$ 11,180,000 (DSUE) + <$ 5,490,000> $ 8,908,644 (H) $ 14,598,644	$35,855,755
Amount subject to estate tax	$35,855,755 gross estate -$14,598,644 exemption $ 21,257,111	$0

Estate tax (40%)	$8,502,844	$0

d. There is no portability of the GST exemption;

e. There is no statute of limitations on values for purposes of determining the DSUE that begins to run from the time the first deceased spouse's estate tax return is filed whereas the statute of limitations runs on values if a credit shelter trust is funded at the first spouse's death. See *Estate of Sower v. C.I.R.*, 149 T.C. No. 11;

f. Credit shelter trust could be funded with discounted / hard-to-value assets when there may be a low audit risk at the first spouse's death;

g. Credit shelter trust assets are protected from creditors, predators and divorce;

h. Credit shelter trust provides a mechanism for the management of assets if the surviving spouse is incompetent or otherwise unable to properly manage assets;

i. Individuals other than the surviving spouse can be included as beneficiaries of the credit shelter trust, which allows assets to be distributed to beneficiaries other than the spouse without the surviving spouse using exemption to make gifts; and

j. Predeceased spouse can control the disposition of the credit shelter trust assets during the surviving spouse's lifetime and upon the death of the surviving spouse. This is extremely important for blended families / second marriages.

4. *Planning for Blended Families is Critical*. In a blended family situation, substantial inequities may result if the credit shelter approach is not used.

a. If the assets are left outright to the surviving spouse, the spouse may give or bequeath the assets to persons other than the first deceased spouse's descendants (or may favor some over others of those descendants in ways that the deceased spouse would not have wanted).

b. If even a QTIP trust is used, the surviving spouse may be able to take steps that would significantly disadvantage the deceased spouse's descendants even though the assets are "protected" in a QTIP trust.

(1) For example, if the executor makes a QTIP election and elects portability, the surviving spouse will have the DSUE amount from the deceased spouse and could make gifts of the surviving spouse's assets to his or her own descendants utilizing all of the DSUE amount and his or her gift exemption amount. (Alternatively, the surviving spouse could make a gift using just the DSUE amount, and at death might leave all assets owned by the surviving spouse to his or her descendants.) At the surviving spouse's death, the QTIP trust is required to reimburse the surviving spouse's estate for taxes attributable to the QTIP trust assets pursuant to Code § 2207A. In effect, the first deceased spouse's descendants would not have benefitted at all from the first deceased spouse's exemption amount.

(2) This could be addressed in a prenuptial agreement or other marital agreement, to provide that the portability election would be made if the surviving spouse agreed to waive reimbursement rights from the QTIP trust. For example, the decedent's will could direct the executor not to make the portability election unless the surviving spouse agrees to waive the right to be reimbursed for estate taxes from the QTIP trust at the surviving spouse's subsequent death.

c. Use of credit shelter trust to assure that the first deceased spouse's descendants are treated fairly avoids these complexities.

C. Structuring Revocable Trusts and Wills for Clients Across the Wealth Spectrum

1. Clients with less than $11.18 million net worth

a. The major focus for estate planning for clients having assets under $11.18 million will be (i) core dispositive planning, (ii) income tax planning and (iii) preservation and management of assets.

b. *Transfer Taxes Generally Irrelevant.* Transfer taxes will generally be irrelevant for clients in this range. One issue clients will face is whether to make the portability election at the death of the first spouse. Filing an estate tax return and making the election will be preferable in most cases. The assets must be valued in any event for basis purposes, and the portability regulations allow a relaxed reporting procedure to merely list assets qualifying for the marital deduction rather than listing values of each of the assets. Filling out the estate tax return will not be overly onerous. If an estate tax return is not filed to make the portability election, the planner will want a written waiver letter signed by the personal representative (and perhaps the surviving spouse and other beneficiaries).

c. *Core Dispositive Planning.* Clients will continue to need estate planning documents disposing of their assets among their desired beneficiaries and coordinating beneficiary designations to achieve the desired result.

d. *Income Tax Planning.* While transfer taxes may be irrelevant, income tax issues will remain. A key issue for clients in this range will be preserving a step-up in basis at the death of each spouse. There are several ways to accomplish this which are discussed in Section V.C.2 and V.C.3 below.

e. *Preservation and Management of Assets; Trust Planning.* A key decision will be whether to use trusts as part of the estate plan for non-tax reasons. Non-tax reasons that a trust may be appropriate include:

(1) The surviving spouse is not capable of managing assets;

(2) There is a second marriage / blended family and each deceased spouse wants to control where his or her assets will pass;

(3) The parties have a concern about the spouse's remarriage or undue influence; or

(4) There is a need for asset protection or divorce protection.

If a trust is used, consider allowing discretionary income and principal distributions for health, education, support and maintenance – not for tax reasons but to ensure that distributions are made when needed. Consider making distributions to children or others subject to the consent of the spouse. Give the spouse a lifetime or testamentary general power of appointment in order to achieve a step up in basis at the surviving spouse's death. Be aware, however, that if asset protection is a concern, creating an enforceable right in the spouse to a "HEMS" distribution or granting a general power of appointment is not desirable.

f. *Rethinking Traditional Planning Concepts.* In light of the fact the transfer taxes are largely irrelevant (absent "winning the lottery" or a change in future transfer tax laws), planners will need to rethink traditional planning concepts. For example, steps that are taken to assure qualification for the annual exclusion, to avoid retained interests in trusts, etc. may no longer be necessary. Clients may opt for owning life insurance outright instead of creating irrevocable life insurance trusts.

g. *Focus on Maintaining Standard of Living.* Rather than focusing on strategies for wealth transfer, these clients may focus more on having sufficient assets to maintain the spouses during their retirement years.

h. *Qualified Retirement Plans.* A large part of planning for retirement will be to structure withdrawals from qualified retirement plans so that they can last for the lifetimes of the spouses.

i. *Elder Law/Medicaid Planning.* For clients with modest means, planning for long-term and nursing home care is important.

j. Asset Protection Planning.

(1) *Tenancy by the Entireties.* Florida law provides that assets held as tenants by the entireties are protected from the creditors of an individual spouse. However, a creditor of both spouses could reach assets owned as tenants by the entireties. Additionally, these assets will become subject to the creditors of the surviving spouse upon the death of the first spouse to die.

(2) *Qualified Retirement Plans.* Florida law generally protects assets held in qualified retirement plans (including inherited IRAs) from creditors' claims.

(3) *Life Insurance and Annuities*. Florida law generally protects the cash surrender value of life insurance policies issued upon the lives of residents of Florida and annuity contracts issued to residents (Fla. Stat. § 222.14).

k. *State Transfer Taxes.* About half of the states have state estate taxes with exemptions considerably lower than the $10 million indexed federal exemption. Planning to avoid state transfer taxes is important for clients who have property in those states.

2. Clients with $11.18 million - $22.36 million net worth

a. In addition to the planning issues discussed above, a primary estate planning decision for clients in this range will be whether to use a credit shelter trust or rely on portability at the first spouse's death. The key to planning for these clients is <u>flexibility</u>.

b. Possible Planning Approaches

(1) *All to spouse with optional disclaimer to credit shelter trust* -This structure permits the surviving spouse to determine upon the death of the predeceased spouse whether to have

any assets pass to a credit shelter trust or whether it would be preferable to transfer the assets outright and rely on portability.

(a) Disclaimed assets in credit shelter trust do not get a basis adjustment at death of surviving spouse.

(b) Disclaimer must be made within 9 months of decedent's death even if due date of estate tax return is extended.

(c) Caution: Surviving spouse cannot hold a power over the disclaimed property in the credit shelter trust as trustee or otherwise to make distributions or appoint assets unless limited by an ascertainable standard. Otherwise, the disclaimer will not be a qualified disclaimer for tax purposes.

(2) *All to QTIPable trust for spouse (including possibility of a Clayton QTIP)* – This plan has the potential to provide an optimal approach because it would (i) provide asset protection for trust assets, (ii) permit a basis adjustment for income tax purposes for trust assets at the death of the surviving spouse, (iii) permit the GST exemption of the predeceased spouse to be used for QTIP assets by virtue of a "reverse QTIP election" under Code § 2652(a)(3) or for assets passing to the non-QTIP trust and (iv) permit the DSUE amount of the predeceased spouse to be ported to the surviving spouse.

(a) All assets could pass to a single trust that is QTIPable. If the QTIP election were made in respect to all of the assets, then the deceased spouse's applicable exclusion amount would not be used and the DSUE amount could pass to the surviving spouse. If the QTIP election were made in respect to only a fraction or percentage of the assets, then a portion or all of the deceased spouse's applicable exclusion amount would be used, reducing or eliminating the DSUE amount that could pass to the surviving spouse. If a partial QTIP election is made, the trust should be divided into two separate trusts. The drawback to this planning is that all of the assets would be held under the same terms regardless of whether the QTIP election were made – including mandatory income to the surviving spouse.

(b) A variation of this planning, and perhaps even more beneficial, would be to use a "Clayton" provision, providing that any portion of the assets that otherwise would pass to the QTIPable marital trust over which the QTIP election was not made instead would pass to a credit shelter trust. The credit shelter trust could include beneficiaries other than the surviving spouse and allow discretionary, rather than mandatory, distributions. The surviving spouse also could have preference in distributions of the credit shelter trust.

(c) Personal representative has up to 15 months after death (assuming an election is filed to extend the due date of the estate tax return) to decide whether to make a QTIP election. This is 6 months longer than disclaimer planning.

(d) Rev. Proc. 2016-49 provides procedures under which the IRS will continue to disregard unnecessary QTIP elections and treat them as null and void. However, it will treat a QTIP election as valid in certain situations, including where an executor of an estate makes a portability election under Sec. 2010(c)(5)(A) to transfer the decedent's unused applicable exclusion amount (DSUE).

(3) Exemption gift to Credit Shelter Trust with a power in an independent person to (i) make distributions for any purpose and/or (ii) grant a general power of appointment in the surviving spouse.

(a) Authorizing an independent person to make distributions for any purpose will permit assets to be distributed to the surviving spouse if it is determined that it will be more beneficial to have these assets included in the surviving spouse's gross estate, and, thus, receive a basis adjustment.

(b) Authorizing an independent person to grant the surviving spouse a general power of appointment provides flexibility to cause the assets in the credit shelter trust to be includible in the surviving spouse's gross estate, and, therefore, receive a stepped-up basis, if the trust assets would not incur estate tax or it would be more beneficial to pay estate tax and get the income tax basis step up than avoid subjecting the trust assets to estate tax.

3. Clients with more than $22.36 million net worth

a. Traditional planning strategies for large estates will generally continue to apply in addition to many of the planning issues discussed above.

(1) Formula division of assets between marital and credit shelter trusts.

(2) Retitling assets to ensure each spouse has sufficient assets to fund a credit shelter trust at the death of the first spouse.

b. *Using Portability and the DSUE to Create a Grantor Trust.* One planning technique for large estates instead of using a credit shelter trust that was not available prior to portability may be to transfer assets outright to the surviving spouse at the first spouse's death (together with the deceased spouse's exemption via portability) and then have the surviving spouse make a gift to a grantor trust shortly after receiving the assets to utilize the DSUE amount.

(1) Gift by surviving spouse uses DSUE prior to using the surviving spouse's exemption.

(2) Payment of income tax by the surviving spouse effectively means that the trust assets will grow income tax free to the trust beneficiaries.

(3) Grantor trust status could be terminated at any time, including if the income taxes on the trust assets become too burdensome for the surviving spouse.

(4) Although assets will generally acquire a date of death basis at the death of the first spouse, this technique means that the assets will not obtain a date of death basis at the death of the surviving spouse unless further planning is done. For example, the surviving spouse could repurchase the assets prior to death, which would not have any income tax consequences because the trust is a grantor trust. See Rev. Rul. 85-13. The surviving spouse could also substitute high basis assets owned by the surviving spouse for low basis assets held in the trust prior to death if the surviving spouse has a power of substitution.

(5) Grantor trust can own S corp. stock without having to make an ESBT or QSST election.

(6) Surviving spouse can sell assets to or borrow assets from the grantor trust without creating income tax.

VI. Benefits of 2018 Gifts

A. Considerations in Determining Whether to Make Gifts and How Much

1. Maintain sufficient cash flow for donor(s)

   a. Gift property that will not impact or reduce the donors' cash flow below an amount they are comfortable with, such as 2nd or 3rd homes, art, vacant land, life insurance or other non-income producing property.

   b. Cancel debts that donor does not expect repayment for. Potential may be available to take a discount on the face value of the obligation if the obligor appears financially unable to repay debt.

2. Basis issues

   a. Gifted assets take a carryover basis. Therefore, advisors must analyze whether it is more important for the donor to hold the asset at death to obtain a step-up. If a grantor trust is used, then it is still possible to retain a power of substitution over the assets, which can be used to require the assets prior to death to get a step-up. A grantor can have limited right of substitution without estate tax problems. See Rev. Rul. 2011-28. Alternatively, a donor can always buy assets back from the grantor trust if there is no power of substitution.

3. Use of credit comes off the bottom, not the top

   a. Gift needs to be in excess of the future exemption to get the benefit of the 2018-2025 exemptions. For example, a donor who has not made any gifts prior to 2018 will not specifically benefit from the higher exemptions in 2018 by making a gift of $5 million if the exemption amounts in subsequent years is $5 million or more.

4. Exemptions are as high as they have ever been and applicable federal rates and Code § 7520 rates are still low.

5. Donors are better off making lifetime gifts than transferring property at death, even if the tax rates are identical, because gifts are tax exclusive while transfers at death are tax inclusive.

   a. Example: D has assets of $1,400,000. If D makes a gift of $1 million, D will incur $400,000 in gift tax and the donee will receive $1 million. If, however, D holds $1,400,000 until his death, then D's estate will pay estate tax of $560,000 (40% x $1,400,000). The beneficiary of D's estate will only receive $840,000 ($1,400,000 - $560,000).

6. With exemptions scheduled to revert to $5+ million in 2026, there is currently another opportunity to give away a significant amount of property transfer tax free. Even if exemptions return to these levels at some point in the future, making gifts now allows the appreciation and income on transferred assets to grow in the hands of the donee, not the donor. The growth can even be compounded income tax free to the donee if transfers are made to a grantor trust.

7. Estate planning in 2018-2025 is still estate planning, just with a twist

   a. $10+ million may be very difficult for clients to give away during their lifetime. Clients may be very apprehensive about giving away such a large amount out of fear that they may need the money at some point in the future.

   b. The twist is figuring out how to protect those clients who are apprehensive and want to retain an interest in the property so that they will be able to access the value that was gifted if necessary at some point in the future with minimal or no adverse tax consequences.

B. What is the "clawback" and will it apply?

1. If a gift is made in 2018 which uses exemption in excess of the estate tax exemption in the year of the decedent's death, will estate tax have to be paid on the difference?

2. Example: Assume taxpayer who made gifts (not covered by the annual gift exclusion) of $10,000,000 in 2018 dies with $5 million of assets in 2026 when the exemption is $5 million and top rate is 40%.

<u>2018 Gift Tax Computation</u>

Taxable Gifts	$10,000,000
Prior Taxable Gifts	$ 0
Total Taxable Gifts	$10,000,000
Tax of Total Taxable Gifts	$ 3,945,800
Maximum Unified Credit	<$ 3,945,800>
Gift Tax Due	$ 0

No Gift vs. Clawback vs. No Clawback at Death

	No Gift	Clawback	No Clawback
Tentative Taxable Estate	$15,000,000	$5,000,000	$5,000,000
Adjusted Taxable Gifts	$ 0	$10,000,000	$10,000,000
Augmented Amount	$15,000,000	$15,000,000	$15,000,000
Tax on Augmented Amount	$5,945,800	$5,945,800	$5,945,800
Gift Tax on Adjusted Taxable Gifts	$ 0	$ 0*	($3,945,800)*
Gross Estate Tax	$5,945,800	$5,945,800	$2,000,000
Unified Credit	($1,945,800)	($1,945,800)	($1,945,800)
Net Estate Tax	$4,000,000	$4,000,000	$2,000,000**

* Gift tax on gifts at 2018 rates	$3,945,800
Unified Credit computed using applicable credit amount in 2026 not indexed for inflation	($3,945,800)
Total	$ 0

** $5,000,000 @ 40% = $2,000,000

3. Section 2001(g)(2) addresses the clawback by providing: "[t]he Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between --

    (A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and

    (B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent."

4. The Regulations to be issued pursuant to Code § 2001(g) will hopefully clarify that clawback will not occur. Practitioners should nonetheless caution clients making new exemption gifts of this possible risk.

C. Even if the clawback applies, is it still a good idea to make gifts in 2018-2025?

1. The donor should not be worse off than if the assets were held until death, unless (a) the assets depreciate in value between the date of gift and date of death or (b) low basis assets are gifted and the income tax cost of losing a stepped-up basis is greater than the estate taxes saved on the appreciation in the assets since the date of transfer (which always have been caveats in making lifetime gifts).

2. The clawback would impose tax only on the value of the gift on the original date of transfer. The income and appreciation of the gifted property would still avoid estate tax.

VII. Planning Ideas for 2018-2025 to use Lifetime Gift/GST Exemption without the Grantor or the Grantor's Spouse Retaining any Interest in the Transferred Property

Before undertaking any transactions to fully utilize gift or GST exemptions, it is important to determine exactly how much of each exemption you or your client have used. This includes carefully reviewing prior gifts to trusts. Even if the gift tax return does not report an allocation of GST exemption to a gift to a trust, it is possible that GST exemption could have been automatically allocated to the transfer pursuant to Code § 2632, even if the current beneficiaries are only one generation below the transferor.

A. Gifts to grantor dynasty trusts for the benefit of children and descendants

1. Use gift and GST exemption to transfer assets to dynasty trusts for the benefit of children and descendants, thereby getting income and appreciation out of transfer tax system for generations to come.

2. Can supercharge the benefit of the exemptions by making the trust a grantor trust. Because grantor is legally responsible for the payment of all income tax on income and gains of trust assets, the payment of such tax is not treated as an additional gift to the trust or its beneficiaries. Rev. Rul. 2004-64. This effectively allows the income and appreciation to grow inside the trust income tax free.

3. The benefits can be supercharged even more by gifting assets which are subject to valuation discounts, such as business interests or fractional interests in real property (see *Defined Value Formula Gifts* below for ways to protect against valuation adjustments).

   a. For gifts of real property (or interests in entities holding real property), the grantor could lease the transferred property back from the trust and pay fair market rent if the grantor has a desire to use the transferred property after making the gift. This permits the grantor to transfer additional funds into the trust gift tax free.

Additionally, no income tax should be due on the rent. This is an especially good idea for vacation homes.

b. On October 20, 2017, the IRS withdrew the controversial 2704 proposed regulations that would have significantly curtailed valuation discounts applicable to transfers of interests in closely-held family businesses for tax purposes. The 2704 proposed regulations will not be revised and republished while the current administration is in office. It is possible that these rules could be revived under a different administration, but for now and the foreseeable future, they should not be of concern to taxpayers and tax practitioners.

4. Cash is a great asset to gift as well for multiple reasons because it provides the trustee flexibility to purchase assets from the grantor on an installment basis (see *Sales to Grantor Trusts* below) and there is no potential IRS dispute over the value of a cash gift. There is also no problem with the loss of basis step-up (see below).

B. Trusts for grandchildren (and more remote generations)

1. Clients may have exemptions remaining, but not want to make more gifts for the benefit of children because they have already taken care of them and do not want to waste GST exemption on possible distributions to children.

2. Create dynasty trusts that are grantor trusts for the benefit of grandchildren and more remote descendants and allocate GST exemption.

a. Trusts can last up to 360 years in Florida.

b. A trust protector can be included in the trust with the power to add to the class of beneficiaries, which could be exercised to add the children if a need ever arose. However, distributions to children would waste GST exemption that was allocated to the trust.

c. Caution: Crummey powers may be given to trust beneficiaries to get annual exclusions for gifts to a grandchildren's trust. However, the crummey annual exclusion is only for gift tax purposes. GST exemption still needs to be allocated to a transfer subject to a crummey right of withdrawal unless (a) the trust is for the sole benefit of the powerholder and (b) the assets of the trust will be includible in the gross estate of the powerholder at his or her death. Code § 2642(c).

3. Consider "generation-jumping", especially if the donor does not have any GST exemption remaining, but has gift tax exemption remaining.

a. Only one GST tax applies regardless of how many generations are skipped. Code § 2653. Therefore, a donor can create a trust for the benefit of great-grandchildren and pay only one GST tax.

b. Since GST exemption would not be allocated to the trust, the assets will not be subject to estate tax until the death of great-grandchildren. This would avoid two levels of estate tax (children and grandchildren).

C. Cancellation of existing debt obligations

1. The value of the gift is presumed to be the amount of unpaid principal of the obligation, plus accrued interest to the date of the gift. Treas. Reg. § 25.2512-4. However, the donor may assert a lower value for a promissory note if there is satisfactory evidence that the note is worth less than the unpaid principal plus accrued interest because of factors such as the interest rate, date of maturity, insolvency of the obligor and insufficency of the collateral. Treas. Reg. § 25.2512-4.

2. The cancellation of a debt owed by a grantor trust to the grantor will be disregarded for income tax purposes. Rev. Rul. 85-13.

3. Cancellation of indebtedness income under Code § 108 should not arise to the obligor if the cancellation is intended to be a gift. Rev. Rul. 2004-37.

4. Consider gifting cash to a trust that will be used to repay a note instead of simply cancelling the note.

a. It is more conservative for the donor to gift cash to the trust if the donor is attempting to claim crummey annual exclusion gifts.

b. Generally, it's a great idea to repay promissory notes in full during the grantor's life because it gives more credibility that the initial transaction creating the obligation was bona fide and not a disguised gift. Additionally, the satisfaction of a note by a grantor trust during the grantor's life avoids the potential that the IRS will treat the death of the grantor as a disposition triggering gain. See *Madorin v. Commissioner*, 84 T.C. 667 (1985).

5. If the debt originated from an installment sale to someone other than a grantor trust, then the cancellation of the debt will accelerate the deferred gain or loss, potentially creating income tax for the donor. Code § 453B(f). Effectively, the cancellation is treated for income tax purposes as if the obligor paid off the remaining balance of the note.

6. Before cancelling a debt obligation, the donor should consider the history of the loan and the payments thereunder. The IRS has successfully argued that a transfer of funds was actually a gift, and not a loan, where the donor

did not have an expectation of repayment at the time the initial transfer was made (notwithstanding any loan documentation to the contrary at the time of the transfer), and there was no history of repayment.

a. This could result in substantial tax consequences to the donor because the transfer will be treated as a gift in the year it was initially made, not in the year that the loan was cancelled, thus triggering possible interest and penalties.

b. The substantial changes and window in the 2018-2025 gift tax laws should provide strong support for a donor to defend against this argument by the IRS. A donor could argue that he or she decided to forgive the loan to take advantage of $11.18 million worth of gifts.

D. Life Insurance Planning

1. Existing ILITs

a. Make lump sum cash gift into ILITs to pay for future premiums or purchase assets that will generate the income necessary to pay premiums. This is especially a good idea if (1) the trust does not contain crummey withdrawal powers, (2) the donor already makes or intends to make annual exclusion gifts to the trust beneficiaries outside of the trust or (3) the annual premiums exceed the amount of available annual exclusions.

b. If the terms of the existing ILIT are not great, decant the policy into a new ILIT with more favorable terms, and then make the gift to the new ILIT.

2. New ILITs

a. Make lump sum cash gift into a new ILIT to purchase a new policy (e.g., single premium policy) or to purchase a policy owned by an existing ILIT whose terms are not as favorable as the new ILIT.

(1) Sale between trusts will be disregarded for income tax purposes if each trust is treated as having the same grantor.

3. Existing policies owned by the insured

a. Gifting cash to a trust to purchase the policy from the owner is better than gifting the policy to the trust.

(1) If the policy is gifted, the insurance proceeds will be included in the estate of the insured if the insured dies within 3 years of the date of the transfer. Code § 2035.

However, a policy that is sold for fair market value can be removed from the insured's estate even if the insured dies with 3 years of the sale. Code § 2035(d).

(2) The purchase and sale of the policy may have income tax consequences unless the seller is treated as the grantor of the purchasing trust for income tax purposes. See Rev. Ruls. 2009-13 and 2009-14.

(3) Structure the transaction to avoid the "transfer-for-value" rule of Code § 101. The failure to meet one of the exceptions may cause at least a portion of the proceeds to be taxed as ordinary income (note: a sale from the grantor to his or her grantor trust avoids the transfer for value rule because the policy is treated as being transferred to the insured. PLR 200636086).

(4) Avoid the step transaction doctrine. Upon the receipt of cash by the trust, it is best for some time to pass before the purchase. Additionally, the trustee may want to explore other investment opportunities before deciding if the policy is a good investment.

(5) The gift tax return for the donor will reflect a cash gift rather than a gift of the policy, which may or may not reduce the chances of an audit. The donor should consider disclosing the sale of the policy by attaching a statement to the return pursuant to Treas. Reg. § 301.6501(c)-1(f)(4) to commence the statute of limitations for the IRS to challenge the transaction.

4. Valuing policies for gift tax purposes

a. Treasury regulations *do not* sanction the use of cash surrender value as an adequate measure of fair market value.

b. Generally, interpolated terminal reserve value is an accepted measure of value for policies on which additional premiums will be due. If the policy is a single premium or paid-up, then replacement cost may be used. Treas. Reg. § 25.2512-6(a).

c. It may even be necessary to explore the secondary market to determine fair market value if the insured is older or in declining health.

5. Life insurance is a great way to leverage the GST exemption of the donor by structuring the donee trust as a dynasty trust. In addition, ILITs can

provide liquidity for the payment of estate tax by purchasing assets from, or loaning cash to, the estate after a decedent's death.

E. Exercising Powers of Appointment

1. A general power of appointment over existing trust assets may be exercised to appoint the property into a new trust and avoid estate tax at the death of the power holder. The power holder will be treated as the transferor of the property for gift and GST tax purposes, thus using the power holder's exemptions and starting a new measuring period for the maximum duration of the trust. Code § 2514(b).

2. The exercise of a limited power of appointment will be treated as a general power if the limited power is exercised by creating another power of appointment which can be used to postpone the vesting period of the trust property (the "Delaware tax trap"). Code § 2514(d). Therefore, the power holder can appoint the property into a new trust and create another limited power of appointment in a beneficiary of the new trust. The original power holder will be treated as the transferor of the appointed property for gift and GST tax purposes, thus using the power holder's exemptions and starting a new measuring period for the maximum duration of the trust.

F. Late allocations of GST exemption to existing trusts

1. Even if a client has already exhausted his or her gift tax exemption through lifetime gifts, they may have GST exemption remaining.

2. Existing trusts should be analyzed to determine whether a late allocation of GST exemption can be made to avoid GST or estate tax that will be incurred in the future. See Code § 2642(b)(3).

3. If existing trusts are not currently structured as GST trusts, consider modifying these trusts (either judicially or nonjudicially) or decanting into new GST trusts in order to use the donor's GST exemption.

VIII. Planning Ideas for 2018 to Use Lifetime Gift/GST Exemption Where the Grantor or the Grantor's Spouse Desires to Retain an Interest in or from the Transferred Property

A. Sales to Grantor Trusts

1. One of the best ways to leverage transfers to trusts is to sell an asset to the trust, have the trust pay for it in installments and use the income from the asset to make the note payments. This allows the grantor to get back the value of the asset on the date of sale, but all appreciation in the asset will stay in the trust to pass outside of the grantor's estate.

a. Example: Donor sells an asset worth $10,000,000 to a grantor trust in exchange for a promissory note. Donor receives payments of principal and interest at the current low rates. If the asset is worth $15,000,000 when grantor dies, then $5 million has escaped estate tax.

2. The sale is disregarded for income tax purposes so no gain or loss will be recognized on the transfer. Rev. Rul. 85-13. The trust will have a carryover basis in the purchased assets. Additionally, no income tax is due on the interest payments back to the grantor.

3. Although there is no bright-line rule, practitioners generally agree that a trust should own assets equal to at least 10% of the purchase price. The remainder of the purchase price can be paid by the issuance of a promissory note. Income generated from the purchased assets (or any other assets of the trust) can be used to make note payments.

4. Economically, this is a low risk transaction for the grantor, but has substantial tax savings and can significantly benefit the donee.

   a. Cash can be returned to the donor almost immediately in the form of a down payment by the trust.

   b. The grantor is obligated to pay the income tax on the income generated by the trust assets, which further reduces the gross estate of the grantor and allows the trust assets to grow income tax free to the trust.

   c. The income and appreciation of all purchased assets in excess of the interest rate due under the note increases the value of the trust, not the grantor's estate. Only the value of the note, which has a fixed growth rate equal to the interest, should remain in the grantor's estate.

   d. The grantor receives a consistent income stream back from the trust pursuant to the note terms. Payments under the note can be structured in an amount to meet the grantor's cash needs. Alternatively, note payments can be interest only and prepayments of principal can be made as necessary to meet the grantor's cash needs.

   e. If the note payments cannot be satisfied in cash, then the trust can retransfer assets back to the grantor as payment.

   f. Grantor can retain a secured interest in the assets sold to the trust.

5. A gift tax return would report a gift of the initial "seed" assets to the trust if the trust does not have sufficient equity. The seed gift is often in the

form of cash, which may or may not reduce the risk of an audit. The donor should still consider attaching a statement to his or her gift tax return pursuant to Treas. Reg. § 301.6501(c)-1(f)(4) disclosing the sale to get the statute of limitations running. Additionally, the donor should not be required to answer "yes" to the question on the gift tax return asking whether any item on Schedule A reflects a valuation discount because Schedule A will only reflect a gift of cash.

6. The purchased assets should still be appraised if market values are not readily ascertainable. However, it is advisable for the assets to be sold for a price negotiated between the parties at arm's length after giving due consideration to the appraisal rather than simply relying on the appraised value without further negotiation.

   a. If the IRS argues that the assets were sold for less than fair market value, then the donor can still argue that the transfer was made in the ordinary course of business (i.e., bona fide, at arm's length and free from donative intent). If a transfer is made in the ordinary course of business, then it is considered to be made for adequate and full consideration, regardless of whether the purchase price is less than fair market value. See Treas. Reg. § 25.2512-8.

   b. An appraisal may include a combined discount that is substantially higher than anything that the IRS is willing to accept. The negotiation of a sales price permits the donor to report on the disclosure statement that the assets were sold for greater than its appraised value.

7. Gifted assets retain a carryover basis in the hands of the grantor trust. However, this does not mean the assets cannot later receive a step up in basis at the donor's death. The grantor can retain a power to substitute assets of the trust (other than Code § 2036(b) stock) during his lifetime under Code § 675(4), which can be exercised near his or her death to substitute high basis assets into the trust for lower basis assets, or substitute cash into the trust for the low basis assets. If a trust does not contain a power of substitution, the grantor can purchase the assets from the trust shortly before his or her death for cash. The sale will be disregarded for income tax purposes because the trust is a grantor trust. It may even be a good idea to borrow money, if necessary, to repurchase the assets. After death, cash can be generated to repay the loan by reselling assets. See Rev. Rul. 2011-28.

B. Long-term Grantor Retained Annuity Trusts (GRATs)

1. Grantor transfers assets to a trust, but retains the right to receive an annuity from the trust at least annually. The value of the gift is equal to the value of the remainder interest in the trust calculated at the time of the

gift and is based, in part, on the Code § 7520 rate. The lower the Code § 7520 rate, the smaller the value of the remainder interest.

2. The purpose of a long-term GRAT is to lock in the Code § 7520 rate, which is currently near historical lows, for an extended period of time and transfer the appreciation in the asset without transfer tax to the remainder beneficiaries of the trust.

3. Although the assets of the GRAT will be included in the grantor's gross estate if the grantor dies during the annuity term, Treasury released final regulations under Code § 2036 in November 2011 which provide that the amount to be included in the grantor's gross estate for estate tax purposes is that portion of the trust corpus necessary to generate sufficient income to satisfy the retained annuity using the Code § 7520 rate in effect at the time of the decedent's death.

    a. The appreciation of the trust assets in excess of the Code § 7520 rate (currently 2.6%) is not included in the decedent's gross estate.

    b. The decedent will realize a benefit as well if the Code § 7520 rate is higher at date of death than date of funding because a higher rate at death will result in a lower amount of principal necessary to produce the decedent's retained income interest.

4. Some practitioners have even suggested doing a 99 year GRAT to maximize the potential benefits. However, a 99 year GRAT has not been the subject of a court case or PLR. It is possible the IRS may consider it to be abusive.

C. Domestic Asset Protection Trusts (DAPTs)

1. Donor creates an irrevocable trust in one of the jurisdictions that permits DAPTs and retains an interest in the trust as a discretionary beneficiary. An independent person is typically designated to serve as trustee so that the donor does not have any control over distributions.

2. DAPTs are intended to shield assets of the settlor from the settlor's future creditors.

3. Gifts to these trusts can be completed gifts for gift tax purposes even if the donor retains an interest in the trust as a discretionary beneficiary, which means exemption will be used.

4. The retention of an interest in the trust as a discretionary beneficiary does not, by itself, cause the assets to be included in the estate of the grantor under Code § 2036. However, assets of the trust will be included in the estate of the settlor under Code § 2036 if (i) there was an implied agreement or understanding between the settlor and trustee that

distributions would be made for the benefit of the settlor or (ii) creditors would be able to reach the assets of the trust under state law. PLR 200944002.

5. Florida law does not provide creditor protection for assets held in a self-settled trust created under Florida law. It is unsettled under existing caselaw whether assets held in a self-settled asset protection trust created by a Florida debtor in a jurisdiction that permits such trusts (such as Alaska, Delaware, Nevada etc.) will be protected from the creditors of the Florida debtor.

6. Caution: the Florida Uniform Fraudulent Transfer Act (F.S. Chapter 726) can be invoked to recover assets (or equivalent value) transferred to third parties (including trusts) if the transfer is made with the actual intent to hinder, delay or defraud a creditor, or without receiving reasonably equivalent value.

D. Family/Credit Trusts

1. Donor creates an irrevocable trust for the benefit of spouse and descendants during the spouse's lifetime. The assets of the trust will not be included in the spouse's estate for estate tax purposes.

2. Donor will typically be treated as the grantor of this trust for income tax purposes since spouse is a beneficiary, unless certain limitations are drafted into the trust. Code § 677(a).

3. Spouse may have a limited power of appointment, but it should not be exercisable in favor of the donor spouse.

   a. If the beneficiary spouse can appoint the trust property for the benefit of the donor spouse, then this could arguably be viewed as a retained interest subjecting the trust assets to the donor's creditors under state law and thus causing estate tax inclusion under Code § 2036.

   b. Alternatively, the IRS may argue that there was an implied agreement or understanding that the spouse would appoint the property back into trust for the donor spouse, thus causing inclusion under Code § 2036 or potentially Code § 2038.

   c. Several steps can be taken to minimize the inclusion risk if the spouse wants to be able to appoint the property back to the donor spouse, such as waiting as long as possible (several years) to exercise the power appointing property back to the donor spouse.

   d. Consider granting authority to the Trust Protector to give property back to the donor in trust.

4. Trustee(s) should be mindful of making distributions to the spouse because the gift exemption (and GST exemption if allocated to the trust) of the donor spouse would be wasted. Trust assets should be considered as a last resort for the spouse since the donor can make unlimited gifts directly to spouse outside of the trust tax free.

5. The trust should contain a clear definition of the term "spouse" to define what interest, if any, the spouse will have as a beneficiary in the event the donor and donor's spouse get divorced after the creation of the trust.

6. Gifts to a trust of which the spouse is a beneficiary generally cannot be split for gift tax purposes under Code § 2513 unless the value of the spouse's beneficial interest is capable of being valued so that it can be severed from the rest of the gift. Treas. Reg. Code § 25.2513-(1)(b)(4). However, see *Robertson v. Commissioner*, 26 T.C. 246 (1956) (spouse was permitted to split gifts made to a trust of which she was a discretionary beneficiary because the trustee was required to consider other assets and resources available to such spouse in making distributions, and the sufficient personal assets available to the spouse showed that there as no likelihood that any distributions would be made.)

7. A beneficiary cannot have a right to receive a distribution from the trust that would satisfy the legal obligations of the donor to support that beneficiary.

   a. For example, the trust should not permit distributions to be made for the support and maintenance of the donor's spouse or minor children because the donor has a legal obligation under state law to support his or her spouse and minor children. The failure to prohibit such distributions may cause the assets of the trust to be included in the donor's estate for estate tax purposes under Code § 2036.

   b. Trusts should include a savings clause that provides a blanket prohibition on distributions in satisfaction of a legal obligation, such as "none of the principal and none of the income therefrom shall ever be payable to me or to discharge any obligation of me to my creditors, to my estate or to the creditors of my estate. The authorization to distribute income or principal for a beneficiary's support does not include authority to make distributions that would discharge or substitute for any obligation of mine to support the beneficiary. I intend that no distribution from a trust hereunder shall be deemed to discharge or substitute for my obligation to support a beneficiary of a trust hereunder, and I direct that no distribution shall be made that would have that effect."

E. Non-reciprocal Trusts (e.g., Spousal Lifetime Access Trusts (SLATs))

1. Each spouse creates an irrevocable trust for the benefit of the other spouse.

2. How to avoid the "reciprocal trust doctrine".

   a. *Estate of Levy v. Commissioner*, T.C. Memo 1983-453 held that the reciprocal trust doctrine did not apply to trusts created by spouses for the benefit of each other because wife had a broad lifetime limited power to appoint assets of the trust created for her benefit to anyone other than herself, her creditors, her estate and the creditors of her estate, while husband did not have a power of appointment in the trust created for his benefit.

   b. Notwithstanding *Estate of Levy*, it is advisable to take precautions in addition to creating different powers of appointment to avoid the reciprocal trust doctrine, such as:

      (1) Create trusts at different times;

      (2) Fund trusts with different assets and different values;

      (3) Have different distribution standards (HEMS vs. any purpose);

      (4) Require trustee to consider other assets of one spouse, but not in the other trust;

      (5) Permit one trust to be converted to a unitrust; and

      (6) Have different trustees and removal powers.

3. Non-reciprocal trusts can also be created between persons who are not married (e.g., siblings, partners, etc.). Additional caution should be used when trusts are created outside immediate family members because the IRS may be more likely to use substance over form arguments.

4. Potential consequences if trusts are treated as reciprocal.

   a. Trust assets will be included in the donor spouse's estate for estate tax purposes under Code § 2036 to the extent mutual value was contributed to the reciprocal trust. Drafter should build in a contingent marital trust where any assets included in the donor spouse's estate would be transferred to defer estate tax at the death of the donor spouse.

   b. Although the reciprocal trust doctrine is a tax law concept, state courts may invoke a similar concept to treat each donor as if he or she created the trust for himself or herself. This would result in self-settled trusts for each donor, which are not valid under Florida law to protect trust assets from the creditors of the settlor.

F. Terminate QTIP Trusts

1. Many use QTIP trusts to (1) delay taxation on the trust property until his or her spouse's death; (2) provide income for his or her spouse's life; (3) control the disposition of the remainder interest on his or her spouse's death; (4) protect assets from creditors; and (5) balance the taxable estates of spouses to assist a less wealthy spouse in using his or her estate tax unified credit.

2. An individual can use gift tax exemption by terminating a QTIP trust.

a. Termination of a QTIP Trust may result in the surviving spouse making two separate gifts: (1) a gift under Code section 2511 of the present value of spouse's life income interest determined under Code section 7520 (unless spouse is compensated for such interest); and (2) a gift under Code section 2519 of the remainder interest (if distributed to the remainder beneficiaries) equal to the fair market value of the trust less the present value of spouse's life income interest.

(1) Code § 2519 gift is not eligible for the annual exclusion.

(2) When a Code § 2519 gift (as opposed to a Code § 2511 gift) results in actual gift taxes, spouse has a right to recover from the trust the gift tax under Code § 2207A. This results in a "net gift" whereby the gift tax is calculated based upon the amount of property actually received by the remainder beneficiaries. However, spouse must use his or her gift tax exemption against the gift since the right of recovery under Code § 2207A applies only to actual taxes incurred, not the use of exemption. If a tax results from the QTIP termination and spouse chooses not to exercise his or her right of recovery under Code § 2207A, spouse will be treated as making an additional taxable gift equal to the amount of taxes spouse could have collected. See Treas. Reg. § 25.2207A-1(b).

3. *Estate Tax Consequences*. Code § 2035(b) adds to the gross estate for federal estate purposes the amount of any gift taxes paid on gifts made by the decedent within three years of death. In *Estate of Anne Morgens v. Commissioner*, No. 10-73698, 9th Cir. (May 3, 2012), Aff'g 133 T.C. No. 17 (December 21, 2009), the U.S Court of Appeals for the Ninth Circuit affirmed the Tax Court's holding that gift tax paid on a Code § 2519 is includible in the spouse's estate under Code § 2035(b) when the spouse

dies within three years of the trust termination notwithstanding the spouse's exercise of the right of recovery from the trust under Code § 2207A. The Court held that Code § 2035(b) applies based upon its finding that the spouse was legally responsible for the tax notwithstanding her right to recover the taxes from the trusts.

4. *Income Tax Consequences*. There are also income tax consequences to consider in deciding whether to terminate a QTIP trust. Code § 1001(e) provides that, for purposes of determining gain or loss on the disposition of the income interest in the QTIP trust, the adjusted basis of the life income interest should be disregarded. Therefore, when spouse "sells" his or her income interest when a QTIP trust is terminated, the entire value of the property received in exchange for the right to receive income is treated as gain.

5. *Divide the QTIP Trust First*. It may be possible to divide a QTIP trust into two separate trusts prior to termination so that the above tax implications can be minimized to the separate trust that is subsequently terminated. *See* PLRs 200723014 and 199926019.

IX. Using Defined Value Formula Gifts to Protect Against Unanticipated Gift Tax

A. This is a formula transfer structured to define the specific value of a certain asset being transferred to a donee. If given full effect, the clause should operate to avoid any unanticipated gift tax for the donor.

1. Example: Donor makes a gift of $500,000 worth of XYZ stock. If the value of one share of XYZ stock is determined to be $1,000 pursuant to an appraisal obtained by the donor, then the books of XYZ are adjusted to reflect 500 shares being transferred for the benefit of the donee. If the IRS audits the transaction and determines that the per share value is actually $2,000, then donor has still only made a gift of "$500,000 worth of XYZ stock." Therefore, donee only has a legal right (which has not changed despite the IRS audit) to 250 shares, not 500 shares. Accordingly, the donor has transferred only 250 shares and retained the remaining 250 shares.

B. Generally, this type of transfer will only be necessary when the donor intends to make a gift of a specific dollar amount of property, and no more than that amount, such as when a donor is using up the remaining amount of his or her gift tax exemption.

C. Defined value clauses should not be confused with "savings clauses", which the IRS has successfully attacked for decades. On their face, savings clause appear to be essentially the same as defined value formula clauses. From a technical standpoint, the two clauses operate differently. Courts have upheld defined value formula clauses while rejecting savings clauses because of these technical differences. Careful drafting is a must.

1. Defined value formula clause: "I hereby gift $100,000 worth of XYZ stock to Trust A." Here, the value of the gift is fixed at $100,000 regardless of the shares of stock necessary to satisfy that amount.

2. Savings clause: "I hereby gift 10 shares of XYZ stock worth $100,000, but if such shares are finally determined to be worth more than $100,000, then the amount of shares gifted shall be reduced." Here, the donor made a gift of 10 shares, but has the right to recover some portion of the shares if their value is later determined to exceed $100,000.

* The distinction lies in determining what property right is created in the donee at the time of the gift.

D. Several cases in recent years have upheld the use of defined value formula clauses. See *Hendrix v. Commissioner,* T.C. Memo 2011-133; *Petter v. Commissioner*, 653 F. 3d 1012 (9th Cir. 2011); *Christiansen v. Commissioner*, 586 F. 3d 1061 (8th Cir. 2009); *McCord v. Commissioner*, 461 F.3d 614 (5th Cir. 2006). However, each case involved the use of a charity to receive any amount of the transfer that would have otherwise caused a gift tax if transferred to the non-charitable donee.

E. Enter *Wandry v. Commissioner*, T.C. Memo 2012-88 (March 26, 2012), which is the first court opinion upholding the use of a defined value formula gift where a charity was not involved. The IRS issued a notice of NonAcquiescense in regard to the *Wandry* decision. See *IRS Announcement Relating to: Joanne M. Wandry, Albert D. Wandry, A.K.A. A. Dean Wandry,* 2012-46 I.R.B. 543 (IRS ACQ 2012)

F. If the donor desires to transfer multiple assets pursuant to formula, consider contributing these assets first to an entity and then transferring an interest in the entity. This would permit a single asset to be transferred pursuant to the formula.

G. Planning points when using defined value formula gifts:

1. Include an adjustment clause that will automatically adjust the property between the donor and donee to the appropriate allocation under the formula clause once the value is finally determined.

2. Use a grantor trust as the donee. There will be a period of time where the IRS has the opportunity to challenge the gift. This will create uncertainty as to the appropriate allocation of the gifted asset between the donor and donee. Using a grantor trust alleviates the need to file amended income tax returns if the initial allocation is improper because all tax items will have been reported on the grantor's individual return.

3. Prepare the gift tax return consistent with the formula gift by reporting the formula and the value.

4. The grantor should not be the trustee of the donee trust. It is advisable to have an independent trustee acting on behalf of the trust beneficiaries to ensure that the trust receives the proper amount of the gifted asset pursuant to the formula.

H. One alternative is gifting cash and doing a defined value formula sale.

1. Gift tax return reports cash gift and no valuation discounts.

2. It is advisable to disclose the sale by filing a disclosure statement to start the statute of limitations. Treas. Reg. § 301.6501(c)-1(f)(4).

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Michael Minton is the Chair of the firm's Agribusiness Industry Team and the new Solar Energy Industry Team. He represents family businesses with an emphasis on generationally-owned agricultural businesses. He assists with their organizational structure, federal income, estate and gift tax planning and business succession planning. He offers his clients extensive experience focusing on tax issues related to agri-business, as well as water resource issues and new innovative uses of land for value added propositions.

Mr. Minton's clients receive the benefit of his more than 35 years of experience in Florida agri-business and interaction with agencies that regulate the utilization and optimization of their assets and business opportunities. Mr. Minton is a past Vice-Chair of the Governing Board of South Florida Water Management District (1997-2001). He is also a member of the Water Resource Assessment Team (WRAT) of the Central Florida Water Initiative and has stayed involved in water related issues across the State of Florida.

Key Practice Areas

- Agribusiness
- Estate and Succession Planning
- Gift Tax
- Tax
- Water Resources

Primary Industries

- Agribusiness
- Healthcare and Life Sciences
- Real Estate Development
- Solar Energy

Professional and Civic Activities

- American Bar Association, Tax Section – Member
- The Florida Bar, Tax Section
  - Chair Elect, 2017-2018
  - Member, Directors Committee
  - Past Vice Chair, Long Range Planning Committee
  - Past Chair, Agricultural Tax Law Committee
  - Chair, Specialty Tax Areas Committee

- Florida Chamber of Commerce – Member of the Board of Directors; Regional Chair for Palm Beach/ Treasure Coast
- University of Florida College of Law Center Association, Inc.
    - Chair of the Nominating Committee
    - Florida Alumni Tax Advisory Committee (FATAC)
    - Past Chair of the Board of Trustees
- University of Florida Foundation Board – Member of the Board of Directors
- Orlando Economic Partnership – Board of Directors
    - Member of the Water Resource Assessment Team (WRAT) of CFWI
- Florida Tax Watch – Board of Trustees
- Martin Health Systems
    - Finance Committee
    - Past Board Member
- Martin Health Foundation – Past Board Member
- South Florida Water Management District Governing Board
    - Past Vice Chairman
    - Member, 1997 – 2001
- Harbor Branch Oceanographic Institute Foundation, Inc.
    - Board Member
    - Past Chair of the Foundation
- UCF College of Medicine, Co-chair of the Charter Class Scholarship Fundraising Committee
- The Florida Bar, Agricultural Law Committee – Past Chairman
- The Florida Bar Foundation, Inc. – Fellow
- Orlando Regional Chamber of Commerce – Past Board Member
- Governor's Committee for a Sustainable Treasure Coast-Member and Chair, Natural Resources Committee
- (IFAS) Food and Resource Economics Dept./Food & Agricultural Sciences – Member of the External Advisory Board
- Treasure Coast Agricultural Research Foundation, Inc. – Past Legal Advisor
- Governor's Growth Management Task Force – Past Member
- Judicial Nominating Commission for the Nineteenth Judicial Circuit – Past Member
- St. Lucie County Chamber of Commerce – Past President
- Indian River State College Foundation Board, Inc. – Member, Past Chair
- Treasure Coast University Task Force – Past Member
- U.S.D.A. Lab Site Selection Task Force – Past Chairman
- Fort Pierce Main Street – Past Board Member

Charitable and Pro Bono Service

Indian River State College Foundation, Inc. - Past Chair

Mr. Minton has been an integral leader for the firm in support of its partnership with the Indian River State College "President's Challenge to SOAR/Take Stock in Children" program. This program has awarded 915 scholarships over the past 20+ years to benefit eighth and ninth grade students who are mentored throughout high school and college. This dynamic program helps to break the cycle of poverty by giving at-risk children the opportunity to pursue education and the chance for a future of success.

University of Central Florida College of Medicine Endowed Scholarship

Mr. Minton is the founding member and past co-chair of the UCF College of Medicine's Scholarship Committee, a group of University officials and local professionals whose mission was to raise funds for the scholarships for all 41 students in the inaugural class. Dean Mead was the first organization in central Florida to announce that it would fully fund an endowed scholarship at the College. The scholarship was named for Mr. Robert Mead, one of the founding partners at the law firm, and a significant legal advisor to central Florida's medical community for more than 40 years.

Education

- Master of Laws (LL.M.) in Taxation: University of Florida Levin College of Law, Gainesville, Florida, 1982
- Juris Doctor: University of Florida Levin College of Law, Gainesville, Florida, *with honors*, 1981
- Bachelor of Science Degree: University of Florida, Gainesville, Florida, *with high honors*, 1979

Bar Admissions

Florida

Recognition & Awards

- Recipient of the University of Florida College of Agricultural and Life Sciences (CALS) Alumni and Friends Award of Distinction, 2017
- Awarded the The Living Legacy Award by Treasure Coast Chapter of the Association of Fundraising Professionals, 2016
- Awarded the Pete Hegener Leadership Award by the St. Lucie County EDC, 2016
- Awarded Special Merit Award by The Florida Bar Tax Section, 2009
- Named an Outstanding Tax Attorney in *Florida Trend* Magazine's Legal Elite, 2005 – 2008, 2011, 2012, 2014 and 2015
- Named an Outstanding Tax Attorney in *Chambers USA*, America's Leading Business Lawyers, 2006 – 2017
- Named an Outstanding Tax Lawyer in *The Best Lawyers in America*®, 2007 – 2018
- Named an Outstanding Agriculture Lawyer in *The Best Lawyers in America*®, 2018

- Named one of Florida's Top Environmental Attorneys and Outstanding Tax Attorney, 2007-2017 in *Florida Super Lawyers* Magazine
- Florida Blue Key, 2017
- Outstanding Conservationist Award, 2003
- Martin Luther King, Jr. Community Service Award, 1997
- Martindale Hubbell: AV Rating

Speaking Engagements

- Panel Moderator, *Florida's Current Climate is Ripe for Solar Energy, Florida Agriculture Financial Management Conference (FAFMC), B Resort & Spa, Orlando, FL, November, 2017*
- Moderator, *Agricultural Cost-Share and Payment for Environmental Services – Identifying and Seizing the Right Opportunities for Your Business*, Florida Agriculture Financial Management Conference (FAFMC), Omni Orlando Hotel, Orlando, FL, August 25, 2016
- *Tax and Succession Planning for Regions Bank Private Wealth Management*, The Lighthouse Restaurant, Fanning Springs, February 24, 2016
- Panel member, *The Value of Water to the Business Community and Our Economy*, Water Alliance Forum, Hyatt Regency, Sarasota, FL, November 12, 2015
- *With Adversity Comes Opportunity*, Third Annual Business & Manufacturing Conference, Indian River State College, Fort Pierce, FL, October 8, 2015
- Moderator, *Central Florida Water Initiative: Water for Tomorrow*, Florida Cattlemen's Association Annual Convention, Omni Orlando Hotel, Orlando, FL, June 16, 2015
- Panel Member, *Securing Florida's Water Future*, Florida Chamber's Board of Governors Capitol Days, March 4, 2015
- *Working Together to Advance a Regional Water Strategy,* Central Florida Partnership Regional Leadership Forum, Hyatt Regency Orlando International Airport, November 21, 2014
- *Water Policy Panel Discussion,* National Pest Management Association's annual PestWorld Conference, The Walt Disney Swan and Dolphin Convention Center, October 22, 2014
- *Connecting Our Shared Values with Our Shared Future*, Central Florida Partnership's Regional Leadership Forum, Hyatt Regency Orlando International Airport, June 19, 2014
- *Central Florida Water Initiative- A Regional Response to Avoid a Pending Crisis,* 2014 Florida Water Law & Policy Conference, Hyatt Regency, Orlando, FL, February 6-7, 2014
- *Changes in Latitudes; Changes in Attitudes: Florida Agriculture is Part of the Solution!* 27th Annual Environmental Permitting Summer School Conference, Marco Island Marriott Resort, Marco Island, FL, July 16-19, 2013
- *After the Storm: How Have Recent Tax Changes Affected Estate Planning and Real Estate Investments?* Old Historic City Hall, Fort Pierce, FL, May 16, 2013
- *Estate Planning for Land Owners Post ATRA 2012 – Clarity, But Still Not Out of the Woods!* National Cattleman's Beef Association Annual Convention, Tampa, FL, February 8, 2013

Publications

- **Are There Bright Futures in Solar Farming**, feature story in *Florida Grower* magazine, December 14, 2017
- Quoted in the article entitled, **Solar Energy from Abandoned Groves**, published in *Citrus Industry Magazine*, November 2017
- Quoted in the article entitled, **Bill Nelson: GOP tax plan would burden Florida small biz**, published in the *Orlando Sentinel*, November 21, 2017
- **Florida's Current Climate is Ripe for Solar Tax Incentives**, guest column published in The Florida Bar *Tax Bulletin*, Vol. XXXIV, No. 2, Fall 2017
- **Preserving Your Power: 10 Tips for Negotiating a Solar Farm Lease**, published in *Farm Credit LEADER*, Fall 2017
- **Florida's Water Crises: Can We Afford The Solutions? (Part III)**, co-authored with Brad Gould and Dana Apfelbaum, published in *The Florida Bar Tax Section Bulletin, Vol. XXXIV, No. 1*, Spring 2017
- **Water Wise**, *Forward Florida* **–** a publication of the Central Florida Partnership, December 2014
- **Central Florida Water Initiative - A Regional Response to Avoid a Pending Crisis**, co-authored with Laura Minton Young and John Wharton, *Florida Engineering Society Journal*, September 2014
- **2 Ways Growers Can Adapt In An Improving Economy**, co-authored with Laura M. Young, *Grower Magazine*, February, 2014
- **Temporary Tax Relief Provides Significant Planning Opportunities for Small Business Owners**, co-authored with Richard I. Withers and Robert J. Naberhaus III, published in *Farm Credit of Central Florida*, August 2011
- **Back to the Future for Estate Tax Planning**, *Farm Credit Leader*, December, 2010
- **Legal and Tax Issues of Carbon Credit Trading**, co-authored with Christine L. Weingart, AF&PA General Counsels Committee Meeting, May 2010
- **Biofuel Tax Incentives Revisited: The Stimulus Bill Stimulating Renewable Energy,** published in *The Florida Bar Tax Section Bulletin*, August 2009
- **Biofuel Tax Incentives in Florida Agriculture: Are We Serious About Energy Independence?,** published in *The Florida Bar Tax Section Bulletin*, December 2008
- **Year End Estate and Tax Planning for Farmers**, published in the *Farm Credit Leader*, December 2007
- **The Federal Income Tax Consequences of the Receipt of Compensation for the Removal of Commercial Citrus Trees**, published in *The Florida Bar Tax Section Bulletin*, September 2006
- Mr. Minton is a frequent contributor to Dean Mead's Water Law Blog at www.deanmead.com. *His recent blog posts include:*
  - Nothing But Net
  - Preserving Your Power: 10 Tips for Negotiating a Solar Farm Lease
  - Florida's Water Crises: Can We Afford The Solutions? (Part III)

- Florida’s Water Crises: Can We Afford The Solutions? (Part II)
- Florida’s Water Crises: Can We Afford The Solutions? (Part I)
- Florida’s New Comprehensive Water Policy: “Think Globally, Act Locally”
- Gov. Rick Scott Signs Monumental Water Bill That Rewards Central Florida’s Planning Approach
- Some Sunshine for Florida Citrus Growers in the Battle Against Citrus Greening
- The Next Big Opportunity for Florida Agriculture
- Central Florida Water Initiative Plan Provides Long-Range Strategy for Central Florida Region
- Florida Legislature Tackles Comprehensive Water Policy Update
- Dean Mead Works with Local, Regional and State Leaders to Resolve Florida’s Water Issues

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Mr. Egerton is one of the founding shareholders of Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth, P.A. He is Board Certified in Tax Law by The Florida Bar Board of Legal Specialization. He is a tax and corporate attorney whose practice emphasizes tax planning for real estate transactions including tax-free exchanges, planning to preserve long-term capital gains in dispositions of real estate, tax planning for debt restructuring and workouts and tax structuring of joint ventures for the acquisition and development of real properties; negotiating and drafting partnership and limited liability company agreements; mergers, sales and acquisitions of businesses; and the handling of federal tax controversies at the audit, trial and appeals levels. Mr. Egerton is the Past Chair of the American Bar Association's Section of Taxation, the nation's largest organization of tax lawyers.

Key Practice Areas
- Corporations
- Mergers and Acquisitions
- Federal Taxation: Tax Planning for Real Estate Transactions
- Federal Taxation: Tax Free Exchanges of Real Estate
- Federal Taxation: Partnership Taxation
- Federal Taxation: Tax Controversies
- Partnerships and Limited Liability Companies

Primary Industries
- Healthcare and Life Sciences
- Real Estate Development

Professional and Civic Activities
- American Bar Association, Tax Section
  - Past Chair (2010-2011)
  - Former Vice-Chair (Committee Operations)
  - Council Member
  - Former Liaison for ABA Tax Section to AICPA
  - Former Chair of the Committee on Partnerships and LLCs
  - Former Liaison to SB/SE Division of the IRS
- The Florida Bar, Tax Section
  - Former Chair
  - Former Chair of Tax Certification Committee
- American College of Tax Counsel - Fellow and Former Regent for 11th Circuit

- Southern Federal Tax Institute- Former Chairman and Trustee and current Advisory Trustee
- American Bar Foundation - Fellow
- The Florida Bar Foundation, Inc. - Fellow

Charitable and Pro Bono Service

- YMCA of Central Florida
  - YMCA Metropolitan Board – Chair (2014-2015)
  - Annual Campaign - Chair (2014)
  - Member of Board of Directors
- Community Foundation of Central Florida - Former Chairman and Member of Board of Directors
- Downtown YMCA - Former Member of Board of Directors and Former Chairman

Education

- Master of Laws (LL.M.) in Taxation: New York University School of Law, New York, New York, 1971
- Juris Doctor: University of Florida Levin College of Law, Gainesville, Florida, 1969
- B.B.A. Degree: Emory University, Atlanta, Georgia, 1966

Bar Admissions

- Florida
- U.S. Supreme Court
- U.S. Court of Appeals 11th Circuit
- U.S. Tax Court
- U.S. District Court Middle District of Florida

Recognition & Awards

- Recognized by The Florida Bar Board of Legal Specialization as one of only 221 members of the Florida Bar who earned legal board certification in civil trial or tax law in 1983 and has remained certified for over 30 years
- Named an Outstanding Tax Attorney in *The Best Lawyers in America*® for 35 years
- Named one of Orlando's Best Lawyers by *Orlando Magazine*, 1983-2017
- Named an Outstanding Tax Attorney in *Chambers USA*, America’s Leading Business Lawyers, 2003-2017
- Named an Outstanding Tax and Business/Corporate Attorney, *Florida Super Lawyers Magazine*, 2006-2017
- Named an Outstanding Tax Attorney in *Florida Trend* Magazine’s Legal Elite, 2005-2009, 2012 and 2015
- Named an Outstanding Corporate Tax Attorney in *The International Who's Who of Corporate Tax Lawyers*, 2006 – 2013
- Recipient of the Gerald T. Hart Award as the Outstanding Tax Attorney in the State of Florida by The Florida Bar Tax Section, 1998
- Martindale Hubbell: Preeminent AV Rating

Speaking Engagements

Mr. Egerton is a frequent lecturer on tax topics for national, state and local organizations including *New York University Institute on Federal Taxation*, *University of Miami Heckerling Institute on Estate Planning*, *Southern Federal Tax Institute*, *University of Virginia Tax Institute*, *University of North Carolina Tax Institute*, *American Federal Tax Institute* and numerous presentations to seminars sponsored by the *American Bar Association Section of Taxation*, *The Florida Bar Section of Taxation* and the *Florida Institute of CPAs*.

He was a featured speaker at the 69th Annual Virginia Conference on Federal Taxation held at the University of Virginia Darden School of Business in Charlottesville, Virginia on June 9, 2017. A description of his presentation follows: "Optimizing Capital Gains in Real Estate Transactions". There has been an uptick in real estate transactions in the past few years as the economy has slowly emerged from the depths of the "Great Recession." As a result, tax advisors must find creative ways to maximize long-term capital gains and minimize capital losses. This session focused on rates, holding periods, character-freezing provisions, and the often-litigated dealer vs. investor distinction. It also covered possible ways to convert high-rate gain into lower-rate gain.

Publications

Mr. Egerton is also the author of various articles on tax topics in publications such as *NYU Institute on Federal Taxation*, *University of Miami Heckerling Institute on Estate Planning*, *Journal of Taxation*, *Journal of Passthrough Entities*, *Business Entities*, *The Tax Lawyer*, *Journal of Partnership Taxation*, *The Florida Bar Journal* and *University of Florida Law Review*.

- *Do Not Overlook the Impact of the Character Freezing Provisions on Real Estate Transactions by or with a Passthrough Entity,* co-authored with Edward A. Waters, Journal of Passthrough Entities, Vol. 20, No.1, January-February 2017
- *Can a Sale of Real Property Under Threat of Condemnation Be Structured as a Part-Charitable Gift/Part-Sale Transaction?,* co-authored with Edward A. Waters, *Journal of Passthrough Entities, Vol. 19, No.3*, May-June 2016
- *Tax Accounting Dilemma Continues for Condo Developers,* co-authored with Edward A. Waters, *Journal of Passthrough Entities, Vol.18, No.5,* September-October 2015
- *Sales of Real Estate Between Related Entities – Planning to Avoid Unpleasant Surprises*, co-authored with Edward A. Waters, *Journal of Passthrough Entities, Vol. 18, No.3,* May-June 2015
- *What Happens When You Receive a Promissory Note for Your Relinquished Property in a Section 1031 Exchange*, co-authored with Edward A. Waters, *Journal of Passthrough Entities, Vol. 18, No.1*, January-February 2015
- *Options to Acquire Real Estate: When Will They Not Be Respected as 'Options' for Tax Purposes,* co-authored with Christine Weingart, *Journal of Passthrough Entities,* May-June 2013 edition
- *What Will the Affordable Care Act Mean to Agriculture?, Florida Grower Magazine*, May 2013 edition
- *Overhauling the U.S. Tax Code: A Taxing Issue Worth Addressing, Accounting Today*, February 11, 2013

Brad Gould

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Brad Gould practices in the areas of federal income, estate, and gift tax law and business succession planning and concentrates on business and tax law issues, especially those involving closely held business organizations (S corporations, partnerships, and limited liability companies), and their owners. Brad represents businesses and business owners in all types of business and tax matters, including entity selection, reorganization, and governance. He routinely counsels business owners and other clients on estate and asset preservation planning matters. In addition, he represents individuals, businesses and fiduciaries before the Internal Revenue Service and trustees, personal representatives and family members in disputes over wills, trusts and estates. Currently, Brad is a Vice-Chair of the S Corporations Committee of the American Bar Association's Tax Section.

Significant Representations

- Represented a married couple that operated a multi-state, luxury rental business before the IRS. The IRS argued that the losses from the business were passive and assessed over $500,000 in taxes and penalties. After establishing a strong case before IRS Appeals that the spouse operating the business qualified as a real estate professional, the IRS conceded on all counts and permitted the deduction of all of the losses.

- Represented a closely-held S corporation operating a large cattle ranch with the tax-free split-up. The corporation was owned and operated by two generations of ranchers consisting of several siblings and their children. As the younger generation became involved with management, discrete family groups established different goals for the direction of the company. In order to avoid a costly and divisive lawsuit, a plan was developed to divide the corporation in tax–free reorganization and avoid the millions of dollars in state and federal income taxes that would normally be due when a corporation distributes its assets to its shareholders.

- Represented a family in one of the early voluntary offshore disclosure filings with the IRS OVDP program. After the death of their parents, our clients learned one of their parents owned an undisclosed multi-million dollar offshore bank account. In addition to failing to report the account on an FBAR, the parent omitted all of the income from the account for income tax purposes and the account was not reported for estate tax purposes on either parent's estate tax return. Through participating in the OVDP program, we helped our clients mitigate their tax exposure, including utilizing an estate tax deduction for the OVDP penalty and avoiding a criminal investigation.

- Represented the descendants of a man suffering from dementia who was secluded from his family for over a decade by his second wife, during which time she methodically transferred his $15 million estate to her and her descendants. After extensive discovery and mediation, the man's heirs recovered the assets they would have received under his will as if his wife had not taken them during his life.

- Represented a terminally ill client with succession of a multi-state, multi-generational family farm with holdings in excess of $100 million. We worked with the client to develop a succession plan for the transition of control of the business and to preserve the farm's assets. After the client's death, certain of his family members sought to set aside his succession plans through aggressive litigation. However, we were able to mediate a resolution that preserved the bulk of the farm assets to benefit the family as intended and spun-off, in a tax advantageous manner, a small portion of the farm to the challengers.

- Represented the personal representative and trustee of a combined $40 million estate and trust from a challenge by the decedent's daughter. The decedent was a serial entrepreneur who wanted to leave the bulk of his assets to charity and left significant bequests to friends, family, and employees. He was estranged from daughter for over a decade at the time of his death and disinherited her. She sought to recover a $1 million bequest that he had made in prior versions of his estate planning documents. We successfully defended the challenge after a three-day trial.

Key Practice Areas
- Business Entities
- Estate and Succession Planning
- Tax
- Tax Controversies
- Trust and Estate Administration

Primary Industries
Healthcare and Life Sciences
Agribusiness

Professional and Civic Activities
- Florida Bar Association
    - Tax Section
    - Real Property, Probate and Trust Law Section
- American College of Tax Counsel
    - Fellow
- American Bar Association (ABA)
    - Tax Section – Member
        - S Corporation Committee – Vice Chair
- American Institute of Certified Public Accountants
- Florida Institute of Certified Public Accountants (FICPA)
    - Board of Directors/ Executive Committee, 2015 – present
    - Council/Board of Governors, 2012 – present
    - University of Florida Annual Accounting Conference
        - Committee Member
        - Committee Chairman – 2009
    - LGBT Task Force
        - Chair

- University of Florida, Fisher School of Accounting
    - Advisory Board
- St. Lucie County Bar Association
    - Member and Past Treasurer
- St. Lucie County Chamber of Commerce

Charitable and Pro Bono Service
- Big Brothers Big Sisters of St. Lucie, Indian River and Okeechobee Counties
    - Board Member, 2005-present
    - Past Chair, 2008
- Treasure Coast Hospice
    - Board of Directors
- Parent Academy of St. Lucie County
    - Founding Board Member, 2010-2017
    - Chair, 20110-2015

Education
- Juris Doctor: University of Florida Levin College of Law, Gainesville, Florida, *with honors*, 2001
- Master of Accounting: University of Florida, Gainesville, Florida, 1998
- Bachelor of Science in Accounting: University of Florida, Gainesville Florida, *with honors*, 1998

Bar Admissions
- Florida
- U.S. Tax Court

Prior Business Experience
CPA, Deloitte & Touche

Recognition & Awards
- Martindale Hubbell: AV Rating
- Special Chair Service Award, FICPA, 2014, Orlando, FL

Speaking Engagements
- *Estate and Trust Accountings Seminar*, co-presented with Dana M. Apfelbaum, Stuart, FL, November 8, 2017
- *Estate and Trust Accountings*, University of Florida Accounting Conference presented by the Florida Institute of Certified Public Accountants, Gainesville, FL, October 6, 2017
- *Tax and Succession Planning for Closely-Held Businesses*, Fall Meeting & Education Conference for the American Academy of Attorney-CPAs, Houston, TX, November 9, 2016
- Panel member, *Proposed Regulations for Section 2704* and S Corporation Current Developments program, Joint Fall CLE Meeting of the ABA Tax Section, Boston, MA, September 30, 2016

- Panel member, *Agricultural Cost-Share and Payment for Environmental Services – Identifying and Seizing the Right Opportunities for Your Business*, Florida Agriculture Financial Management Conference (FAFMC), Omni Orlando Hotel, Orlando, FL, August 25, 2016
- Moderator, *Current Developments Program for the S Corporation Committee*, S Corporation Committee of the ABA Tax Section May Meeting, Washington, D.C., May 6, 2016
- *Current Developments Program for the S Corporation Committee,* S Corporation Committee of the ABA Tax Section Mid-Year Meeting, Los Angeles, California, January 29, 2016
- *Current Developments Program for the S Corporation Committee*, S Corporation Committee of the ABA Tax Section, and Real Property, Trust & Estate Law Section, Trust & Estate Division Joint Fall CLE Meeting, Chicago, Illinois, September 18, 2015
- *Tax and Succession Planning for Agricultural Businesses*, FAFMC, Omni Orlando Resort at ChampionsGate, Orlando FL, August 27, 2015
- *Same Sex Marriages*, FICPA Mega CPE Conference, Orlando, FL, June 12, 2015
- *Current Developments Program for the S Corporation Committee,* S Corporation Committee of the ABA Tax Section, Washington D.C., May 8, 2015
- *DOMA and Estate Planning,* Estate Planning Council of Polk County, February 10, 2015
- *Current Developments Program for the S Corporation Committee*, S Corporation Committee of the ABA Tax Section, Midyear Meeting in Houston, TX, January 30, 2015
- *Current Developments Program and IC-DISCs and S Corporations,* S Corporation Committee of the ABA Tax Section Joint Fall CLE Meeting, Denver, CO, September 19, 2014
- *Federal Tax Issues for Same Sex Couples,* FICPA Mega CPE Conference, Orlando FL, June 14, 2014
- *Current Developments*, S Corporation Committee of the ABA Tax Section, Annual Meeting, Washington, D.C., May 9, 2014
- *Current Developments ,* S Corporation Committee of the ABA Tax Section, Mid-Year Meeting, in Phoenix, AZ, January 24, 2014
- *Current Developments*, S Corporation Committee of the ABA Tax Section, Joint Fall CLE Meeting, San Francisco, CA September 20, 2013
- *After the Storm: How Have Recent Tax Changes Affected Estate Planning and Real Estate Investments?,* Old Historic City Hall, Fort Pierce, FL, May 16, 2013
- *Current Development Program*, S Corporation Committee of the ABA Tax Section, Annual Meeting, Washington, D.C., May 10, 2013
- The End of the Perfect Storm of Estate Planning is Nearing (maybe!) – Planning for the Remainder of 2012, Fort Pierce, Florida, November 14, 2012
- *Real Estate Professionals*, Orange County Bar Tax Section, Orlando, Florida, January, 2012
- Asset Protection and Transfer Tax Aspects from the 2010 Tax Act, FICPA, Merritt Island, Florida, July 26, 2011
- Federal Transfer Tax Developments and Asset Protection Planning, FICPA Sailfish Chapter, Palm City, Florida, May 18, 2011
- *Federal Tax Update*, FICPA 25th Annual Accounting Show, Fort Lauderdale, Florida, October, 2010

- *Recent Federal Tax Updates*, FICPA Florida Accounting and Business Expo, Tampa, Florida, June 25, 2010
- *Small Business Tax Update*, BioFlorida Southeast Chapter, Torrey Pines Institute for Molecular Studies, Port St. Lucie, Florida, May 20, 2010
- *Partnership Agreements and Operating Agreements*, Terms and Provisions (Related Information) Every CPA (Representing Partnerships/Limited Liability Companies or their Owners) Needs to Know), FICPA, Florida Institute on Federal Taxation, Orlando, Florida, November 14, 2008
- *Beneficiary Designations*, FICPA, University of Florida Accounting Conference, Gainesville, Florida, November 1, 2007
- *Federal Tax Update*, FICPA, University of Florida Accounting Conference, Gainesville, Florida, October 5, 2006

Publications

- *Florida's Water Crises: Can We Afford The Solutions? (Part III)*, co-authored with Michael Minton and Dana Apfelbaum, published in The Florida Bar Tax Section Bulletin, Vol. XXXIV, No. 1, Spring 2017
- Mr. Gould co-authored with Dana Apfelbaum the chapter titled, *Tax Considerations in Eminent Domain Proceedings*, as part of the treatise "Florida Eminent Domain Practice and Procedure", 10th Edition, published by *The Florida Bar* and distributed by LexisNexis.
- *Update on S Corporations*, co-authored with Stephen R. Looney, Florida CPA today, January/February 2017 issue
- *The State of Same-Sex Marriage in Florida*, co-authored with Dana Apfelbaum, Law360, October 2014
- *Estate-planning Issues for Same-sex Couples*, co-authored with Dana Apfelbaum, Florida CPA Today, September/October, 2014 issue
- *Federal Tax Issues Affect Same-Sex Couples*, co-authored with Dana Apfelbaum, Florida CPA Today, May/June 2014 issue
- 'Fiscal cliff' Bill Brings Certainty to Small-business Owners, St. Lucie News Tribune, January 20, 2013
- *Introduction to Estate Planning and Charitable Giving*, co-authored with Robert J. Naberhaus III, May 20, 2011
- *Federal Transfer Tax Developments and Asset Protection Planning*, co-authored with Robert J. Naberhaus III, May 18, 2011
- *New Reporting Requirements for Foreign Financial Assets*, co-authored with Dana M. Trachtenberg, Dean Mead Newsletter, November, 2010
- *Estate Tax Planning for Personal Residences and Vacation Homes*, co-authored with Richard I. Withers, September, 2009
- *Year End Estate and Tax Planning for Ranchers, Growers and Farmers*, co-authored with Michael D. Minton, November, 2007
- *Tax Relief for Sale of Livestock Due to Drought*, October, 2007

- *Choice of Entity for Agricultural Businesses*, co-authored with Michael D. Minton, April, 2007
- *Get Green for Going Green*, December, 2006
- *Charitable Conservation Easements*, October, 2006
- *Federal Tax Consequences of Citrus Canker Payments*, co-authored with Michael D. Minton, February, 2006

Mr. Gould is a frequent contributor to Dean Mead's Blogs at www.deanmead.com.

- His recent blog posts include:
  - Details Matter: Probate Litigation Edition
  - Florida's Water Crises: Can We Afford The Solutions? (Part III)
  - Failure to Follow Signing Formalities Can Sink an Estate Plan
  - UHF Relocation under the Spectrum Act Subject to Tax Deferral
  - Widow Allowed to Expense Previously Expensed Farming Inputs
  - Florida's Water Crises: Can We Afford The Solutions? (Part II)
  - Florida's Water Crises: Can We Afford The Solutions? (Part I)
  - IRS Holds Surgery Center Can Offset Passive Losses
  - Appeals Court Provides Guidance on Method for Revoking a Trust
  - Top Five Estate Planning Steps to Take During a Divorce
  - Legal Fees and the Elective Share
  - President Obama Signs PATH Act Into Law
  - Tax Extenders are (almost) Here
  - Some Sunshine for Florida Citrus Growers in the Battle Against Citrus Greening
  - Enforceability of Settlement Agreements in Probate Litigation
  - Impact of Divorce on Last Will and Testament
  - U.S. Supreme Court Rules on Same Sex Marriage
  - U.S. Supreme Court to Rule on Same Sex Marriage
  - Same Sex Marriages Have Begun in Florida
  - President Obama Signs Tax Extenders Bill Into Law
  - U.S. Supreme Court Denies Review of Same Sex Marriage Cases
  - New Developments in Florida on Same-Sex Marriage – Is the Supreme Court Next?
  - What You Should Know about the New Limited Liability Company Act
  - New Developments in Kentucky and Virginia on Same-Sex Marriage – Is Florida Next?

Dana M. Apfelbaum

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Ms. Apfelbaum practices in the areas of federal income, estate, and gift tax law and family business succession planning. She counsels individuals in estate planning, with an emphasis on implementing the client's objectives, asset protection and minimizing wealth transfer taxes. Ms. Apfelbaum also represents fiduciaries through all stages of probate, estate and trust administration. In addition, she represents businesses and business owners in all types of business and tax matters, including choice of entity, mergers and acquisitions, reorganizations, other general business matters, and succession planning.

Key Practice Areas

- Business and Succession Planning
- Estate Planning
- Probate and Estate Administration
- Tax

Primary Industries

- Agribusiness
- Solar Energy

Professional and Civic Activities

- The Florida Bar
  - Tax Section
    - New Tax Lawyers Division, Co-Director
  - Young Lawyers Division
- Leadership St. Lucie
- St. Lucie Bar Association – Member
  - Young Lawyers Division – Past Chair
- Port St. Lucie Businesswomen’s Association – Member
- Royal Palms of St. Lucie County – Member

Charitable and Pro Bono Service

- United Way of St. Lucie County – Board of Directors
- Early Learning Coalition of St. Lucie County – Vice Chair
- Parent Academy of St. Lucie County
  - Chair of the Planning Committee - Inaugural Lip Sync Battle

Education

- Master of Laws (LL.M.) in Taxation: University of Florida Levin College of Law, Gainesville, Florida, 2010,
  - *Honors:* Graduate Assistant for Professor Dennis A. Calfee, 2010
- Juris Doctor: University of Florida Levin College of Law, Gainesville, Florida, *cum laude*, 2009
  - *Honors:* Member, Florida Law Review, Research Assistant to Professor Elizabeth T. Lear
  - Certificate in Trusts and Estates
  - Book Awards in Estate Planning and Income Taxation of Estates and Trusts
- Undergraduate Degree: University of Florida, *cum laude*, 2006

Bar Admissions

Florida, 2009

Recognition & Awards

- Recognized as a Legal Elite 'Up and Comer' Tax Attorney by *Florida Trend Magazine*, 2017
- 2011 Award received from St. Lucie County Bar Association for recruiting membership, presiding over meetings and planning a program of activities for the Young Lawyers Division of the Association.

Speaking Engagements

- *Estate and Trust Accountings Seminar*, co-presented with Brad Gould, Stuart, FL, November 8, 2017
- *Florida's Current Climate is Ripe for Solar Energy,* Florida Agriculture Financial Management Conference (FAFMC), B Resort & Spa, Orlando, FL, November 2, 2017
- *Tax and Succession Planning for Regions Bank Private Wealth Management*, The Lighthouse Restaurant, Fanning Springs, February 24, 2016
- *Tax and Succession Planning for Agricultural Businesses,* Florida Agricultural Financial Management Conference, Omni Orlando Resort at ChampionsGate, Orlando FL, August 27, 2015
- *After the Storm: How Have Recent Tax Changes Affected Estate Planning and Real Estate Investments?* Old Historic City Hall, Fort Pierce, FL, May 16, 2013
- *Estate Planning After the American Taxpayer Relief Act of 2012,* Wesche Jewelers, Melbourne, FL, April 23, 2013
- *The End of the Perfect Storm of Estate Planning is Nearing (maybe!) – Planning for the Remainder of 2012*, Fort Pierce, Florida, November 14, 2012

Publications

- **Florida's Current Climate is Ripe for Solar Tax Incentives**, guest column published in The Florida Bar *Tax Bulletin*, Vol. XXXIV, No. 2, Fall 2017
- **Florida's Water Crises: Can We Afford The Solutions? (Part III)**, co-authored with Michael Minton and Brad Gould, published in *The Florida Bar Tax Section Bulletin, Vol. XXXIV*, *No. 1,* Spring 2017

- Ms. Apfelbaum co-authored with Brad Gould the chapter titled, **Tax Considerations in Eminent Domain Proceedings**, as part of the treatise "Florida Eminent Domain Practice and Procedure", 10th Edition, published by *The Florida Bar* and distributed by LexisNexis.
- **The State of Same-Sex Marriage in Florida**, co-authored with Brad Gould, Law360, October 2014
- **Estate-planning Issues for Same-sex Couples**, co-authored with Brad Gould, Florida CPA Today, September/October, 2014 issue
- **Federal Tax Issues Affect Same-Sex Couples**, co-authored with Brad Gould, Florida CPA Today, May/June 2014 issue
- **New Reporting Requirements for Foreign Financial Assets**, co-authored with Brad Gould, Dean Mead Newsletter, November, 2010
- Ms. Apfelbaum is a frequent contributor to Dean Mead's Blogs at www.deanmead.com. *Her recent blog posts include:*
  - Tariffs on Solar Energy Cells and Panels Announced
  - The Tax Cuts and Jobs Act of 2017 – What's New for Renewable Energy?
  - Florida's Water Crises: Can We Afford The Solutions? (Part III)
  - Florida's Water Crises: Can We Afford The Solutions? (Part II)
  - Florida's Water Crises: Can We Afford The Solutions? (Part I)
  - Long-Awaited Proposed Regulations for Section 2704 Issued!
  - Starting a Business – An Alphabet Soup of Choices (of Entity)
  - Plan to Replant – A Future Without Citrus Greening
  - Five Reasons You Need an Estate Plan (Even If You Aren't a Powerball Winner)
  - Some Sunshine for Florida Citrus Growers in the Battle Against Citrus Greening
  - Impact of Divorce on Last Will and Testament
  - A Case for Burial Instructions
  - Florida Supreme Court Case Illustrates the Dangers of Online Legal Forms
  - New Developments in Kentucky and Virginia on Same-Sex Marriage – Is Florida Next?

Tax Department

Dean Mead's Tax and Business Law attorneys have extensive experience in the design, formation, and operation of all types of business entities, including corporations, limited liability companies, limited partnerships, general partnerships and professional associations. We have extensive experience with mergers, acquisitions, joint ventures and with the related issues that arise in such transactions.

Our lawyers often counsel clients on the most appropriate entity to use for any given business venture. This advice includes the tax advantages of the respective entities as well as the non-tax and business issues surrounding each transaction.

Our attorneys have worked with numerous existing companies in Florida, as well as entrepreneurs who are launching new business ventures involving a variety of corporate matters including:

- Formation and Representation of All Business Entities
- Mergers and Acquisitions
- Purchases and Sales of Businesses
- Registrations and Exemptions
- Federal and State Laws
- Initial Public Offerings
- Private Placements
- Corporate Reorganizations
- Non-profit and Charitable Organizations
- Partnerships, S Corporations, C Corporations, LLCs, Professional Associations
- Academic and Education Law
- Appellate
- Corporate Integrity and Compliance
- Criminal Defense
- Professional Licensing and Administrative Hearings
- Regulatory Compliance
- Tax Enforcement and Compliance
- White Collar Defense and Government Investigations

We continue representation of our clients on an ongoing basis and provide advice on the business issues that arise during the course of operation, including employment, tax, contracts, securities, and licensing and regulatory matters.

Our Corporate Practice Group also negotiates mergers and acquisitions on behalf of our clients. In addition, we advise clients on the purchase or sale of businesses, tax free mergers and other reorganizations of business entities, as well as the spin-off or structuring of divisions of an existing entity into two or more new entities.

Business Entity Formation and Operation (Partnerships, LLCs, S Corporations, and C Corporations)

We assist business owners with selecting and establishing the best legal entity to conduct a business, including partnerships, LLCs, S corporations, and C corporations. Our Tax Team also assists our clients in all aspects of tax planning related to the operation of their businesses (whether a partnership, LLC, S corporation, or C corporation).

Our lawyers advise clients on the most appropriate entity to use for any given business venture. This advice includes the tax advantages of the respective entities as well as the non-tax and business issues surrounding each transaction. We continue representation of our clients on an ongoing basis and provide advice on the business issues that arise during the course of operation, including employment, tax, contracts, securities, and licensing and regulatory matters.

Mergers and Acquisitions

A large part of our tax practice involves providing tax advice to our clients in connection with the sale and purchase of businesses, including mergers and acquisitions. This work also involves other tax-free reorganizations of business entities, stock sales, purchases and redemptions, and asset sales and purchases. This may also involve the spin-off or structuring of divisions of an existing entity into two or more new entities.

Real Estate Tax

We provide a broad array of tax services in connection with real estate transactions, including the structuring of tax-free exchanges (forward, reverse, and build-to-suit exchanges), planning to preserve long-term capital gains in connection with dispositions of real estate, and the structuring of joint venture arrangements for the acquisition and/or development of real properties. Team member Charlie Egerton (former chair of the Tax Section of the American Bar Association) is recognized as a national expert in the areas of like-kind exchanges and taxation of real estate development.

We have extensive experience negotiating and drafting RESPA Affiliated Business Arrangements for developers so that they may share in the income generated by the title policies and mortgage loans originating from their developments.

State and Local Taxation

Dean Mead practices in the areas of state and local taxation and multi-state taxation. We have represented clients in various states on issues in administrative and judicial actions relating to sales, corporate income, business and organization taxes and telecommunications taxes, as well as state taxation of intellectual property, electronic commerce taxation (E-commerce) and unclaimed property (escheat) issues.

We routinely advise clients on the state and local tax implications of corporate transactions and reorganizations, including multi-state analyses of mergers and acquisitions. Additionally, the firm represents clients on legislative tax matters, including the taxation of computer services, corporate income tax issues and sales tax exemption matters. Our attorneys have extensive background in structuring business transactions to minimize state tax impacts and also assisted representing new businesses and expanding businesses in dealing with Enterprise Florida and the Florida Department of Economic Opportunity.

Tax-Exempt Organizations

Our Corporate & Tax Department represents tax-exempt organizations with numerous organizational and operational issues. We assist clients in selecting the initial structure of the organization, such as Section 501(c)(3) charitable organizations, Section 501(c)(6) trade associations, Section 501(c)(4) social welfare organizations and a variety of other categories of tax-exempt organizations. We also assist in evaluating the tax-exempt purposes of the organization, qualifying it as tax-exempt and complying with laws governing tax-exempt organizations.

Many tax-exempt organizations wish to qualify under Section 501(c)(3) of the Internal Revenue Code because contributions to these organizations are deductible to the donors. We assist our clients in determining whether the organization qualifies as a Section 501(c)(3) organization. Each Section 501(c)(3) organization is further classified as a public charity or a private foundation and we help our clients determine which status would be more beneficial to their organization.

Our lawyers also handle tax issues that surround the qualification, operations and transactions of the tax-exempt organization. State law is an important consideration for tax-exempt organizations. We assist our tax-exempt organization clients in obtaining state law tax exemptions and complying with registration requirements for fundraising. In addition, we provide legal services to tax-exempt organizations that are operating in combination with taxable entities. For example, tax-exempt organization clients may use a taxable subsidiary to hold an unrelated business.

Estate and Succession Planning Department

Dean Mead's Estate and Succession Planning Department is one of the largest and most respected groups of estate planning attorneys in Florida. We are frequently called on by accountants, other attorneys, banks, and trust companies to handle the most sophisticated estate planning, probate, and trust administration cases. The firm's high level of expertise in those areas is evidenced by the fact that our team members include:

- Chair of the Department named Orlando *Best Lawyers®* Litigation – Trusts & Estates Lawyer of the Year for 2013; and the Orlando *Best Lawyers®* Tax Lawyer of the Year for 2011
- Chair of the Department recognized among the "Top 50 Women in Florida" by *Super Lawyers magazine*, 2015 - 2017
- Chair of the Department is the Founding Board Member and Chairperson of the annual Florida Tax Institute, a program of the University of Florida Levin College of Law
- Another attorney named Orlando *Best Lawyers* Trusts and Estates Lawyer of the Year for 2017.
- Two Fellows in the American College of Trusts and Estates Counsel
- An adjunct professor of Estate Planning in the Graduate Tax Program at the University of Florida Levin College of Law
- Three Fellows of the American College of Tax Counsel
- Past Chair of the American Bar Association Section of Taxation
- Chair Elect of the Tax Section of the Florida Bar
- Former chair of the Florida Bar Certification Committee for Wills, Trusts, and Estates
- The Florida Bar Tax Section's "Outstanding Tax Lawyer of the Year" (2005)
- Four attorneys who are Board Certified as experts in Wills, Trusts, and Estates
- Three attorneys who are Board Certified as experts in Tax law
- Eleven attorneys who have master of laws degrees in taxation (LL.M.)
- Current President of the Central Florida Estate Planning Council
- Current President of the Brevard County Estate Planning Council
- Three Past Presidents of the Central Florida Estate Planning Council
- Past President of the Indian River County Estate Planning Council
- Past President of the Martin County Estate Planning Council

Our Estate and Succession Planning Department specializes in estate and trust administration matters and the development of estate plans which help our clients achieve maximum savings in income, estate, gift, and generation-skipping transfer taxes. We handle the traditional aspects of personal estate planning, such as the preparation of revocable trusts, wills, and irrevocable trusts. In addition, we work closely with our clients to plan for the succession of family businesses and wealth among generations in a tax efficient manner. We analyze and implement the latest techniques to reduce estate and gift taxes and preserve our clients' wealth, including limited liability business entities such as family limited partnerships and limited liability companies, GRATS, and charitable remainder and lead trusts. Further, we assist our clients with the preparation of estate and gift tax returns, audits of those returns, and appeals to the IRS and courts to contest proposed tax deficiencies.

Our Estate and Succession Planning Department constantly monitors the latest developments in both tax and non-tax laws affecting our clients. We advise our clients on the income, gift, and estate tax consequences of charitable gifts and our Team has extensive experience in the establishment of private and publicly supported charitable organizations. We handle the negotiation and preparation of marital agreements and provide asset protection planning for individuals. Our Team has significant experience assisting land owners in multigenerational business succession planning while preserving land holdings. When necessary, we represent fiduciaries and beneficiaries in court and mediation to settle disputes that arise during administration of a trust or estate.

We recognize that our clients' estate planning needs frequently require expertise in other areas of the law, so we work closely with attorneys in the firm's other practice groups to provide our clients with the full service they need. We pride ourselves on utilizing the latest technology to provide exemplary service in an efficient and cost effective manner to our clients.

Areas of Experience
- Business Succession Planning
- Charitable Giving
- Estate, Gift and Generation-Skipping Tax
- Limited Liability Business Entities
- Probate and Guardianship
- Trust, Estate and Fiduciary Litigation
- Tax Controversies and Audits
- Trust Administration
- Trust and Estate Income Taxation
- Wills and Trusts
- Wealth Preservation

Dean, Mead, Minton & Zwemer
Fort Pierce Office Overview

Dean, Mead, Minton & Zwemer is located on the Treasure Coast of Florida. The guiding principle of our law firm today, as it was more than 30 years ago, is to provide our clients with exceptional legal service using the highest ethics and integrity possible.

Treasure Coast Connections

Our Treasure Coast office opened in 1987 when Michael Minton returned to his hometown of Fort Pierce. What began with one attorney has since grown to seven attorneys who are deeply rooted in the local community.

The combination of our legal experience, business knowledge and community leadership distinguishes us from other law firms on the Treasure Coast. We have an inherent understanding of the needs of the Treasure Coast community because this is our home.

We have continued to support our local community by serving in leadership roles throughout the Treasure Coast, including the following civic and philanthropic organizations:

- St. Lucie County Economic Development Commission
- Harbor Branch Oceanographic Institute Foundation
- Indian River State College Foundation
- Children's Services Council of St. Lucie
- St. Lucie Council on Aging
- Sunrise Theatre
- Big Brothers Big Sisters of St. Lucie, Indian River and Okeechobee Counties
- Parent Academy of St. Lucie County
- St. Lucie Chamber of Commerce
- Education Foundation of St. Lucie County

Our attorneys are dedicated to our profession and mentoring younger attorneys. We have provided leadership within legal organizations throughout the Treasure Coast and the state, including The Florida Bar Foundation, Tax Section of the Florida Bar, St. Lucie County Bar Association and the Bankruptcy Bar Association.

Striving to Meet Your Needs

We understand the challenges that businesses and individuals face in today's ever-changing economy. That is why our goal is to provide you with thoughtful and innovative legal solutions - in a timely manner - while meeting or, we hope, exceeding your expectations.

In our experience, the most successful legal solutions are the result of a strong relationship between a law firm and its clients. That is why we focus on fully understanding your business' operations or personal objectives.

With your financial interests in mind, we utilize the latest technology to increase our efficiency and, through careful cost control, we strive to deliver cost effective results to you.

Our Team

We are a close-knit group of professionals who work in a team atmosphere. We genuinely enjoy working together and our cooperative relationship enables us to develop comprehensive and innovative solutions for your legal needs.

Please see the abbreviated bios below for the attorneys who work in our Treasure Coast office.

Dana M. Apfelbaum practices in the areas of federal income, estate, and gift tax law and family business succession planning. She counsels individuals in estate planning, with an emphasis on implementing the client's objectives, asset protection and minimizing wealth transfer taxes. Ms. Apfelbaum also represents fiduciaries through all stages of probate, estate and trust administration. In addition, she represents businesses and business owners in all types of business and tax matters, including choice of entity, mergers and acquisitions, reorganizations, other general business matters, and succession planning. She may be reached at dapfelbaum@deanmead.com.

Dennis G. Corrick practices in the areas of commercial real estate, zoning and land use, and general business law. He has experience in every element of real estate purchase, ownership, governance and sale. In addition, he assists clients in land use and zoning matters, permitting and licensing, and in agreements governing the use of property such as covenants and restrictions, commercial and agricultural leases, easements and licenses. Mr. Corrick has extensive experience working with issues unique to agricultural businesses and properties. These include conservation easements, grazing leases and matters related to water use and environmental permitting, as well as financing, sale and purchase of farms and ranch properties. He is a member of Dean Mead's Agribusiness Industry team, and works with other firm attorneys in litigation matters involving title disputes, and probate and trust matters where real property is involved. He may be reached at dcorrick@deanmead.com.

W. Lee Dobbins practices in the areas of zoning, land use and commercial real estate transactions in the Fort Pierce and Port St. Lucie areas. He represents property owners in the acquisition and development of land, including negotiating complex purchase contracts, due diligence, financing, title issues, closings and obtaining zoning and land use and site plan approvals from the local municipalities. Mr. Dobbins has assisted clients in taking residential, commercial and mixed-use developments from the purchase of raw land through obtaining final development approvals. He also has experience in obtaining economic development incentive grants and tax abatements, resolving utility issues, concurrency, debt restructuring transactions and drafting, and negotiating complex commercial leases. He may be reached at ldobbins@deanmed.com.

Brad Gould practices in the areas of federal income, estate, and gift tax law and business succession planning and concentrates on business and tax law issues, especially those involving closely held business organizations (S corporations, partnerships, and limited liability companies), and their owners. Mr. Gould represents businesses and business owners in all types of business and tax matters, including entity selection, reorganization, and governance. He routinely counsels business owners and other clients on estate and asset preservation planning matters. In addition, he represents individuals, businesses and fiduciaries before the Internal Revenue Service and trustees, personal representatives and family members in disputes over wills, trusts and estates. Mr. Gould serves as Vice-Chair of the S Corporations Committee of the American Bar Association Tax Section and a member of the Board of Directors of the Florida Institute of Certified Public Accountants (FICPA). He was elected as Fellow of the American College of Tax Counsel. He may be reached at bgould@deanmead.com.

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