PHILADELPHIA ESTATE PLANNING COUNCIL

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President's Message

J.R. Burke

It's a great honor to serve as your President for the 78th year of the Philadelphia Estate Planning Council.

I have been privileged to have worked on committees and to serve on the board with the last six PEPC presidents, all of whom have led this organization with great wisdom over that time. I want to begin by thanking them for their hard work and dedication to the goals and objectives of the PEPC.

Once again the Council this year has a very strong board and I would like thank in advance all of the committee chairpersons and especially the executive committee:

- Vice President: Scott Isdaner, CPA, JD - Isdaner & Company LLC
- Treasurer: Andrew J. Haas, Esq. - Blank Rome LLP
- Secretary: Eric Hildenbrand, CFA - Coho Partners
- Immediate Past President: Richard M. Schwartz - J.P. Morgan Private Bank

I'd like to take this opportunity to point out the objectives of the Council as stated in our bylaws and to assure all of our members that the board uses these as benchmarks for running the Council and in our leadership decisions:

- To advocate and assist in the spreading of knowledge concerning estate planning and the administration of trusts and estates (i.e., "fiduciary administration") among members of the Council and, if deemed appropriate, from time to time, to others;
- To foster understanding of the proper relationship between the function of the life underwriter, trust officer, attorney, accountant, financial advisor and any other party or parties, having to do with estate planning and fiduciary administration, and to encourage the cooperation of persons acting under those disciplines;
- To support and promote proper ethical standards in dealing with one another, mutual clients, and the public;
- To help the members render the highest type of service to clients and customers; and
- To do any and all of those things that will aid and improve the process of careful and proper estate planning.

I have been a member for over 40 years and as I reflect back over my career and my membership in the PEPC there has been a significant change in the relationships among the various estate planning disciplines. Today there is tremendous cooperation on behalf of our clients, whereas early in my career there was much more of a distance. I know that from the insurance person's perspective there was frequently a feeling that the other advisors were "deal killers". A big part of this change in perspective

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Tax & Financial Strategies for Life's Big Changes

James Revels, CPA, MST, Citrin Cooperman

Estate and financial advisors are typically deemed to be the "trusted advisor" and they are frequently the first person informed of significant personal and financial events during a client's life. It is important that advisors communicate the various significant changes made with the enactment of the Tax Cuts and Jobs Act of 2017 that will certainly have an effect on them personally. The trusted advisor provides consultations and provides recommendations at many different stages of a person's life whether it be moving to another state, the birth of a child or terminal illness to name a few.

Trusted advisors are often confronted with client situations that require proactive and not reactive guidance in a timely fashion. Being able to respond to a client's need is important to maintaining the relationship. There are times that they are informed of a client's life changing event and need to

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UPCOMING EVENTS

LUNCHEON PROGRAMS

The Union League of Philadelphia
140 South Broad Street
Philadelphia, PA 19102
www.unionleague.org

11:45 a.m. – 12 p.m.	Registration
12 – 12:30 p.m.	Luncheon
12:30 – 1:45 p.m.	Program

2018-2019 Luncheon Program Dates
Tuesday, October 16, 2018
Tuesday, November 13, 2018
Tuesday, January 8, 2019
Tuesday, February 19, 2019
Tuesday, March 19, 2019

DROP-IN NETWORKING EVENT

Wednesday, October 24, 2018
5:30 – 7:30 p.m.
Revolution House
200 Market Street
Philadelphia, PA 19106

POWER SPEED NETWORKING EVENT

Tuesday, October 30, 2018
5:30 – 8:00 p.m.
Pyramid Club
1735 Market Street, 52nd Floor
Philadelphia, PA 19103

HOLIDAY CELEBRATION

Tuesday, December 4, 2018
5:30 – 7:30 p.m.
Union Trust
717 Chestnut Street
Philadelphia, PA 19106

ANNUAL MEETING, SEMINAR & RECEPTION

Thursday, May 16, 2019
3:00 – 3:30 p.m. Registration
3:30 – 6:00 p.m. Council Remarks & Program
6:00 – 8:00 p.m. Reception & Venue Access
National Museum of American Jewish History
101 S. Independence Mall East
Philadelphia, PA 19106

ANNUAL GOLF & TENNIS OUTING

Monday, June 24, 2019
12:30 p.m. Golf Tee Time
2:30 p.m. Tennis Round Robin
The Union League Golf Club at Torresdale
3801 Grant Avenue
Philadelphia, PA 19114

Please register at www.philaepc.org.

President's Message continued

is a result of the programs that the PEPC has sponsored but also because of the relationships that have been developed as a result of membership and committee work. All members are welcome to serve on our committees and I can tell you from personal experience that it will enhance your professional growth and will also open up new relationships for you. The council website contains a list of all of the committees and the contact information for the chairs.

The dates of our luncheon meetings and The Annual Meeting are listed in this newsletter. I encourage all of you to attend as many as possible. The luncheon meeting topics will include a perspective on the markets and the future of advice; planning opportunities to consider before year end as a result of the new tax law; what's going on inside the beltway after the mid-term elections; values-based estate planning; philanthropy; and maximizing Social Security benefits. The annual meeting will focus on claims involving estates and trusts that are unique yet growing around the country.

Lastly, I am thrilled to announce that PEPC has been awarded the *Leonard H. Neiman & Walter Lee Davis, Jr. Council of Excellence Award* for the second year in a row in the extra-large council category. This award was created to recognize councils that are successful in their efforts to provide a strong multi-disciplinary council for their members. Created by a group of council leaders, past presidents of NAEPC, and current board and council relations committee members, the Council of Excellence Award is intended to honor those councils that truly work to grow their programs and services and to provide an exceptional member experience.

The award ceremony will take place in Ft. Lauderdale on Tuesday, November 6, 2018, at the NAEPC Annual Advanced Estate Planning Strategies Conference during Council Leadership Day. Scott Isdaner and I will accept the award on behalf of the PEPC.

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be able to provide meaningful support. For example, when it is discovered that a client or someone in the client's family is terminally ill, the emotional impact on those who care for that individual cannot be overstated.

Financial details should not be overlooked and astute planning can help everyone emotionally and financially.

Moving to Another State

Relocating to a new state requires a person to make a number of financial-related changes. Some of these changes are setting up new accounts with banks and brokerage firms or at least changing the mailing address. Various forms of new insurance policies will need to be reviewed and put into place. Existing life insurance policies will need to be updated.

Health care is sometimes never even considered. A person needs to be reminded to determine if their health care policy provides coverage in the new state of residency. Advisors should suggest that before the move occurs that steps be taken to maintain coverage (e.g., complete a new application form) or possibly change coverage. Someone with employer coverage likely is automatically covered in the new state, but they should be reminded to check with the plan administrator.

Medicare Considerations - Medicare-age individuals need to consider the type of coverage they choose. For example, the Medicare Advantage plan costs are lower when seeing doctors who are in network, this is beneficial for a person who lives in one place. Comparatively, Original Medicare is typically more beneficial for someone with multiple residences since the coverage applies in all states. Advisors that are aware a client who is relocating with a Medicare Advantage plan or Medicare Part D should inform them that there is a special enrollment period (SEP) to change plans.

Legal Issues - When a person moves to another state, all of the personal documents, including wills, trusts, powers of attorney, and health care directives and appointments, must be reviewed, changed and executed. Obviously, most advisors realize that typically wills executed in one state may not be valid in a new state of residence. In addition, many states have different laws that will necessitate the creation of new legal documents. Typically, this task is forgotten about or just pushed off until a later date which from time to time is too late. Another reason advisors should explain why these documents should be executed sooner rather than later is because the probate process in some states is more onerous than in others. This may require the use of living trusts to avoid probate and some states impose a death or inheritance tax which makes planning even more important. When a client already knows the state and city they will be moving to an advisor can make an introduction to advisors before they move to get the process started before the actual physical move occurs. This could be especially important if the clients are elderly and their mental capacity maybe declining.

Many people do not understand the significant differences in community property states - Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington (and Alaska for couples who opt in to treat their assets as

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community) - are states that could require significant new planning as a client moves into one of these aforementioned states. On a day-to-day basis, community property laws are invisible. However, in the events of divorce, death, and taxes, there are big differences in the results to spouses. One consideration for spouses who keep their assets separate is to consider post-nuptial agreements designed to nullify community property laws. In addition to the extent pre-nuptial agreements exist, they should be reviewed.

Advisors all have snow birds as clients they live in the North in the late spring, summer and early fall and spend winter in the South. These clients need special attention for their legal documents. The will should be written and executed in the state where the person is domiciled; only the most recent will can be probated (regardless of where it is made). An advisor should consider having durable powers of attorney drafted in each of the states that the client resides in during a typical year. They should consider an attorney in each state, or one who is licensed in all the states that the client resides.

Birth of a Child

Planning for a new child in the family can be not only stressful but expensive. According to the U.S. Department of Agriculture's latest figures, it costs $233,610 to raise a child through age 17. There are many types of advice that should be given to expecting or new parents that typically may not be on the clients mind. Realistically they are looking at many things and the following items are potentially low on the priority list.

Certain tax credits may now be available. A qualifying child is a person under the age of 17 by the end of the year who is a U.S. Citizen, national, or resident alien that did not provide more than half of his/her support and lived with the taxpayer for more than half a year. Advice should be given that they may want to revise wage withholding and/or estimated taxes as they may be able to benefit from the child tax credit now that the dependency exemption has been eliminated. In addition, if both spouses are working they may be able to benefit from the dependent care credit, which can have a direct impact on their paychecks if they opt to be part of an employer plan.

Now more so than ever saving for education needs to be one of the top items advisors provide guidance on. The sooner (rather than later) parents begin to invest in their child's education the better.

According to *U.S. News,* the average tuition and fees for 2017-2018 are:

$34,699 at private schools

$21,632 at public schools for out-of-state students

$9,528 for public in-state students.

These amounts do not include room and board, books, transportation, and other costs of attendance.

One of the best ways parents can begin saving for education is with the use of education savings plans – 529 Plans. These plans come with many flexible benefits that many people are not aware of. Unused amounts in an account can be transferred tax free to another beneficiary. Many states allow for an income tax deduction or credit to residents on certain amounts of contributions, regardless of the parents gross income. Multiple 529 accounts can be maintained for a beneficiary, therefore allowing for further diversification of investment options. In addition, parents may set up one plan and the grandparents may set up another. One item to note to add potential future flexibility is to have dual parent approval on all forms for disbursement. This way if one parent is not able to make a distribution to an educational institution, the other has the capability to act on their behalf.

There are many important document changes that should be made soon after the birth of a child. Some of those changes include making beneficiary changes on life insurance policies and trusts, annuity contracts, retirement plans, and/or IRAs. Typically if this is the first child, it may require the creation or revision of wills and other estate planning documents. This is also the time that parents may want to name a guardian and a successor guardian for the child. Consider providing guidance to have two guardians, one to care for the child and another to handle financial matters.

Planning for the Terminally Ill

Clients that are going through serious medical issues may not be focused on asking certain questions that may help them since they are focused on taking care of themselves or a loved one who is terminally ill. Advisors should reach out to the client's spouse, children, or other close parties to ask the difficult questions and offer practical suggestions. Planning during terminal illness falls into two different categories. One is maximizing current cash flow, to cover the medical expenses and the second is estate planning, which becomes even more urgent when death is imminent. Advisors tend to shy away from clients when they are going through difficult times mainly because they think that the client wants to be left alone to deal with their situation. This is typically not the case, this is the time they want their trusted advisor to step in and help.

It is important to inquire if there is adequate cash flow. It can make a difference if the terminally ill person was still in the work force. Group disability

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benefits may be available from an employer, and worker's compensation payouts might be possible. Social Security disability benefits also could be a source of needed income. Personally owned disability insurance, instead of or as a supplement to group coverage, may be another resource that is available for needed cash flow.

Advice may be needed as to the taxation of disability benefits as they may or may not be considered taxable income. Disability insurance premiums that were paid with after-tax dollars are tax-free when distributions are made. However, if the employer pays the premiums for the disability insurance, the distributions will be taxable income. For example, disability insurance premiums paid under Section 125 employer health plans will result in taxable income if the benefit is ever needed. It is vital to know how the premiums have been paid.

When there is a cash flow issue, it is important to be able to provide advice on how to obtain alternative sources to fund the cash flow deficit. Retirement accounts usually may be used, which will in most situations trigger additional tax, but that may not be an issue for people who otherwise are short of cash flow.

Another resource for additional cash flow can be found in life insurance policies. Some life insurance policies are structured so that the death benefit can be partially paid out to the insured individual, if certain health-related tests are passed. Typically, to receive an "accelerated death benefit," the policy will include a rider offering a lifetime payout if the insured individual has a life expectancy of less than 24 months, as certified by his or her physician. The life insurance policy could be surrendered for its cash value or money may be available to be withdrawn or the policy may allow a person to borrow against the policy. Some policies have a "disability waiver of premium" provision that allows the policy to remain in force if the insured individual becomes disabled. Policyholders may want to take into consideration that while they may be able to withdraw money from or borrow against permanent life insurance, tax-free, any excess policy loans or withdrawals could generate a tax obligation after a policy lapses.

Individuals and investor groups may offer to buy it, and pay the required premiums. This will provide more money to the seller than the other alternatives. Some life insurance policy sales are known as viatical settlements. (Viaticum, in Latin, refers to the provisions furnished to a Roman official going on a journey). Selling an insurance policy on one's own life involves more than cash flow and taxes. The seller must be comfortable that unknown investors will collect a benefit at his or her death. Viatical arrangements usually take place when the seller has less than two years to live. Typically, funds received from a viatical settlement are not subject to federal income tax. People who are chronically rather than terminally ill can avoid tax on these transactions if the money received is used to pay for qualified long-term care. In order for the proceeds to be tax-free, the buyer generally must be a licensed or registered viatical settlement company.

Sales of life insurance policies that do not qualify as viatical settlements are known as life settlements which may generate a tax obligation. For example: a life insurance policy is sold for $500,000 of which $200,000 of premiums were contributed and the cash value of the policy is $325,000. Under this scenario, this sale will result in a gain of $300,000 which will be part ordinary and part capital gain. The $125,000 gap between the premiums paid ($200,000) and the policy's cash value $325,000 will be subject to taxations as ordinary income. The remaining $175,000 of gain would be taxed as a long-term gain. In addition, the 3.8% surtax on net investment income also may apply. This outcome is a result of the Tax Cuts and Jobs Act of 2017 reversing Revenue Ruling 2009-13.

Purchasers of life insurance policies typically want to know the seller's life expectancy, as indicated on medical reports, which are usually required to be submitted. Buyers usually prefer policies held by people who are age 75 or older. People who are below this age will need to show a severe medical condition exists in order for them to be able to sell their insurance policy. Cash value policies (whole life, universal life, and variable life) generally are preferred by buyers. Term life policies may be acceptable if they're convertible to some form of cash value policy.

Advisors should emphasize a thorough estate plan review as this can help to put the terminally ill person and the family's mind at ease. The new exemption of $11,180,000 means relatively few people will leave an estate that is subject to federal estate tax. Consequently, people who are terminally ill, below those asset levels, may ignore estate planning. Nearly half of all states impose estate or inheritance taxes which means that planning is still necessary. Without appropriate estate planning, assets might wind up in the wrong hands, after death, and there could be unnecessary costs as well as delays in wealth transfer.

Advisors should communicate that a comprehensive estate plan consists of more than a will. Assets as joint tenants with right of survivorship (JTWROS), those assets will pass directly to the surviving co-owner after the first death. In some situations, there are good reasons to title property as JTWROS. Assets held in this manner will go to a surviving

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co-owner without going through probate. Avoiding probate can save time and money. Assets such as IRAs, employer retirement plans, and life insurance policies often will not go to the heirs under a decedent's will and will generally pass under a beneficiary designation. Assets held in trust may pass under the terms of the trust, without going through probate. Moving assets into a trust, not only can avoid probate but, this tactic might reduce the threat of a will being contested.

Very often critical thoughts are left silent as it is very unlikely that anyone will be able to cover everything in a will or transfer everything to a trust. Where can valuable papers be found? Who will care for a beloved pet? A terminally ill individual might create a letter of instruction to supplement other estate planning documents. Financial details can be described: savings and investment accounts, location of real estate deeds and life insurance policies, contact information for accountants and attorneys and other advisors, etc. The letter can also include computer user names, passwords, PIN numbers and other information necessary for access to electronic records. A letter of instruction also can supplement a will by providing details about how the terminally ill person would like personal possessions to be distributed. This letter might specify that a valued watch will go to grandson, a particular bracelet to granddaughter, and so on. Generally, the terms of a letter of instruction are not legally binding. The letter is more of a roadmap to help survivors locate and distribute assets based on the deceased wishes.

These are only three of the life events where advisors can make a significant impact in the planning process of a client. As mentioned these are only a few of the life changing events that a person goes through and there are many others that advisors need to be able to help provide advice, support and recommendations as a client continues through their family life cycle.

James A.J. Revels, co-practice leader of Citrin Cooperman's Trust and Estate Group, is a tax partner with more than 25 years of experience in the areas of income tax, trust, gift, and estate planning. He advises a broad range of clients including high net worth individuals, executives, entrepreneurs, owners of closely held entities, foreign individuals, early stage corporations, foreign corporations, bio-tech companies and not-for-profit organizations.

New Partnership Audit Rules Require Attention

Michael Hirschfeld and Thomas R. McDonnell, Andersen Tax

In response to concerns by the IRS about properly auditing partnerships and collecting any resulting tax deficiency from the partners, the administrative procedures for auditing partnerships were totally revamped by the enactment of the Bipartisan Budget Act ("BBA") in 2015. The most dramatic change made was that the IRS will now be able to collect any unpaid tax directly from the partnership rather than having to pursue each partner. These changes first apply to audits of 2018 and later partnership tax returns. The previous audit rules first adopted in 1982 under the Tax Equity and Financial Responsibility Act ("TEFRA") remain in existence for audits of pre-2018 taxable years.[1] As a result, partnerships have to cope with two possible audit procedures based on the year to which the audit relates.

Since the TEFRA rules still survive for audits of pre-2018 years, a brief overview of what they require is worth noting. Under TEFRA, the IRS was first able to audit a partnership and determine a tax deficiency at the partnership level rather than having to separately audit each partner. However, once a final audit determination was made, the IRS had to pursue each partner for the collection of tax due, which is an exhausting task that sometimes led to an IRS decision to not audit in the first case. TEFRA also required a partnership to appoint a tax matters partner ("TMP") to deal with the IRS on audit matters. The TMP had to be a partner and TEFRA imposed on the TMP certain responsibilities in keeping the partners informed of the audit and possible settlement. Partnerships having 10 or fewer partners who were all natural persons (or meet certain other criteria) were exempt from TEFRA unless they elected to apply its rules, which very few ever did.

The new BBA streamlined partnership audit rules create a single set of audit rules for all partnerships, but they do allow certain partnerships with 100 or fewer partners to elect out. As noted earlier, any audit adjustments would be taken into account by the partnership (and not each partner), and the partnership would then pay any tax that is then due in the adjustment year, which is the year the audit is completed or, if later, the expiration of any judicial review.

The Unlimited Power of the Partnership Representative

Under the new procedure, the partnership audit will be handled by a newly-created person called the Partnership Representative ("PR"). The Partnership Representative replaces the TMP, but

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only for audits of 2018 and later years. As a result, every partnership needs to have both a TMP and a Partnership Representative who has much more power than the TMP ever did. The Partnership Representative is the sole person representing the partnership before the IRS. The partners have no statutory rights to participate in the audit process or even get notice of the audit. Partners desiring to get notice of or be involved in an audit need to have the partnership agreement or other governing document mandate such involvement because the Internal Revenue Code offers them no assistance.

While the TMP had to be a partner, the Partnership Representative can be any person provided such person has a "substantial presence" in the US. The substantial presence test is imposed to make sure the IRS can easily contact the representative to talk about audit issues. The IRS does not want to chase someone based in London, Shanghai or elsewhere. In order to have a "substantial presence" in the US the Representative must 1) be able to meet an IRS agent in the country at a reasonable time and place by the IRS' discretion; 2) the Representative must have a US street address and phone number with an American area code and 3) the Representative must have a US taxpayer identification number.[2]

Despite concerns based on early IRS guidance, final IRS regulations clarified that the Partnership Representative can be either the partnership itself or a disregarded entity ("DRE") for tax purposes. Choosing the partnership as the Partnership Representative may be a good option for partnerships that are not sure who to pick. A DRE is commonly used and includes a single member Delaware or other US limited liability company. DRE status ignores the LLC as being any form of taxable entity. Rather, the tax law "looks through" the DRE and treats the single member as owning everything the DRE owns and receiving all the income it gets.

Final IRS regulations clarify that if the partnership or any business entity is appointed as the Partnership Representative, then that entity must also appoint a designated individual to represent it before the IRS. The IRS wants to know exactly who it can deal with on the audit. The IRS will deal with that individual alone and no one else on all audit matters. Thus, the selection of the Partnership Representative and that individual are extremely important.

The designation of the Partnership Representative and the individual will first be made on the annual partnership tax return filed on Form 1065 for the 2018 taxable year, which is due for filing on or before March 15, 2019 (unless a request for extending filing of the return is made). While that filing date may seem far off into the future, the partnership should not delay in selecting a Partnership Representative. That choice may be made more difficult due to concerns of Partnership Representatives about possible liability exposure they may incur if they become a Partnership Representative. As noted above, the Partnership Representative has sole authority to settle the audit and then have the partnership pay any resulting assessment. America is a very litigious society, and the Partnership Representative may be concerned about being sued by an aggrieved partner. Partnerships should be agreeable to a request for indemnification relating to claims of negligence, which a court may easily find. However, partnerships may want to draw the line and not agree to indemnify if gross negligence is found to have occurred.

Partnerships may also want to contractually obligate the Partnership Representative to inform the partners of the commencement of an audit and any material developments. Partnerships may also want to contractually require the Partnership Representative to consult with the partners or seek approval of the partners before settling any audit. However, the Code and applicable guidance are both clear that a failure of the Partnership Representative to follow such procedures is totally irrelevant to the settlement or any action taken by the Partnership Representative. Simply put, an IRS agent does not want to hear and will not give any favorable reaction to a Partnership Representative who asks for more time to consult with the partners or get their approval.

Compared to the early IRS guidance, final regulations allow for greater flexibility in changing the Partnership Representative or allowing such person to resign. Final regulations allow the partnership to change the Partnership Representative when the IRS notifies the partnership that its return has been selected for audit. The partnership may also change the Partnership Representative when the IRS mails it a notice of an administrative proceeding. By contrast, proposed regulations only allowed for a change when the partnership actually received a notice of an administrative proceeding.

The final regulations also eliminated the power of the resigning Partnership Representative or designated individual acting on its behalf to designate a successor. Partnerships have the ability to revoke a PR, but only if they are able to designate a replacement immediately. Revocation procedures require that a person who was a partner at any time during the partnership taxable year to which the revocation relates or as provided in forms, instructions and other guidance prescribed by the IRS,

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must sign the revocation.[3] Under certain circumstances, the IRS may determine that the designation of a Partnership Representative is not in effect.[4] In that case, the IRS will notify the partnership that the designated PR is not in effect.[5] If all else fails and the partnership fails to designate a Partnership Representative, the IRS has the power to appoint a Partnership Representative.[6] Every partnership should not leave itself in that uncomfortable position and should appoint a Partnership Representative.

Options on Collection of Tax Due

After the IRS concludes the audit, the IRS will issue a final partnership adjustment ("FPA") that reports the required adjustments (for example, added taxable income or loss of tax deductions). There are three different methods for how taxes owed as a result of the adjustments will be determined and collected.

The first payment method is a basic default rule that provides that the partnership, and not the partners, pays the tax in the adjustment year. The IRS will determine the tax due, first by netting all adjustments made in the audit and, next, by determining the imputed underpayment of tax on the resulting net income by multiplying the net income by the highest tax rate in effect for any type of partner (that is, corporate or individual) for the reviewed year. If the audit served to reallocate an item among the partners (for example, a loss allocated to one partner is reallocated to another partner), these rules take a harsh approach by providing that the imputed underpayment should disregard decreases in income or gain and increases in deductions, losses, or credits.[7]

This imputed underpayment is often different from the total tax due if tax liability was determined at the partner level because the imputed underpayment assumes a maximum rate of tax and ignores the specific tax status of each partner. This difference may be material and may work to the detriment of the partners. To alleviate this problem, the partnership can file a request with the IRS within 270 days of the issuance of the FPA, to lower the imputed underpayment by showing that a lower tax rate applies to certain partners (for example, individuals get favorable treatment for long-term capital gains).[8] If applicable, the partnership may also request lowering the imputed underpayment by showing that a partner may not owe any tax because of its status as a tax-exempt entity.[9] Despite these adjustments, the imputed underpayment may overstate the tax that would have been due if the tax burden were determined at the level of each partner.

The second payment method allows the partnership to "push out" the tax liability arising from the FPA to the reviewed year partners (that is, the partners affected by the earlier tax return filed by the partnership, and not the current partners).[10] This option must be chosen by the partnership within 45 days after issuance of the FPA. In this case, the partnership will issue adjusted information returns on Form K-1s to those reviewed year partners, but the K-1 will be issued for the year in which the "adjustment" is made. That K-1 is then subject to a simplified amended return process rather than a more cumbersome process that would apply if an amended K-1 were issued for the earlier year. Although the adjusted K-1 may be for the current year, interest and penalties are due as if the tax were owed from the prior year.[11] Such partner then must pay interest on the tax owed at a higher interest rate, which is 5% above the IRS-published short-term applicable federal rate (AFR), rather than the normal 3% above such AFR amount.[12]

The third payment method modifies the basic default rule if (1) any partner from the reviewed year chooses within 270 days after issuance of the FPA to file an amended income tax return for the reviewed year that takes into account the partner's allocable share of the partnership adjustments[13] and (2) that partner pays the additional tax due. If this method is chosen, the imputed tax underpayment owed by the partnership is reduced to take into account that partner's share of that income.[14] If every partner for the reviewed year files an amended return and pays the additional tax, the partnership will have no liability for unpaid tax.

If the partnership does not agree with the FPA, then the partnership representative can contest the FPA in court. The petition must be filed by the partnership representative within 90 days of the FPA. Although TEFRA allowed the TMP an additional 60-day period to file, no such extension exists under the new audit procedure.

Election out of New Audit Rules

Partnerships with 100 or fewer partners may be able to elect out of the new rules.[15] If it does opt out, it must provide its partners with written notice within 30 days of making the decision. The ability to elect out is available only if each of the partners is (1) an individual, (2) a C corporation (that is, a US corporation subject to corporate level tax), (3) an S corporation (that is, a US corporation meeting certain requirements that can result in the corporation generally not being subject to corporate tax, in which case its shareholders currently pay tax on their share of the S corporation's income), (4) the estate of a deceased partner, or (5) a foreign entity that would be a C corporation if it was a US corporation.[16] The reference to individuals is not limited to US citizens or resident alien individuals;

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however, if a non-US individual is a partner, then partnership withholding on effectively connected income or income from the sale of US real estate would still apply. As a result, the partnership may be liable for any unpaid tax allocable to any foreign partner.[17] If a partner is an S corporation, then each of its shareholders is counted for purposes of applying the 100-partner limitation.[18]

If a partner is itself a partnership, then that partner is not an eligible partner. Treasury does have regulatory authority with respect to allowing a partnership to be an eligible partner but has not indicated that it has any intention of doing so (such as for a tiered partnership discussed below).[19]

An important requirement to elect out of the new audit rules is that the election must be made on the partnership's timely filed Form 1065.[20] The election out cannot be delayed until an audit starts.

Concerns for New Partners

If the current partners are the same as those that were partners in the earlier (audited) year and there has been no admission of new partners or change in the partnership agreement since the audited year, then the tax burden resulting from the audit will generally fall on the partners whose income is being adjusted in the audit, regardless of when payment may be due. However, if a new partner is admitted to a partnership or an existing partner sells their interest to a new partner and there is an audit for a taxable year prior to the new partner's admission to the partnership ("pre-admission year") that results in an assessment, then the new partner would bear the burden of paying part of any tax assessment for the pre-admission year if the partnership pays the assessment.

A new partner needs to assess the potential tax exposure for prior years, and any new partner may desire to seek indemnification for any past due tax from either the person who sold him the partnership interest or the partnership itself if he bought the partnership interest from the partnership. In addition, the new partner may request that if there is any tax assessment for a pre-admission year, then the partnership would make the "push-out" election discussed earlier, which will impose the burden to pay the tax on the partners for the pre-admission year.

Tiered Partnerships

A tiered partnership is a structure in which one or more partners in a partnership (the "upper-tier partnership") are partners in another partnership (the "lower-tier partnership"). Although a tiered partnership may evoke images of complex partnership structures, many partnerships whose business operations are not complex can have some partners who are partnerships and thus are tiered partnerships. A tiered partnership involved in a partnership audit can greatly complicate the audit process and has frustrated the IRS's ability to audit these tiered partnerships.

The new audit rules shift many of the complexities in dealing with these tiered partnership audits from the IRS to the affected partnership, which must pay the tax owed once an audit is complete. Even if a lower-tier partnership has fewer than 100 partners, the election-out option discussed earlier is not an option for a lower-tier partnership because a partnership is not an eligible partner [Treasury has the authority to offer relief for tiered partnerships, but has neither exercised that authority or indicated that relief may be forthcoming].[21]

Conclusion

The new partnership audit rules will usher in a period of greater scrutiny of partnerships and may increase the number of partnership audits. Given the enhanced power of the Partnership Representative in handling tax audits, care must be taken in the choice of a Partnership Representative and a designated individual to represent entities that serve in that capacity. Partnerships must also consider electing out of these new rules if they qualify, or if not, consider "pushing out" any assessments to reviewed year partners, which reduces the financial burden on the partnership and assures that the appropriate partner's bear that expense. Lastly, the prior TEFRA rules still survive for audits of pre-2018 years. As a result, partnerships must keep track of two possible audit regimes and retain their TMPs.

Notes:

1 When TEFRA was enacted in 1982, there were far fewer businesses operating in partnership form and, generally, tiered partnership structures did not exist. The hedge fund and private equity industry was far smaller in scale than what it has grown to today. Moreover, LLCs were rarely used since they were then generally classified as corporations under the former entity classification regulations, which did not allow flexibility in entity characterization. By contrast, the later adopted entity classification "check the box" regulations allow taxpayers to generally treat the entity as a corporation, partnership or to disregard the existence of the entity for income tax purposes, which led to an explosion in use of LLCs characterized as partnerships for tax purposes. Between the increasing use of LLCs and the adoption of the entity "check-the-box" regulations, it became extremely difficult for the IRS to administer the rules under TEFRA from a practical standpoint.

2 Reg. §301.6223-1(b)(2). Proposed regulations with respect to the rules for Partnership Representatives were finalized by Treasury on August 9, 2018.

3 Reg. §301.6223-1(e)(4).

4 Reg. §301.6223-1(f)(2)

5 Reg. §301.6223-1(f)(1).

6 Ibid.

7 Code §6225(b)(2). All Code references are to the

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Internal Revenue Code of 1986, as amended.

8 Code §6225(c)(4)(a)(ii).

9 IRC §6225(c)(3).

10 Code §6226(b).

11 Code §6226(c).

12 Code §6226(c)(2)(c).

13 Code §6225(c)(7)

14 Code §6225(c)(4)(B)(i).

15 Code §6221(b).

16 Code §6221(b)(1)(C).

17 Code §§1445, 1446.

18 IRC § 6221(b)(2)(A).

19 Code §6221(b)(2)(C).

20 Code §6221(b)(1)(D)(i).

21 Code §6221(b).

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Is There a Salve for the SALT that was Rubbed into Our Wounds?

Joel Luber

Effective 2018, individual and married taxpayers filing jointly may deduct only up to $10,000 for their combined state and local (i) real and personal property taxes, and (ii) income taxes or sales taxes (herein together called "SALT"). For married taxpayers filing separately, each taxpayer is limited to a $5,000 deduction. The $10,000 limit is not indexed for inflation. Absent a cataclysmic change in the body politic, we will awake from this nightmare on January 1, 2026. Coupled with this change, and closely related thereto, is the increase in the standard deduction from $12,700 to $24,000 for married taxpayers filing jointly, making moot for many taxpayers the issue of itemized deductions. This, too, carries with it the same limited window of applicability expiring on December 31, 2025. See, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (the "2017 Tax Act" or "Act"), Pub. L. No. 115-97, § 11042, 131 Stat. 2054 (2017) (H.R. 1).

The two questions for planners like us are: (i) is there one or more viable strategies that can be implemented to circumvent this limitation and (ii) is the effort, both in terms of cost and complexity, worth the tax savings that could be derived from any such strategy? In the nine months since enactment of the Act (as of this writing), any number of commentators have begun to publish ideas on such planning. This article is an attempt to shed some more light on those ideas.

Basic Structure of Plan. The structure most often appearing in tax journals and other publications reporting on such matters involves some combination of (i) a limited liability company ("LLC"); (ii) multiple non-grantor trusts, with either an incomplete transfer ("INGs") or a completed transfer of assets; and/or (iii) a spousal limited access trust ("SLAT")(the latter, together with a non-grantor trust, being called a "SALTy SLAT"). How it works is as follows: A personal residence, whether primary or a secondary/vacation residence, with an annual property tax well in excess of $10,000 is transferred to an LLC. The client makes a gift of the LLC membership interests into separate non-grantor trusts. The LLC and trusts do not have to be created in the same jurisdiction, but preferably in one that has no state income tax. There are currently eight states with no state income tax.[1] An investment portfolio, or a business interest, generating enough income to offset that member's share of the property tax deduction is also gifted to the trusts. Each trust should qualify for its own $10,000 property tax deduction.[2] The entire property tax is deductible, and there is no loss of the tax deduction arising from the annual SALT cap of $10,000. Mission accomplished.

First hurdle: IRC Section 643(f). This section states as follows: "For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if— (1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter. For purposes of the preceding sentence, a husband and wife shall be treated as 1 person."

Obviously, if all of the separate trusts created under this plan design are treated as one trust, the plan fails. But, quick to point out by some commentators (prior to August 8, 2018 – See *Postscript* below), no regulations have ever been issued by Treasury since §643(f) was enacted in 1984. Ergo, the provision should have no enforcement power. I have yet to see any real authority for that proposition, although two commentators have cited the same recent Tax Court case for same.[3] However, upon my own review of that case, it is clear that there was no such holding. To the contrary, I would proffer that the rule set forth in *Estate of Neumann v. Commissioner*, 106 T.C. 216 (1996) is the better authority.[4]

Also relevant, I suggest, is the legislative history of the statute, which states that §643(f) was the result of congressional decision to overrule a case that had

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invalidated earlier Treasury regulations on the subject.[5] That regulation was intended to reverse a defeat sustained by the IRS in *Estelle Morris Trusts v. Comm*[6], which held against a background of silence in the Code and Regs that 20 separate trusts created by 10 virtually identical instruments should be treated as separate taxpayers. Almost immediately that Regulation was attacked in *Stephenson Trust v. Comm.*[7], and the Tax Court invalidated it, stating, in part, that it added restrictions not contained in the statute nor contemplated by Congress. Section 643(f) was designed to overrule *Stephenson*. The legislative history indicates that Congress wanted Treasury to issue new regulations, somewhat different from those held invalid under *Stephenson*. The committee reports include two examples that illustrate the congressional intent. There also exists a number of private letter rulings that have addressed §643(f), one that concluded multiple charitable lead trusts created under one instrument would not be consolidated under §643(f)[8]; and another where multiple trusts were created to settle intrafamily litigation, with the Service ruling, in part, that §643(f) would not apply because a primary purpose was not the avoidance of income tax within the meaning of §643(f)(2)[9].

Why have I taken off on so long a tangent about §643(f), when others have paid it very short shrift? Because I believe this is a real issue that we cannot avoid discussing with our clients if we are going to be so bold to suggest this type of planning to save income taxes. As the old saying goes, "Do you want to make your client famous?" The good folks at the Service read the same journals as we read. Navigating around the prohibition of "substantially the same primary beneficiary or beneficiaries" ought not to be too difficult. [Think reciprocal SLAT's that are designed not to be reciprocal.] But one may be hard pressed to argue, with a straight face, that one of the purposes for engaging in any derivation of the transaction described herein is not to avoid a tax imposed by Chapter 1 of the Code. So, at best, you may be arguing that it was not "a principal purpose" for doing so, which is different from arguing, and more difficult to sustain, than arguing it was not the only purpose for doing so. Moreover, seeking a private letter ruling will not be a solution to resolve the issue of intent. As was stated in *PLR 200220012*, "Determining whether avoidance of income tax is a primary purpose…is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office of the District Director…"

Second hurdle: Jurisdiction and Plan Design. Assuming we, and our clients, are intrepid enough to turn a blind eye to §643(f), or can create another principal purpose for engaging in this type of planning other than to avoid paying income tax, what do these multiple trusts look like? They come in two flavors: incomplete transfers and completed transfers. In either case, for the most part, each trust will have the following characteristics:

- The trust must be located in a state that does not tax trust income [See Footnote 1].
- The trust cannot be subject to tax in the grantor's state of residence. Many states,[10] Pennsylvania included, label trust "resident trusts", and therefore subject to state taxation, simply by virtue of the grantor being a resident of that state, regardless of where the trust is located. Query, whether such statutes are subject to challenge.[11]
- The trust cannot be a grantor trust [More about eliminating the "strings" below].
- The trust will look to allow for discretionary distributions to the grantor. This is certainly not a requirement, but if desired, it will trigger other design requirements. Distributions to trust beneficiaries (children and other descendants) should also be discretionary, if for no other reason than asset protection.
- The grantor maintains enough control over the transferred assets to avoid making it a completed gift. On the other hand, with the lifetime exemptions doubled under the Act to $11.18M, there may be plenty of gifting capacity left for many clients so as not to be concerned with this. But keep in mind that the new higher exemptions are also scheduled to sunset and return to about $5.6M after 2025. So, this may become a "use it or lose it" proposition to be taken into consideration.

The Grantor Trust Strings.

a. Section 677. What may be a first line of inquiry with our clients is whether they anticipate needing the income that will be generated inside the trusts, or if they are prepared to give it up. If the former, then in order to avoid grantor trust status, each trust agreement must include a provision that the income can only be distributed to, or held and accumulated for future distribution to, the grantor or the grantor's spouse with the approval or consent of an adverse party. IRC §677(a)(2). Thus, one best have a very friendly "adverse party", as defined in §672(a), willing to play along.

b. Section 674. Any power to control the beneficial enjoyment of corpus or income exercisable by the grantor or a non-adverse party, or both, without the approval or consent of an adverse party will cause grantor trust status under §674(a). This power is rarely used in creating an "intentionally defective" grantor trust, because such power also

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results in estate tax inclusion of trust assets under §2036 and/or §2038. So, even in those instances when we are looking for "incomplete transfers" to trigger estate tax inclusion, this is not the provision that should be included in the trust agreement; because you then lose non-grantor trust status for income tax purposes. On the other hand, if the goal is to make a completed transfer, although there are eight exceptions to grantor trust status in §674(b), that is, one or more of these eight powers can be included in the trust agreement without undermining non-grantor trust status, one needs to be careful as to which one may also result in an incomplete transfer, and concomitantly estate tax inclusion.

c. Section 675. The administrative powers in this section of the Code have been the darlings of the grantor trust world of planning for years, because they result in the grantor being treated as the owner of the trust for income tax purposes, facilitating gift tax free additions to a trust by a grantor when he or she pays the income taxes that otherwise would be payable by the trust; yet for the most part, the retention of such powers does not result in estate tax inclusion. The most common of these powers is the "swap" power in §675(4)(C), and the power to borrow from the trust without adequate interest in §675(2), with the "swap" generally being favored because it allows the grantor to recapture appreciated assets inside the trust and subject those assets to inclusion in grantor's estate in order to get a step up in basis at death. So, clients will have to understand that they cannot retain any of these popular powers if they want to create the non-grantor trust required

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for SALT planning purposes.

The Incomplete Transfer Strings.

As suggested above, one can carefully select from the exceptions to §674(b) to create an incomplete transfer, yet maintain non-grantor trust status. But further consideration should be given to Treas. Reg. §25.2511-2 (c), which provides, in part, that a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interest of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. A careful examination of this regulation, as compared to the exceptions in §674(b)(2), (3), and (5), is required. The inclusion in the trust agreement of a testamentary special power of appointment should accomplish both goals of incomplete transfer and non-grantor trust status [(b)(3)].[12] But, for example, the retention of a power to distribute corpus to a beneficiary needs to be, at the same time (i) not a fiduciary power limited by a fixed or ascertainable standard (to accomplish incomplete transfer), and (ii) limited by a reasonably definite standard (to accomplish non-grantor status). Good luck trying to thread that needle.

Third Hurdle: Cost/Benefit Analysis. If a client walks in the door, who is paying $150,000 in property taxes, are you going to suggest he set up fifteen (15) trusts, none of which can have "substantially the same primary beneficiary"? One would need to have an investment portfolio, assuming a 5% annual return, equal to $3,000,000 to cover that much in property taxes, and be prepared to give it away. Other than the ultra-high net worth client (i) this will likely require the incomplete transfer design of trust, and (ii) some access to same by the grantor during his or her lifetime. I won't venture to guess what any attorney will charge to put a plan like this together, other than to suggest a range anywhere between low to mid five figures to north of six figures. Beyond the fees/costs of creating multiple trusts, not to be overlooked are those for creating the LLC, preparing an operating agreement for the LLC, a lease between the grantor and the trusts, annual filing of multiple income tax returns, and retaining separate counsel for the various parties to the plan. Will the tax benefit justify all of these costs?

Example: Client, a resident of Pennsylvania, has an investment portfolio generating a 5% annual return of $325,732, a home with a property tax of $60,000, and is paying federal tax at the highest marginal rate of 37%. The state income tax on the portfolio income at 3.07% is $10,000. Assuming his total itemized deductions exceed the standard deduction of $12,700, this tax will be fully deductible for federal income tax purposes, and reduce his federal tax by $3700 ($10,000 x .37), making the net cost of the state tax $6300. The real estate tax will not be deductible for federal income tax purposes because of the $10,000 SALT limitation, making the net cost of the property tax $60,000. Total net cost of both deductions is $66,300 ($6300 + $60,000). Client has two children and four grandchildren. He is prepared to set up six separate non-grantor trusts (not in Pennsylvania and hopefully not subject to PA tax as a result of the *McNeil v. Commonwealth* decision) for each descendant as the primary beneficiary in order to be able to deduct, for federal income tax purposes, both his state income tax and his property tax. He can choose to move either the entire portfolio or the home, or some combination thereof, to each of the six trusts. Assume he wants to transfer just enough of his portfolio to create $60,000 of income ($10,000 per trust). The total value of the transfer to the trusts will be $1,200,000 of portfolio assets (assuming the 5% annual return) plus the value of the home. Assume further that this will be an incomplete transfer to avoid utilizing any more of Client's exemption amount or paying gift taxes. How much in taxes will Client save?

Client's portfolio income is now $265,732 ($325,732 - $60,000). State income tax on portfolio income at 3.07% is $8158, which is fully deductible. This reduces his federal tax by $3018, making the net cost of the state tax of $5,140. The property tax deduction of $60,000 will now be fully deductible against the portfolio income now inside the trusts, which will reduce federal taxes by $21,000 (assuming each trust's marginal federal tax rate of 35%), making the net cost of the property deduction of $39,000. Total cost of both deductions is $44,140 ($5140 + $39,000). After tax savings with the six trusts are $22,160 per year ($66,300 - $44,140).

Conclusion: Some planning ideas look a whole lot better on paper than they do when time comes to implement them. The economics of the SALT deduction are not particularly impressive on a standalone basis. But there can be meaningful income tax savings when leveraged over multiple trusts that stay in place over the remaining seven-year window under the Act. While the structure described is ostensibly legal, Section 643(f) cannot be ignored. The calculation of savings in the example above is just that – one example. It cannot be considered indicative of the savings in every case. The transaction costs always need to be considered. In short, do the math.

Post Script.

a.States Concocting Their Own Salve. Some states are not sitting around allowing their residents to succumb to this new tax regime. They are taking the

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fight to their state legislatures and to the courts. On July 17, 2018, four states (Connecticut, Maryland, New Jersey, and New York) filed a lawsuit to strike down the cap on SALT deductions under the Act. The case is *State of New York, State of Connecticut, State of Maryland and State of New Jersey v. Steven T. Mnuchin et al* (S.D.N.Y., Civil Action No. 18-cv-6427). The plaintiffs are seeking "declaratory and injunctive relief" to eliminate the cap, citing the Sixteenth Amendment and the Tenth Amendment, arguing that the SALT cap disregards states' rights and the "distinct and inviolable role in our federalist scheme." The complaint also alleges, "as many members of Congress transparently admitted, it deliberately seeks to compel certain states to reduce their public spending." That, the complaint argues, is unconstitutional.

Three states, Connecticut, New York, and Pennsylvania, have enacted legislation, each of which have as its goal, a "workaround" to the new $10,000 SALT deduction. New York has a new optional payroll tax, referred to as the Employer Compensation Expense Tax ("ECET"), and a charitable contribution workaround. The intention of both is to shift the state tax burden from the individual (subject to the cap) to either a charitable deduction or a business entity. Connecticut came up with a new pass-through entity tax ("PTE"), where individual partners and corporate partners are entitled to a credit equal to 93.01% of the pro rata share of the tax paid by the PTE, the intention being to shift the tax burden to the PTE, and converting the tax paid into a business expenses; yet the state receives substantially the same amount of Connecticut tax. And in Pennsylvania, a business entity can make a charitable contribution through the Pennsylvania Educational Improvement Tax Credit Program ("EITC"). While not a new program in this state, the tax benefits may provide individuals with a vehicle to turn a non-deductible tax into a deductible contribution.

b. Proposed Regulations. Between the date this article was first drafted and the date it went to press, Treasury has already issued two sets of proposed regulations that will have to be monitored carefully and taken into account before engaging in the planning ideas discussed in this article, or if one hopes that a new state law may be the salve that cures the sting. The first set, released on August 8, 2018, is the long anticipated proposed regulations for new IRC §199A. But buried at the very end of the 184 pages is new *Section 1.643(f)-1*. Apparently, Treasury felt that the use of "multiple trusts" might be considered by our brethren in circumventing the new §199A rules. So, it included this new "anti-abuse" regulation. And, lo and behold, all of the discussion above as to whether IRC §643(f) can be safely ignored (or not) because of there being no regulations just became academic. This new regulation includes only two paragraphs: (a) and (b), and also includes two examples: one good, and one bad. Paragraph (a) is the "General rule", which is pretty much the statute copied verbatim. However, Paragraph (b), titled "A principal purpose", reads as follows: "A principal purpose for establishing or funding a trust will be presumed if it results in a significant income tax benefit unless there is a significant non-tax (or non-income tax) purpose that could not have been achieved without the creation of these separate trusts." (emphasis added).

The second set of regulations, issued on August 23, 2018, is proposed regulations to counteract the state legislation counteract, with a revision to *Section 1.170A-1*, which deals with charitable contributions. This new regulation provides that a taxpayer who makes payments or transfers property to an entity eligible to receive tax deductible contributions must reduce their charitable deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive.

Query, whether new *Section 1.643(f)-1* just blew out the entire planning ideas described in this article. Maybe not, but at a minimum, it significantly reduced the window of opportunity to do so; as the proposed regulations have no force or effect until finalized, which could be late this year or early next year. In the interim, planners best don their most creative bonnet in documenting the "significant non-tax (or non-income tax) purpose" for the multiple trusts needed to accomplish the workaround of the SALT limitation. Perhaps, we will need to dust off our "legitimate business or non-tax purposes" that we used in the context of defending FLPs in order to satisfy the bona fide sale exception to Section 2036(a). It was not easy, but it was not impossible. [See e.g., *Estate of Stone v. Comm.*, T.C. Memo. 2003-309; *Estate of Kimbell v. U.S.*, 371 F.3d 257 (5th Cir. 2004); and *Estate of Church v. U.S.*, 85 AFTR2d 2000-804 (W.D. Tex. 2000)]. That task in the context of defeating a §643(f) attack on our SALT planning is not likely to be any easier.

Notes:

1 AK, FL, NV, NH, SD, TX, WA, WY

2 The $10,000 limit on deducting state and local taxes under the Act applies to trusts, as made clear in footnote 171 of the Joint Explanatory Statement. There is no standard deduction for a non-grantor trust.

3 SIH Partners LLLP v. Comm. 150 T.C. No. 3 (Jan. 2018)

4 The test laid out by the Tax Court for determining whether the issuance of regulations is a precondition to the application of the statute draws a distinction between regulations that explain "how" the tax is collected and regulations that dictate "whether" the tax is collected. It may

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be open to debate as to whether the regulation referred to in §643(f) deals only with how, and not whether, the tax is to be applied. Count me as one on the "how" side.

5 Treas. Reg. §1.641(a)-0(c).

6 51 TC 20 (1968), aff'd per curiam 427 F.2d 1361 (9th Cir. 1970)

7 81 TC 283 (1983)

8 PLR 200149016

9 PLR 200209008

10 CN, DC, IL, LA, ME, MD, MI, MN, NE, OH, OK, PA, UT, VT, WV and WI

11 In McNeil v. Commonwealth, 67 A.3d 185 (2013), two intervivos trusts were created by a Pennsylvania resident, governed by Delaware law, with sole trustee located in Delaware, none of the trusts' assets located in Pennsylvania, and no income from Pennsylvania sources. However, all of the trusts' discretionary beneficiaries were residents of Pennsylvania. Commonwealth Court found that the Commerce Clause of U.S. Const. art. I, § 8, cl. 3 was violated by the imposition of PIT in the circumstances.

12 But, see, e.g., PLR 201650005 where the Service consistently rules that a testamentary special power of appointment reserved by a grantor acts to make the transfer of principal, only, incomplete for gift tax purpose, but not with respect to the income of the trust .

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Supreme Court Upholds State Statute on Default Beneficiary Designations

Tim Egan

In *Sveen et al. v. Melin*, the Supreme Court upheld the retroactive application of Minnesota's statute on default beneficiary designation in the case of divorce. The case's fact pattern emphasizes the importance of monitoring developments in state law and regularly updating estate planning documents and structures.

Mark Sveen and Kaye Melin, residents of Minnesota, were married in 1997. The following year, Sveen purchased a life insurance policy on himself, naming Melin as the primary beneficiary and designating his children from a prior marriage, Ashley and Antone Sveen, as contingent beneficiaries.

In 2002, Minnesota enacted a statute altering the default rules for beneficiary designations. Minn. Stat. § 524.2–804, subd. 1, provides that "the dissolution or annulment of a marriage revokes any revocable . . . disposition, beneficiary designation, or appointment of property made by an individual to the individual's former spouse in a governing instrument."

Sveen and Melin divorced in 2007, and Sveen died in 2011 having never updated the beneficiary designations on his life insurance policy. The Sveen children and Melin each claimed the proceeds: the Sveens argued that the 2002 statute removed Kaye as beneficiary; while Melin argued that the statute was unconstitutional under the Contracts Clause because it impaired the obligation of an existing contract. The federal district court found in favor of the Sveens; however, the U.S. Court of Appeals for the 8th Circuit overturned and agreed with Melin that the law impaired the obligation of a contract in violation of the Contracts Clause.

The Supreme Court reversed the Court of Appeals in favor of the Sveens, holding that Minnesota's automatic revocation rule does not violate the Contracts Clause. Justice Elena Kagan delivered the opinion, writing for an 8-1 majority (Justice Neil Gorsuch dissented). She noted that while the "Contracts Clause restricts the powers of States to disrupt contractual arrangements . . . not all laws affecting pre-existing contracts violate the Clause."

Kagan applied a two-part test: first, whether the state law is a "substantial impairment of a contractual relationship;" and second, whether the law is "drawn in an 'appropriate' and 'reasonable' way to advance 'a significant and legitimate public purpose.'" The Minnesota statue does not substantially impair the relationship created by the contract, Kagan wrote, for three reasons:

First, while the law does change the beneficiary designated by the policyholder, it does so in order to reflect the policyholder's intent. In the case of a divorce, it's reasonable to assume the policyholder most likely does not want proceeds going to the former spouse.

Second, in divorce proceedings, the policyholder likely assumes that beneficiary designations will be changed. Courts have wide latitude to divide property in divorce proceedings, including life insurance policies.

Lastly, if the policyholder wishes to override the statute, the burden is small. As Kagan says, "he may do so by the simple act of sending a change-of-beneficiary form to his insurer." Because the law does not therefore cause a substantial impairment of a contractual

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relationship, it is not necessary to proceed to the second question (whether the law advances a significant and legitimate public purpose).

In his dissent, Gorsuch disagreed, writing that the statute "substantially impairs life insurance contracts by retroactively revising their key term."

To avoid issues and surprises arising from outdated beneficiary designations, advisors should always ask their clients about major life changes and update governing instruments and designations accordingly.

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September Luncheon Program

Sponsored by:

Claire McCusker (sponsor), J.R. Burke (President), Bill McNabb (speaker) and Ryan Gager (sponsor)

2018 GOLF & TENNIS OUTING

Philadelphia Estate Planning Council held its 22nd Annual Golf and Tennis Outing on Monday, June 25, 2018. Both the golf outing and tennis outing were held at The Union League Golf Club at Torresdale.

Joe and Peggy Robus

Golf Outing Co-Chairs, Kevin Manning, Frank Branca, Jr., and Christopher Borden welcome golfers to the outing.

Doug Simon getting ready to hit the golf course.

John Boxer and J.R. Burke head out onto the course.

2018 tennis outing participants

Erin McQuiggan, Brian Kim, Matthew Holt and and Dustin Covello

Richard Schwartz, Matt Lakofsky, J.R. Burke and John Boxer

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2018 ANNUAL MEETING, SEMINAR & RECEPTION

The 2018 Annual Meeting, Seminar and Reception was held on Thursday, May 3, 2018, at One, formerly known as the Masonic Temple. One is a stunning world-renowned architectural wonder, featuring magnificent rooms based on themes of ancient architecture and sweeping grand staircases. This year's annual meeting featured two presentations by Michael Kitces: "Life and Death Tax Planning for Annuities" and "Safe Withdrawal Rates: Mechanics, Uses and Caveats." Meeting attendees enjoyed a cocktail reception following the program.

President Richard Schwartz passes the gavel to Vice President J.R. Burke.

2017-2018 Board of Directors

2017-2018 Officers: Andrew Haas (Secretary), Richard Schwartz (President), Huldah A. Robertson (Immediate Past President), Scott Isdaner (Treasurer) and J.R. Burke (Vice President)

2018-2019 Officers: Eric Hildenbrand (Secretary), Scott Isdaner (Vice President), J.R. Burke (President), Richard Schwartz (Immediate Past President) and Andrew Haas (Treasurer)

2018 ANNUAL MEETING, SEMINAR & RECEPTION continued

2018-2019 Board of Directors

Annual Meeting speaker, Michael Kitces

2018 Annual Meeting at One

Enjoying the cocktail reception following the program

Andrew Haas and Doug Simon

Domenica Leitner and Hugo Rocha

The Philadelphia Estate Planning Council Thanks Our Annual Meeting Sponsors

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The Philadelphia Estate Planning Council Welcomes New Members

June, August and September 2018

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Catherine Shelley	BNY Mellon Wealth Management
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Dean Walters	The Law Office of Dean A. Walters
Heshan Wanigasekera	J.P. Morgan
Eduard Zolotarev	Morris J. Cohen & Co., P.C.

Mark Your Calendar

Tuesday, October 16, 2018
Topic: "Strategic Planning for Business Owners after 2017 Tax Reform: Insights 10 Months Later"
Speaker: Steven B. Gorin, Thompson Coburn LLP

Sponsored by Heckscher, Teillon, Terrill & Sager

Tuesday, November 13, 2018
Topic: "Now What? A Washington Update from AALU after the 2018 Mid-Term Elections"
Speaker: Chris Morton, The Association for Advanced Life Underwriting

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Tuesday, January 8, 2019
Topic: "Strategic Philanthropy: Lessons Learned and Best Practices for Coherent Family Giving"
Speaker: Bruce DeBoskey, The DeBoskey Group

Sponsored by Glenmede

Tuesday, February 19, 2019
Topic: "Preparing the Next Generation for What's Ahead"
Speaker: Donna Trammell, Bessemer Trust

Sponsored by Bessemer Trust

Tuesday, March 19, 2019
Topic: "Social Security Planning"
Speaker: Kurt Czarnowski, Czarnowski Consulting

Sponsored by The American Association for Cancer Research