Senate Estate And Gift Tax Bill

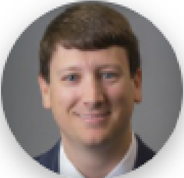
Presented by:

Alan Gassman
agassman@gassmanpa.com

Brandon Ketron
Brandon@gassmanpa.com

Saturday, April 3rd, 2021
11 to 11:30 AM EDT (30 minutes)

GASSMAN CROTTY & DENICOLO P.A.
ATTORNEYS AT LAW
1245 Court Street, Clearwater, FL 33756



ESTATE TAX PLANNING WHILE THERE IS TIME:HOW TO PLAN, EXPLAIN AND IMPLEMENT EFFECTIVE ESTATE TAX PLANNING BEFORE AND AFTER ENACTMENT OF A SANDERS OR OTHER PLAN. - A Special Re Broadcast

Tuesday April 6

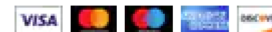
2:00PM ET - 3:30PM ET

If you are not a LISI member please use the Buy Now Button below to pay the non-member price of $149*. *plus applicable sales tax (if any)

Registrant Email:

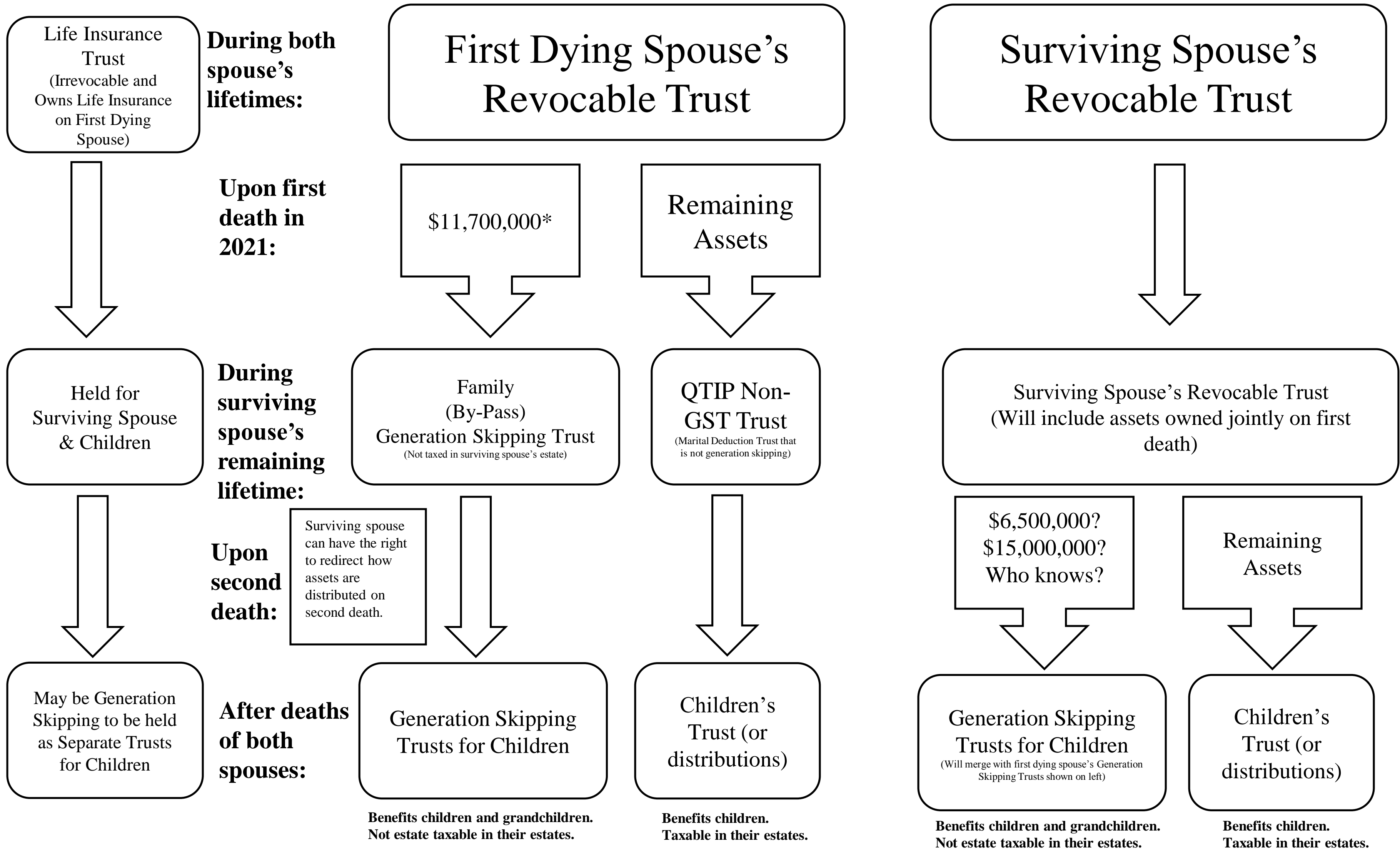
https://leimbergservices.com/wdev/register.cfm?id=1098

Buy Now



Copyright © 2021 Gassman, Crotty & Denicolo, P.A. | Estate and Gift Tax / 4.3.21

Protective Trust Logistical Chart



***Assumes first spouse dies in 2021 when the exemption is $11,700,000, and that the surviving spouse dies in a later year when the estate tax exemption has changed. The estate tax exemption is $11,700,000, less any prior reportable gifts, for those that die in 2021, and increases with the "Chained CPI."**

If the first spouse does not use the entire exemption amount, what remains may be added to the surviving spouse's allowance under the "portability rules" but will not grow with inflation, and will be lost if the surviving spouse remarries and the new spouse dies first, leaving no exemption.

Copyright © 2021 Gassman, Crotty & Denicolo, P.A. | Estate and Gift Tax / 4.3.21

Determining How to Best Allocate Assets as Between a Married Couple – Part 1

General Rules:

-Typically want each trust funded with at least $11,200,000 worth of assets on death for estate tax planning.

- May be funded from ½ of tenancy by the entireties assets via disclaimer and probate or by life insurance/pension/IRA assets.

Spouse 1

Spouse 2

Trustee other than Spouse 1 or Spouse 2

Spouse 2 could be Trustee if Spouse 1 is sole grantor (or vice versa)

Protected life insurance and annuity contracts "owned by the insured."

Spouse 1's Revocable Trust

Spouse 2's Revocable Trust

Gifting Trust (Irrevocable)

Lifetime By-Pass Trust (Irrevocable)

FLORIDA TBE (Tenancy by the Entireties)

Spouse 1's Revocable Trust:

1. Assets held directly by revocable trust are subject to Spouse 1's creditor claims.
2. Direct ownership of limited partnership or LLC not in TBE may have charging order protection **(meaning that if a creditor obtains a lien on the limited partnership or LLC, the Spouse 1 cannot receive monies from the limited partnership or LLC without the creditor being paid).**

FLORIDA TBE:

1. Only exposed to creditors if **both spouses owe the creditor, if one spouse dies and the surviving spouse has a creditor, the spouses divorce, or state law or the state of residence changes.**
2. On death of one spouse, surviving spouse may disclaim up to ½ (if no creditor is pursuing the **deceased** spouse) to fund By-Pass Trust on first death.

Spouse 2's Revocable Trust:

1. Safe from creditors of Spouse 1 but exposed to creditors of Spouse 2 (Maintain large umbrella liability insurance coverage to protect these assets.)
2. On Spouse 2's death, can be held **under a protective trust, which will** continue to be safe from creditors of Spouse 1, subsequent spouses, and "future new family."

Gifting Trust:

1. Safe from creditors of both spouses.
2. If divorce occurs, should not be subject to rules for division of property between spouses.
3. May be controlled by the "entrepreneurial spouse" by using a Family Limited Partnership.

Lifetime By-Pass Trust:

1. **Safe from the creditors of the Grantor's spouse.**
2. If funded by one spouse, may benefit other spouse and children during the lifetime of both spouses.
3. Otherwise can be identical to gifting trust pictured to the left.

SEE NEXT PAGE FOR SECOND TIER PLANNING

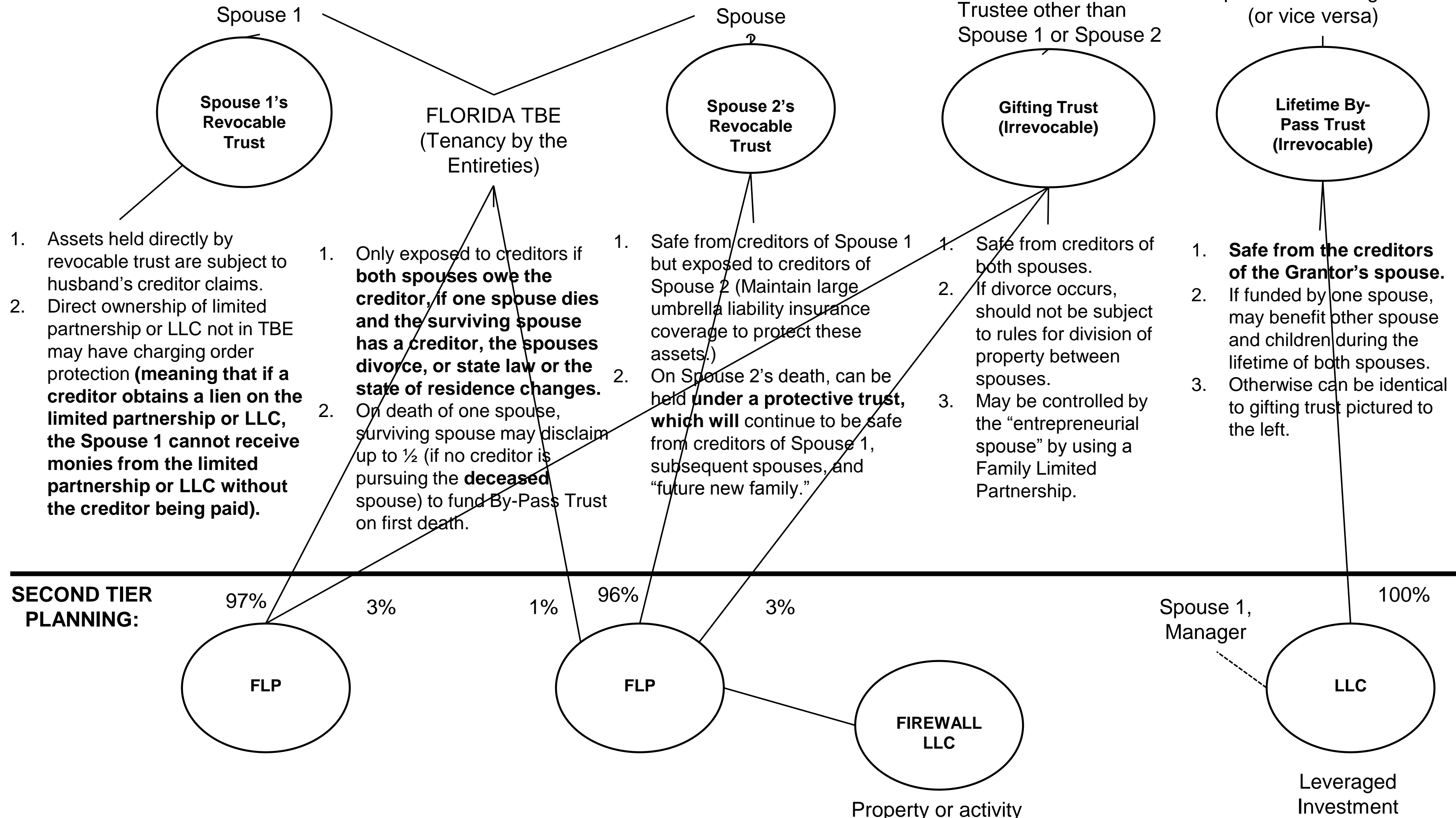
A COMMON SOLUTION - to use a limited partnership or similar mechanisms and have no assets directly in the "high risk" spouse's trust, half to two-thirds of the assets held as tenants by the entireties, and half to two-thirds of the assets directly in the "low risk" spouse's trust.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Determining How to Best Allocate Assets as Between a Married Couple – Part 2

General Rules:
-Typically want each trust funded with at least $11,200,000 worth of assets on death for estate tax planning.
- May be funded from ½ of tenancy by the entireties assets via disclaimer and probate or by life insurance/pension/IRA assets.



A COMMON SOLUTION - to use a limited partnership or similar mechanisms and have no assets directly in the "high risk" spouse's trust, half to two-thirds of the assets held as tenants by the entireties, and half to two-thirds of the assets directly in the "low risk" spouse's trust.

Copyright © 2021 Gassman, Crotty & Denicolo, P.A. | Estate and Gift Tax / 4.3.21

Summary of Senator Sander's Proposed Bill (The 99.5% Act)

1. Effective 2022, estate tax exemption would be reduced to $3.5 million per person ($7 million per married couple) effective January 1, 2022.

Effective the first day of 2022, the estate tax exemption amount would drop to $3.5 million per person from the present level of $11.7 million per person. This means the exemption for a married couple would only be $7,000,000, a 70% decrease! In addition, the rate will not be adjusted annually to account for inflation. Many individuals (for good reason) will seek to gift a majority of what remains of their existing $11.7 million exemption prior to year end, but it is important to note that if an individual's lifetime reportable gifting does not exceed $3.5 million, then the current additional exclusion amount will be wasted. In other words you have to "use" the current $11.7 million exemption or "lose it".

EXAMPLE 1: Bob has made $2 million of taxable gifts and has a $9.7 million of his exemption remaining. If Bob uses another $1.5 million of his exemption, then he will have nothing left for 2022 if the legislation were to pass since total prior gifts would be equal to $3.5 million. Bob may be encouraged to use at least $6.2 million of his exemption before year's end so that he does not lose that amount, and should consider using the full $9.7 million of exemption remaining. Bob would have to give more than $3.5 million in total in order to take advantage of the current increased exclusion amount.

The amount (in the above example) may be transferred to an irrevocable trust for the benefit of Bob's spouse and descendants. That trust may also benefit Bob in the event Bob were to suffer any financial hardship, so long as the trust is properly formed and operated in a creditor-protection jurisdiction.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of Senator Sander's Proposed Bill (The 99.5% Act)

2. Portability allowances will not be reduced for those who died before 2022 (when to pull the plug on great-grandpa.

   EXAMPLE 2: Bob's wife Gladys dies in 2021 and leaves all of her assets to Bob. Bob will then have an $11.7 million portability allowance, in addition to his own $3.5 million estate tax exemption if the law passes. Bob could therefore pass $15.2 million estate and gift tax-free, so long as he does not re-marry and the new spouse dies before him. In such situation, the new spouse's portability allowance would be substituted for the amount of Gladys' allowance "ported" to Bob.

3. <u>Effective 2022</u>, gift tax exemption would be reduced to $1 million, not adjusted with inflation.

4. <u>Effective 2022</u>, estate tax rates will become progressive beginning at 45% and going up to 65%

   - **45% - On the first $6.5 million of assets, once the $3.5 million exemption has been used;**
   - **50% - The next $40 million (a total of $50 million in assets);**
   - **55% - The next $950 million in assets (from $50 million to $1 billion); and**
   - **65% - Anything that is above $1 billion in assets.**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of Senator Sander's Proposed Bill (The 99.5% Act)

5. Effective upon passing, Grantor Trusts created or funded after enactment would be included in gross estate of the Grantor. A Trust treated as owned by the Grantor would be subject to estate tax in the Grantor's estate.

   What about Life Insurance Trusts?

6. After enactment, Grantor Trusts created and funded before enactment, that are not added to or exchanged with, will continue to be outside of the Grantor's estate, and the Grantor can continue to pay income taxes on income from the Trust without this being considered to be a gift.

   Grandfathering will apparently not apply for IRC Section 678 Trusts.

7. Effective upon passing, no step-up in basis for grandfathered Grantor Trust assets, unless the trust is included in the Grantor's estate for estate tax purposes.

   This is evidence that a step-up should apply – should many taxpayers amend their returns if they were advised otherwise following the death of a Grantor?

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of Senator Sander's Proposed Bill (The 99.5% Act)

8. Effective upon passing, Grantor Retained Annuity Trusts (GRATS) would be required to have a minimum 10 year term and a remainder interest of at least 25% of the value of the contributed property (aka no zeroed out GRATS).

9. Effective 2022, deemed termination of GST trusts every 50 years.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of Senator Sander's Proposed Bill (The 99.5% Act)

10. Annual gifting limited to $30,000 in total per donor for certain transfers, including transfers into a trust (That's *Crummey*!)

    These limitation transfers, to which the $30,000 *per donor* limitations apply, are as follows:

    A. A transfer into a trust;

    B. A transfer of an interest in certain family entities;

    C. A transfer of an interest in an asset that is subject to a prohibition on sale; and

    D. A transfer of an asset that cannot be immediately liquidated by the donee.

11. Increased benefits for conservation easements.

12. Increased threshold for Qualified Farm Property valuation adjustment under Section 2032A.

13. Increased ability to receive estate tax payment deferral, under Section 6166.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Subject: Alan Gassman & Brandon Ketron: Potential Estate and Gift Tax Bill Could Reduce Exemption to a Fraction of Its Current Amount - What Is at Stake

"Senator Bernie Sanders released his proposed tax reform legislation on March 25th which outlined major changes to the estate and gift tax rules. This bill, which was co-sponsored by Senators Kirsten Gillibrand, Sheldon Whitehouse, Jack Reed and Chris Van Hollen, will have a similar version read into the House of Representatives by Representative Jimmy Gomez.

This bill is impactful and complex from a financial aspect, but is straightforward in how it would achieve its goals – by reducing the current estate and gift tax exemption levels to $3,500,000 and $1,000,000 respectively beginning in 2022 and significantly eliminating or curtailing many of the important planning techniques used by estate planners effective upon enactment. The following commentary seeks to summarize and sort out some of the more important aspects of the pending legislation and, perhaps more importantly, outline what exactly we stand to lose."

Alan Gassman and **Brandon Ketron** provide members with commentary examines the planning implications raised by the tax reform legislation Senator Bernie Sanders introduced on March 25th. Members will find their commentary particularly helpful as it contains a sample "call to action" letter that can be used with clients.

Members who wish to learn more should consider watching their **LISI** Webinar on April 1st @ 2PM ET titled "**Estate Tax Planning While There Is Time: How To Plan, Explain & Implement Effective Estate Tax Planning Before And After Enactment of a Sanders or Other Plan**" where Alan and Brandon will be joined by **Jerry Hesch**. Click this link to learn more: Alan/Jerry/Brandon.
Alan S. Gassman, J.D., LL.M., is a partner in the law firm of **Gassman, Crotty & Denicolo, P.A.**, and practices in Clearwater, Florida. He is a frequent contributor to LISI, and has published numerous articles and books in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, and Interactive Legal and is co-author of Gassman and Markham on Florida and Federal Creditor Protection and several other books. His email is alan@gassmanpa.com.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

Brandon Ketron, CPA, JD, LL.M. is an associate at the law firm of **Gassman, Crotty & Denicolo, P.A.**, in Clearwater, Florida and practices in the areas of Estate Planning, Tax and Corporate and Business Law. Brandon is a frequent contributor to LISI and presents webinars on various topics for both clients and practitioners. Brandon attended Stetson University College of Law where he graduated cum laude, and received his LL. M. in Taxation from the University of Florida. He received his undergraduate degree at Roanoke College where he graduated cum laude with a degree in Business Administration and a concentration in both Accounting and Finance. Brandon is also a licensed CPA in the states of Florida and Virginia. His email address is brandon@gassmanpa.com.

Here is their commentary:

EXECUTIVE SUMMARY:

Senator Bernie Sanders released his proposed tax reform legislation on March 25th which outlined major changes to the estate and gift tax rules. This bill, which was co-sponsored by Senators Kirsten Gillibrand, Sheldon Whitehouse, Jack Reed and Chris Van Hollen, will have a similar version read into the House of Representatives by Representative Jimmy Gomez.

This bill is impactful and complex from a financial aspect, but is straightforward in how it would achieve its goals – by reducing the current estate and gift tax exemption levels to $3,500,000 and $1,000,000 respectively beginning in 2022 and significantly eliminating or curtailing many of the important planning techniques used by estate planners effective upon enactment. The following commentary seeks to summarize and sort out some of the more important aspects of the pending legislation and, perhaps more importantly, outline what exactly we stand to lose.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

COMMENT:

Besides a reduction of the estate tax exemption to $3,500,000 from the current amount of $11,700,000, and a reduction of the lifetime gift tax exemption to $1,000,000 in 2022, many very important planning strategies will become obsolete after the passage of the legislation.

Those Who Snooze, May Lose. If you have clients that may possibly be detrimentally impacted by this proposed legislation, it is important to encourage them to act quickly. Considering the nation-wide impact of this potential future legislation, and how quickly the change may occur, it is important to plan ahead, considering many estate and tax planning planners and experts will have lines of clients wanting to change their existing structure if and when Biden signs this legislation into law.

It is good, however, that most of the tax and estate planning structures that were put into place before the enactment of this legislation will be "grandfathered in" from an estate and gift tax standpoint. This only makes it more beneficial to act quickly and without delay.

The following is a client letter that the authors have prepared that can be used to reach out to clients to inform them of the proposed tax law changes:

LETTER TO CLIENTS:

RE: SANDERS 99.5% ACT ESTATE TAX PROPOSAL

Dear Clients:

Last Thursday, Senators Sanders and Whitehouse formally proposed a bill which would make changes to the current estate and gift tax system, that apparently has some support among Democratic Senators and Congressmen.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

LETTER TO CLIENTS, cont.:

While it is our hope that this proposed law will not be enacted, it seems best to "plan for the worst and hope for the best," given the unpredictable political climate, and the possible changes that may be made if a watered down version of this potent proposed law passes.

The good news is that the reduction of the estate tax exemption amount from $11,700,000 to $3,500,000 would not occur until January 1, 2022.

The same timing applies for the proposed reduction of the gift tax allowance to only $1,000,000, which means that people will not be able to gift more than $1,000,000 after 2021 without paying gift tax.
Also, the proposed increase in the estate tax rate to 45% once a deceased person's taxable estate exceeds $3,500,000, and 50% and higher when the amount subject to tax exceeds $10,000,000 will not apply until 2022.

In addition to the above exemption and tax changes, gifting of up to $15,000 per year per person will be limited to $30,000 per donor per year for gifts to irrevocable trusts or of interests in certain "flow through entities" beginning in 2022.

The tougher news for many clients is that some of the primary tools and strategies that we have used in the past will not be available in the future, beginning upon the date that President Biden signs the bill into law, if this occurs.

Once that happens, we will not be able to fund or have assets sold to Irrevocable Trusts that can be disregarded for income tax purposes, and we will also not be able to use valuation discounts or Grantor Retained Annuity Trusts (GRAT's) in most circumstances, although those arrangements put into place before the new law is passed will be grandfathered as long as they are not added to or altered after the law is passed, as presently written.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

LETTER TO CLIENTS, cont.:

This is an important **call to action** for families having assets expected to exceed $3,500,000 per person to take a serious look at their present planning situation in order to determine whether to take **immediate steps to avoid death taxes.**

In particular, clients who have irrevocable trusts may want to act without delay to extend any notes that may be owned by them to the longest period practical, and to sell assets that may go up in value, and exchanges for assets that may be more suitable to be owned by these trusts, given that exchanges and changes made after a new law is passed may not be possible.

We have been very busy with estate tax planning since the middle of last year and are generally operating at capacity.

If you wish to complete an estate tax plan that you have started with us or to further develop or act upon an estate tax planning structure you already have in place, please let us know immediately, and confirm that you can provide us with updated asset and entity information so that we can avoid any delays in putting whatever you would like to do into action before new law may pass. We will give first priority to clients who contact us without delay and have plans in place or in progress.

If you do not have an estate tax planning structure or a plan in process, then we recommend that you start immediately with us or another qualified firm before the demand for these services causes us to be unavailable to finish before a new law may be enacted.

Best personal regards,
VIA EMAIL & U.S. MAIL
Alan S. Gassman

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

The following helps to explain the rules, and provides some helpful pointers along the way:

Unfortunately for Many, the Exemption Would be Only $3.5 Million (Minus any Past Reportable Gifts) – Use It or Lose It!

Effective the first day of 2022, the estate tax exemption amount would drop to $3.5 million per person from the present level of $11.7 million per person. This means the exemption for a married couple would only be $7,000,000, a 70% decrease! In addition, the rate will not be adjusted annually to account for inflation. Many individuals (for good reason) will seek to gift a majority of what remains of their existing $11.7 million exemption prior to year end, but it is important to note that if an individual's lifetime reportable gifting does not exceed $3.5 million, then the current additional exclusion amount will be wasted. In other words you have to "use" the current $11.7 million exemption or "lose it".

EXAMPLE 1: Bob has made $2 million of taxable gifts and has a $9.7 million of his exemption remaining. If Bob uses another $1.5 million of his exemption, then he will have nothing left for 2022 if the legislation were to pass since total prior gifts would be equal to $3.5 million. Bob may be encouraged to use at least $6.2 million of his exemption before year's end so that he does not lose that amount, and should consider using the full $9.7 million of exemption remaining. Bob would have to give more than $3.5 million in total in order to take advantage of the current increased exclusion amount.

The amount (in the above example) may be transferred to an irrevocable trust for the benefit of Bob's spouse and descendants. That trust may also benefit Bob in the event Bob were to suffer any financial hardship, so long as the trust is properly formed and operated in a creditor-protection jurisdiction.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

It is likely that many married couples, in response to this rule, will have one of the spouses establish the above-referenced trust for each other and the couple's descendants, while the other spouse establishes a trust that *solely* benefits the couple's descendants. This type of planning is in response to what is known as the "Reciprocal Trust Doctrine."

The end of this year will be a contemplative time for wealthy individuals who are, or who have family who are, in intensive care, as there will be significant estate tax savings that could come with "pulling the plug." Surviving spouses who already have their portability allowance will not have this allowance reduced under this legislation.

EXAMPLE 2: Bob's wife Gladys dies in 2021 and leaves all of her assets to Bob. Bob will then have an $11.7 million portability allowance, in addition to his own $3.5 million estate tax exemption if the law passes. Bob could therefore pass $15.2 million estate and gift tax-free, so long as he does not re-marry and the new spouse dies before him. In such situation, the new spouse's portability allowance would be substituted for the amount of Gladys' allowance "ported" to Bob.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

New Year, New Limits: The gift tax exemption would be limited to $1,000,000 beginning January 1, 2022.

As previously mentioned, the current estate and gift tax exemptions are set at $11.7 million, minus whatever taxable gifts have been made previously. Such exemption is reduced whenever gifts are made that exceed $15,000 per person in any given year.

In Example 1 above, Bob has a $9.7 million exemption remaining after a prior gift of $2,000,000. If the legislation passes, Bob's tax exemption will go down to $1 million in 2022, and after reducing this amount my prior gifts made, Bob will have no exemption remaining to make future gifts without paying gift tax.

In other words, Bob will only be able to gift the $15,000 of assets per year/per person without paying gift tax. Many families, in response to this change, will make significant gifts in 2021 in order to use the increased exclusion amount in case this legislation passes.

It is worth noting that many clients of the author and of other well-respected estate planning attorneys will choose to leave some of their exemption amount intact, to protect against the possibility of the IRS conducting a gift tax audit and finding that certain gifts were under-reported.

EXAMPLE 3: Frank owns 49% of ABC, Co., which is worth $30 million. The 49% ownership of the company is valued for Frank at significantly less than $15 million because of valuation discounts. These discounts account for the ownership share's lack of marketability and lack of control. The courts do not align as to determining what percentage of valuation discount applies, but most claim that the determination involves the individual facts and circumstances. In many situations (such as this one), a compromise is struck and the valuation discount is placed somewhere between where Frank thinks it should be and where the IRS auditor thinks it should be.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

In other words, Bob will only be able to gift the $15,000 of assets per year/per person without paying gift tax. Many families, in response to this change, will make significant gifts in 2021 in order to use the increased exclusion amount in case this legislation passes.

It is worth noting that many clients of the author and of other well-respected estate planning attorneys will choose to leave some of their exemption amount intact, to protect against the possibility of the IRS conducting a gift tax audit and finding that certain gifts were under-reported.

EXAMPLE 3: Frank owns 49% of ABC, Co., which is worth $30 million. The 49% ownership of the company is valued for Frank at significantly less than $15 million because of valuation discounts. These discounts account for the ownership share's lack of marketability and lack of control. The courts do not align as to determining what percentage of valuation discount applies, but most claim that the determination involves the individual facts and circumstances. In many situations (such as this one), a compromise is struck and the valuation discount is placed somewhere between where Frank thinks it should be and where the IRS auditor thinks it should be.

A typical plan would involve Frank gifting the 49% ownership to a trust for the benefit of Frank's wife and descendants. The transfer may be valued at $10,000,000 (assuming a 33.33% discount rate), which would leave $1,000,000 of exemption remaining as a buffer in case the IRS were to challenge the valuation of the company or the applicable discount taken so that no gift tax would be owed on any adjustment.

If the new law passes Frank would have no exemption remaining for future transfers, except for increases caused by inflation adjustments on the $1 million base exemption amount if an inflation adjustment is included in a final bill, as the exemption would drop to $1 million for gift tax and $3.5 million for estate tax, which is less than the amount Frank will have already gifted during his lifetime. Future transfers would need to be below $15,000/ per person or gift tax would be due and payable.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

The $1 Million Gift Limit Will Limit Income Shifting. Get Your Shifting Done in 2021

Example, Senior is in the 45% income tax bracket and has 4 adult children over age 24 who are in the 25% bracket.

Senior owns $10,000,000 worth of stock in a company that pays $1,000,000 a year of dividends.

Can Senior gift half of the stock ($5,000,000 worth) to Junior and his 4 siblings so that each of them receives $100,000 per year in income, saving over $100,000 a year on income tax, and future estate tax?

It will be too late to do this January 1, 2022.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

CONSIDER MAKING A TAXABLE GIFT
AND PAYING 40% IN 2021 INSTEAD OF MUCH HIGHER AMOUNTS ON DEATH.

IF THE DONOR LIVES AT LEAST 3 YEARS AFTER THE DEATH THEN THE TAXES PAID REDUCE THE ESTATE AND BRING THE MARGINAL ESTATE AND GIFT RATE DOWN BELOW 30%.

"PAY US NOW OR PAY US MORE LATER".

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Many Are Ir*RATE* at the Rate Increases.

The current flat estate tax rate of 40% will also go up in 2022 if the proposed bill is passed. This increase will make the rate a progressive rate beginning at 45% for taxable estates between $3.5 million and $10 million, 50% for estates between $10 million and $50 million, 55% for estates between $50 million and $1 billion, and 65% for estates over $1 billion.

EXAMPLE 4: Leonard dies with $2 billion in his estate in 2022. Leonard, before his death, never made a taxable gift. Leonard's rates are as follows:

- **45% - After accounting for the $3.5 million exemption, the next $6.5 million (for a total of $10 million in assets);**
- **50% - The next $40 million (a total of $50 million in assets);**
- **55% - The next $950 million in assets (from $50 million to $1 billion); and**
- **65% - Anything that is above $1 billion in assets.**

One of the biggest victors of this change would be charities. It is likely that many will benefit under this legislation as individuals seek to donate large amounts of money *during* their lifetime in order to maximize deductions and reduce estate tax exposure. Many families establish their own private foundations that can qualify for these deductions and allow for family members to control the foundations and even receive compensation for services rendered, as long as the charitable foundation rules are followed. This should increase if this Act is passed. IRA's can also pass to such foundations to avoid both income tax on withdrawal and estate taxes, where the combined tax rate on death can exceed 75%, or more. While charities should be excited, they should be sure to remember that any changes that this legislation might bring would not go into effect until the beginning of 2022.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

Taxpayers have approximately nine more months to plan accordingly for these changes. As mentioned above, moving fast is important as many of the key strategies in planning for this legislation (such as irrevocable trusts and certain discounts) will be rendered unavailable should this Act pass.

Do not get discouraged, however, as many great estate planning techniques will still be available after this legislation's potential passing. These include:

- Low-interest rate promissory note installment sale planning between family members;
- Self-cancelling installment notes; and
- Charitable Lead Annuity Trusts (CLATs).

While the above planning tools are excellent, the three tools that will either be disappearing completely or curtailed heavily under this act are even more helpful to most individuals. These (soon-to-be-gone) tools are:

- Grantor Retained Annuity Trusts (GRATs);
- Grantor Trusts; and
- Family entity discounts.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

Should this act pass, the following outlines some of the other changes that are set to occur:

ELIMINATING DISCOUNTS FOR NON-BUSINESS ENTITIES AND ASSETS.

Married couples can presently place $15 million of assets into an LLC and then each spouse can then sell a 49% ownership in that LLC to an irrevocable trust in exchange for a $5 million note each (which assumes a 33.33% valuation discount).

This type of valuation would not be possible under this new Act. The new Act would amend the IRC and require that family entities base their valuation on the pro-rata percentage of ownership times the value of all the underlying assets. The exceptions to this valuation rule under the new legislation are very slim.

The legislation includes new look-through rules which seek to prevent against entitles abusing the valuation discount rules. Under this new legislation, even a 10% ownership of an entity being held by an entity will be valued at 10% of the value of the assets owned by such entity. Presumably ownership of less than 10% can be discounted, but this takes away significant discounts that used to apply to minority ownership interests.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

THE DEFECTIVE GRANTOR TRUST WILL NOW BE TRULY DEFECTIVE.

In what is a crushing blow to estate planning and tax professionals across the U.S., Section 2901, which would be added to the IRC under this legislation, would mandate that any trust which is created, funded, or transacted with after the date of enactment of the law, and is considered to be owned by the Grantor for income tax purposes or by a person that exchanges assets with such trust, will be subject to federal estate tax on the death of the Grantor as if the Grantor him or herself owned the trust's assets.

Good-bye "Defective Grantor Trusts," given that the passage of this law will make it essential that grantor trusts be fully funded and established before the enactment of such legislation.

To recap: Currently, a taxpayer can create a trust that will (a) not be subject to federal estate tax **but** (b) will be considered as owned by that taxpayer for income tax purposes. Doing so enables the taxpayer to pay the income tax on trust earnings *without* the payment of such taxes being considered a gift. Alternatively a taxpayer can sell significant assets to the trust in exchange for long-term low interest rate promissory notes, special notes that may vanish on death, or special arrangements called "Private Annuity Sales" that may be used without triggering income tax on the exchange. The taxpayer may also exchange assets with the trust on an income tax-free basis.

agassman@gassmanpa.com
Brandon@gassmanpa.com

THE ART AND SCIENCE OF THE SLAT
("Spousal Limited Access Trust")
in 2021

1. The trust can make distributions for the Grantor's spouse - and essentially pay half of the household expenses, which can indirectly benefit the Grantor by reducing living expense.
2. On divorce the trust can divide into one SLAT for the spouse beneficiary and another SLAT where the Grantor will control who the Trustee is. The Trustee can have discretion to have no payments to the spouse, and to benefit a subsequent spouse of the Grantor (aka "floating spouse").

3. If the trust is formed in an Asset Protection Trust ("APT") jurisdiction then the Grantor may be added as a beneficiary by non-fiduciary Trust Protectors if the Grantor faces unexpected financial destitution.

4. The SLAT can loan money to the Grantor and family members at arm's-length.

5. The Grantor may have to pay income tax on the income of the SLAT, even if (a) the Grantor releases any power to replace trust assets with assets of equal value and (b) a beneficiary other than the spouse (an "Adverse Party") must approve any distributions to the spouse

   This because of the repeal of IRC §682 - the Grantor is considered to be the beneficiary of a trust that benefitted his or her spouse upon inception under IRC §677.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

THE ART AND SCIENCE OF THE SLAT
("Spousal Limited Access Trust")
in 2021

6. An Independent Trustee can transfer all assets in the SLAT to the Grantor's spouse to "undo" the trust.

7. According to some advisors the Grantor's spouse can be given 9 months from the date of funding of the trust to disclaim any right to benefit from the trust - the trust can provide that if such a disclaimer is issued then the Trustee may distribute the trust assets to the Grantor.

   Compare the above disclaimer strategy to the use of a Lifetime Q-TIP, which can have the same result, but is statutorily blessed and allows the Grantor to decide whether to abandon ship by the filing due date (with extensions) of the next year's gift tax return.

8. The beneficiary spouse may file a gift tax return and "split the gift" if he or she is unlikely to benefit from the trust. For this reason the Trust Agreement may indicate that all assets and resources of the trust should be considered before distributions are made to him or her.

9. Not everyone is comfortable with "reciprocal trusts". Safer for any trust funded by the recipient spouse to be for descendants only, unless perhaps in an APT jurisdiction with non fiduciary Trust Protectors who can add one or both spouses if there is an unforeseen financial problem.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

This income tax-free nature will be eliminated under the new Act. Because of this, the time to act is now for individuals who have been intending to exchange low-interest promissory notes for other trust assets in order to **freeze** any future appreciation. If you wish to know more about these techniques, please see Alan S. Gassman, Jerome B. Hesch & Martin B. Shenkman on the *Biden 2-Step for Wealthy Families: Why Affluent Families Should Immediately Sell Assets to Irrevocable Trusts for Promissory Notes Before Year-End and Forgive the Notes If Joe Biden Is Elected, A/K/A What You May Not Know About Valuing Promissory Notes and Using Lifetime Q-Tip Trusts* LISI Estate Planning Newsletter 2813 (August 10, 2020).

To learn more about the use of installment sales and Grantor Trusts, please see the YouTube video at https://www.youtube.com/watch?v=4e7utgxtn7A&t=1534s. This video was recorded with Professor Jerry Hesch and estate tax planning lawyer Marty Shenkman in September, 2020. The relevant discussion begins at 6 minutes and 30 seconds into the presentation. **WARNING: This is a pretty deep dive into the nitty-gritty of the law. This is primarily aimed at tax advisors, tax professionals, those who like mathematical discussions, and those who have trouble going to sleep.**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

INSTALLMENT SALES TO NON-DEFECTIVE TRUSTS AND INDIVIDUALS – A CONVERSATON WITH JERRY HESCH

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Traditional Installment Sale to Grantor Trust

Assumptions:

Sale of 49% Interest in Company valued at $20,000,000 for $6,533,333 15-Year Interest Only Promissory Note (Assumes 33.33% discount applies).

Interest Rate – 1.46%

Growth Rate – Assumes Company is sold in 5 Years for $30,000,000 and 7% Growth on Investments thereafter.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Year	Value of ABC (Assumes Sale in 5 Years for $30,000,000 and 7% Growth on Investments Thereafter)	Value of Trust Account (Seed Gift) (7% Growth)	Sale Price of 49% LLC Interest with 33.33% Discount	Net Value of Descendants Trust	Outstanding Balance of Note	Annual Note Payments Payable to Grantor	Trust Income Taxes Paid by Grantor* (33% Tax Rate)	Amount Included in Grantor's Estate if He/She Dies in Particular Year (Assuming that Note Payments are spent on income tax payments)	Value of Assets Shifted Outside of Grantor's Estate If Grantor Dies in a Particular Year	Estate Tax Savings if Grantor Dies in a Particular Year (Assumes 40% Estate Tax Rate)
1	$20,000,000.00	$653,333.33	$6,533,333.33	$3,824,613.33	$6,533,333.33	$95,386.67	($166,982.20)	$6,533,333.33	$3,266,666.67	$1,306,666.67
2	$21,000,000.00	$699,066.67		$4,264,960.00	$6,533,333.33	$95,386.67	($175,436.95)	$6,533,333.33	$3,756,666.67	$1,502,666.67
3	$22,000,000.00	$748,001.33		$4,708,508.00	$6,533,333.33	$95,386.67	($183,917.59)	$6,533,333.33	$4,246,666.67	$1,698,666.67
4	$23,000,000.00	$800,361.43		$5,155,481.43	$6,533,333.33	$95,386.67	($192,425.92)	$6,533,333.33	$4,736,666.67	$1,894,666.67
5	$30,000,000.00	$856,386.73		$8,546,120.06	$6,533,333.33	$95,386.67	($249,473.89)	$6,533,333.33	$8,166,666.67	$3,266,666.67
6	$32,100,000.00	$916,333.80		$9,539,680.46	$6,533,333.33	$95,386.67	($266,937.06)	$6,533,333.33	$9,195,666.67	$3,678,266.67
7	$34,347,000.00	$980,477.16		$10,609,467.16	$6,533,333.33	$95,386.67	($285,622.65)	$6,533,333.33	$10,296,696.67	$4,118,678.67
8	$36,751,290.00	$1,049,110.56		$11,760,816.00	$6,533,333.33	$95,386.67	($305,616.24)	$6,533,333.33	$11,474,798.77	$4,589,919.51
9	$39,323,880.30	$1,122,548.30		$12,999,436.32	$6,533,333.33	$95,386.67	($327,009.38)	$6,533,333.33	$12,735,368.01	$5,094,147.21
10	$42,076,551.92	$1,201,126.69		$14,331,437.13	$6,533,333.33	$95,386.67	($349,900.03)	$6,533,333.33	$14,084,177.11	$5,633,670.84
11	$45,021,910.56	$1,285,205.55		$15,763,355.06	$6,533,333.33	$95,386.67	($374,393.03)	$6,533,333.33	$15,527,402.84	$6,210,961.14
12	$48,173,444.29	$1,375,169.94		$17,302,184.31	$6,533,333.33	$95,386.67	($400,600.55)	$6,533,333.33	$17,071,654.37	$6,828,661.75
13	$51,545,585.39	$1,471,431.84		$18,955,408.68	$6,533,333.33	$95,386.67	($428,642.58)	$6,533,333.33	$18,724,003.51	$7,489,601.40
14	$55,153,776.37	$1,574,432.07		$20,731,035.82	$6,533,333.33	$95,386.67	($458,647.57)	$6,533,333.33	$20,492,017.09	$8,196,806.84
15	$59,014,540.72	$1,684,642.31		$22,637,633.93	$6,533,333.33	$6,628,720.00	($490,752.89)	$6,137,967.11	$22,779,157.85	$9,111,663.14

Interest Rate:	1.460%
Loan Amount:	$6,533,333.33
Annual Interest Payment	$95,386.67
Balloon Payment Amount	$6,533,333.33
Total Loan Payments	$7,964,133.33
Value of Assets Removed From Estate in Year 15:	$22,779,157.85
Estate Tax Savings:	$9,111,663.14

agassman@gassmanpa.com
Brandon@gassmanpa.com

Installment Sale to Non-Grantor Trust

Assumptions:

Sale of 49% Interest in Company valued at $20,000,000 for $9,800,000 15-Year Interest Only Promissory Note (Assumes no discount applies).

Interest Rate – 1.46%

Growth Rate – Assumes Company is sold in 5 Years for $30,000,000 and 7% Growth on Investments thereafter.

Basis in 49% Interest of Company at time of Sale - $0

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Year	Value of ABC (Assumes Sale in 5 Years for $30,000,000 and 7% Growth on Investments Thereafter)	Value of Trust Account (Seed Gift) (7% Growth)	Sale Price of 49% LLC Interest with No Discount	Net Value of Descendants Trust	Outstanding Balance of Note	Annual Note Payments Payable to Grantor	Trust Income Taxes Paid by Trust* (33% Tax Rate)	Income Taxes Paid on Installment Sale by Grantor (Assumes 20% Capital Gain Rate)	Amount Included in Grantor's Estate if He/She Dies in Particular Year (Assuming that Note Payments are spent on income tax payments)	Value of Assets Shifted Outside of Grantor's Estate If Grantor Dies in a Particular Year	Estate Tax Savings if Grantor Dies in a Particular Year (Assumes 45% Estate Tax Rate)
1	$20,000,000.00	$980,000.00	$9,800,000.00	$667,296.70	$9,800,000.00	$143,080.00	($169,623.30)	($28,616.00)	$9,800,000.00	$0.00	$0.00
2	$21,000,000.00	$1,048,600.00		$1,074,177.07	$9,800,000.00	$143,080.00	($178,262.93)	($28,616.00)	$9,800,000.00	$490,000.00	$220,500.00
3	$22,000,000.00	$1,122,002.00		$1,485,820.61	$9,800,000.00	$143,080.00	($186,941.39)	($28,616.00)	$9,800,000.00	$980,000.00	$441,000.00
4	$23,000,000.00	$1,200,542.14		$1,902,560.76	$9,800,000.00	$143,080.00	($195,661.38)	($28,616.00)	$9,800,000.00	$1,470,000.00	$661,500.00
5	$30,000,000.00	$1,284,580.09		$4,489,180.09	$9,800,000.00	$143,080.00	($980,000.00)	($28,616.00)	$9,800,000.00	$4,900,000.00	$2,205,000.00
6	$32,100,000.00	$1,374,500.70		$6,174,379.36	$9,800,000.00	$143,080.00	($270,641.34)	($28,616.00)	$9,800,000.00	$5,929,000.00	$2,668,050.00
7	$34,347,000.00	$1,470,715.74		$7,209,599.51	$9,800,000.00	$143,080.00	($289,586.23)	($28,616.00)	$9,800,000.00	$7,030,030.00	$3,163,513.50
8	$36,751,290.00	$1,573,665.85		$8,327,300.68	$9,800,000.00	$143,080.00	($309,857.27)	($28,616.00)	$9,800,000.00	$8,208,132.10	$3,693,659.45
9	$39,323,880.30	$1,683,822.46		$9,533,256.53	$9,800,000.00	$143,080.00	($331,547.28)	($28,616.00)	$9,800,000.00	$9,468,701.35	$4,260,915.61
10	$42,076,551.92	$1,801,690.03		$10,833,644.88	$9,800,000.00	$143,080.00	($354,755.59)	($28,616.00)	$9,800,000.00	$10,817,510.44	$4,867,879.70
11	$45,021,910.56	$1,927,808.33		$12,235,076.03	$9,800,000.00	$143,080.00	($379,588.48)	($28,616.00)	$9,800,000.00	$12,260,736.17	$5,517,331.28
12	$48,173,444.29	$2,062,754.91		$13,744,622.95	$9,800,000.00	$143,080.00	($406,159.67)	($28,616.00)	$9,800,000.00	$13,804,987.70	$6,212,244.47
13	$51,545,585.39	$2,207,147.76		$15,369,853.75	$9,800,000.00	$143,080.00	($434,590.85)	($28,616.00)	$9,800,000.00	$15,457,336.84	$6,955,801.58
14	$55,153,776.37	$2,361,648.10		$17,118,866.32	$9,800,000.00	$143,080.00	($465,012.21)	($28,616.00)	$9,800,000.00	$17,225,350.42	$7,751,407.69
15	$59,014,540.72	$2,526,963.47		$19,000,325.36	$9,800,000.00	$9,943,080.00	($497,563.06)	($1,988,616.00)	$9,800,000.00	$19,117,124.95	$8,602,706.23

Interest Rate:	1.460%
Loan Amount:	$9,800,000.00
Annual Interest Payment	$143,080.00
Balloon Payment Amount	$9,800,000.00
Total Loan Payments	$11,946,200.00

Value of Assets Removed From Estate in Year 15:	$19,117,124.95
Estate Tax Savings:	$8,602,706.23

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

WHETHER TO GIFT NOW - - -
BEFORE IT MIGHT BE TOO LATE!

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Step Transaction Doctrine

- *Senda, Holman*, and other court decisions.
- A transfer of assets to an LLC that is immediately followed by a transfer of non-voting member interests by gift will be considered to be a gift of the underlying assets, with no discount permitted.
- It is safest to wait 30-45 days between contribution and member interest transfer.
- The more volatile the asset contributed, the less waiting time required.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of cases where courts have addressed the step transaction doctrine by analyzing the close proximity between date of funding of entity and date of transfer of entity interests.

Case Name/ Court	Deci-sion Date	Date Entity Formed	Date Assets Transf-erred	Date Interest Gifted	# of days in between	Court Found For	Type of Assets Inves-ted	Court Held	Court's Dicta	Special notes
Holman v. Comr. (U.S. Tax Ct.)	5/27/08	11/3/99	11/2/99	11/8/99	6	Taxpayer	Shares of Dell stock	The limited partnership was formed and the shares of Dell stock were transferred to it almost 1 week in advance of the gift, so that on the facts before us, the transfer cannot be viewed as an indirect gift of the shares to the donees. Furthermore, the gift may not be viewed as an indirect gift of the shares to the donees under the step transaction doctrine.	This case is distinguishable from *Senda* because petitioners did not contribute the Dell shares to the partnership on the same day they made the 1999 gift; indeed, almost 1 week passed between petitioners' formation and funding of the partnership and the 1999 gift. Petitioners bore the risk that the value of an LP unit could change between the time they formed and funded the partnership and the times they chose to transfer the LP units. Therefore, the Court decided not to disregard the passage of time and treat the formation and funding of the partnership and the subsequent gifts as occurring simultaneously under the step transaction doctrine. Also, in this case, the IRS conceded that a 2-month separation is sufficient to give independent significance to the funding of a partnership and a subsequent gift of LP units.	There were other gifts and transfers, but the Court was only concerned with the November set of transactions.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of cases where courts have addressed the step transaction doctrine by analyzing the close proximity between date of funding of entity and date of transfer of entity interests.

Case Name/ Court	Deci-sion Date	Date Entity Formed	Date Assets Transf-erred	Date Interest Gifted	# of days in between	Court Found For	Type of Assets Inves-ted	Court Held	Court's Dicta	Special notes
Senda v. Comr. (U.S. Tax Ct.)	7/12/04	6/3/98 (SFLP I) 12/2/99 (SFLP II)	12/28/98 12/20/99	12/28/98 12/20/99	0 0	IRS	Shares of stock Shares of stock	The taxpayers' transfers of stock to partnerships, coupled with transfer of limited partnership interests to their children, were indirect gifts of stock to children, and thus, stock and not partnership interests, would be valued for gift tax purposes.	Petitioners presented no reliable evidence that they contributed the stock to the partnerships before they transferred the partnership interests to the children. It is unclear whether petitioners' contributions of stock were ever reflected in their capital accounts. At best, the transactions were integrated and, in effect, simultaneous. Therefore, the Court concluded that the value of the children's partnership interests was enhanced upon petitioners' contributions of stock to the partnerships and were indirect gifts.	On January 31, 2000, petitioner gave to each child an additional 4.5-percent limited partnership interest in SFLP II.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of cases where courts have addressed the step transaction doctrine by analyzing the close proximity between date of funding of entity and date of transfer of entity interests.

Case Name/ Court	Deci-sion Date	Date Entity Formed	Date Assets Transf-erred	Date Interest Gifted	# of days in between	Court Found For	Type of Assets Inves-ted	Court Held	Court's Dicta	Special notes
Estate of Jones v. Comr. (U.S. Tax Ct.)	3/6/01	1/1/95 (JBLP) 1/1/95 (AVLP)	1/1/95 1/1/95	1/1/95 1/1/95	0 0	Tax-payer	Assets including real property	Transfers of property to partnerships were not taxable gifts.	All of the contributions of property were properly reflected in the capital accounts of the taxpayer, and the value of the other partners' interests was not enhanced by the contributions of decedent. Therefore, the contributions do not reflect taxable gifts.	

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Summary of cases where courts have addressed the step transaction doctrine by analyzing the close proximity between date of funding of entity and date of transfer of entity interests.

Case Name/ Court	Deci-sion Date	Date Entity Formed	Date Assets Transf-erred	Date Interest Gifted	# of days in between	Court Found For	Type of Assets Inves-ted	Court Held	Court's Dicta	Special notes
Shepherd v. Comr. (U.S. Tax Ct.)	10/26/00	8/2/91	Leased Land (8/1/91) ; Bank Stock (9/9/91)	8/2/91	Varies	IRS	Fee interest in timberland subject to a long-term timber lease and stocks in three banks	Transfers represent separate indirect gifts to his sons of 25% undivided interests in the leased timberland and stocks.	Not every capital contribution to a partnership results in a gift to the other partners, particularly where the contributing partner's capital account is increased by the amount of his contribution, thus entitling him to recoup the same amount upon liquidation of the partnership. Here, however, petitioner's contributions of the leased land and bank stock were allocated to his and his sons' capital accounts according to their respective partnership shares. Upon dissolution of the partnership, each son was entitled to receive payment of the balance in his capital account.	

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Must a sale for adequate consideration be reported on a Gift Tax Return? vs. Optional (Recommended)

WHAT HAS TO BE REPORTED ON A GIFT TAX RETURN VERSES OPTIONAL (BUT RECOMMENDED)

		Required To Be Disclosed	Not Required To Be Disclosed
1.	Any seed capital gift to the irrevocable trust.	Required, if exceeds the $15,000 annual exclusion that may be available.	
2.	The funding of a family holding LLC		May not need to be reported.
3.	A sale for a proper note - amount owed equals FMV of assets sold.		May not need to be reported.
4.	Cancellation or gifting of the note.	This will need to be reported.	

agassman@gassmanpa.com
Brandon@gassmanpa.com

GASSMAN CROTTY DENICOLO, P.A.
ATTORNEYS AT LAW

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

CAN YOU GIFT OR SELL NOW AND REVERSE IT IF CONGRESS DOES NOT ACT?

agassman@gassmanpa.com
Brandon@gassmanpa.com

GASSMAN CROTTY DENICOLO, P.A.
ATTORNEYS AT LAW

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

THE DISCLAIMER BACK TO ME TRUST

Spouse 1 makes a gift to a Spousal Limited Access Trust (“SLAT”), which provides that the beneficiary spouse (“imaginatively named Spouse 2”) may disclaim or cause a disclaimer of all beneficial rights under the Trust, in which event the Trust assets may return to Spouse 1.

1. Will this work?

2. This would provide a 9-month lookback.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

A LIFETIME Q-TIP TRUST TO THE RESCUE

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

A Lifetime Q-TIP Trust to the Rescue

An alternative strategy that married taxpayers may use to have the client the ability to pull the plug on a large 2021 gift as late as September of 2022, would be to transfer the low interest long-term note in late December of 2021 to a "Lifetime Q-TIP Trust" that will qualify for the estate tax deduction to the extent necessary to avoid imposition of gift tax on the donor spouse.

A Q-TIP Trust is a trust that must pay all income to the spouse beneficiary, and can be used solely to benefit the spouse beneficiary during his or her lifetime. A trustee can be given the power to devise all assets under the trust to such spouse.

A Q-TIP Trust can be divided into two separate sub trusts, one of which can be considered to be a Credit Shelter Trust that will not be subject to estate tax on the death of the spouse beneficiary, with the other trust qualifying for the marital deduction and being considered to be a Grantor Trust owned by the spouse beneficiary during her lifetime.

The Grantor of the Q-TIP Trust can elect what portion of the trust will be treated as the Credit Shelter Trust, and what portion of the trust will be considered to be the Marital Deduction Trust, in the manner described above by an election that must be filed by April 15 of the calendar year following the contribution to the Trust, or by October 15, if the Grantor spouse files a timely extension. It is essential that the election be made on time, because there is no relief available if not. *See Creative Trust Planning Strategies for Using Lifetime Q-Tips, by Richard S. Franklin, ABA Section of Real Property Trusts and Estates Law Webinar April 7, 2018.* Richard Franklin can be contacted at rfranklin@fkl-law.com.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

A Lifetime Q-TIP Trust to the Rescue, *Cont'd*

This mechanism allows a grantor who is uncertain as to whether he or she wants to use some or all of his or her remaining estate tax exemption amount, and also enables the Grantor to use a "Formula Clause", which may best be described by the following example:

Harold has $10,000,000 of his $11,700,000 estate tax exclusion remaining in December, 2021. He also has a $15,000,000 low interest rate promissory note that pays interest annually and will balloon in 20 years. The note may be worth $12,000,000.

Harold places the promissory note into a lifetime Q-TIP Trust for his wife, Dorothy in 2021. Harold then waits to see whether the estate tax exemption is reduced by legislation. On or before the due date in 2022 Harold may file an election to treat the entire Q-TIP Trust as a Marital Deduction Gift, and thus retain his exclusion amount, as if no gift was made. In that event, the trustee of the Q-TIP Trust may distribute the note to Dorothy, so that no large gift has essentially been made.

Alternatively, if the estate tax exclusion is reduced, then Harold can make the gift to the Q-TIP Trust effective in 2021 as a "retroactive" gift of his remaining exemption amount by making a Formula Election which says "have an amount of assets in Credit Shelter portion of the Q-TIP Trust equal in value to my remaining exclusion amount divided by the total value of trust assets, with the remaining trust assets to be held as a Marital Deduction Trust."

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

A Lifetime Q-TIP Trust to the Rescue, *Cont'd*

The Trustee hires a valuation expert after Harold has made his election, and the expert opines that 83.33% of the note should pass to the Credit Shelter portion of the Q-TIP Trust and 16.67% of the note should pass to the Marital Deduction portion. 83.33% of $15,000,000 is $12,500,000 in principal that the Credit Shelter Trust may receive if the note is paid off after a few years of having the trust receive interest payments. The remaining $2,550,000 portion of the note that is in the Q-TIP Marital Deduction sub trust will be included in his spouse's taxable estate, and may be subject to both a time value of money discount for the low interest rate situation and a partial ownership discount, as per the *Smith v. U.S.* case, which is discussed above.

If the IRS audits a gift tax return more of the note may have to be allocated to the Marital Deduction portion, but no gift tax will be owed.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

A Lifetime Q-TIP Trust to the Rescue, *Cont'd*

One disadvantage of the Credit Shelter Sub-trust feature of the Q-TIP Trust is that it must pay all income to the surviving spouse, which would mean all interest payments on the promissory note portion allocated to the Credit Shelter Trust will come out to the spouse, but the note may be paid in full, and then the money may be invested in growth stocks that pay no dividends.

In the 1992 5th Circuit Court of Appeals decision of *Estate of Clayton* (976 F.2d 1486), the Court held that the portion of the Q-TIP Trust designated as a Credit Shelter Trust (to not qualify for the marital deduction) would not have to pay income to the surviving spouse if drafted to provide for this. The IRS responded to this case by establishing the "Clayton Q-TIP Election" regulations at Sec. 20.2056(b)-7(d) to allow for this for a Q-TIP trust formed at death, but it is not clear whether this treatment can apply for a lifetime Q-TIP gift.[1]

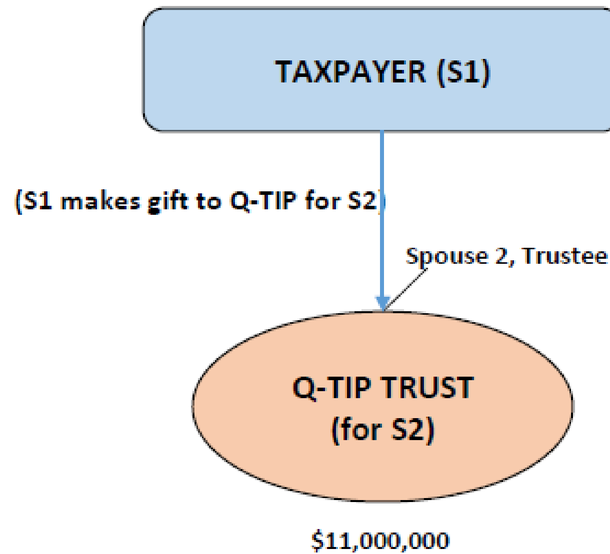
agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

WAIT AND SEE Q-TIP TRUST

2020

Flexible Planning With A Q-Tip Trust



In 2010, S1 conveys assets (could be $11,000,000 worth) to Q-TIP Trust for S2.

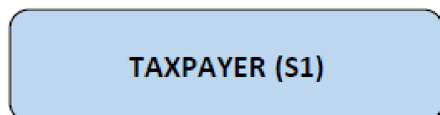
Must pay all income to S2 and solely benefit S2 for S2's lifetime, plus can provide health, education and maintenance - and even more benefits and payments to S2.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

WAIT AND SEE Q-TIP TRUST

2020

Flexible Planning With A Q-Tip Trust



(S1 makes gift to Q-TIP for S2)

Spouse 2, Trustee

Q-TIP TRUST
(for S2)

$11,000,000

In 2010, S1 conveys assets (could be $11,000,000 worth) to Q-TIP Trust for S2.

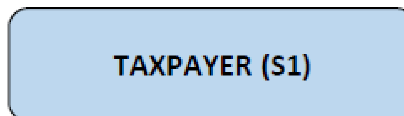
Must pay all income to S2 and solely benefit S2 for S2's lifetime, plus can provide health, education and maintenance - and even more benefits and payments to S2.

On or before September 15, 2021, S1 has the following choices:

2021

Treat The Entire Q-TIP Trust As A Marital Deduction Trust

OPTION 1



(No exclusion used by S1)

Spouse 2, Trustee

Q-TIP TRUST
(for S2)

$11,000,000

OPTION
1 Treat the entire Q-TIP Trust as a Marital Deduction Trust -

- A No use of exemption has occurred.
- B Trustee can continue Trust - Trust assets protected from creditors.
- C Trust Protectors or Independent Trustee may cause all assets to be distributed to S2 to terminate the Trust
- D All income must be paid to S2
- E Some or all of Trust assets may be transferred to S2
- F S2 may exercise Power of Appointment, so that assets are held for lifetime health, education and maintenance of S1
- G Protected from creditors of S1, if S1 resides in Florida or another "Q-TIP Trust protection state."

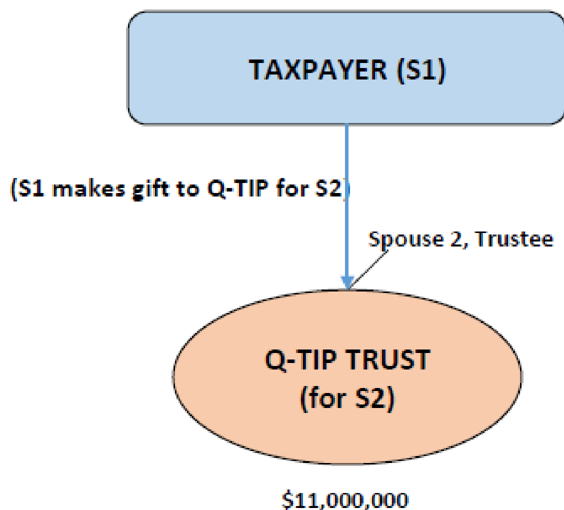
agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

WAIT AND SEE Q-TIP TRUST

2020

Flexible Planning With A Q-Tip Trust



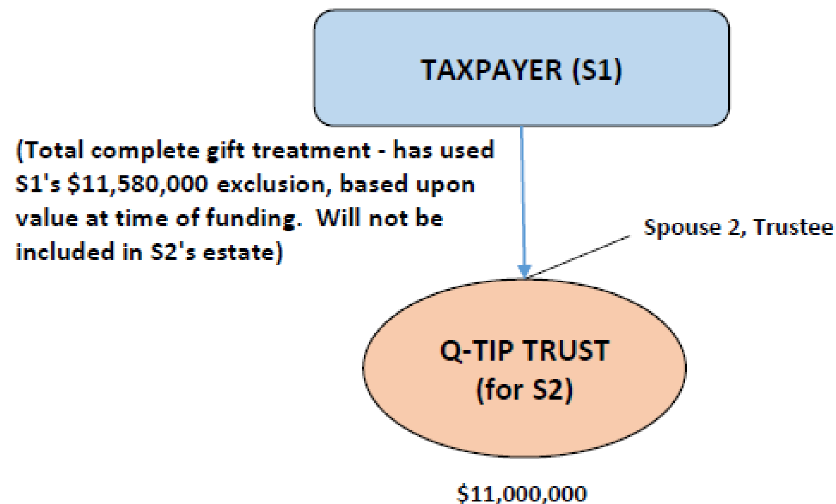
In 2010, S1 conveys assets (could be $11,000,000 worth) to Q-TIP Trust for S2.

Must pay all income to S2 and solely benefit S2 for S2's lifetime, plus can provide health, education and maintenance - and even more benefits and payments to S2.

2021

S1 Elects To Have Entire Trust Be A "Completed Gift"

OPTION 2



OPTION 2 — S1 elects to have entire trust be a "completed gift":

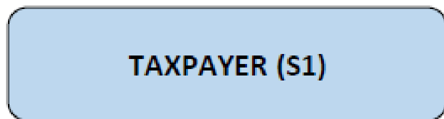
- A Uses S1's $11,580,000 exemption to the extent of assets contributed.
- B Can limit payments to being (1) all income to S2, and (2) only amounts as needed for S2's health, education and maintenance.
- C Trust assets will not be taxed in estate of S1 or S2 - income received by S2 will be added to S2's estate, if not spent.
- D Trust can invest in low or no income assets, or may be able to use a "Blocker LLC" to reduce or eliminate income.
- * Treasury Regulations do not provide for a lifetime Q-TIP "Clayton" election that would cause the income interest to not apply.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

WAIT AND SEE Q-TIP TRUST

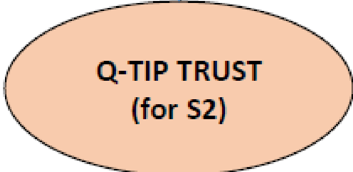
2020

Flexible Planning With A Q-Tip Trust



(S1 makes gift to Q-TIP for S2)

Spouse 2, Trustee



$11,000,000

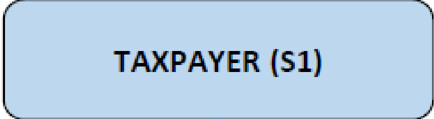
In 2010, S1 conveys assets (could be $11,000,000 worth) to Q-TIP Trust for S2.

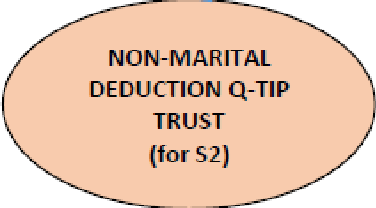
Must pay all income to S2 and solely benefit S2 for S2's lifetime, plus can provide health, education and maintenance - and even more benefits and payments to S2.

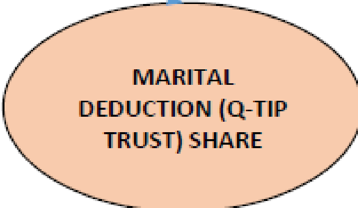
2021

Partial Marital Deduction Election

OPTION 3







1. Not included in surviving spouse's estate
2. Must pay income to surviving spouse
3. May be appointed to benefit S1 after S2's death.

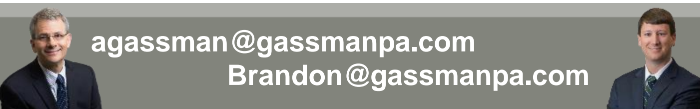
1. Pays income to surviving spouse.
2. Independent Trustee or Trust Protectors may transfer all assets to surviving spouse to terminate.
3. Will be considered to be owned by S2 for federal estate tax purposes when S2 dies.

OPTION

3 Partial marital deduction election exercise -

Example A Have marital deduction apply to the extent of $3,000,000 - the other $7,000,000 stays in Non-Marital Deduction Q-TIP Trust.

Example B Marital Deduction Trust to the extent exceeding $8,000,000 so that Non-Marital Deduction Trust is $3,000,000.

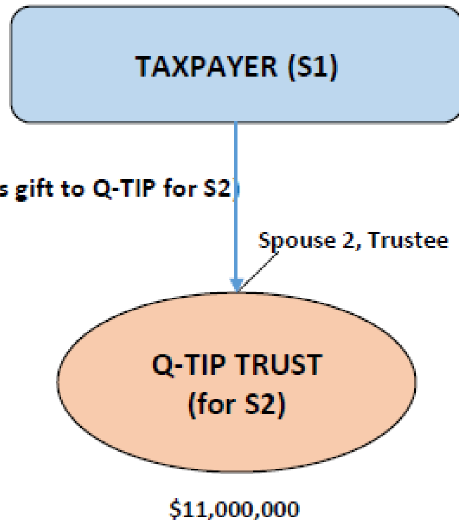


Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

WAIT AND SEE Q-TIP TRUST

2020

Flexible Planning With A Q-Tip Trust



$11,000,000

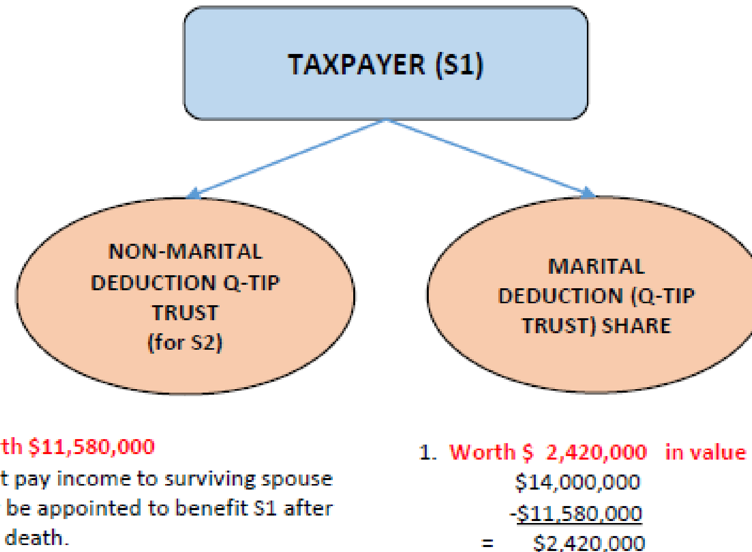
In 2010, S1 conveys assets (could be $11,000,000 worth) to Q-TIP Trust for S2.

Must pay all income to S2 and solely benefit S2 for S2's lifetime, plus can provide health, education and maintenance - and even more benefits and payments to S2.

2021

Formula Division When Assets May Exceed Exemption Amount

OPTION 4



1. Worth $11,580,000
2. Must pay income to surviving spouse
3. May be appointed to benefit S1 after S2's death.

1. Worth $ 2,420,000 in value

$14,000,000
-$11,580,000
= $2,420,000

OPTION 4 — The September 15th election can provide that the amount that can pass gift tax-free will pass to Non-Marital Deduction Q-TIP Trust with remaining assets passing to Marital Deduction Trust.
The Taxpayer may claim that the assets are worth less than $11,580,000. If the IRS audits, there will be no gift tax due - but assets will be pushed to the Marital Deduction Trust.

STRONG WARNING - Failure to file a gift tax return with election on a timely basis causes loss of marital deduction-significant malpractice risk.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

STEP RIGHT UP FOR GOOD NEWS: THE GREAT BASIS STEP UP IN THE SKY STILL APPLIES ALBEIT WITH SOME SLIGHT MODIFICATIONS.

One piece of good news from the legislation is that capital gains taxes may still be avoided when the estate of a recently-deceased person is sold, as IRC 1014 still provides that any assets owned at death will receive a step up (or step down) in basis equal to their fair market value “date of death” amount.

EXAMPLE 5: Olivia owns stock worth $100,000 on death that cost her $10,000 initially. If Olivia’s family sells the stock for $110,000 after Olivia’s death, then only $10,000 is taxed as capital gains.

The question remains, however, what would happen if Olivia were to gift stock before she died to an irrevocable trust that was (a) located outside of her estate for estate tax purposes, but (b) considered to be owned by her for income tax purposes?

Under this new legislation, when the owner of a Defective Grantor trust dies, no fair market value (FMV) income tax basis will be assigned for the assets of the trust unless the trust is included in the Grantor’s estate. This is a definite defeat for those with existing grantor trusts who wished to continue those trusts’ existence until death.

There is still uncertainty in the law as to whether a new FMV income tax basis will be received when the Grantor of a trust disregarded for income tax purposes dies. Estate planning experts are split as to whether the step-up should be received. This pending law change is evidence that those who pre-decease the law’s enactment should get the step up in tax basis.

This provision would apply for all irrevocable trusts, including those formed prior to the passage of this Act, that are treated as owned by the Grantor of the trust.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

TRUE GRIT ABOUT GRATs.

This legislation would severely impact the efficacy of an important planning structure known as the Grantor Retained Annuity Trust (GRAT).

Using a GRAT, a taxpayer can place assets in a trust and have all growth (exceeding a fairly low rate-of-return) pass to family members without such passage being considered a “gift” for tax purposes.
The Walton family, behind the Wal-Mart brand, brought the GRAT to the attention of many by winning an IRS Tax Court case that sought to challenge the ability to set up a short-term GRAT. Their involvement with GRATs even led to the popularization of the term “Walton GRAT.”

Using a “Walton GRAT,” a taxpayer could put up to $10 million worth of stock in a trust that pays back $5 million each year plus a small interest payment, for two years. Anything that remains after those two annual distributions can pass to children free of estate taxes. The Walton case found that the funding of such a GRAT as described in this case is not considered a gift.

In contrast to the above, the “anti-Walton” GRAT provision in the new legislation would require GRATs to have a minimum term of ten (10) years, and for there to be a minimum gift considered to have been made on the funding of the GRAT that would have to be at least equal to either:

1. 25% of the fair market value of the property placed in the GRAT; or

2. $500,000, depending upon the circumstances.

Similarly to defective grantor trusts, this legislation will cause GRATs to be much less attractive as an estate tax avoidance technique. Many savvy families will be forced to enter into GRAT transactions immediately so as to be grandfathered in if and when the Act is signed into law.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

50 WAYS TO LEAVE YOUR GENERATION-SKIPPING TRUST.

One of the most controversial portions of the Sanders Plan is the requirement that long-term, multi-generational trusts be taxed occasionally as generations die.

As the law currently stands, long-term trusts can be established for beneficiaries and the trustee given the discretion to make distributions under an ascertainable standard, which will generally be for the "health, education, maintenance and support" of the applicable beneficiaries. This type of trust can benefit multiple generations without ever being subject to federal estate tax. This estate tax evasion even extends as new generations become beneficiaries.

The new legislation would cap a trust that would otherwise be exempt from the generation-skipping tax (GST) to a 50-year term and will cause pre-existing trusts to be deemed "terminated" 50 years after the passage date of the Act. If this new act passes, you will not catch a multi-generational trust saying "I'll be back."

What remains for pre-funded Dynasty Trusts is still unclear, but it seems that the intention of the law is clear and the IRS will have the authority to proscribe whatever regulations necessary to carry out the Act.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

ANNUAL GIFTING TECHNIQUES CURTAILED.

Beginning January 1, 2022, the $15,000 per donee gift tax exemption will be limited to $30,000 per *donor* with respect to certain transfers.

Under the law, the $15,000 per year gift tax exclusion will be adjusted with inflation in increments of $1,000. The maximum *"per donor"* amount for qualifying transfers will increase accordingly.

EXAMPLE 6: Abraham's $15,000 per year annual gift tax exclusion increases to $16,000, but he is still curious what his *per donor* amount is. Abraham's *per donor* amount increased to $32,000 in this case with reference to the below mentioned "limitation transfers."

As most sophisticated planners know, the annual exclusion can be leveraged by giving trust beneficiaries withdrawal rights to withdraw contributions made to a trust for a period of time (known as *Crummey* Powers). These contributions would qualify for the annual exclusion and thus reduce the amount of gift tax or exclusion used to fund a trust resulting in significant tax savings for trusts with multiple beneficiaries. For example, a $300,000 contribution to a trust with ten beneficiaries would result in no taxable gift if each beneficiary was given the right to withdraw a pro rata portion of the contribution.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Will a Promissory Note Between Family Members and Trusts Be Legally Binding? – *Cont'd*

For many would-be donors, the requirement that a promissory note be supported by consideration is a significant nontax benefit. Donors sometimes fear, often with some justice, that their gifts will not inspire gratitude from the donees. A donative promise may partially allay such fears. In order to make a taxable gift of a promise of money in the future, a donor has no choice but to demand, on the advice of counsel, that the donees take actions that they might otherwise be reluctant to perform. For example, in consideration for a $5.12 million note, the donees could, in principle, promise to keep kosher for the rest of the year, cancel their subscription to *The New York Times*, visit their mother on Mother's Day, or read Ayn Rand's *Atlas Shrugged*.

Finally, the donor could consider structuring the contract so that the note is payable to an irrevocable trust for the benefit of the donees. For example, in exchange for a legally sufficient consideration from the donees, a donor could promise to pay $5.12 million to a trust for their benefit. As a third-party beneficiary of a contract is generally enforceable by the intended beneficiary, **[Restatement (Second) of Contracts §§ 304 and 346 comment c.]** it should be possible to structure the contract so that the note is delivered to and is enforceable by the trustee of the trust, even if the consideration is furnished by the beneficiaries. The beneficiaries should not, in that case, be considered to have made an indirect gift to the trust, as the gift in question will have been made by the donor rather than the beneficiaries. **[In a related context, Regulations provide that where a gift is made through an intermediary, only one gift by the donor (and not the intermediary) is made. Reg. 25.2511-1(h)(2). In other words, even where a third party is involved in a transfer from the donor or the donee, only one taxable gift occurs, not two. But see *Johnstone*, 15 AFTR 382, 76 F2d 55, 35-1 USTC ¶9198, 1935-2 CB 346 (CA-9, 1935) (creating a potential for double taxation by holding that trust assets were included in the decedent's gross estate where the decedent held a general power of appointment that could have been extinguished at any time by the settlor).]**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Will a Promissory Note Between Family Members and Trusts Be Legally Binding? – *Cont'd*

The next question is whether a promissory note that is given for little or no consideration will be a legally binding instrument under state law. Bramwell summarizes the common law that applies in most states as follows:

> As a general rule, a promissory note is enforceable to the same extent that a contract is enforceable. **[11 Am. Jur. 2d Bills and Notes § 2; see also Uniform Commercial Code3-303Uniform Commercial Code 3-303.]** In order to make a note enforceable, therefore, it should be delivered to the donee pursuant to a valid and enforceable contract. **[The traditional elements of a contract are multiple parties, offer and acceptance, and consideration**] In particular, the note must be delivered in exchange for consideration. Legally sufficient consideration can take a variety of forms. For example, performance of an act **[11 Am. Jur. 2d Bills and Notes § 129.]** or a promise to perform a future act **[11 Am. Jur. 2d Bills and Notes § 128.]** can both be sufficient consideration. Another example of valid consideration is an act of forbearance. Thus, to take a classic example, refraining from smoking has been held to be sufficient consideration. **[*Hamer v. Sidway*, 27 NE 256 (N.Y., 1891).]** Consideration can also take the form of a transfer of property, even though both parties know that the property is being overvalued by the purchaser **[Restatement (Second) of Contracts § 71 comment c]** and even if the value of the consideration is grossly inadequate. **[Restatement (Second) of Contracts § 79 comment c.]**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Will a Promissory Note Between Family Members and Trusts Be Legally Binding? – *Cont'd*

Courts will generally not consider the value of consideration that may be given for a promise to pay money. A key decision in this area is the case of *Hamer v. Sigway*, where the New York Court of Appeals opined in 1891 that a promise to pay a nephew $5,000 to refrain from "drinking liquor, using tobacco, swearing and play cards or billiards for money until he should become 21 years of age" was valid consideration.

The *Hamer* court quoted an 1875 case which confirmed that "valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered upon or undertaken by the other . . . It is enough that something is promised, done, forborne or suffered by the party to whom the promise is made as consideration for the promise made to him . . . Any damage, or suspension, or forbearance of a right will be sufficient to sustain a promise."

It therefore appears that a large promissory note made payable to an irrevocable trust will be enforceable if the Trustee of the trust undertakes to fulfill a nominal or slightly more than nominal obligation to the notemaker. Bramwell's article points out that the obligation might be to read a book, follow a pattern of conduct for a year, or otherwise do something that is definable.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Whether to Make the Note Self-Canceling

The IRS takes the position that a self-canceling note is worth significantly less than the face value, if the lender whose life is referenced has less than a normal life expectancy.

The statutes permit a private annuity sale using standard life expectancy amounts, if the lender whose life is used has better than a 50% chance of living at least one year at the time that the arrangement is put into place.

Private annuity sales normally do not work as well as sales for promissory notes because:

a. Special "probability of exhaustion" rules require that any trust purchasing assets in exchange for a private annuity must have a significant amount of assets, which will usually significantly exceed the amount of the note.

b. An individual sale for a private annuity can trigger significant ordinary income (when a defective grantor trust is not being used).

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

MORE THAN ONE WAY TO SCIN A GRAT? (The "SCGRAT") WHAT IF THERE IS NOT TIME TO APPRAISE THE UNDERLYING ASSETS AND ENTITY DISCOUNTS BEFORE COMPLETING A SELF-CANCELLING INSTALLMENT NOTE TRANSACTION?

GRAT provides that first $400,000 worth of assets remain in GRAT and any excess from initial contribution will be payable over 5 annual installments of excess amount plus the 7520 Rate.

GRAT

Can benefit spouse and descendants after 5 years of payments to Grantor.

100%

SCIN $1,500,000

CLIENT/GRANTOR

LLC

Step 1 – Client places assets in LLC owned by client and receives back a Self-Cancelling Installment Note.
Step 2 – Client gifts 100% ownership in the LLC to the GRAT.
Step 3 – A valuation firm values the assets under the LLC and actuarial tables are used to determine the SCIN value.
Step 4 – The excess of asset value over the SCIN value is the GRAT contribution amount.
Step 5 – The GRAT may provide for holding assets equal to $400,000, and distributing back 5 annual payments based upon any excess over $400,000.
$2,000,000 - $1,500,000 = $500,000 . $500,000 - $400,000 = $100,000. $100,000/5 = $20,000
Step 6 – If the IRS determines that the valuation assumptions used are incorrect, any excess value will pass back to the Grantor over 5 annual payments, and will qualify for the estate tax marital deduction if the grantor dies during the first 5 years survived by a spouse.

Cash $500,000

Assets estimated to be worth $2,000,000

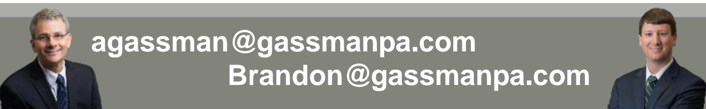
($500,000 in cash plus $1,500,000 in Grandpa's LLC interest (90%))

90%

Grandpa, 10%

GRANDPA LLC

$1,928,571 in assets
($1,928,571 x .9 x .7 = $1,500,000)



GASSMAN CROTTY DENICOLO P.A.
ATTORNEYS AT LAW

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

These limitation transfers, to which the $30,000 *per donor* limitations apply, are as follows:

A. A transfer into a trust;

B. A transfer of an interest in certain family entities;

C. A transfer of an interest in an asset that is subject to a prohibition on sale; and

D. A transfer of an asset that cannot be immediately liquidated by the donee.

These limitations will also make it more difficult to transfer wealth from one generation to the next while still maintaining some degree of control over the use of such transferred assets.

EXAMPLE 7: Phil and Susan have four children. They can presently gift $120,000 of money or other assets into trusts. This amount is based upon the current $15,000 per parent, per child rule.
After this law passes, Phil and Susan will only be able to transfer a total of $60,000 into trusts for their children, while the other $60,000 that they would have transferred might have to be given to the children as gifts or transferred into 529 College Plans.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Email Newsletter
Archive Message #2873

<u>DID THEY GIVE AWAY THE FARM</u>?

Farms and conservation easements are the target of the final changes of the legislation.

The Act provides for greater benefits for estates that use their property for farming or another family business that will keep the business in the family for 8+ years after the death of the Grantor.

Currently, families that use portions of their property for “qualified” purposes, as described above, may reduce the applicable value for estate tax purposes to take into account the decreased value the property would be worth if based on its historical trade/farming use. This limit, which is currently $1.19 million as indexed for 2021, stands to be increased to $3 million under this Act, with the number still set to index with inflation.

Additionally, the maximum estate tax exclusion amounts for conservation easements increased dramatically. The limit, which used to be $500,000, has quadrupled to $2 million and may be increased even further in the future.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Conclusion

This piece of legislation, whose fate is still undetermined, could have a profound impact on millions of American families hoping to plan for the future. Many, especially given the Coronavirus pandemic and the government's slow response, have not expected sweeping changes to estate tax laws to occur. Such families will need to act fast if they want to preserve their wealth in what could be one of the most significant estate tax changes in decades.

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

Alan Gassman
Brandon Ketron

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Some Other Thoughts and Ideas from Jerry Hesch, Esq.

On Charitable Trusts:

- Currently, the mortality tables used to calculate the present value of a remainder interest in a trust are 20 years old (from 2000). This out-datedness can allow for the generation of an over-inflated charitable income tax deduction for a taxpayer utilizing a charitable trust.

On Self-cancelling Installment Notes:

- Under the statutes, self-cancelling installment notes are considered debt obligations, not annuities. It is still possible to do a related-party installment sale in exchange for a promissory note and defer gain, so long as the party waits two years before re-selling the assert if they wish to continue the installment method.

On Planning with Promissory Notes:

- It is possible to take a discount on a promissory note, especially if the AFR increases (which would increase the discount).

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

THE BIDEN 2-STEP:

ESTATE TAX AVOIDANCE FOR HIGH NET WORTH TAXPAYERS

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Please see separate handout for full article.

Leimberg Information Services, Inc.

Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2813

Date:10-Aug-20

Subject: Alan S. Gassman, Jerome B. Hesch & Martin B. Shenkman on the Biden 2-Step for Wealthy Families: Why Affluent Families Should Immediately Sell Assets to Irrevocable Trusts for Promissory Notes Before Year-End and Forgive the Notes If Joe Biden Is Elected, A/K/A What You May Not Know About Valuing Promissory Notes and Using Lifetime Q-Tip Trusts

"Wealthy individuals who postpone taking appropriate action to eliminate estate taxes may not be able to use the $11,580,000 gift tax exemption after 2020. A political change in November 2020 could lead to lower estate and gift tax exemptions effective as early as January 1, 2021. In Quarty v. U.S., the ninth Circuit Court of Appeals ruled that a retroactive tax increase does not violate the Constitution. The court held that the increase in the estate and gift tax rates was a rational means to raise revenue, noting that an increase in tax rate was merely an increase of an existing tax, not a wholly new tax, citing other court decisions as precedent. Reducing the exemption is not a new tax. The time to act is now!

Implementation of the planning process can take several months. Consideration of the step-transaction doctrine and the reciprocal trust doctrine might suggest planning for time between various components of a plan. Using valuation discounts often requires time for an appraisal. Changing the ownership of assets, may require getting approval from co-owners or lenders with due on change in ownership provisions, complying with terms of governing documents for the entities to be transferred, and more. Determining planning decisions, which can take time. Additionally, valuation discounts, note sale transactions, and other techniques, may be subject to gift tax return audits and possible IRS challenges. What is not always addressed is that the stress, costs, and risks of discount planning can be reduced significantly by using the '2-Step Process' described below.

This newsletter is designed to explain the fundamental legal and financial principles underlying the concepts we will discuss and why those concepts should be implemented over two calendar years (2020 and 2021), or better in 2020, to best position clients for a possible reduction in the estate tax

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step?

The Biden 2-Step is a multiple step planning protocol that may be used by high net value taxpayers that would like to both:

(A) eliminate or reduce federal estate taxes, and

(B) be well situated to make use of a large part of what remains of each taxpayer's $11,700,000 estate tax exemption, at least for the rest of the 2021 year.

(This $11,700,000 exemption increases each year with chained CPI, and will be reduced to one-half of its then applicable level on 1/1/2026, unless Congress and a President delay or eliminate this reduction.)

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

It is possible that the exemption amount is reduced to a lower level effective January 1, 2021, but 2022 is much more likely. Legislation to raise tax revenues enacted any time during the 2021 year can be retroactive to the first day of the year.

Therefore, it will be best to be ready for the most effective manner of using the exemption, especially if there are other tax burdens that come with changes, such as loss of discounts, stepped up basis upon death, and paying a higher tax sooner on inherited IRA's and other "IRD assets".

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

(Back to the Biden 2-Step)

Step One - Exchange assets / net worth for a long-term low interest promissory note via a sale to an irrevocable "intentional grantor trust."

(Many taxpayers will want to complete the intra-family installment sale as soon as possible so as not to wait until legislation is passed to implement the first step (the installment sale to a grantor trust) and lose significant discounts that might not apply under new legislation.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

Step Two - **Before year-end, if necessary, make a gift of the promissory note via one or more of the following:**

(A) simply forgive some or all the note.

(B) gift the note to one or more individuals or other entities.

(C) gift the note to a Q-TIP Trust, so that it can be decided on or before 9/15/2022 whether to consider this a "complete gift" to a trust that will not be taxed in the spouse's estate, or a "marital deduction gift" that can result in the spouse receiving the note or other contributed assets, and later forgiving it.

This will be discussed on later slides.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Current and Recent Applicable Federal Rates (2021)

MONTH	SHORT TERM	MID-TERM	LONG-TERM
Oct. 2020	0.14%	0.38%	1.12%
Nov. 2020	0.13%	0.39%	1.17%
Dec. 2020	0.15%	0.48%	1.31%
Jan. 2021	0.14%	0.52%	1.35%
Feb. 2021	0.12%	0.56%	1.46%
Mar. 2021	0.11%	0.62%	1.62%
Apr. 2021	0.12%	0.89%	1.98%

Can use lowest of last three months on a "sale or exchange" under IRC Section 1274(d)(2). See IRC Section 7872(f)(2)

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

$1,000,000 PROMISSORY NOTE/SCIN/PRIVATE ANNUITY/GRAT ALTERNATIVES

April 2021 / CLIENT AGE 73

Alternatives: (Using April 2021 Applicable Federal Rates and April 2021 7520 Rate of .8%)

TRUST (PURCHASER) → **CLIENT** (AGE 73)

- <3 Year Interest Only Installment Note @ .12% - **Payment = $1,200 per year***
- 9 Year Interest Only Installment Note .89% - **Payment = $8,900 per year***
- <9 Year Interest Only Installment Note @ 1.98% - **Payment = $19,800 per year***
- 12 Year Interest Only SCIN @ 6.200% - **Payment = $62,000 per year***
- Private Annuity Level Annual Payment - **Payment = $86,816.86 per year***
- 3 Year Level Payment GRAT @ .8% - **Payment = $338,684.55 per year***
- **3 Year GRAT @ .8% - **Initial Payment = $279,399.85 and Increases Annually by 20%**

* Notes would have no penalty for prepayment – minimum payments are shown above.
Self-cancelling installment Notes must balloon before life expectancy as measured at time of Note being made. Client's life expectancy is 12.33 years under IRS tables. The SCIN calculations above are based on a 12-year note term.

** This GRAT assumes that each annuity payment will increase by 20% each year. **All GRATs assume no taxable gift on funding**
If interest rates increase in the future, consider the use of a 20-year interest only note at the 1.98% long-term AFR, locking in a 1.98% rate for the next 20 years.

Note: April 2021 rates for annual compounding are:
Short-Term -- .12%
Mid-Term – .89%
Long-Term – 1.98%
} Usable through May 31, 2021 for a "sale or exchange"

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Married Couple with $4,000,000 Home (3.25% Growth Rate) and $48,000,000 in Investments (5.5% Growth Rate) – Save $300,000/Yr – Husband Dies in 6 Years, Wife Dies in 15 Years

Estate Tax with No Planning $42,434,027

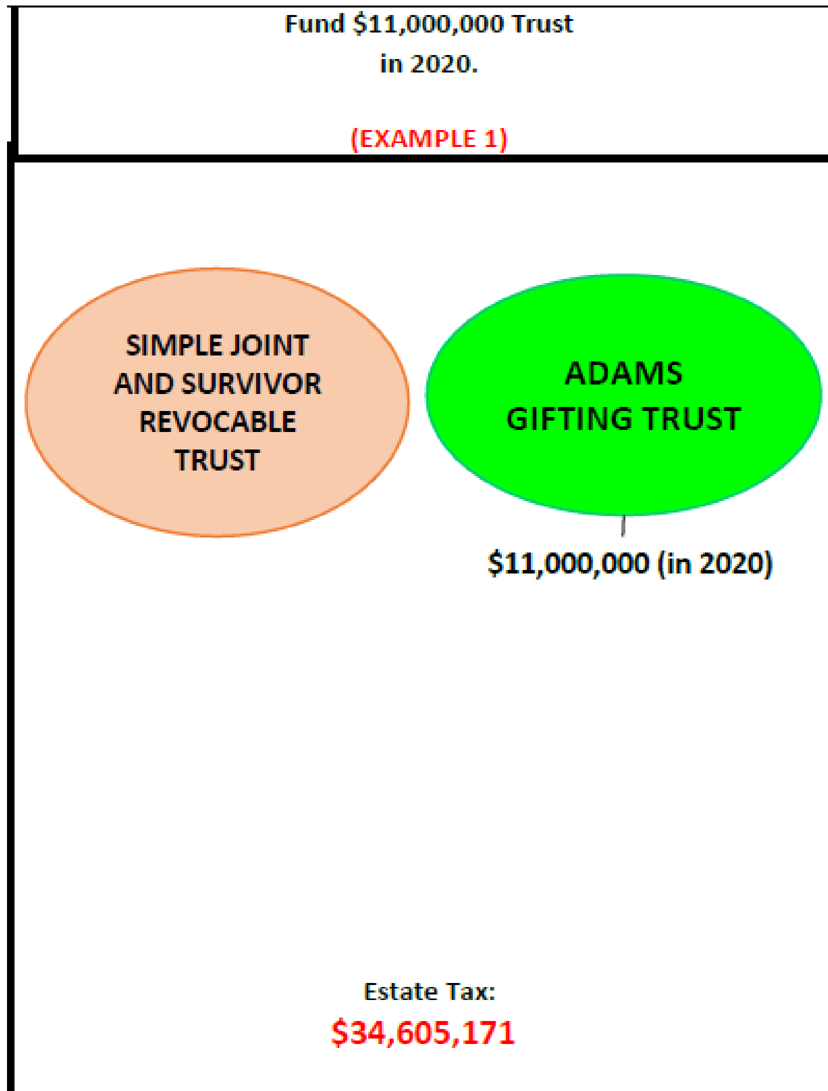
No Planning - All to Surviving Spouse.	Capture $6,790,000 on first death in 2026 under Credit Shelter Trust Rest to Surviving Spouse.
SIMPLE JOINT AND SURVIVOR REVOCABLE TRUST	SIMPLE JOINT AND SURVIVOR REVOCABLE TRUST → CREDIT SHELTER TRUST ($6,790,000) (Established on first death)
Estate Tax: $42,434,027	Estate Tax: $40,752,567

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Married Couple with $4,000,000 Home (3.25% Growth Rate) and $48,000,000 in Investments (5.5% Growth Rate) – Save $300,000/Yr – Husband Dies in 6 Years, Wife Dies in 15 Years

Estate Tax with No Planning $42,434,027



(EXAMPLE 1)

Under the first scenario, George makes an $11,000,000 gift to the Irrevocable Trust in 2020, and the assets under the Trust produce income and/or growth based on a total of 5% a year, net of expenses.

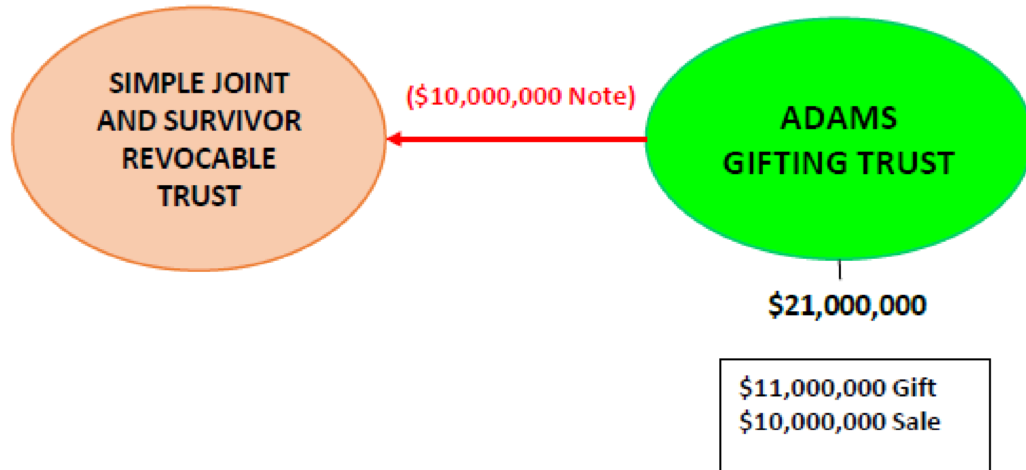
This would bring the estate tax in year 15 down from $40,752,567, which was the original amount that we reviewed to apply, if no planning is done other than George leaving a $6,790,000 By-Pass Trust on his death to $34,605,171.

A $6,147,396 estate tax savings.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Married Couple with $4,000,000 Home (3.25% Growth Rate) and $48,000,000 in Investments (5.5% Growth Rate) – Save $300,000/Yr – Husband Dies in 6 Years, Wife Dies in 15 Years

Estate Tax with No Planning $42,434,027



(EXAMPLE 2)

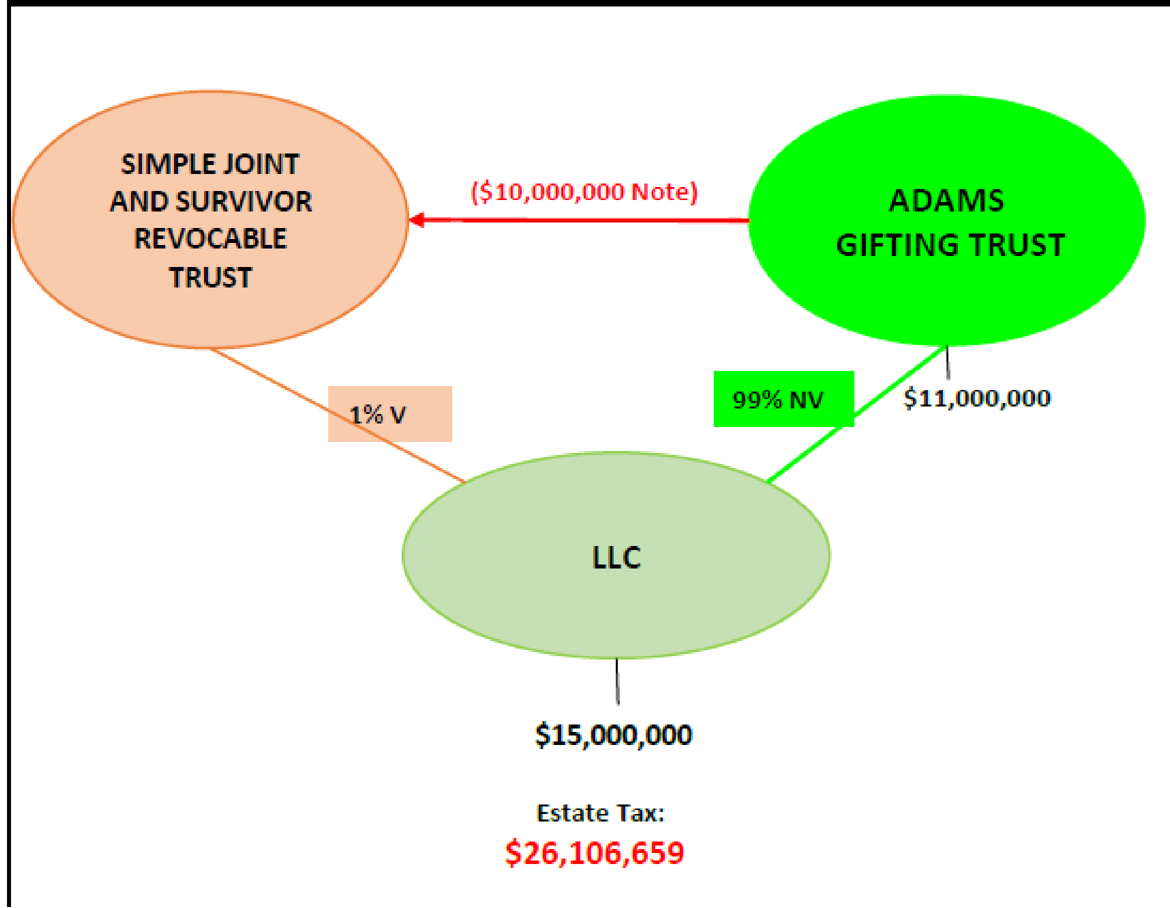
The next alternative is that instead of only transferring $11,000,000 worth of assets to the Trust, George sells another $10,000,000 worth, so that the Trust has $21,000,000 in assets producing a 5% rate of return, and owes George $10,000,000 at 1% interest.

After 15 years, this Trust would be worth $36,367,267, that would pass estate tax-free to the children on the second death.

The estate tax savings on this would be an additional $4,033,559, based upon the assumptions we are using.

Married Couple with $4,000,000 Home (3.25% Growth Rate) and $48,000,000 in Investments (5.5% Growth Rate) – Save $300,000/Yr – Husband Dies in 6 Years, Wife Dies in 15 Years

Estate Tax with No Planning $42,434,027



(EXAMPLE 3)

For the third example, I have assumed that George would put $15,000,000 into an LLC and sell the 99% non-voting member interest in the LLC for a $10,000,000 note.

This puts an additional $5,000,000 (approximately) into the Irrevocable Trust, and brings the value of the Irrevocable Trust on the second death to $47,482,132.

The additional estate tax savings is $4,464,953.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Married Couple with $4,000,000 Home (3.25% Growth Rate) and $48,000,000 in Investments (5.5% Growth Rate) – Save $300,000/Yr – Husband Dies in 6 Years, Wife Dies in 15 Years

Estate Tax with No Planning $42,434,027

George puts $11,000,000 in the Irrevocable Trust
and $32,000,000 into LLC.
Sells 99% ownership in LLC for $21,333,333 note.
(EXAMPLE 4)

SIMPLE JOINT AND SURVIVOR REVOCABLE TRUST

($21,333,333 Note)

ADAMS GIFTING TRUST

1% V

99% NV

$11,000,000

LLC

$32,000,000

Estate Tax:
$16,475,012

(EXAMPLE 4)

For the fourth example, I have assumed that George would put $32,000,000 into an LLC and sell the 99% non-voting member interest in the LLC for a $21,333,333 note.

This puts an additional $10,666,667(approximately) into the Irrevocable Trust (as compared to example 3), and brings the value of the Irrevocable Trust on the second death to $71,418,122.

The additional estate tax savings is $9,631,647.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Estate Planning Technique(s) Used	Total Estate Tax Liability	Additional Estate Tax Savings Over Previous Step	Cumulative Estate Tax Savings
No planning.	$42,434,027	N/A	N/A
1. Creation of Credit Shelter Trust on Death of First Dying Spouse	$40,752,567	$1,681,460	$1,681,460
2. **INSTEAD** Making a Gift to an Irrevocable Trust of $11,000,000	$34,605,171	$6,147,396	$7,828,856
3. Item 2 **PLUS** Selling $10,000,000 to Revocable Trust in Exchange for Low-Interest Note	$30,571,612	$4,033,559	$11,862,415
4. Item 2 **PLUS** Placing $15,000,000 into an LLC and selling a 99% Non-voting Interest for a $10,000,000 Note.	$26,106,659	$4,464,953	$16,327,368
5. Item 2 **PLUS** placing $32,000,000 into an LLC and selling a 99% Non-voting Interest for a $21,333,333 Note.	$16,475,012	$9,631,647	$25,959,059

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

2036 Retained Life Interests – Stay Away From the Fruit of the Tree

Assets transferred will still be considered as owned by the transferor:

a) (§ 2036(a)(1)) - The transferor had any written or oral agreement or understanding to be able to have to receive <u>any</u> "fruit from the tree." The ability to put one cow on a large farm is enough to cause the entire farm to be subject to estate tax.

b) (§ 2036(a)(2)) - The grantor retains any right exercisable *in conjunction with anyone* to control if and when the property will be received by others.

The *Powell* and *Strangi* Tax Court cases rely on the language *"a power in conjunction with any other person."* **Example:** The sole general partner is a S corporation. Because decedent was a minority shareholder, decedent was not in control of the general partner. The "in conjunction" language was not limited to only a power that could control.

<u>THREE YEAR RULE - § 2036(a) can apply even after the rights are given up if the grantor dies within three years of giving the rights up.</u>

<u>BONA FIDE SALE EXCEPTION - 2036(a) will not apply if the arrangement was a bona fide sale for good and valuable consideration - this can be a very hard test to satisfy.</u>

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Typical Annual Gifting and Use of Exemption Gifting for Estate Taxable Clients
(Part 1)

(Gift)

SPOUSE 1

SPOUSE 2

Neither spouse will be Trustee.

GIFTING TRUST FOR DESCENDANTS
(Funded by Spouse 1)

Trustee will be neither spouse nor any person named under any Power of Attorney or any trust to act as a fiduciary for a spouse.

IRREVOCABLE TRUST

Nevada Trustee?

TRUST FOR SPOUSE 1 & DESCENDANTS
(Funded by Spouse 2)

___% NV

___% NV

(Can control if/when there will be liquidations or distributions)

.5% SGP

LLC OR FLP

Spouse 1 funds trust for Spouse 2 and Descendants

Spouse 2 funds trust for Descendants.

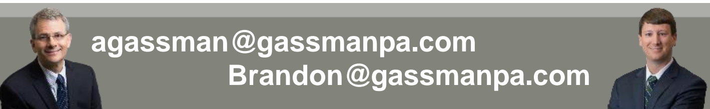
Annual gifting and/or exclusion gifting of discounted entity interests.

To avoid Powell/Strangi liqidation and distribution rights are given to third party fiduciary who is not otherwise a fiduciary for either spouse.

Asset that has been held under this entity a sufficient perod of time to avoid step transaction issues.

J:\G\Gassman\Charts\Installment Sale - Part 1a.xlsx

:dlg*caw 10.04.19



agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

TYPICAL ANNUAL GIFTING AND USE OF EXEMPTION GIFTING FOR ESTATE TAXABLE CLIENTS (Installment Sale - Part 2)

Key Considerations:

1. Need seed capital and/or guarantees to at least meet the "imaginary" 10% test.

2. Normally keep small enough so that disallowance of all discounts would not cause imposition of federal estate tax.

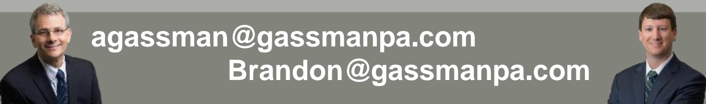
3. Use *Wandry* style adjustment agreements so that if discounts are disallowed, the sales price goes up and the promissory notes increase.

4. Consider self-cancelling installment notes, but the risk posed by the IRS's position in *Davidson*.

5. Consider private annuity, but probability of exhaustion test and income tax issues if the trust is not used.

J:\G\Gassman\Charts\Installment Sale - Part 2a.xlsx

:dig*caw 10.04.19



agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

JOHN SMITH ILLUSTRATION CHART (2)

Step One - Establish Holdings, L.L.C. and transfer building LLCs to it.

Step Two - Establish Irrevocable Trusts and transfer seed capital gifts to them. DONALD DOE, CPA, as Replaceable Trustee receives 7/10 of 1% seed capital gifts and transfers these to LLCs as part of initial contribution.

Step Three - Sell 99% non-voting interest to Irrevocable Trust in exchange for promissory note.

Step Four - Make annual note payments of interest and principal as needed.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

Back to Step One: **Sell Property Interests to a Trust for a Note**

Most of the Presenters' Clients Use LLC's as Family Holding Companies:

There are good business reasons to aggregate investment and business assets and entity ownership under a holding company.

(A) To allow multiple generations to have involvement with identification and management of the assets.

(B) To shield the assets from potential undue influence or lack of management that can occur if the taxpayer becomes incapacitated or compromised.

(C) To provide creditor protection in case the taxpayer is ever sued for a car accident or other activities or exposures.

(D) To facilitate sharing ownership of the assets during the taxpayer's lifetime using the techniques herein discussed, and thereafter by family members who inherit them.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

Determining a Sales Price

Once it is decided what assets will go under the holding company and what assets may be sold directly to an irrevocable trust, these items can be valued, so that a sales price is determined.

Typically, there will be a discount if a non-voting membership interest in a family LLC is being sold. The same applies to transferring limited partnership interests in a limited partnership.

Size of the valuation discount for lack of control and lack of marketability? In the long run, the discount is insignificant. The more effective wealth transfer occurs with the grantor trust earning a rate of return greater than the 1% interest rate on the note and the grantor paying the income taxes on the grantor trust's taxable income. Aggressive valuation discounts increase the gift tax audit exposure!!

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

Using the Irrevocable Grantor Trust to Make the Purchase:

While or after the Family LLC is established and funded an irrevocable trust that may be held for a spouse and/or descendants and/or others, which may include charity, is established and has been funded by only the taxpayer who will sell the assets.

The trust is "disregarded" for income tax purposes.

The discussion of such a trust could go for hours and is beyond the scope of today's talk.

The irrevocable grantor trust purchases the non-voting member interest in the holding company, and whatever other assets are being sold, for a long-term note bearing interest at the applicable federal rate (which is presently 1% for notes that exceed 9 years).

The above completes Step One.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What Is The Biden 2-Step? – *Cont'd*

As Step Two, and before the estate tax exemption is reduced, the taxpayer can:

(A) Forgive the note, if desired, after receiving election results and report this as a gift in an amount equal to the stated principal (its face value).

(B) Consider valuing the note based upon its fair market value, as opposed to the face amount owed and then gifting it (forgiving the note is also a gift) For example, a $13,000,000 low interest long term note may be worth $11,000,000 because its interest rate is lower than market rates and other factors.

(C) In the future there may be a possible swap of the low interest long-term note for a higher interest shorter term note of equal value, but with a lower amount owed. That note would be forgiven or gifted at face value. For example, the $13,000,000 note above is traded for a current rate $11,000,000 demand note, and that note is forgiven as a gift.

(D) Transfer the note to a Q-TIP Trust for the spouse of the taxpayer and decide by the due date of the marital deduction election deadline in 2022 whether to have this be considered to be either (a) a 2021 gift to a non marital deduction trust, thus using part of the $11,700,000 exemption, or (b) a transfer to the spouse via the marital deduction being elected and the trustee distributing the note to the spouse, thus using none of the exemption, as if no transfer was made.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Income Tax Consequences of the Installment Sale to a Grantor Trust

- If the Trust is structured as a grantor trust, then no income tax will result from the sale. Under the grantor trust rules, the grantor is treated as the income tax owner of the trust's assets(a disregarded entity for income tax purposes only). One cannot realize a gain if there is no sale of exchange. Rev. Rul. 85-13

- Not only is no income tax gain realized on the sale, no interest income no interest deduction is reported for income tax purposes.

- Any income, deduction and credit of the Trust must be reported on the grantor's individual income tax return.

- If the trust is no longer a grantor trust during the note term for reasons other than the grantor's death, then the assets are deemed to have been sold to the trust for federal income tax purposes, which results an income taxable installment sale by the grantor at the time the trust becomes a non-grantor trust. See Treas. Reg. §1.1001-2(c) Example (5).

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Valuation of Promissory Notes for Transfer Tax Purposes										
	Date the note was entered in to	**Face amount of the note**	**Duration of the note**	**Interest rate on the note**	**Decedent's date of death**	**How long the note had to run following death of decedent**	**Applicable federal rate on date of death**	**Whether or not the note was secured**	**Financial strength of the lender**	**Discount rate applied**
Estate of Berkman v. Commissioner (1)	5 notes: 1 in '68 1 in '69 2 in '70 1 in '72	$275,000	20 years	6%	1974 (2-6 years after issuance of notes - depending on the note)	Unknown	9.75%	No	Unknown	50% or more for each note (longer term notes got greater discounts)
B. Smith v. U.S. (2)	1977	$10,312,000	20 years	6%	1988	Unknown	7.57%	Unknown	Unknown	Discount applied – specific percentage amount not given. (Lack of marketability, lack of protective covenants, lack of formal acknowledgement of the debt by the lender, unusual payment schedule, market interest rate increase.)
Estate of Hoffman v. Commissioner (3)	1992	2 notes: $278,147; $173,083	20	7.61%	1994	Until maturity	7.58%	No	Strong	Discount applied – specific percentage amount not given.
Estate of Harper v. Commissioner (4)	1991	$450,000	1 year	10.75%	1995	Note was renewed each year until decedent's death	7.19%	Yes	Unknown	12% (no assurance that the note would be paid in full at the next maturity date and issues affecting the property the note was secured by.)

Valuation of Promissory Notes for Transfer Tax Purposes										
	Date the note was entered in to	**Face amount of the note**	**Duration of the note**	**Interest rate on the note**	**Decedent's date of death**	**How long the note had to run following death of decedent**	**Applicable federal rate on date of death**	**Whether or not the note was secured**	**Financial strength of the lender**	**Discount rate applied**
Example Appraisal One **(5)**	2012	Unknown	9 years	0.95%	Unknown	Unknown	3.40%	Unknown	Unknown	12.85% (lack of collection rights and lack of marketability)
Example Appraisal Two **(6)**	2012	Unknown	9 years	1.07%	Unknown	Unknown	Not provided	Yes	Weak	21.6% (no protective covenants, size of the note, lack of marketability, weak financial strength of issuer.)
Valuation Scenario 1 **(7)**	Unknown	$1,000,000	9 years	3%	Unknown	Unknown	3%	Unknown	Unknown	Subject to discounts because note likely would not have a fair market value equal to its face value. No specific discount percentage given.
Valuation Scenario 2 **(8)**	Unknown	$1,000,000	20 years	4%	Exactly one year after issuance of note	Unknown	4%	Unknown	Unknown	Subject to discounts because, when compared, other similar long-terms loans are meaningfully discounted. No specific discount percentage given.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

What if the Grantor Dies During the Note Term?

- It is unclear whether income tax would be realized if the grantor dies during the note term.
- A few commentators believe that the promissory note represents income in respect of decedent, which does not get a step-up in basis under IRC Section 1014. Thus, in their view, gain would be recognized if the outstanding note balance exceeded the grantor's basis in the note immediately before death. This view is flawed!
  - If the deemed sale qualifies for installment treatment under Section 453, the realized gain would be reported only as principal payments are made; if the assets sold were marketable securities, the installment sale is not eligible for the installment method and gain is deemed to be reported, most likely on the sellers' final income tax return death.
- Because the note cannot be income in respect of a decedent, the holder of the note (i.e., the grantor's successor-in-interest) is entitled to a step-up in basis on the note upon the grantor's death pursuant to Section 1014, which presumably would equal the value of the note included in the gross estate. If the note is valued in the gross estate at a discount, that value must be used and a market discount debt obligation is created under § 1276.
- For an excellent discussion of both sides of this issue (and other issues applicable to the Installment Sale to a Grantor Trust), see Michael D. Mulligan's paper, "A 'Reality of Sale' Analysis of Installment Sales to Grantor Trusts: Properly Structured, the Best Transfer Tax Strategy" presented at the 2015 Notre Dame Tax & Estate Planning Institute.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

1. **What is income in respect of a decedent?** Under § 691, IRD is income that was earned while the decedent was living but was not reported on the decedent's individual income tax returns.

   Example: A cash method taxpayer was not paid wages earned while living because the decedent used the cash method of accounting.

   Example. While living the decedent sold an appreciated asset in exchange for third-party buyer's installment note and used the installment method of accounting to report the gain "realized" while living to when the note principal is paid. The gain was "realized" by the seller while living but was not reported because the installment method of accounting deferred reporting the "realized" gain.

2. With an installment sale to a grantor trust no gain was "realized" while the decedent was living.

3. **Because the note included in decedent's gross estate is not IRD, its basis is determined under § 1014(a).** Caution: If note value is discounted, § 1276 creates a market discount debt obligation. When the note principal is paid, the excess of principal over basis is ordinary income.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

4. Because death cannot be an income tax realization event, no gain can be reported when the grantor dies with the grantor trust's note still outstanding.

That leaves two choices.

a. Apply Section 1015(b): "If property is acquired by a transfer in trust, the basis shall be the same as it would be in the hands of the grantor." The note in the grantor's gross estate takes a Section 1014(a) basis and the grantor's basis continues as the non-grantor trust's basis. Because Section 1015 was only intended to apply to gifts in trust, and the grantor's sale was not a gift, Section 1015(b) should not apply to transfers at death.

b. Upon conversion to a non-grantor trust by reason of death, the transfer occurred simultaneously with death. The trust is deemed to acquire the asset by purchase and its basis in the asset purchased should be a cost basis under section 1012, equal to the outstanding principal on the note at the time of death.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Must a sale for adequate consideration be reported on a Gift Tax Return? vs. Optional (Recommended)

WHAT HAS TO BE REPORTED ON A GIFT TAX RETURN VERSES OPTIONAL (BUT RECOMMENDED)

		Required To Be Disclosed	Not Required To Be Disclosed
1.	Any seed capital gift to the irrevocable trust.	Required, if exceeds the $15,000 annual exclusion that may be available.	
2.	The funding of a family holding LLC		May not need to be reported.
3.	A sale for a proper note - amount owed equals FMV of assets sold.		May not need to be reported.
4.	Cancellation or gifting of the note.	This will need to be reported.	

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Will a Promissory Note Between Family Members and Trusts Be Legally Binding? – *Cont'd*

For many would-be donors, the requirement that a promissory note be supported by consideration is a significant nontax benefit. Donors sometimes fear, often with some justice, that their gifts will not inspire gratitude from the donees. A donative promise may partially allay such fears. In order to make a taxable gift of a promise of money in the future, a donor has no choice but to demand, on the advice of counsel, that the donees take actions that they might otherwise be reluctant to perform. For example, in consideration for a $5.12 million note, the donees could, in principle, promise to keep kosher for the rest of the year, cancel their subscription to *The New York Times*, visit their mother on Mother's Day, or read Ayn Rand's *Atlas Shrugged*.

Finally, the donor could consider structuring the contract so that the note is payable to an irrevocable trust for the benefit of the donees. For example, in exchange for a legally sufficient consideration from the donees, a donor could promise to pay $5.12 million to a trust for their benefit. As a third-party beneficiary of a contract is generally enforceable by the intended beneficiary, **[Restatement (Second) of Contracts §§ 304 and 346 comment c.]** it should be possible to structure the contract so that the note is delivered to and is enforceable by the trustee of the trust, even if the consideration is furnished by the beneficiaries. The beneficiaries should not, in that case, be considered to have made an indirect gift to the trust, as the gift in question will have been made by the donor rather than the beneficiaries. **[In a related context, Regulations provide that where a gift is made through an intermediary, only one gift by the donor (and not the intermediary) is made. Reg. 25.2511-1(h)(2). In other words, even where a third party is involved in a transfer from the donor or the donee, only one taxable gift occurs, not two. But see *Johnstone*, 15 AFTR 382, 76 F2d 55, 35-1 USTC ¶9198, 1935-2 CB 346 (CA-9, 1935) (creating a potential for double taxation by holding that trust assets were included in the decedent's gross estate where the decedent held a general power of appointment that could have been extinguished at any time by the settlor).]**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Will a Promissory Note Between Family Members and Trusts Be Legally Binding? – *Cont'd*

The next question is whether a promissory note that is given for little or no consideration will be a legally binding instrument under state law. Bramwell summarizes the common law that applies in most states as follows:

> As a general rule, a promissory note is enforceable to the same extent that a contract is enforceable. **[11 Am. Jur. 2d Bills and Notes § 2; see also Uniform Commercial Code3-303Uniform Commercial Code 3-303.]** In order to make a note enforceable, therefore, it should be delivered to the donee pursuant to a valid and enforceable contract. **[The traditional elements of a contract are multiple parties, offer and acceptance, and consideration**] In particular, the note must be delivered in exchange for consideration. Legally sufficient consideration can take a variety of forms. For example, performance of an act **[11 Am. Jur. 2d Bills and Notes § 129.]** or a promise to perform a future act **[11 Am. Jur. 2d Bills and Notes § 128.]** can both be sufficient consideration. Another example of valid consideration is an act of forbearance. Thus, to take a classic example, refraining from smoking has been held to be sufficient consideration. **[*Hamer v. Sidway*, 27 NE 256 (N.Y., 1891).]** Consideration can also take the form of a transfer of property, even though both parties know that the property is being overvalued by the purchaser **[Restatement (Second) of Contracts § 71 comment c]** and even if the value of the consideration is grossly inadequate. **[Restatement (Second) of Contracts § 79 comment c.]**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Will a Promissory Note Between Family Members and Trusts Be Legally Binding? – *Cont'd*

Courts will generally not consider the value of consideration that may be given for a promise to pay money. A key decision in this area is the case of *Hamer v. Sigway*, where the New York Court of Appeals opined in 1891 that a promise to pay a nephew $5,000 to refrain from "drinking liquor, using tobacco, swearing and play cards or billiards for money until he should become 21 years of age" was valid consideration.

The *Hamer* court quoted an 1875 case which confirmed that "valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered upon or undertaken by the other . . . It is enough that something is promised, done, forborne or suffered by the party to whom the promise is made as consideration for the promise made to him . . . Any damage, or suspension, or forbearance of a right will be sufficient to sustain a promise."

It therefore appears that a large promissory note made payable to an irrevocable trust will be enforceable if the Trustee of the trust undertakes to fulfill a nominal or slightly more than nominal obligation to the notemaker. Bramwell's article points out that the obligation might be to read a book, follow a pattern of conduct for a year, or otherwise do something that is definable.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Whether to Make the Note Self-Canceling

The IRS takes the position that a self-canceling note is worth significantly less than the face value, if the lender whose life is referenced has less than a normal life expectancy.

The statutes permit a private annuity sale using standard life expectancy amounts, if the lender whose life is used has better than a 50% chance of living at least one year at the time that the arrangement is put into place.

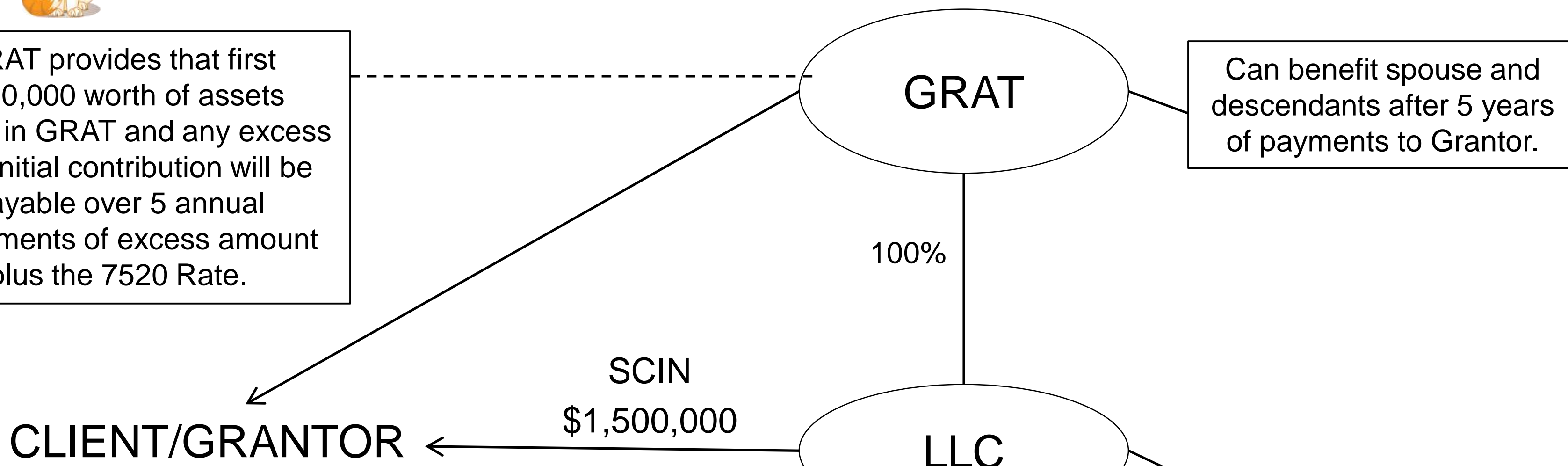
Private annuity sales normally do not work as well as sales for promissory notes because:

a. Special “probability of exhaustion” rules require that any trust purchasing assets in exchange for a private annuity must have a significant amount of assets, which will usually significantly exceed the amount of the note.

b. An individual sale for a private annuity can trigger significant ordinary income (when a defective grantor trust is not being used).

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

MORE THAN ONE WAY TO SCIN A GRAT? (The "SCGRAT") WHAT IF THERE IS NOT TIME TO APPRAISE THE UNDERLYING ASSETS AND ENTITY DISCOUNTS BEFORE COMPLETING A SELF-CANCELLING INSTALLMENT NOTE TRANSACTION?



SCIN
$1,500,000

CLIENT/GRANTOR

LLC

Cash $500,000

90%

Grandpa, 10%

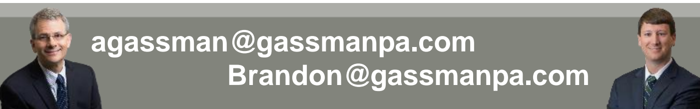
Assets estimated to be worth $2,000,000

($500,000 in cash plus $1,500,000 in Grandpa's LLC interest (90%))

GRANDPA LLC

$1,928,571 in assets
($1,928,571 x .9 x .7 = $1,500,000)

Step 1 – Client places assets in LLC owned by client and receives back a Self-Cancelling Installment Note.
Step 2 – Client gifts 100% ownership in the LLC to the GRAT.
Step 3 – A valuation firm values the assets under the LLC and actuarial tables are used to determine the SCIN value.
Step 4 – The excess of asset value over the SCIN value is the GRAT contribution amount.
Step 5 – The GRAT may provide for holding assets equal to $400,000, and distributing back 5 annual payments based upon any excess over $400,000.
$2,000,000 - $1,500,000 = $500,000 . $500,000 - $400,000 = $100,000. $100,000/5 = $20,000
Step 6 – If the IRS determines that the valuation assumptions used are incorrect, any excess value will pass back to the Grantor over 5 annual payments, and will qualify for the estate tax marital deduction if the grantor dies during the first 5 years survived by a spouse.



agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

The use of a leveraged Grantor owned limited liability company, or limited partnership is the subject of extensive writings provided by S. Stacy Eastland, who is a well respected estate tax planning lawyer who presently works as a Managing Director for Goldman & Sachs.

Mr. Eastland's Bloomberg BNA outline that was presented on March 23, 2012 entitled Two of our Favorite 2012 Gift Planning Ideas We See Out There; The Leveraged GRAT and the Remainder Purchase Marital Trust discusses the use of an LLC that can initially be owned by the Grantor to hold investments and can owe a note back to the Grantor to effectively leverage the contribution to a Grantor Retained Annuity Trust ("GRAT").

These materials include an in depth discussion of the Step Transaction Doctrine at pages 23 through 26 indicating that "The creation of the family limited partnership, or Family Limited Liability Company should be designed to be sufficiently independent on its own, and as an a act that does not require a sale to that trust. There does not have to be a business purpose for the creation of the trust. It is difficult for this writer (Mr. Eastland) to understand the business purpose of any gift. As noted above, the Supreme Court has said on two separate occasions, estate and gift tax law should be applied in a manner that follows estate property law analysis. The outlined footnotes the US Supreme Court Cases of *United States v. Bess* (1958), *Morgan v. Commissioner* (1940), and the Ninth Circuit Case of *Lindt v. US*, which provides the following quote from Learned Hand's decision "that anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury" *Helvering v. Gregory* 69 F. 2d 809, 810-11 (2d Cir. 1934)?

Mr. Eastland's outline provides further discussion on the ability to have a GRAT provide that a specified dollar of value in assets can be retained, with excess value being used to measure the GRAT's payments back to the Grantor.
Footnote 61 on page 57 of Mr. Eastland's materials reads as follows:

> For example, the formula might define the annuity as that percentage of the initial value of the trust assets (as finally determined for federal gift tax purposes) which will result in an annuity having a present value at the inception of the trust equal to the initial value of the trust assets (as so determined) less $4,800,000. A GRAT annuity defined in this way has not been passed upon by the IRS or the courts. It should meet the requirements of Treas. Reg. 25.2702-3(b)(i)(B), which permits the annuity to be "[a] fixed fraction or percentage of the initial fair market value of the property transferred to the trust, as finally determined for federal tax purposes, payable periodically but not less frequently than annually, but only to the extent the fraction or
>
> percentage does not exceed 120 percent of the fixed fraction or percentage payable in the preceding year." In order to freeze the remainder value at a constant dollar amount, such a formula definition generates a greater annuity percentage (not just a greater annuity amount) for a higher initial value. The percentage is dependent upon
> finally determined asset values and is fixed by them, since there is only one percentage corresponding to any given initial value of the trust. It therefore is hard to see in what sense this would not be a "fixed percentage," and the regulatory definition, with its reference to values "as finally determined for federal tax purposes," seems entirely consistent with defining the annuity percentage in this way. An initial annuity percentage defined in this way could then be made subject to the 20% annual increase permitted under the regulation, although that is not a feature of the technique under discussion.

Mr. Eastland's materials further discuss whether generation skipping tax exemption can be allocated to a GRAT where there is less than a 5% chance that the Grantor will die before receiving all GRAT payments.

Mr. Eastland states that based upon the rates in effect at the time of publication in 2012 that a two year GRAT payable to a Grantor under age 70 would satisfy the 5% maximum life expectancy requirement and that it should therefore be possible to allocate GST exemption to the GRAT under the ETIP ("Estate Tax Inclusion Period") rules. The ETIP rules prevent allocation of GST exemption to a GRAT in many circumstances. This discussion begins at page 55 of those materials.

It would be safest to wait until the GRAT term ends before allocating GST exemption to the GRAT.

Stacy Eastland
Stacy.eastland@gs.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Client has assets valued at $10,000 that he would like to sell to a trust for his descendants in exchange for a $9,000,000 self-cancelling installment note (SCIN).

He has a disease and a life expectancy of 3 years.

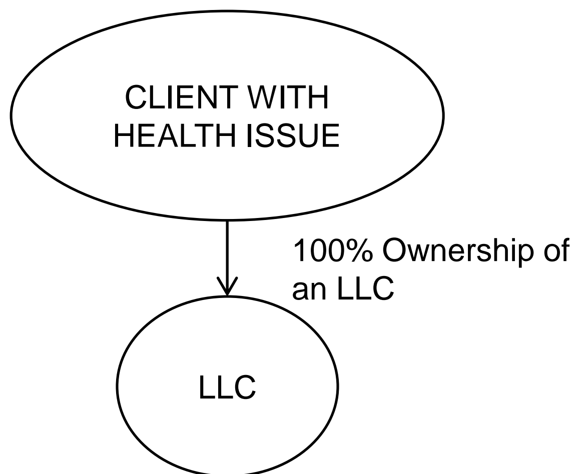
He is age 69 and is informed that under the IRS tables and applicable rules the note could bear interest at 6.438%, payable interest only, and would need to balloon within 14 years.

If the standard tables can be used to compute the value of the SCIN, then it would be worth $9,000,000. If a willing buyer was to buy the SCIN from a willing seller, it would be worth $1,000,000.

Client would like to attempt an installment sale with a trust for his descendants, but does not want to risk being considered to have made an $8,000,000 taxable gift that would result in a $1,064,000 or more gift tax liability. Client hopes to recover from the health challenges, and not have to make a large payment to the IRS during his lifetime.

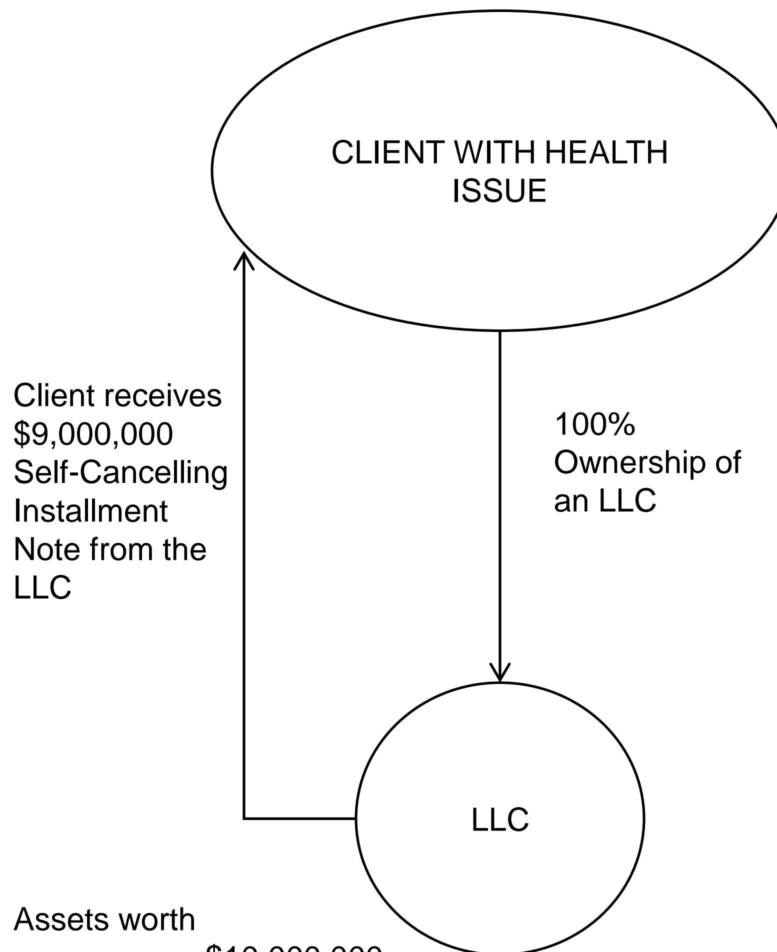
Client is scheduled for surgery this week and has a 5% mortality risk. If client survives the surgery, he will have a life expectancy of 6 years.

STEP 1 – ESTABLISH LLC AND FUND IT WITH ASSETS



Assets worth $10,000,000

STEP 2 – TAKE A NOTE BACK FROM THE LLC



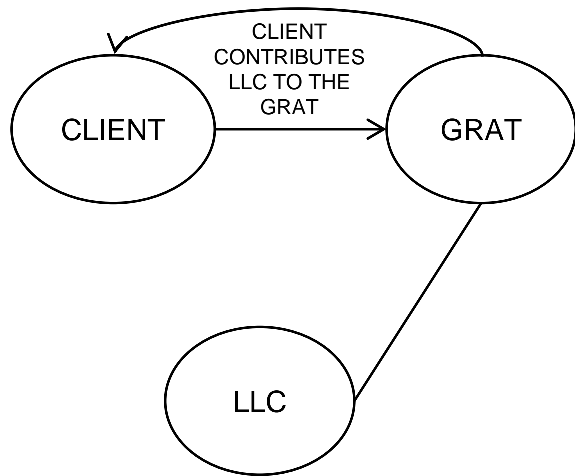
Assets worth $10,000,000
Self-Cancelling Installment Note ($9,000,000)
Taxpayer Calculated Value of LLC $1,000,000
Possible IRS Asserted Value of Note $1,000,000
Possible IRS Asserted Value of LLC $9,000,000

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

STEP 3

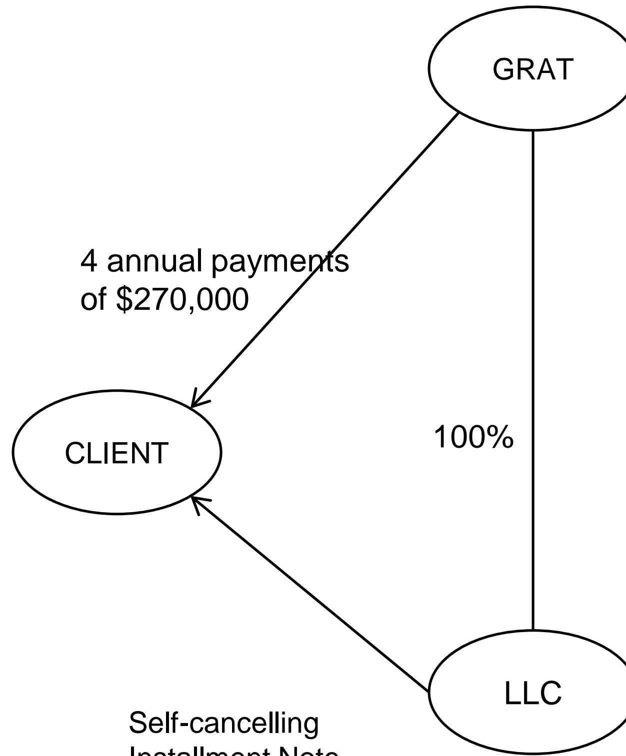
Client establishes a Grantor Retained Annuity Trust (GRAT) which provides that the value of assets contributed to it will be multiplied by 27%, and that dollar amount will be paid to client each year for four (4) consecutive years.

GRAT makes 4 annual payments of 27% of the value of the LLC back to the client.



STEP 4 – HOPED FOR OUTCOME

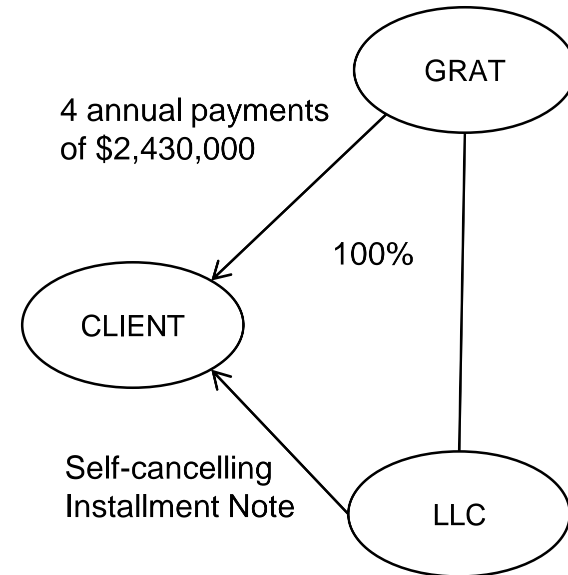
Client transfers 100% ownership of the LLC to the GRAT and payments of $270,000 per year are scheduled to be made.



The client also receives annual interest payments of $579,420 a year from the LLC under the SCIN.

STEP 5 – OUTCOME IF NOTE IS WORTH ONLY $1,000,000

In the unlikely event that the IRS were to succeed in claiming that the promissory note is worth only $1,000,000, then there would be no gift tax due, and because under the GRAT formula payment clause client would have the right to receive $2,430,000 per year worth of assets from the GRAT. This generally places the family back to where they would be.



The client also receives annual interest payments of $64,380 a year from the LLC under the SCIN

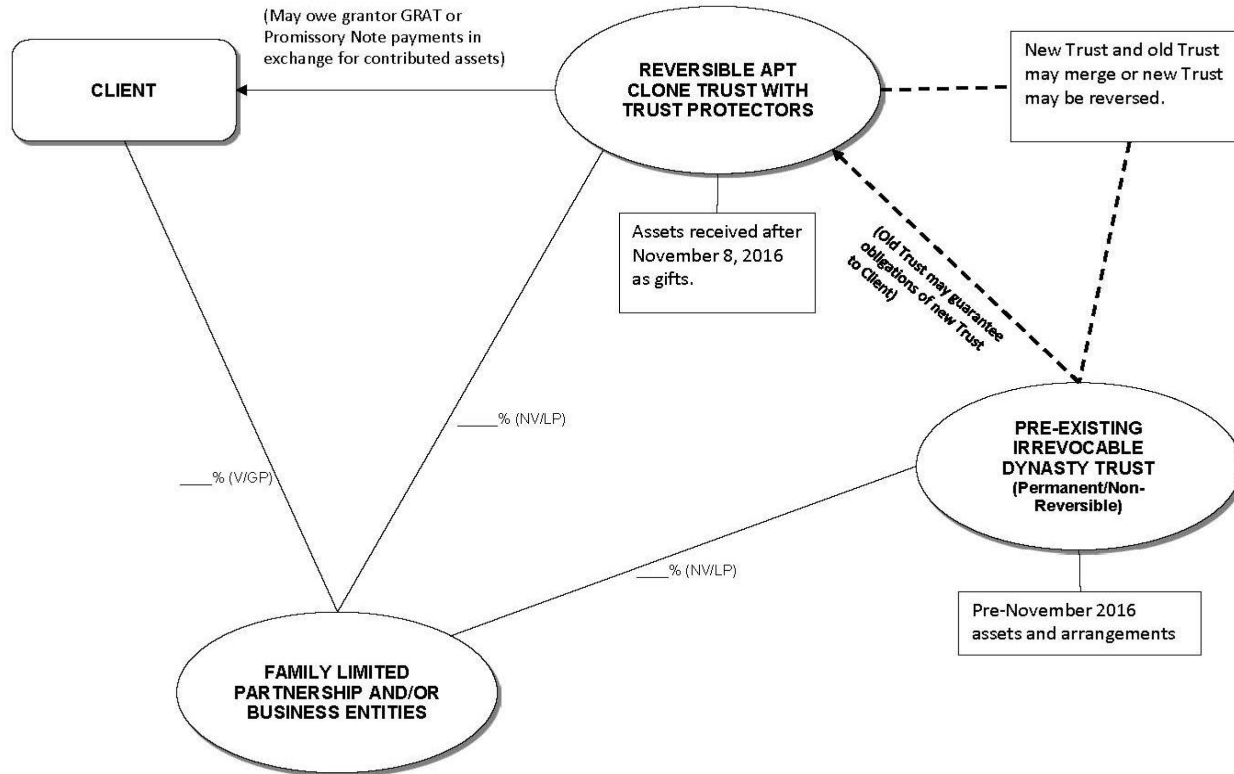
Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

SCIN V. PRIVATE ANNUITY V. GRAT CHART

	SCIN	PRIVATE ANNUITY	GRAT (ineffective if Grantor dies before the term expires)
Can be valued based upon standard life expectancy tables, if taxpayer has better than 50% chance of living one year.	This is being contested by the IRS. CCA 201330033 and *Davidson*	Safe, under Treasury Regulation Sections 20.2031-7(d); 20.7520-3(b)	Safe, under Internal Revenue Code Section 2702(a)(2)(B); 20.7520-3(b).
Must pass the "probability of exhaustion test" (significant minimum value held under trust and/or by guarantors).	No.	Yes- According to Treasury Regulation Section 1.7520-3(b)(2)(i); 20.7520-3(b)(2)(i); 25.7520-3(b)(2)(I), but is the IRS's position under the Regulation incorrect? – See Katzenstein, *Turning the Tables: When do the IRS Actuarial Tables Not Apply?*, Thirty-Seventh Univ.of Miami Inst. On Est. Planning, Ch. 3 (2003) and Wojnaroski, *Private Annuities for Healthy Individuals and How to Deal with the Exhaustion Test,* 37th Annual Notre Dame Tax and Estate Planning Institute, Ch. 11 (2011).	No, if structured as a *Walton*-style GRAT.
Must make annual payments.	Probably, interest only until it balloons. The IRS, in CCA 201330033, implied that payments of interest and principal show indicia of genuine debt.	No- The *Kite* case allowed no payments for the first 9 years.	Yes.
Compatible with defective grantor trust.	Yes.	Yes, subject to probability of exhaustion test.	Yes, it is a Grantor Trust.
Payments must include principal.	Not until it balloons. The IRS, in CCA 201330033, implied that payments of interest and principal show indicia of genuine debt.	Probably not- as in the *Kite* case.	Equal or increasing payments would represent principal conceptually.
Explainable to the client.	Yes.	Yes.	Slightly more complicated.
Income tax imposed upon death.	Possibly not, but IRS may not agree. (See Zaritsky, *Tax Planning for Family Wealth Transfers* §12.04[h], (4th ed. 2002))	No.	No- but on death, there is a negative estate tax impact. Before term expires?
Stepped up basis if assets are sold or transferred to grantor trusts.	Yes, hopefully. (See Blattmachr, Gans and Jacobson, *Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death*, Journal of Taxation, September 2002)	Yes, hopefully. (See Blattmachr, Gans and Jacobson, *Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death*, Journal of Taxation, September 2002)	Yes, hopefully. Depending upon structuring.
Possible usury issues for older taxpayer.	Yes, unless the risk premium is applied to the note principal.	No.	No.
Are Payment Rights Creditor Protected?	Generally not, but can be held by family limited partnership or other entities that provide charging order remedy only or creditor protection.	Yes, in several states.	Yes, in several states.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

The Reversible Exempt Asset Protection ("REAP") Trust



If large gifts are being made to existing irrevocable trusts based upon what was in progress before the election results, consider using an identical but reversible irrevocable trust to gift to, which can either be merged into the pre-existing trust, held in parallel, or reversed back by Trust Protectors if and when the estate tax is truly and permanently eliminated.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Steve Leimberg's Estate Planning Newsletter: Excerpts from "The Reversible Exempt Asset Protection ("REAP") Trust for 2017 Planning" by Alan Gassman, Christopher Denicolo, Kenneth Crotty & Brandon Ketron

THE 'REVERSIBLE EXEMPT ASSET PROTECTION TRUST,' ALSO KNOWN AS THE REVERSIBLE MIRROR TRUST, ALLOWS CLIENTS TO TAKE ADVANTAGE OF PRESENTLY AVAILABLE AND EFFECTIVE ESTATE TAX PLANNING OPPORTUNITIES, WHILE PROVIDING THE FLEXIBILITY NEEDED TO ADDRESS TO THE POSSIBLE UNCERTAINTIES THAT MIGHT EXIST THE HORIZON, WHILE ALSO PROVIDING ASSET PROTECTION THAT MAY GREATLY EXCEED WHAT IS NOW OTHERWISE IN PLACE."

EXECUTIVE SUMMARY:

WHEN WE LOOK BACK IN A YEAR ON THE UNEXPECTED RESULTS OF THE 2016 PRESIDENTIAL ELECTION, AND THE TENDENCY FOR CLIENTS AND ADVISORS TO "WAIT AND SEE" WHAT HAPPENS WITH ESTATE AND GIFT TAXES, WE MAY FIND THAT THE MAJORITY OF PLANNERS AND DECISION MAKERS ERRED ON THE SIDE OF DOING NOTHING, COSTING FAMILIES SIGNIFICANT PORTIONS OF THEIR ASSETS UPON THE DEATH OF LOVED ONES IN THE FUTURE.

ALTERNATIVELY, WHEN WE LOOK BACK IN FIVE YEARS WE MAY FIND THAT THE ESTATE TAX "WENT AWAY" BUT CAME BACK IN HARSHER FORM, AFTER A PERIOD OF TIME DURING WHICH THOSE WHO PLANNED AHEAD CAME OUT MUCH BETTER THAN THOSE WHO DID NOT. WHILE SOME COMMENTATORS BELIEVE THAT REPEAL OF THE ESTATE TAX IS A STRONG POSSIBILITY, OTHERS HAVE POINTED OUT THE SEVERAL LIKELY ALTERNATIVES THAT MUST BE CONSIDERED TO STAY TWO OR MORE MOVE MOVES AHEAD ON THE CHESS BOARD OF FAMILY WEALTH PLANNING IN THIS DYNAMIC ENVIRONMENT.

BY OUR VIEW IT IS CRUCIAL TO GIVE CLIENTS OPTIONS THAT INCLUDE FLEXIBLE METHODS OF TAKING ADVANTAGE OF PRESENT OPPORTUNITIES, WHILE BEING ABLE TO CHANGE OR REVERSE WHAT IS DONE, OR ASSURE THAT IT WOULD BE WANTED IN A NO ESTATE TAX WORLD, WHILE ALSO BEING AHEAD IN THE NON BASIS STEP UP ENVIRONMENT THAT MAY BE COMING.

THE "REVERSIBLE EXEMPT ASSET PROTECTION TRUST," ALSO KNOWN AS THE REVERSIBLE MIRROR TRUST, ALLOWS CLIENTS TO TAKE ADVANTAGE OF PRESENTLY AVAILABLE AND EFFECTIVE ESTATE TAX PLANNING OPPORTUNITIES, WHILE PROVIDING THE FLEXIBILITY NEEDED TO ADDRESS TO THE POSSIBLE UNCERTAINTIES THAT MIGHT EXIST THE HORIZON, WHILE ALSO PROVIDING ASSET PROTECTION THAT MAY GREATLY EXCEED WHAT IS NOW OTHERWISE IN PLACE.

IN OTHER WORDS, WHILE SOME BELIEVE THAT THE ESTATE TAX IS FACING THE GHOULISH PROSPECT OF THE GRIM REAPER, WE THINK THAT KNOWLEDGEABLE ADVISORS SHOULD BE EMBRACING THE REAP TRUST.

FULL ARTICLE MAY BE VIEWED AT: HTTP://LEIMBERGSERVICES.COM/ALL/LISIGASSMANDENICOLOCROTTYKETRON1_11_2017.PDF

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

IRC Section 2518

Under IRC Section 2518 the recipient of a transfer has 9 months to make a disclaimer.

If the disclaimer is valid under state law, then the disclaimant is not considered to have transferred the disclaimed interest to whoever will receive it.

This allows a 9 month look-back for gifts made when it is not finally determined whether the intended gift is appropriate.

For example, John has an $11,700,000 estate and gift tax exemption and intends to use it, but is not so sure.

He makes an $11,700,000 gift to his wife, Mary in the form of an Assignment that he executes that constitutes a transfer to Mary under state law.

The Assignment provides that if Mary does not accept or disclaims the gift, then it will pass into a Dynasty Trust for John and Mary's children.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

IRC Section 2518

He executes this Assignment on December 31, 2021.

Assuming that Mary does not accept and use or control the assets assigned, she has until 9 months after December 31, 2021 (October 1, 2022) to disclaim some or all of the disposition.

Upon making the disclaimer Mary has caused John to be considered to have made a gift directly to the Dynasty Trust for their children on December 31, 2021.

John can file a gift tax return in 2022 to report the transfer and allocate his generation skipping tax exemption to the Trust if the Trust is drafted to be GST exempt (the allocation will be automatic regardless if the Trust is properly drafted).

Mary is not considered to have been a beneficiary of such gift.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

IRC Section 2518

What if Mary is a beneficiary of the Trust or holds a testamentary power to appoint the assets among John and Mary's children, but not to Mary, her estate, her creditors, or creditors of her estate?

Under the disclaimer statute a disclaimer by an individual will not be disregarded under Section 2518 unless the individual making the disclaimer has no right to benefit from or direct the disclaimed asset.

An exception to this applies if the person making the disclaimer is the spouse of the donor. In that instance, the spouse will be permitted to make the disclaimer even though he or she may receive benefits for health, education, maintenance and support from a trust that receives the disclaimed property, but the disclaimant cannot have any power of appointment over the disclaimed property (or the Trust in this example). The spouse must therefore also disclaim any such power of appointment at the time that she disclaims the property, or she will be considered to have gifted the property to the Trust.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

IRC Section 2518

What about if the donor is not married or a transfer to a spouse would cause a reciprocal trust doctrine issue:

Edwin Morrow published LISI Estate Planning Newsletter #2831 on October 19, 2020 entitled "How Donees Can Hit the Undo Button on Taxable Gifts" which reads as follows:

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

From Ed Morrows LISI Estate Planning Newsletter #2831

Tax Effect of a Qualified Disclaimer to the Donor

Often when a donee/beneficiary disclaims an intervivos gift, there is no gift tax effect to the donor. If the gift is initially made to a child who disclaims, for example, but the assets simply stay in trust for or pass to that child's children, the gift is still complete. In such an instance, however, it may now be subject to generation skipping transfer (GST) tax as well, since a disclaimer does not invoke the predeceased ancestor exception.[12]

What if, upon disclaimer, the assets pass back to the donor? Treasury regulations provide that if a donee makes a qualified disclaimer, it "undoes" the gift for federal gift tax purposes if the asset reverts to the donor:

(c)(1) The gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax. See further § 25.2512-8 relating to transfers for insufficient consideration. However, in the case of a transfer creating an interest in property (within the meaning of § 25.2518-2(c)(3) and (c)(4)) made after December 31, 1976, this paragraph (c)(1) shall not apply to the donee if, as a result of a qualified disclaimer by the donee, the interest passes to a different donee. Nor shall it apply to a donor if, as a result of a qualified disclaimer by the donee, a completed transfer of an interest in property is not effected. See section 2518 and the corresponding regulations for rules relating to a qualified disclaimer.[13] **[emphasis added]**

This gift tax regulation contains no time frame or limit as to this important effect, but references §2518 and its regulations, which of course must be done within the later of nine months after the gift or nine months after the disclaimant reaches age 21.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

From Ed Morrows LISI Estate Planning Newsletter #2831

The disclaimer regulations reinforce this conclusion:

(b) Effect of a qualified disclaimer. If a person makes a qualified disclaimer as described in section 2518(b) and § 25.2518-2, for purposes of the Federal estate, gift, and generation-skipping transfer tax provisions, the disclaimed interest in property is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, it is considered as passing directly from the
transferor of the property to the person entitled to receive the property as a result of the disclaimer.[14]
[emphasis added]

Thus, if a donor gives property in September 2020 but the donee disclaims in March of 2021, the gift is undone (if, under state law and the donative instrument, it reverts to the donor). Similarly, if the donee does not become age 21 until March of 2023, and files a qualified disclaimer within nine months of that date, the effect is exactly the same.

Just because a gift **may** come back to the donor through a voluntary action of another does not make the original gift incomplete.[15] Otherwise, no gift would ever initially be complete, since donees can always disclaim or later give it back.

Nuances of these conclusions, however, are discussed below.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Planning – CRTs, CLATs, Private Foundations

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Remainder Trusts

- A Charitable Remainder Trust allows a donor to transfer assets into an irrevocable trust and receive annuity payments for a period not to exceed 20 years.
- At the end of the term of the Charitable Remainder Trust, the remaining assets are contributed to a charitable of the donor's choice.
- The donor is entitled to a charitable income tax deduction in the year the contribution is made based upon the present value of the assets that will pass to charity at the end of the term of the Charitable Remainder Trust.
- There are two main types of Charitable Remainder Trusts, the Charitable Remainder Unitrust and the Charitable Remainder Annuity Trust. The Charitable Remainder Annuity Trust pays a fixed amount to the non-charitable beneficiary each year while the Charitable Remainder Unitrust pays a fixed percentage of the trust's assets each year.
- A Charitable Remainder Trust is not a 501(c)(3) entity but is tax exempt.
- The Charitable Remainder Trust is subject to the rules that are generally applicable to private foundations, including the self-dealing restrictions, unless no charitable deduction is taken at the time of contribution or during the life of the Charitable Remainder Trust.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Remainder Trusts, Continued

Internal Revenue Code Section 4947:

- (2) SPLIT-INTEREST TRUSTS In the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts in trust for which a deduction was allowed under section 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522, section 507 (relating to termination of private foundation status), section 508(e) (relating to governing instruments) to the extent applicable to a trust described in this paragraph, section 4941 (relating to taxes on self-dealing), section 4943 (relating to taxes on excess business holdings) except as provided in subsection (b)(3), section 4944 (relating to investments which jeopardize charitable purpose) except as provided in subsection (b)(3), and section 4945 (relating to taxes on taxable expenditures) shall apply as if such trust were a private foundation. This paragraph shall not apply with respect to—

  (A) any amounts payable under the terms of such trust to income beneficiaries, unless a deduction was allowed under section 170(f)(2)(B), 2055(e)(2)(B), or 2522(c)(2)(B),

  (B) any amounts in trust other than amounts for which a deduction was allowed under section 170, 545(b)(2), 642(c), 2055, 2106(a)(2), or 2522, if such other amounts are segregated from amounts for which no deduction was allowable, or

  (C) any amounts transferred in trust before May 27, 1969.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Remainder Trusts, Continued

- A Charitable Remainder Trust must provide for at least 10% of the assets initially contributed to pass to charity at the end of the term, based upon actuarial calculations.

- A Charitable Remainder Annuity Trust (CRAT) can provide for a fixed dollar amount of no less than 5% (but no more than 50%) of the initial net fair market value of the property contributed to the trust to be paid at least annually for up to 20 years, or based upon the life of one or more non-charitable beneficiaries.

- Additionally, a CRAT based upon a lifetime payout must meet the “5% Probability Test” whereby there must be less than a 5% chance that the Trust assets will be exhausted before the end of the term. If the CRAT fails this Test, then no charitable deduction is allowed.

- A Charitable Remainder Unitrust (CRUT) provides for payments of a fixed percentage of the net fair market value of the property under the trust, valued annually, to be made to one or more non-charitable beneficiaries. The percentage must be at least 5% per year, but can be no more than 50%.

- Either a CRAT or a CRUT can be established during the lifetime of the settlor, or upon his or her death.

- The annuity or unitrust payments received by the non-charitable beneficiary generally are subject to income tax on a “worst first” basis (i.e., ordinary income of the trust first, then capital gains etc.).

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Remainder Trusts, Continued

- The charitable deduction is based upon the actuarial value of the remainder interest that will pass to charity.

- The value of assets that actually pass to the charity at the end of the term do not matter in determining the charitable deduction.

- The Section 7520 Rate issued by the IRS monthly is used in running the actuarial calculations associated with a Charitable Remainder Trust. The Section 7520 rate for the month of funding of the Trust, or the Section 7520 rate for the two months prior, can be used.

- As a rule of thumb, a longer term will result in a smaller charitable deduction, and a shorter term will result in a larger charitable deduction.

- Further, a lower interest rate will result in a smaller charitable deduction under a CRAT, and a higher interest rate will result in a larger charitable deduction CRAT. CRUTs are not affected by the interest rate.

- The settlor can reserve the right to change the charity who will receive the remainder interest at the end of the term.

- Note that there could be gift tax consequences if the annuity or unitrust interest is payable to someone other than the settlor.

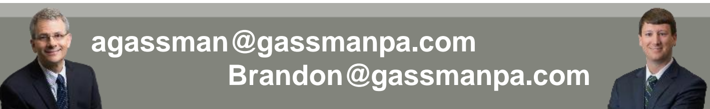
Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 1:

- Age 65, 19.2523% unitrust rate. Contributed asset, basis zero, value of $10,000,000. Florida resident (no state income tax).
- Using projections over 25 years, one is leaving very little to a charity as the mortality tables understate one's life expectancy.

Input Summary	
*****TO UPDATE GO TO "INPUT" TAB*****	
DO NOT CHANGE HERE	
FMV of Trust	*10,000,000*
Income Rate	*5.00%*
Percentage Payout	*19.25%*
Term	*25*
Cap Gain Rate	*23.80%*
Income Tax Rate	*40.80%*

Summary	
Tax Planning	
Total Amount to Taxpayer	17,298,886
Total Amount to Charity	214,073
No Tax Planning	
Total Amount to Taxpayer	15,346,162
Total Amount to Charity	0



Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 1:

Year	Beginning Principal	Income	Distribution	Remainder	Capital Gain Reported	Tax on Cap Gain	Tax on Income	Annual Net After Tax
1	10,000,000	500,000	1,925,230	8,574,770	1,425,230	339,205	204,000	1,382,025
2	8,574,770.00	428,739	1,650,840	7,352,668	1,222,102	290,860	174,925	1,185,055
3	7,352,668.06	367,633	1,415,558	6,304,744	1,047,924	249,406	149,994	1,016,157
4	6,304,743.75	315,237	1,213,808	5,406,173	898,571	213,860	128,617	871,332
5	5,406,172.75	270,309	1,040,813	4,635,669	770,504	183,380	110,286	747,147
6	4,635,668.79	231,783	892,473	3,974,979	660,689	157,244	94,568	640,661
7	3,974,979.37	198,749	765,275	3,408,453	566,526	134,833	81,090	549,352
8	3,408,453.39	170,423	656,206	2,922,670	485,783	115,616	69,532	471,057
9	2,922,670.38	146,134	562,681	2,506,123	416,548	99,138	59,622	403,920
10	2,506,122.63	125,306	482,486	2,148,943	357,180	85,009	51,125	346,352
11	2,148,942.52	107,447	413,721	1,842,669	306,274	72,893	43,838	296,989
12	1,842,668.78	92,133	354,756	1,580,046	262,623	62,504	37,590	254,661
13	1,580,046.10	79,002	304,195	1,354,853	225,193	53,596	32,233	218,366
14	1,354,853.19	67,743	260,840	1,161,755	193,098	45,957	27,639	187,244
15	1,161,755.45	58,088	223,665	996,179	165,577	39,407	23,700	160,558
16	996,178.58	49,809	191,787	854,200	141,978	33,791	20,322	137,674
17	854,200.22	42,710	164,453	732,457	121,743	28,975	17,426	118,053
18	732,457.04	36,623	141,015	628,065	104,392	24,845	14,942	101,227
19	628,065.06	31,403	120,917	538,551	89,514	21,304	12,813	86,800
20	538,551.35	26,928	103,684	461,795	76,756	18,268	10,986	74,429
21	461,795.39	23,090	88,906	395,979	65,816	15,664	9,421	63,821
22	395,978.93	19,799	76,235	339,543	56,436	13,432	8,078	54,725
23	339,542.82	16,977	65,370	291,150	48,393	11,517	6,927	46,926
24	291,150.16	14,558	56,053	249,655	41,496	9,876	5,939	40,238
25	249,654.57	12,483	48,064	214,073	35,582	8,468	5,093	34,503
Summary		**3,433,104.46**	**13,219,031.41**	**214,073.05**	**9,785,926.95**	**2,329,050.61**	**1,400,706.62**	**9,489,274.18**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 1:

Income on Balance	Taxes on Balance Income	Accumulated Year End Balance
-	-	1,382,025
69,101	28,193	2,607,988
130,399	53,203	3,701,342
185,067	75,507	4,682,233
234,112	95,518	5,567,974
278,399	113,587	6,373,447
318,672	130,018	7,111,453
355,573	145,074	7,793,009
389,650	158,977	8,427,603
421,380	171,923	9,023,412
451,171	184,078	9,587,494
479,375	195,585	10,125,946
506,297	206,569	10,644,040
532,202	217,138	11,146,348
557,317	227,385	11,636,837
581,842	237,391	12,118,962
605,948	247,227	12,595,736
629,787	256,953	13,069,797
653,490	266,624	13,543,463
677,173	276,287	14,018,779
700,939	285,983	14,497,556
724,878	295,750	14,981,409
749,070	305,621	15,471,785
773,589	315,624	15,969,987
798,499	325,788	16,477,202
11,803,931.31	**4,816,003.98**	**16,477,202**

Growth on Savings From Charitable Deduction

Income on Charitable Deduction Savings	Tax on Income	Accunulated YE Balance
		408,000
20,400	8,323	420,077
21,004	8,570	432,511
21,626	8,823	445,313
22,266	9,084	458,495
22,925	9,353	472,066
23,603	9,630	486,039
24,302	9,915	500,426
25,021	10,209	515,239
25,762	10,511	530,490
26,524	10,822	546,192
27,310	11,142	562,359
28,118	11,472	579,005
28,950	11,812	596,144
29,807	12,161	613,790
30,689	12,521	631,958
31,598	12,892	650,664
32,533	13,274	669,924
33,496	13,666	689,753
34,488	14,071	710,170
35,508	14,487	731,191
36,560	14,916	752,834
37,642	15,358	775,118
38,756	15,812	798,062
39,903	16,280	821,684
698,791	285,107	821,684

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 1:

No Tax Planning		
Income on money invested	Tax on Income	Accunulated YE Balance
		7,620,000
381,000	155,448	7,845,552
392,278	160,049	8,077,780
403,889	164,787	8,316,883
415,844	169,664	8,563,062
428,153	174,686	8,816,529
440,826	179,857	9,077,498
453,875	185,181	9,346,192
467,310	190,662	9,622,840
481,142	196,306	9,907,676
495,384	202,117	10,200,943
510,047	208,099	10,502,891
525,145	214,259	10,813,776
540,689	220,601	11,133,864
556,693	227,131	11,463,426
573,171	233,854	11,802,744
590,137	240,776	12,152,105
607,605	247,903	12,511,807
625,590	255,241	12,882,157
644,108	262,796	13,263,469
663,173	270,575	13,656,067
682,803	278,584	14,060,287
703,014	286,830	14,476,471
723,824	295,320	14,904,975
745,249	304,061	15,346,162
13,050,950	5,324,787	15,346,162

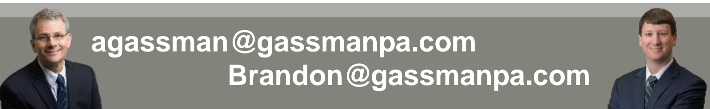
Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 2:

- Age 55, 11.938% unitrust rate. Contributed asset, basis zero, value of $10,000,000. Florida resident (no state income tax).
- Using projections over 25 years, one is leaving very little to a charity as the mortality tables understate one's life expectancy.

Input Summary	
*****TO UPDATE GO TO "INPUT" TAB*****	
DO NOT CHANGE HERE	
FMV of Trust	*10,000,000*
Income Rate	*5.00%*
Percentage Payout	*11.94%*
Term	*25*
Cap Gain Rate	*23.80%*
Income Tax Rate	*40.80%*

Summary	
Tax Planning	
Total Amount to Taxpayer	16,717,389
Total Amount to Charity	1,656,951
No Tax Planning	
Total Amount to Taxpayer	15,346,162
Total Amount to Charity	0



Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 2:

Year	Beginning Principal	Income	Distribution	Remainder	Capital Gain Reported	Tax on Cap Gain	Tax on Income	Annual Net After Tax
1	10,000,000	500,000	1,193,800	9,306,200	693,800	165,124	204,000	824,676
2	9,306,200.00	465,310	1,110,974	8,660,536	645,664	153,668	189,846	767,460
3	8,660,535.84	433,027	1,033,895	8,059,668	600,868	143,007	176,675	714,213
4	8,059,667.87	402,983	962,163	7,500,488	559,180	133,085	164,417	664,661
5	7,500,488.11	375,024	895,408	6,980,104	520,384	123,851	153,010	618,547
6	6,980,104.25	349,005	833,285	6,495,825	484,280	115,259	142,394	575,632
7	6,495,824.61	324,791	775,472	6,045,144	450,680	107,262	132,515	535,695
8	6,045,144.30	302,257	721,669	5,625,732	419,412	99,820	123,321	498,528
9	5,625,732.19	281,287	671,600	5,235,419	390,313	92,895	114,765	463,940
10	5,235,418.89	261,771	625,004	4,872,186	363,233	86,450	106,803	431,752
11	4,872,185.53	243,609	581,642	4,534,153	338,032	80,452	99,393	401,797
12	4,534,153.30	226,708	541,287	4,219,574	314,580	74,870	92,497	373,921
13	4,219,573.74	210,979	503,733	3,926,820	292,754	69,675	86,079	347,978
14	3,926,819.71	196,341	468,784	3,654,377	272,443	64,841	80,107	323,835
15	3,654,376.96	182,719	436,260	3,400,836	253,541	60,343	74,549	301,368
16	3,400,836.29	170,042	405,992	3,164,886	235,950	56,156	69,377	280,459
17	3,164,886.27	158,244	377,824	2,945,306	219,580	52,260	64,564	261,000
18	2,945,306.46	147,265	351,611	2,740,961	204,345	48,634	60,084	242,892
19	2,740,961.10	137,048	327,216	2,550,793	190,168	45,260	55,916	226,040
20	2,550,793.21	127,540	304,514	2,373,819	176,974	42,120	52,036	210,358
21	2,373,819.18	118,691	283,387	2,209,124	164,696	39,198	48,426	195,763
22	2,209,123.61	110,456	263,725	2,055,855	153,269	36,478	45,066	182,181
23	2,055,854.61	102,793	245,428	1,913,219	142,635	33,947	41,939	169,541
24	1,913,219.42	95,661	228,400	1,780,480	132,739	31,592	39,030	157,779
25	1,780,480.25	89,024	212,554	1,656,951	123,530	29,400	36,322	146,832
Summary		**6,012,575.28**	**14,355,624.75**	**1,656,950.53**	**8,343,049.47**	**1,985,645.77**	**2,453,130.72**	**9,916,848.26**

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Example 2:

Income on Balance	Taxes on Balance Income	Accumulated Year End Balance
-	-	824,676
41,234	16,823	1,616,546
80,827	32,978	2,378,609
118,930	48,524	3,113,677
155,684	63,519	3,824,388
191,219	78,018	4,513,222
225,661	92,070	5,182,509
259,125	105,723	5,834,439
291,722	119,023	6,471,079
323,554	132,010	7,094,375
354,719	144,725	7,706,166
385,308	157,206	8,308,189
415,409	169,487	8,902,089
445,104	181,603	9,489,426
474,471	193,584	10,071,681
503,584	205,462	10,650,261
532,513	217,265	11,226,510
561,325	229,021	11,801,706
590,085	240,755	12,377,077
618,854	252,492	12,953,797
647,690	264,257	13,532,992
676,650	276,073	14,115,750
705,787	287,961	14,703,117
735,156	299,944	15,296,108
764,805	312,041	15,895,705
10,099,419.42	**4,120,563.12**	**15,895,705**

Growth on Savings From Charitable Deduction

Income on Charitable Deduction Savings	Tax on Income	Accunulated YE Balance
		408,000
20,400	8,323	420,077
21,004	8,570	432,511
21,626	8,823	445,313
22,266	9,084	458,495
22,925	9,353	472,066
23,603	9,630	486,039
24,302	9,915	500,426
25,021	10,209	515,239
25,762	10,511	530,490
26,524	10,822	546,192
27,310	11,142	562,359
28,118	11,472	579,005
28,950	11,812	596,144
29,807	12,161	613,790
30,689	12,521	631,958
31,598	12,892	650,664
32,533	13,274	669,924
33,496	13,666	689,753
34,488	14,071	710,170
35,508	14,487	731,191
36,560	14,916	752,834
37,642	15,358	775,118
38,756	15,812	798,062
39,903	16,280	821,684
698,791	285,107	821,684

agassman@gassmanpa.com
Brandon@gassmanpa.com

Example 2:

No Tax Planning		
Income on money invested	Tax on Income	Accunulated YE Balance
		7,620,000
381,000	155,448	7,845,552
392,278	160,049	8,077,780
403,889	164,787	8,316,883
415,844	169,664	8,563,062
428,153	174,686	8,816,529
440,826	179,857	9,077,498
453,875	185,181	9,346,192
467,310	190,662	9,622,840
481,142	196,306	9,907,676
495,384	202,117	10,200,943
510,047	208,099	10,502,891
525,145	214,259	10,813,776
540,689	220,601	11,133,864
556,693	227,131	11,463,426
573,171	233,854	11,802,744
590,137	240,776	12,152,105
607,605	247,903	12,511,807
625,590	255,241	12,882,157
644,108	262,796	13,263,469
663,173	270,575	13,656,067
682,803	278,584	14,060,287
703,014	286,830	14,476,471
723,824	295,320	14,904,975
745,249	304,061	15,346,162
13,050,950	5,324,787	15,346,162

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

The Self-Policing Charitable Remainder Trust

Oftentimes a parent would like to provide a large gift for a child, in order to assure that the child has a sense of security, and asset or assets to manage, and limitations on what can be done and amounts that can be withdrawn therefrom.

While giving a gift with such strings attached may seem somewhat awkward and domineering, it can be in the best interests of the child and the child's descendants, especially if there are good reasons for the limitations so that the child does not feel that rules and regulations on investing and spending are based upon a lack of confidence or trust for the child and those who may influence the child.

Parents may also wish to provide a benefit for charity, and to have the child feel and effectuate a duty to charity, and also possibly a relationship with a particular charitable organization.

The Charitable Remainder Uni-Trust can be the best arrangement to achieve the above objectives.

For example, a mother and father may wish to give $100,000 to each of their children, with the expectation that the children will manage the investments prudently and withdraw 7% of the value of trust assets each year for whatever purposes the child likes.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

The Self-Policing Charitable Remainder Trust, Cont'd

Such an arrangement could go on for the life of the child, with the remainder of the assets left in the trust to go to charity, instead of the child's spouse or other family members.

A simple Charitable Remainder Uni-Trust can be established to facilitate this.

Now the Internal Revenue Service, the Attorney General of the state where the Trustee resides, and a particular charity or charities are the "bad guys" that the child would need to answer to, if proper rules are not followed.

The Grantor or child may have the right to change the charity.

The Grantor can retain the right to change the Trustee, or to appoint a successor Trustee, if the child cannot serve.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Remainder Trust Distribution Percentages
Assumes $100,000 Contribution to Charitable Remainder Trusts

	A	B	C	D	E	F
1						
2		Maximum Distribution % Allowed for Lifetime Payout	Charitable Deduction Assuming Maximum Distribution %	Charitable Deduction for 6.92% Uni-Trust	Percentage, if used 20-Year Term Payout	Charitable Deduction Assuming 20-Year Term Payout
3	GEORGE JONES - 55	11.84%	$10,000	$21,669	10.87%	$10,000
4	JAMES JONES - 50	9.64%	$10,000	$16,872	10.87%	$10,000
5	PEGGY JONES - 48	8.96%	$10,000	$15,238	10.87%	$10,000
6	KATHY JONES - 40	6.92%	$10,000	$10,000	10.87%	$10,000

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

CRUT Distribution Percentages

The below charts show the maximum amount a CRUT could payout to the non-charitable beneficiary while still qualifying based upon the individual's age, how many lives the payout is based on, and the June 2020 7520 Rates.

Length	Percentage
20 year term of years	10.87%
30-year-old's life	5.31%
40-year-old's life	6.92%
50-year-old's life	9.64%
60-year-old's life	14.90%

ON THE LIFE OF TWO PEOPLE	
Two 30-year-old individuals	Cannot distribute at least 5%
Two 40-year-old individuals	5.13%
Two 50-year-old individuals	6.60%
Two 60-year-old individuals	9.1%

ON THE LIFE OF THREE PEOPLE	
Three 30-year-old individuals	Cannot distribute at least 5%
Three 40-year-old individuals	Cannot distribute at least 5%
Three 50-year-old individuals	5.92%
Three 60-year-old individuals	7.91%

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Flip-NIMCRUT

- It is possible for a Charitable Remainder Unitrust to be set up where payments only need to be made in years that the Charitable Remainder Unitrust receives income.
- In the event that the Charitable Remainder Unitrust does not receive income and does not pay its annual disbursement amount, the amount that was not distributed must be paid in future years.
- Income for the Charitable Remainder Unitrust is based on fiduciary accounting income so it is possible to set up a disregarded LLC that essentially blocks the income from being received by the Charitable Remainder Unitrust.
- Once the Charitable Remainder Unitrust is ready to start paying its annuity amount, it can release the income by making a distribution from the "blocker LLC" triggering fiduciary accounting income at the trust level to make up for the payments it missed.
- This allows the Flip-NIMCRUT to build value tax free, until the individuals controlling the disregarded entity decide it is time to start paying out the distribution amount.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Flip-NIMCRUT Requirements

- The Charitable Remainder Unitrust can "flip" to a regular Charitable Remainder Unitrust upon a "triggering event," and thereafter simply pay out a annual percentage of the trust assets. The triggering event must be stated in the trust agreement.

- A triggering event could be a set date or an event, and the occurrence of such event must not be discretionary or under the control of the trustee or another person.

- A triggering event could be the sale of unmarketable securities. This would allow a CRUT to hold a subsidiary that holds unmarketable securities. When the donor or another person is ready to flip the NIMCRUT, it can sell the unmarketable securities or a portion thereof.

- The Final Regulations list 7 permissible triggering events as described on the next slide.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Possible Triggering Events For The Flip-NIMCRUT

1. The sale of a non-marketable security - such as a corporation or a limited liability company that may own a promissory note from an unrelated party, real estate, or possibility even marketable securities.

2. Upon the donor’s divorce.

3. Upon the donor’s marriage.

4. When the income recipient has his or her first child.

5. When the income recipient’s father passes away.

6. The sale of the donor’s personal residence.

7. Upon the income recipient reaching a certain age.

It does not appear that these are the only possible triggering events, but these are the only ones listed, so it is safest to stick with the ones that are specifically provided for.

If a donor wants to use a triggering event that is not listed in the Final Regulations the donor should be careful to make sure that no person has control of whether the event is going to happen.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Flip NIMCRUT

JOE CLIENT
DYNASTY TRUST

Trust Co, Mgr.

Joe Client, Investment Advisor

JOE CLIENT L.L.C.

Joe Cliet, IA

Trust Co, Trustee

Trust Co, Trustee

Joe Client, IA

ALPHA FLIP NIMCRUT

BETA FLIP NIMCRUT

Joe Client, Mgr.

ALPHA, LLC (Disregarded)

Trust Co, Mgr.

Joe Client, IA

"BLOCKER ENTITY"
(Partnership)

BETA, LLC (Disregarded)

Will be considered an unmarketable security and upon sale ALHPA NIMCRUT will "flip" to CRUT

Will block "income" from NIMCRUT.

NIMCRUT will only be considered to have "income" when "blocker entity" makes a distribution

ABC, L.L.C.

Expected to be sold for a large gain.

Will be considered an unmarketable security and upon sale ALHPA NIMCRUT will "flip" to CRUT

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Remainder Trust Scenario

A is considering funding a Charitable Trust with stock of his closely held business, ABC Company, prior to the sale of ABC Company in order to defer the gain on the sale.

ABC Company is worth $1,000,000 and A has $200,000 of basis in ABC Company. A expects that he can receive an 8% rate of return after receiving the cash proceeds from the sale of ABC Company, consisting of 1% ordinary income and 7% capital gains.

A has asked whether the tax deferral under a NIMCRUT or a CRUT will leave him in a better position than if A just invests the after tax proceeds of the sale of ABC Company.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

NIMCRUT

Summary Columns

23	24	25	26	27	28	29	30
Year	Total Received By Family Under NIMCRUT (Column 9)	Total Received by Family Under Hypothetical Investment Account (Column 15)	Total Received by Family Under Hypothetical Investment Account with Charitable Contributions (Column 22)	Difference in Amount Family Receives if No Charitable Planning (Column 25-24)	Difference in Amount Family Receives if Charitable Distributions Made Each Year (Column 26-24)	Total Amount Charity Receives Under NIMCRUT at End of 20 Year Term	Total Tax Savings if NIMCRUT is Used
1	$ 5,920	$ 865,624	$ 862,484	$ 859,704	$ 856,564	$ -	$ 195,064
2	$ 12,547	$ 924,511	$ 917,864	$ 911,964	$ 905,317	$ -	$ 199,888
3	$ 19,944	$ 986,398	$ 975,852	$ 966,453	$ 955,907	$ -	$ 204,876
4	$ 28,182	$ 1,051,430	$ 1,036,565	$ 1,023,248	$ 1,008,383	$ -	$ 210,027
5	$ 37,334	$ 1,119,759	$ 1,100,126	$ 1,082,424	$ 1,062,792	$ -	$ 215,343
6	$ 47,481	$ 1,191,540	$ 1,166,661	$ 1,144,059	$ 1,119,179	$ -	$ 220,824
7	$ 58,711	$ 1,266,939	$ 1,236,300	$ 1,208,228	$ 1,177,589	$ -	$ 226,468
8	$ 71,118	$ 1,346,127	$ 1,309,179	$ 1,275,009	$ 1,238,061	$ -	$ 232,275
9	$ 84,803	$ 1,429,282	$ 1,385,439	$ 1,344,479	$ 1,300,636	$ -	$ 238,243
10	$ 99,876	$ 1,516,588	$ 1,465,225	$ 1,416,712	$ 1,365,349	$ -	$ 244,368
11	$ 116,455	$ 1,608,241	$ 1,548,685	$ 1,491,785	$ 1,432,230	$ -	$ 250,646
12	$ 134,669	$ 1,704,440	$ 1,635,976	$ 1,569,771	$ 1,501,307	$ -	$ 257,072
13	$ 154,654	$ 1,805,394	$ 1,727,256	$ 1,650,740	$ 1,572,602	$ -	$ 263,639
14	$ 176,561	$ 1,911,322	$ 1,822,690	$ 1,734,761	$ 1,646,130	$ -	$ 270,339
15	$ 200,548	$ 2,022,449	$ 1,922,448	$ 1,821,901	$ 1,721,900	$ -	$ 277,162
16	$ 226,788	$ 2,139,009	$ 2,026,702	$ 1,912,221	$ 1,799,914	$ -	$ 284,097
17	$ 255,468	$ 2,261,246	$ 2,135,631	$ 2,005,778	$ 1,880,163	$ -	$ 291,129
18	$ 286,789	$ 2,389,413	$ 2,249,420	$ 2,102,624	$ 1,962,631	$ -	$ 298,244
19	$ 320,965	$ 2,523,770	$ 2,368,254	$ 2,202,805	$ 2,047,289	$ -	$ 305,423
20	$ 3,121,984	$ 2,664,589	$ 2,492,327	$ (457,396)	$ (629,658)	$ 242,711	$ (550,574)

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

NIMCRUT w/ Charitable Deduction

$1,000,000 Contribution, With Only 1% Per Year In Distributable Income – Distributions received are used to pay income taxes thereon, and then invested at a 6% rate of return. Charitable Deduction taken.

Analysis of Net Income with Makeup Charitable Remainder Unitrust (NIMCRUT)
(20 Year Term 8% Return)

1	2	3	4	5	6	7	8	9
Year	NIMCRUT Balance (Assumes 8% Growth)	Distribution to Family (Lesser of Trust Income or Unitrust Amount with Make Up Distributions in Years in Which Trust Income Exceeds Unitrust Amount)	Taxes on Distribution	Net Distribution to Family	Charitable Tax Deduction Benefit	Total Value Family Receives (Includes Tax Deduction Benefit)	Total Amount Charity Receives at End of Twenty Year Term	Total Amount Received Under NIMCRUT if Distributions are Reinvested at 6% Rate of Return
1	$ 1,000,000	$ 10,000	$ (4,080)	$ 5,920	$ 51,924	$ 57,844	$ -	$ 5,920
2	$ 1,070,000	$ 10,700	$ (4,366)	$ 6,334	$ -	$ 64,179	$ -	$ 12,547
3	$ 1,144,900	$ 11,449	$ (4,671)	$ 6,778	$ -	$ 70,956	$ -	$ 19,944
4	$ 1,225,043	$ 12,250	$ (4,998)	$ 7,252	$ -	$ 78,209	$ -	$ 28,182
5	$ 1,310,796	$ 13,108	$ (5,348)	$ 7,760	$ -	$ 85,968	$ -	$ 37,334
6	$ 1,402,552	$ 14,026	$ (5,722)	$ 8,303	$ -	$ 94,272	$ -	$ 47,481
7	$ 1,500,730	$ 15,007	$ (6,123)	$ 8,884	$ -	$ 103,156	$ -	$ 58,711
8	$ 1,605,781	$ 16,058	$ (6,552)	$ 9,506	$ -	$ 112,662	$ -	$ 71,118
9	$ 1,718,186	$ 17,182	$ (7,010)	$ 10,172	$ -	$ 122,834	$ -	$ 84,803
10	$ 1,838,459	$ 18,385	$ (7,501)	$ 10,884	$ -	$ 133,717	$ -	$ 99,876
11	$ 1,967,151	$ 19,672	$ (8,026)	$ 11,646	$ -	$ 145,363	$ -	$ 116,455
12	$ 2,104,852	$ 21,049	$ (8,588)	$ 12,461	$ -	$ 157,824	$ -	$ 134,669
13	$ 2,252,192	$ 22,522	$ (9,189)	$ 13,333	$ -	$ 171,157	$ -	$ 154,654
14	$ 2,409,845	$ 24,098	$ (9,832)	$ 14,266	$ -	$ 185,423	$ -	$ 176,561
15	$ 2,578,534	$ 25,785	$ (10,520)	$ 15,265	$ -	$ 200,688	$ -	$ 200,548
16	$ 2,759,032	$ 27,590	$ (11,257)	$ 16,333	$ -	$ 217,021	$ -	$ 226,788
17	$ 2,952,164	$ 29,522	$ (12,045)	$ 17,477	$ -	$ 234,498	$ -	$ 255,468
18	$ 3,158,815	$ 31,588	$ (12,888)	$ 18,700	$ -	$ 253,198	$ -	$ 286,789
19	$ 3,379,932	$ 33,799	$ (13,790)	$ 20,009	$ -	$ 273,208	$ -	$ 320,965
20	$ 3,616,528	$ 3,663,139	$ (877,975)	$ 2,785,163	$ -	$ 3,058,371	$ 242,711	$ 3,173,908

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

NIMCRUT

No Planning - Investment of Sales Proceeds in Hypothetical Investment Account and Receive Distribution Each Year					
10	11	12	13	14	15
Balance of Hypothetical Investment Account (Assumes 8% Growth)	Distribution (Distribution Net of Taxes Equals After Tax CRUT Payment each year)	Taxes (1.00% of Assets)	Ending Balance of Hypothetical Investment Account	Cummulative Net Distribtuions With 6% Growth	Total Amount Received by Family (Net account + Cummulative Net Distributions) (Columns 13+14= Column 15)
$ 809,600	$ 14,664	$ (8,744)	$ 850,961	$ 14,664	$ 865,624
$ 850,961	$ 15,525	$ (9,190)	$ 894,322	$ 30,188	$ 924,511
$ 894,322	$ 16,436	$ (9,659)	$ 939,773	$ 46,625	$ 986,398
$ 939,773	$ 17,402	$ (10,150)	$ 987,403	$ 64,027	$ 1,051,430
$ 987,403	$ 18,424	$ (10,664)	$ 1,037,308	$ 82,451	$ 1,119,759
$ 1,037,308	$ 19,506	$ (11,203)	$ 1,089,584	$ 101,957	$ 1,191,540
$ 1,089,584	$ 20,652	$ (11,768)	$ 1,144,331	$ 122,608	$ 1,266,939
$ 1,144,331	$ 21,865	$ (12,359)	$ 1,201,654	$ 144,473	$ 1,346,127
$ 1,201,654	$ 23,150	$ (12,978)	$ 1,261,659	$ 167,623	$ 1,429,282
$ 1,261,659	$ 24,510	$ (13,626)	$ 1,324,456	$ 192,133	$ 1,516,588
$ 1,324,456	$ 25,950	$ (14,304)	$ 1,390,158	$ 218,082	$ 1,608,241
$ 1,390,158	$ 27,474	$ (15,014)	$ 1,458,883	$ 245,557	$ 1,704,440
$ 1,458,883	$ 29,089	$ (15,756)	$ 1,530,749	$ 274,646	$ 1,805,394
$ 1,530,749	$ 30,798	$ (16,532)	$ 1,605,878	$ 305,444	$ 1,911,322
$ 1,605,878	$ 32,608	$ (17,343)	$ 1,684,397	$ 338,052	$ 2,022,449
$ 1,684,397	$ 34,525	$ (18,191)	$ 1,766,432	$ 372,577	$ 2,139,009
$ 1,766,432	$ 36,554	$ (19,077)	$ 1,852,115	$ 409,132	$ 2,261,246
$ 1,852,115	$ 38,703	$ (20,003)	$ 1,941,578	$ 447,835	$ 2,389,413
$ 1,941,578	$ 40,978	$ (20,969)	$ 2,034,957	$ 488,813	$ 2,523,770
$ 2,034,957	$ 2,175,776	$ (21,978)	$ (0)	$ 2,664,589	$ 2,664,589

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

NIMCRUT

Investment of Net Sales Proceeds in Hypothetical Investment Account and Receive Distributions Each Year Plus Make Charitable Contributions of Equal Present Value						
16	17	18	19	20	21	22
Year	Distribution Received By Family	Payment to Charity	Charitable Deduction Benefit	Cummulative Net Distributions Received by Family	Future Value of Distributions to Charity (Assumes 8% Growth Rate)	Total Benefit Received by Family (Net account + Cummulative Net Distributions - Charity Payment + Value of Charitable Deduction)
1	$ 14,664	$ (5,304)	$ 2,164	$ 14,664	$ 5,304	$ 862,484
2	$ 15,525	$ (5,304)	$ 2,164	$ 30,188	$ 11,032	$ 917,864
3	$ 16,436	$ (5,304)	$ 2,164	$ 46,625	$ 17,218	$ 975,852
4	$ 17,402	$ (5,304)	$ 2,164	$ 64,027	$ 23,899	$ 1,036,565
5	$ 18,424	$ (5,304)	$ 2,164	$ 82,451	$ 31,115	$ 1,100,126
6	$ 19,506	$ (5,304)	$ 2,164	$ 101,957	$ 38,908	$ 1,166,661
7	$ 20,652	$ (5,304)	$ 2,164	$ 122,608	$ 47,325	$ 1,236,300
8	$ 21,865	$ (5,304)	$ 2,164	$ 144,473	$ 56,414	$ 1,309,179
9	$ 23,150	$ (5,304)	$ 2,164	$ 167,623	$ 66,231	$ 1,385,439
10	$ 24,510	$ (5,304)	$ 2,164	$ 192,133	$ 76,833	$ 1,465,225
11	$ 25,950	$ (5,304)	$ 2,164	$ 218,082	$ 88,284	$ 1,548,685
12	$ 27,474	$ (5,304)	$ 2,164	$ 245,557	$ 100,650	$ 1,635,976
13	$ 29,089	$ (5,304)	$ 2,164	$ 274,646	$ 114,006	$ 1,727,256
14	$ 30,798	$ (5,304)	$ 2,164	$ 305,444	$ 128,431	$ 1,822,690
15	$ 32,608	$ (5,304)	$ 2,164	$ 338,052	$ 144,009	$ 1,922,448
16	$ 34,525	$ (5,304)	$ 2,164	$ 372,577	$ 160,833	$ 2,026,702
17	$ 36,554	$ (5,304)	$ 2,164	$ 409,132	$ 179,004	$ 2,135,631
18	$ 38,703	$ (5,304)	$ 2,164	$ 447,835	$ 198,628	$ 2,249,420
19	$ 40,978	$ (5,304)	$ 2,164	$ 488,813	$ 219,822	$ 2,368,254
20	$ 1,960,235	$ (5,304)	$ 2,164	$ 2,449,048	$ 242,711	$ 2,492,327

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

NIMCRUT

Comparison of NIM-CRUT vs. No Planning

$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$-

Age 55 57 59 61 63 65 67 69 71 73
Year 1 3 5 7 9 11 13 15 17 19

$3,121,984
$457,396
$2,664,589
$2,492,327
$242,711

Total Amount Family Receives Under NIMCRUT
Total Amount Received by Family if No Planning
Total Received by Family After Annual Charitable Contributions
Future Value of Annual Charitable Contributions
Total Amount Charity Receives Under NIMCRUT

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Self-Dealing and Flip-NIMCRUTs

- A number of Private Letter Rulings state that "allowed" really means "taken" in the context of the charitable deduction.

- Despite issuing Private Letter Rulings on this as recent as 2017, the IRS is now reluctant to issue Private Letter Rulings on this topic, and it is unclear whether the IRS will take the position that "allowed" really means "taken."

- Thus, if the donor wants to avoid the application of the self-dealing rules, the donor should contribute funds through an entity that is not required to take a charitable deduction, such as a dynasty trust that specifically authorizes the creation of a charitable remainder trust.

- Due to the fact that the private foundation rules generally apply to charitable remainder trusts, it is important to make sure that disqualified persons do not transact with the entity directly. It may be possible to create subsidiaries that are controlled by specially designed trusts that have less than 35% of the beneficial interest being held or made available to disqualified persons.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Charitable Lead Annuity Trust

Client Living Trust

Charitable Lead Annuity Trust

Selected Charities

$100,000 per year for ten year term.

Trusts for Children

Receives CLAT balance of $848,450 after ten year term.

1%V

99% NV

Newly Established LLC

Funded with approximately $1,209,779 of assets and 99% NV Interest transferred to CLAT. Assuming 30% discount the transfer is valued at $846,846.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

CLAT Result Illustration

Assumes a $10,000,000 contribution of assets that will grow at 6% per year – no discounts – zeroed out using the 1.86% October 2019 Section 7520 Rate.

	12-Year / Same Annual Payment Each Year	12-Year / 20% Increasing Payment Year Over Year	20-Year / Same Annual Payment Each Year	20-Year / 20% Increasing Payment Year Over Year
Total amount to charity, not taking into account growth on assets	$11,209,238	$11,209,238	$11,999,371	$11,999,371
Total amount to charity, assuming a 6% rate of return	$15,758,265	$13,965,661	$22,070,198	$16,128,647
Total to Children after CLAT term	$ 4,363,700	$ 6,156,304	$10,001,157	$15,942,708
Percentage to Children	28%	35%	45%	57%
Percentage to Charity	72%	65%	55%	43%

*A 20% increasing CLAT may have income tax liability if the annuity payment to charity is less than the gain the CLAT recognizes.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

CLAT Result Illustration
Assuming 33% Discount and a 6% Annual Growth Rate

	12-Year / Same Annual Payment Each Year with 33% Discount	12-Year / 20% Increasing Payment Year Over Year with 33% Discount	20-Year / Same Annual Payment Each Year with 33% Discount	20-Year / 20% Increasing Payment Year Over Year with 33% Discount
Total amount to charity, not taking into account growth on assets	**$ 7,510,164**	**$ 8,038,660**	**$ 7,512,379**	**$ 8,038,785**
Total amount to charity, assuming a 6% rate of return	**$10,558,002**	**$14,785,343**	**$ 9,359,721**	**$10,805,127**
Total to Children after CLAT term	**$ 9,563,963**	**$17,286,012**	**$10,762,243**	**$21,266,228**
Percentage to Children	**56%**	**59%**	**61%**	**73%**
Percentage to Charity	**44%**	**41%**	**29%**	**27%**

*A 20% increasing CLAT may have income tax liability if the annuity payment to charity is less than the gain the CLAT recognizes.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Private Operating Foundations – Now More Than Ever!

It is simple to establish an irrevocable trust to qualify as a Section 501(c)(3) Private Operating Foundation, which can be treated in the same manner as a Public Charity for most purposes.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

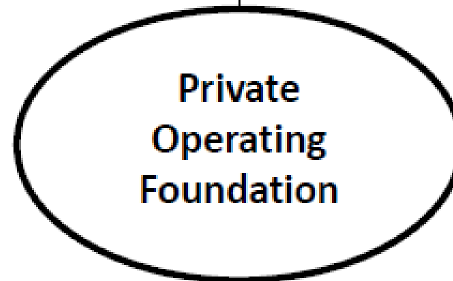
Private Operating Foundations

Charitable deduction of:
60% of AGI for cash contributions,
50% of AGI for non-cash, and
30% of AGI for capital assets.

Generally created by individuals and/or related parties

Donor information is public

A Private Operating Foundation must actively engage in its charitable purpose.[1]



Excess business holdings rule applies. Any voting interest held in a for-profit business of 20% or more, when aggregated with the voting interest held with disqualified persons, must be disposed of within 5 years.*

Self-dealing rules apply but related parties can control the foundation and distributions.

Can grant scholarships with prior IRS approval. Disclosure of scholarship program on Schedule E of Form 1023 is sufficient.

Spend the lesser of 85% of net income or 4.25% of the value of its non-exempt assets on direct charitable expenditures. The Private Operating Foundation must also meet one of three alternative tests, which is usually satisfied if the Private Operating Foundation is spending at least 4.25% of its value on direct charitable expenditures.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Private Operating Foundations and Scholarship Programs

- Generally, providing scholarships and doing nothing more does not meet the active conduct of a charitable purpose requirement for private operating foundations.

- There are exceptions to this rule as provided under Treasury Regulations Section 53.4942(b)-1(b)(2).

- The private operating foundation must do more than merely provide scholarships. The private operating foundation must:

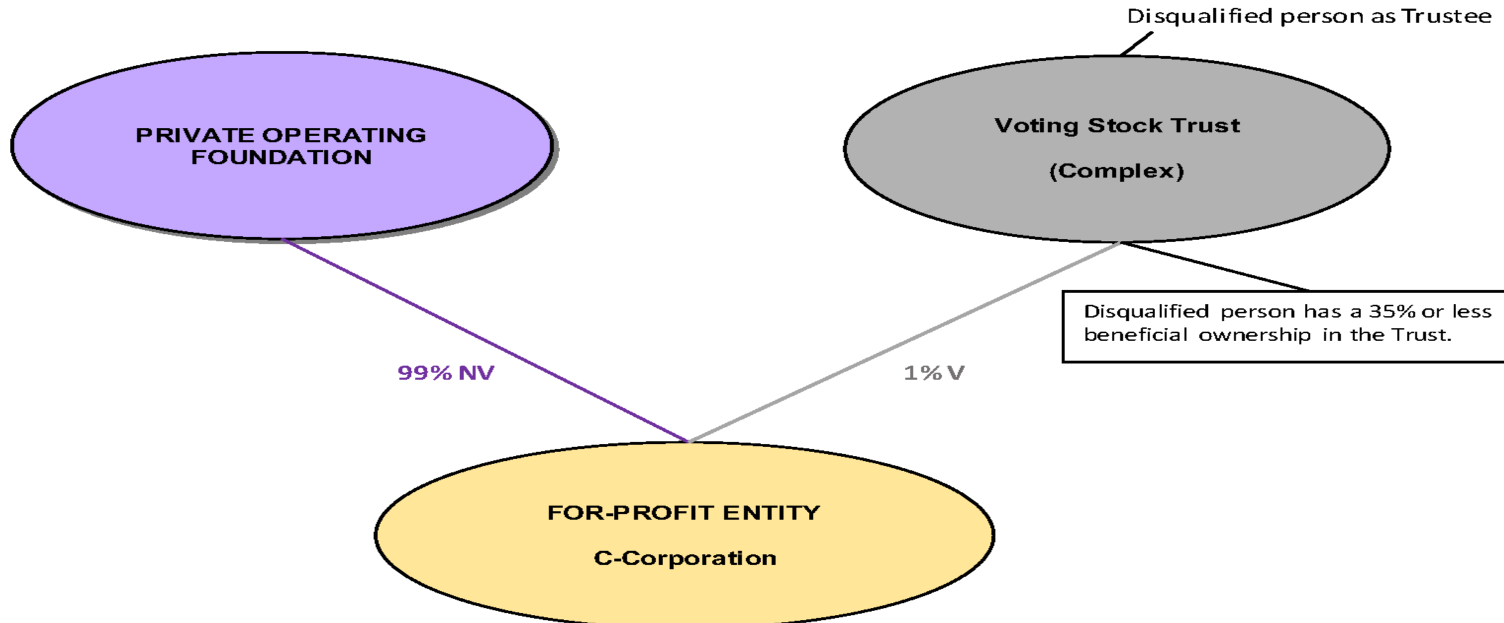
- Actively contribute more than money such as providing direct educational services, mentoring recipients, hosting events that further the recipient's education, analyzing data from the operations of the scholarship program and assisting impoverished individuals.

- The Regulations states that it is easier to meet the standard when the foundation has a main goal of reducing poverty.

- Scholarship programs should be disclosed on Schedule H of the Form 1023 Application for preapproval.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Non-Profit Entity Owning For-Profit Business



A Private Operating Foundation ("POF") will be deemed to have excess business holdings in the event that the POF holds more than 20% of the voting stock of a for profit company, as aggregated with disqualified persons. Section 4943(c)(2)(A). A trust will not be considered to be a disqualified person as long as a disqualified person does not hold more than a 35% beneficial interest in the trust. Section 4946(a)(1)(G).

In the above diagram, the disqualified person does not have more than a 35% beneficial interest in the Voting Stock Trust, so the Voting Stock Trust is not considered to be a disqualified person. The disqualified person can serve as the Trustee of the Voting Stock Trust controlling 100% of the voting interest in the for profit entity because such person is acting in his capacity as Trustee of the Voting Stock Trust and not individually.

The POF can maintain ownership in the 99% non-voting interest in the for profit without causing any excess business holding issues because the POF is not treated as owning over 20% of the voting stock of the for profit entity.

The best entity to use for this strategy, in most cases, is a C-corporation because it would not automatically pass Unrelated Business Taxable Income ("UBTI") up to the POF and dividends paid to the POF are not taxable.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

(PRIVATE OPERATING FOUNDATION)

Donor or Family Member has full control as Trustee

Donor or Family Member, as Trustee

4.25% minimum payment or active expenditures or improvements/set-asides.

PRIVATE OPERATING FOUNDATION

IRREVOCABLE TRUST HOLDING VOTING INTERESTS

Can directly own triple net leases, cash, marketable securities and other assets, but cannot hold the voting interest in the for-profit unless using the Paul Newman Exception.

99% NV

1% V

Family cannot have more than a 35% beneficial ownership interest. IRC § 4946(a)(1)(G).

LLC with Voting and Non-Voting Stock

99% donated or bequeathed by Donor to Foundation or after Donor's death an administrative note given for the non voting stock could be used to fund the Private Foundation. The note could be renegotiated after the Foundation becomes a Public Charity.

100%

Should be taxed as a C corporation to avoid 100% unrelated business taxable income ("UBTI") - taxed at the 21% bracket under present federal tax law, plus state bracket (Florida 5.5%, but state tax is deductible, so effective rate will be approximately 25.345%).

Dividends paid to Foundation are not taxed.

C-CORPORATION (Entity where for profit business is conducted)

Owns and operates an active business and/or actively managed rental properties and may engage in arms length transactions with related parties, although Private Operating Foundation cannot unless it becomes a Public Charity.

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

(PRIVATE OPERATING FOUNDATION)

Private Operating Foundation Rules:

1. Must expend at least 4.25% of its total value each year on active charitable purposes, or construction of charitable facilities that will be used for active charitable purposes.

2. The Private Operating Foundation can be solely managed by the Family Member as Trustee of the Foundation while the corporation can be managed by the Family Member as President, and as the voting stockholder as Trustee of the stock that holds the voting stock trust. The Family Member can receive reasonable compensation from the Foundation for services rendered to the Foundation and from the Company for services rendered to the Company.

3. The Private Operating Foundation does not need to satisfy Public Charity requirements.

4. The Private Operating Foundation cannot lend directly to a disqualified person or related party, but the Corporation would be able to lend money to disqualified persons and related companies at arm's-length and could exchange goods or services with a disqualified person at arm's-length.

5. The Family Member cannot be a beneficiary of more than 35% of the Voting Stock Trust's assets.

6. The Trust is not able to purchase the 99% interest in the Company for a promissory note from the Donor during Donor's lifetime because there would be a self-dealing issue if that promissory note was going to be transferred to the Private Operating Foundation at the Donor's death. After the Donor's death, a note meeting the requirements of the "Administrative Note Exception" (no more than 25-years, interest only) could be given for the non voting stock that is owned by the Donor's revocable trust at the time of the Donor's death.

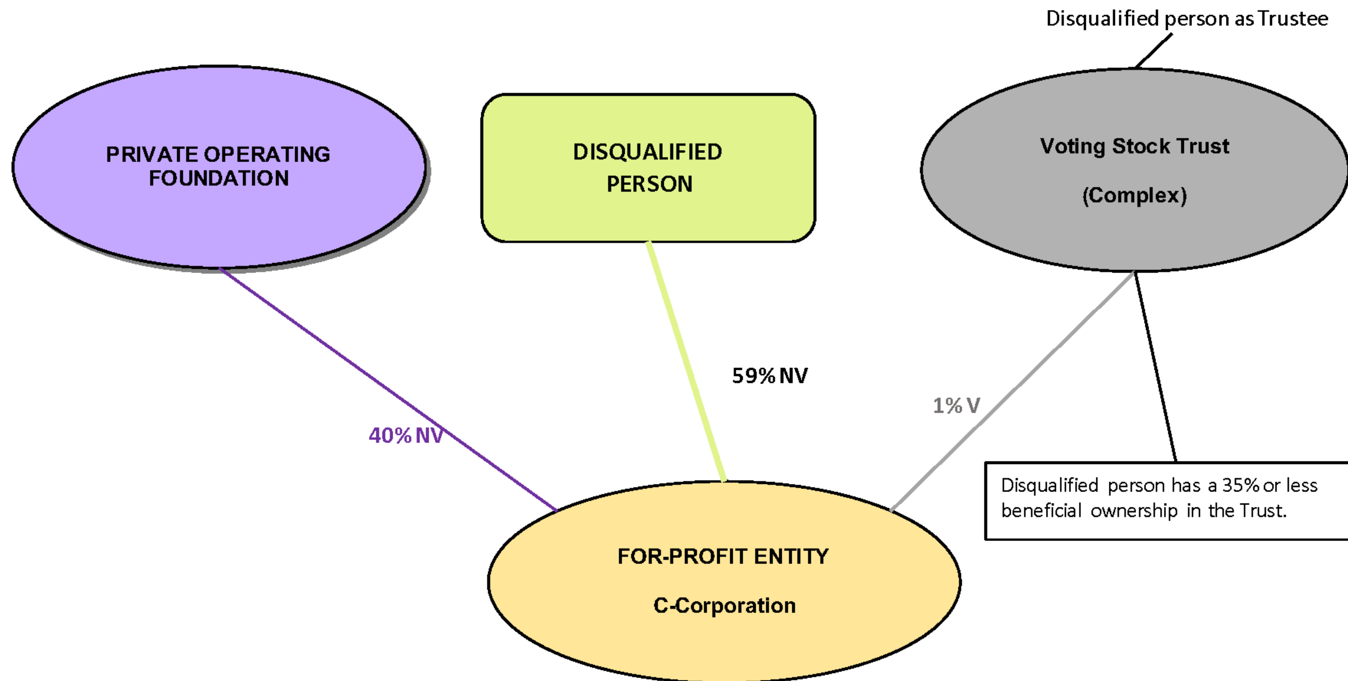
Such note cannot be negotiated or changeable as long as the note owed to the Foundation unless or until the Foundation becomes a Public Charity.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Non-Profit Entity Owning For-Profit Business

Permitted - Disqualified Person Retaining Non-Voting Interests



The above structure should not cause an excess business holdings issue for the POF because the POF will not be deemed to own any of the voting interest that are held by the Voting Stock Trust as the disqualified person has less than a 35% beneficial ownership interest in the Voting Stock Trust. Section 4946(a)(1)(G).

The disqualified person holds a 59% non-voting interest outside of the Voting Stock Trust, which does not lead to an excess business holdings issue because the excess business holdings statute is only concerned with ownership of voting stock. Thus, the disqualified person can continue to own any percentage of the non-voting interest in the company as long as such person controls the voting interest through the use of a non-disqualified Voting Stock Trust.

agassman@gassmanpa.com
Brandon@gassmanpa.com

Copyright © 2020 Gassman, Crotty & Denicolo, P.A.

Senate Estate And Gift Tax Bill

THANK YOU FOR PARTICIPATING!

Presented by:

Alan Gassman
agassman@gassmanpa.com

Brandon Ketron
Brandon@gassmanpa.com

Saturday, April 3rd, 2021
11 to 11:30 AM EDT (30 minutes)

GASSMAN CROTTY & DENICOLO P.A.
ATTORNEYS AT LAW
1245 Court Street, Clearwater, FL 33756