Tulsa Estate Planning Forum Annual Meeting

May 17, 2022

Best of the Top 40 In 2022

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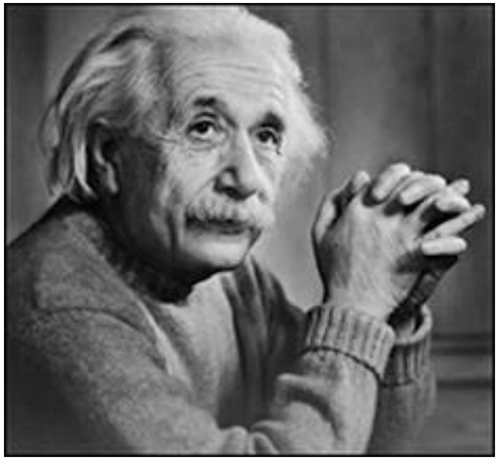
The Top 40 Planning Opportunities

Section 1: Bracket Management Strategies

1. Bracket Management
2. Capital Gain Harvesting
3. Harvesting Capital Losses
4. **Trusts as S Corporation Shareholders: ESBT vs. QSST**



Section 2: Income Smoothing Strategies

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7. **Roth IRA Conversions and IRA Relocation**
8. **Oil & Gas Investments**
9. **Two-Year Installment Sales**
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The Top 40 Planning Opportunities

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The Top 40 Planning Opportunities

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Section 1:

Bracket Management Strategies

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Bracket Management Strategies

1. Bracket Management
2. Capital Gain Harvesting
3. Harvesting Capital Losses
4. **Trusts as S Corporation Shareholders: ESBT vs. QSST**

#4 Trusts as S Corporation Shareholders: ESBT vs. QSST

#4 Trusts as S Corporation Shareholders: ESBT vs. QSST

Overview

- "It's about tax rate management"
- Eligible shareholders for an S Corporation include certain trusts:
  - Grantor trusts
  - IRC Section 678 trusts
  - Qualified subchapter S trusts (QSST)
  - Electing small business trust (ESBT)
  - Certain testamentary trusts
  - Voting trusts
- An ESBT provides greater flexibility while a QSST generally has more favorable tax treatment.

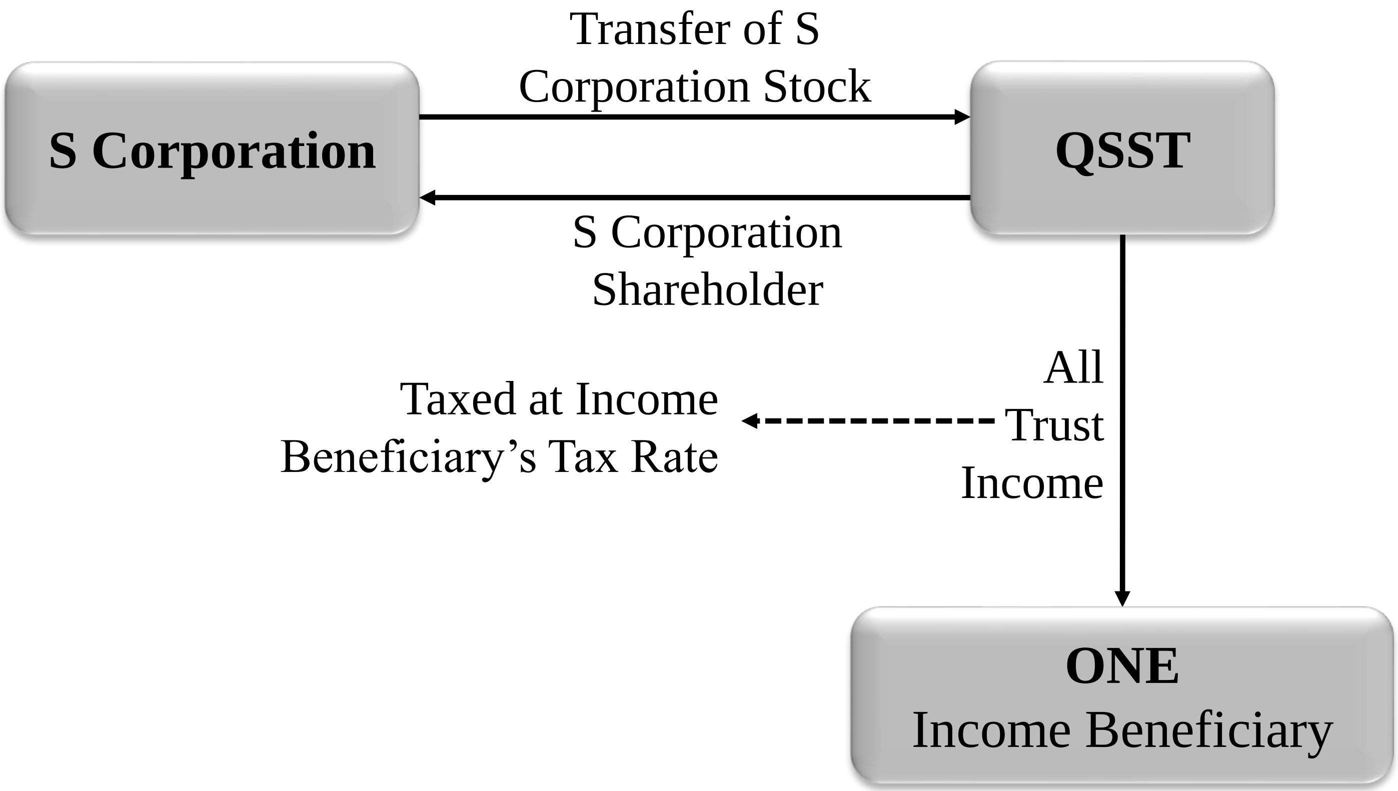
#4 Trusts as S Corporation Shareholders: ESBT vs. QSST

Qualified Subchapter S Trusts (QSST)

- Qualified Subchapter S Trusts (QSST)
  - All trust income must be distributed
  - Trust corpus must be distributed to the income beneficiary
  - Only one current income beneficiary allowed
  - Trust income passes through to the income beneficiary and is taxed at the beneficiary’s tax rate

#4 Trusts as S Corporation Shareholders: ESBT vs. QSST

Qualified Subchapter S Trusts (QSST)



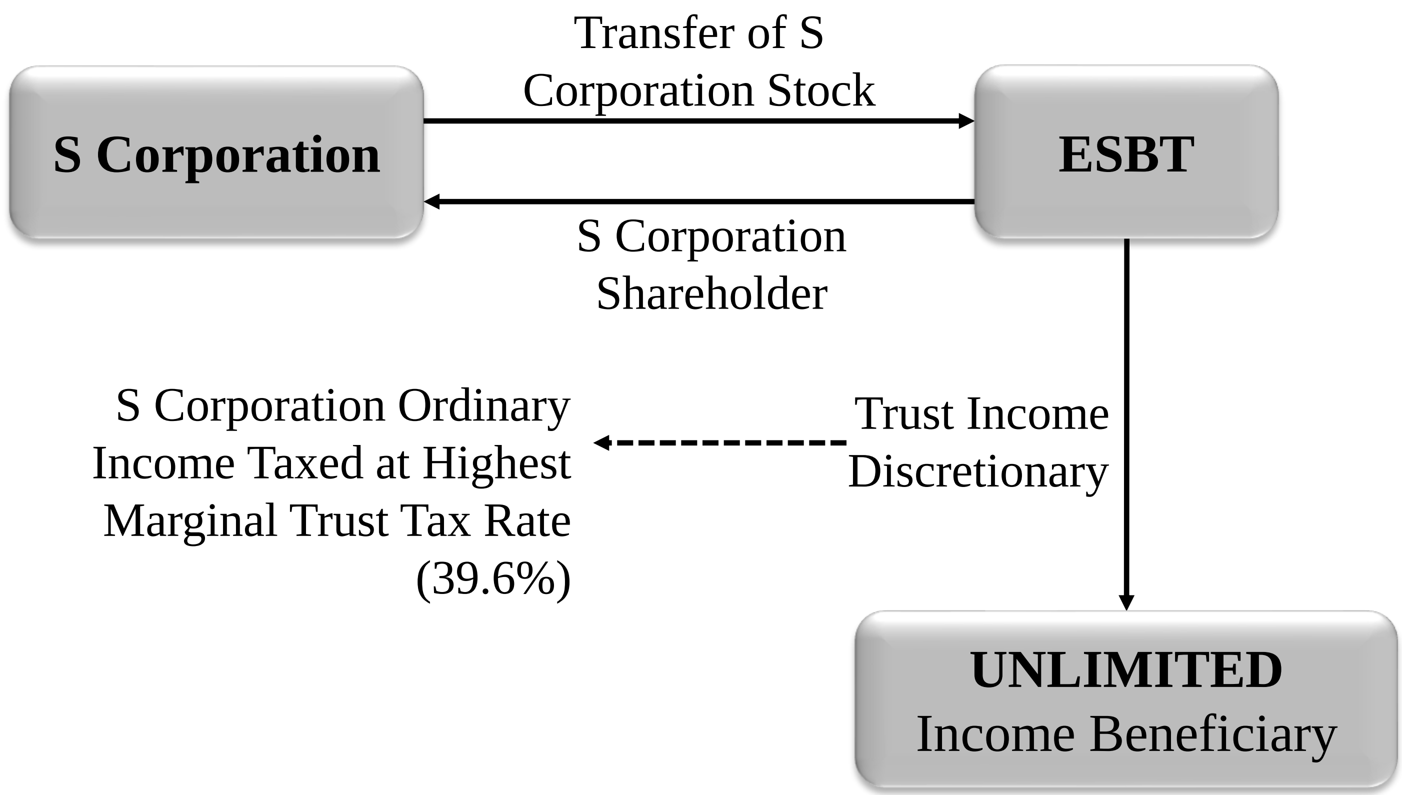
#4 Trusts as S Corporation Shareholders: ESBT vs. QSST

Electing Small Business Trusts (ESBT)

- Electing Small Business Trusts (ESBT)
  - Trust income distributions are discretionary
  - No restriction on trust corpus distributions
  - Unlimited number of current income beneficiaries allowed
  - Trust income is recognized at the trust level and is taxed at a flat rate equal to the highest marginal rate for trusts (37%)
  - See Final Reg. Section 1.1411-3(c) for special rules concerning ESBTs and the NIIT

#4 Trusts as S Corporation Shareholders: ESBT vs. QSST

Election Small Business Trust (ESBT)



Section 2:

Income Smoothing Strategies

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Income Smoothing Strategies

5. **Substantial Sale CRT**
6. Retirement CRT
7. **Roth IRA Conversions and IRA Relocation**
8. **Oil & Gas Investments**
9. **Two-Year Installment Sales**
10. Nonqualified Tax Deferred Annuities and the IRA Annuity Strategy
11. Borrowing From Life Insurance

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#5 Substantial Sale CRT

#5 Substantial Sale CRT

Definition of a Charitable Remainder Trust

- A Charitable Remainder Trust (CRT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is usually paid out to the donor (or some other named beneficiary). At the end of the trust term, the remainder (whatever is left in the trust) is paid to the charity or charities that have been designated in the trust document.

PURPOSE OF STRATEGY (as it relates to the 3.8% NIIT): To harbor "net investment income" in a tax-exempt environment while at the same time leveling income over a longer period of time to keep MAGI below the "threshold amount".

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#5 Substantial Sale CRT

Two Main Types of CRTs

- Charitable Remainder Annuity Trust (CRAT)
  - The beneficiaries receive a stated amount of the initial trust assets each year
    - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)
- Charitable Remainder Unitrust (CRUT)
  - Income beneficiaries receive a stated percentage of the trust's assets each year.
    - The distribution will vary from year to year depending on the investment performance of the trust assets and the amount withdrawn

#5 Substantial Sale CRT

Purposes

- Charitable remainder trusts can be used to reduce or avoid surtax and incremental capital gains tax by smoothing out income

- CRTs are particularly useful when a taxpayer has a large capital gain that pushes income above the applicable threshold amount (ATA)

- Before explaining how the planning works, it will be helpful to look at some background information

#5 Substantial Sale CRT

Taxation

- The donor will NOT realize gain or loss when property is transferred to the trust
- However, the grantor may be required to recognize gain if:
  - Property transferred is subject to indebtedness that exceeds grantor basis
  - Grantor receives property from the trust in exchange for the transfer to the trust.
- The donor will NOT realize gain or loss if and when the transferred assets are subsequently sold by the trustee of the CRT

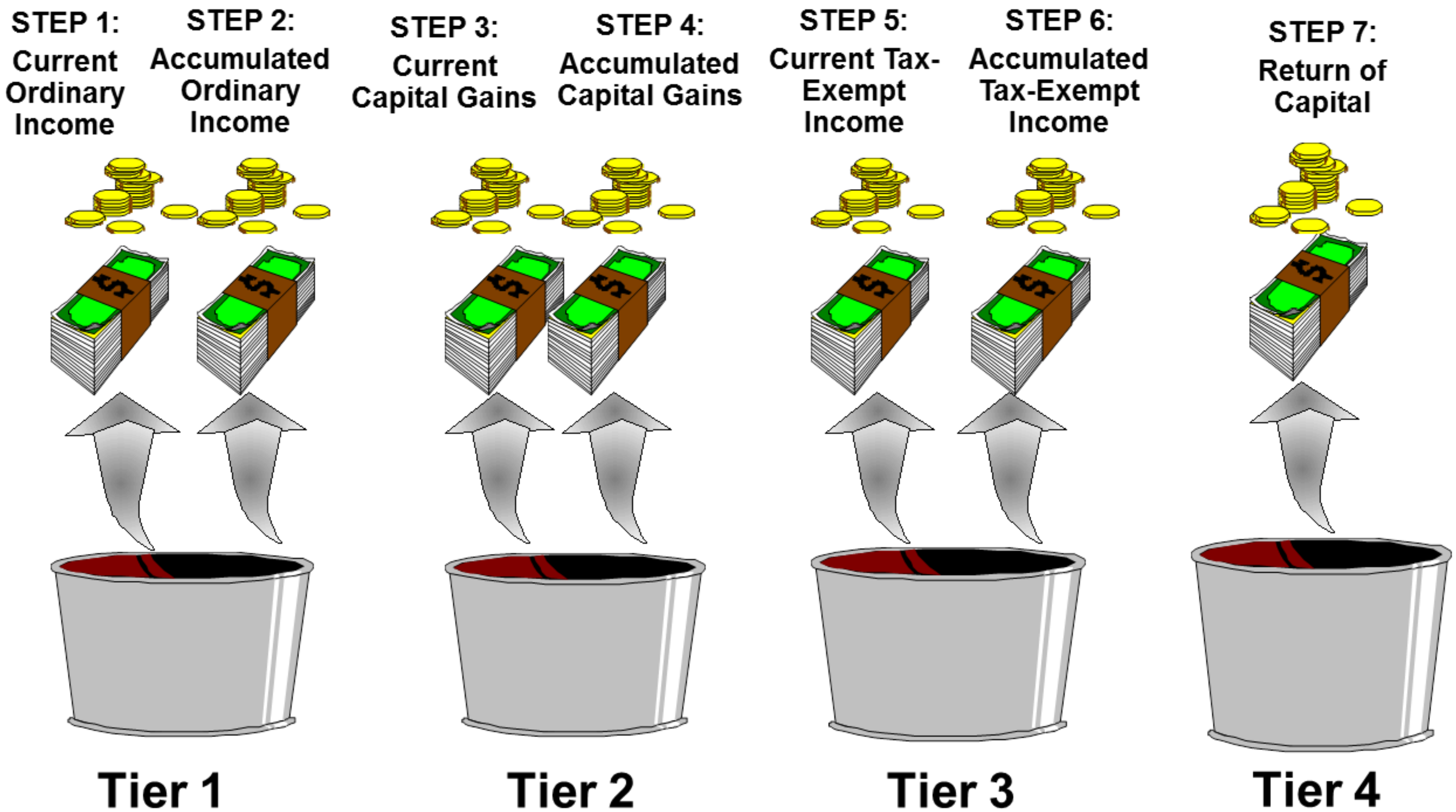
#5 Substantial Sale CRT

Taxation (continued)

- The character of income received by the recipient is subject to and controlled by the tier rules of IRC §664(b)
  - First, distributions are taxed as ordinary income
  - Second, distributions are taxed as capital gains
  - Third, distributions are taxed as tax-exempt income (e.g. municipal bond income)
  - Finally, distributions are assumed to be the non-taxable return of principal
- CRTs are not subject to the 3.8% surtax
  - However, see Reg. Section 1.1411-3(d) for special rules on how the distributions of NII are taxed to beneficiaries

#5 Substantial Sale CRT

Taxation (continued)



#5 Substantial Sale CRT

Strategy

- Substantial Sale CRT (Standard CRT)
  - CRT to eliminate or reduce/defer the 3.8% Surtax and 5% incremental capital gains tax
  - Strategy:
    - Taxpayer has a large capital gain that will push them into the higher tax brackets and/or subject them to the NIIT
    - Instead, Taxpayer contributes the appreciated asset to a CRT
    - CRT sells it without recognizing gain
    - Gain realized by the trust is taxed to the grantor, but only as the annuity or unitrust payments are received
    - Thus, allowing the gain to be spread out over many years and potentially avoiding the higher tax brackets and NIIT
  - The worst case scenario is tax deferral, while the best case scenario is tax rate arbitrage

#5 Substantial Sale CRT

Strategy

Donor
(Income Beneficiary)

Transfer of highly appreciated assets

CRT

Annual (or more frequent) payments for life (or a term of years)

Donor receives an immediate income tax deduction for present value of the remainder interest (must be at least 10% of the value of the assets originally contributed)

At the end of the trust term, the charity receives the residual assets held in the trust

Public Charity
(Remainder Beneficiary)

#5 Substantial Sale CRT

Example

T has a $1 million stock position with $0 basis.

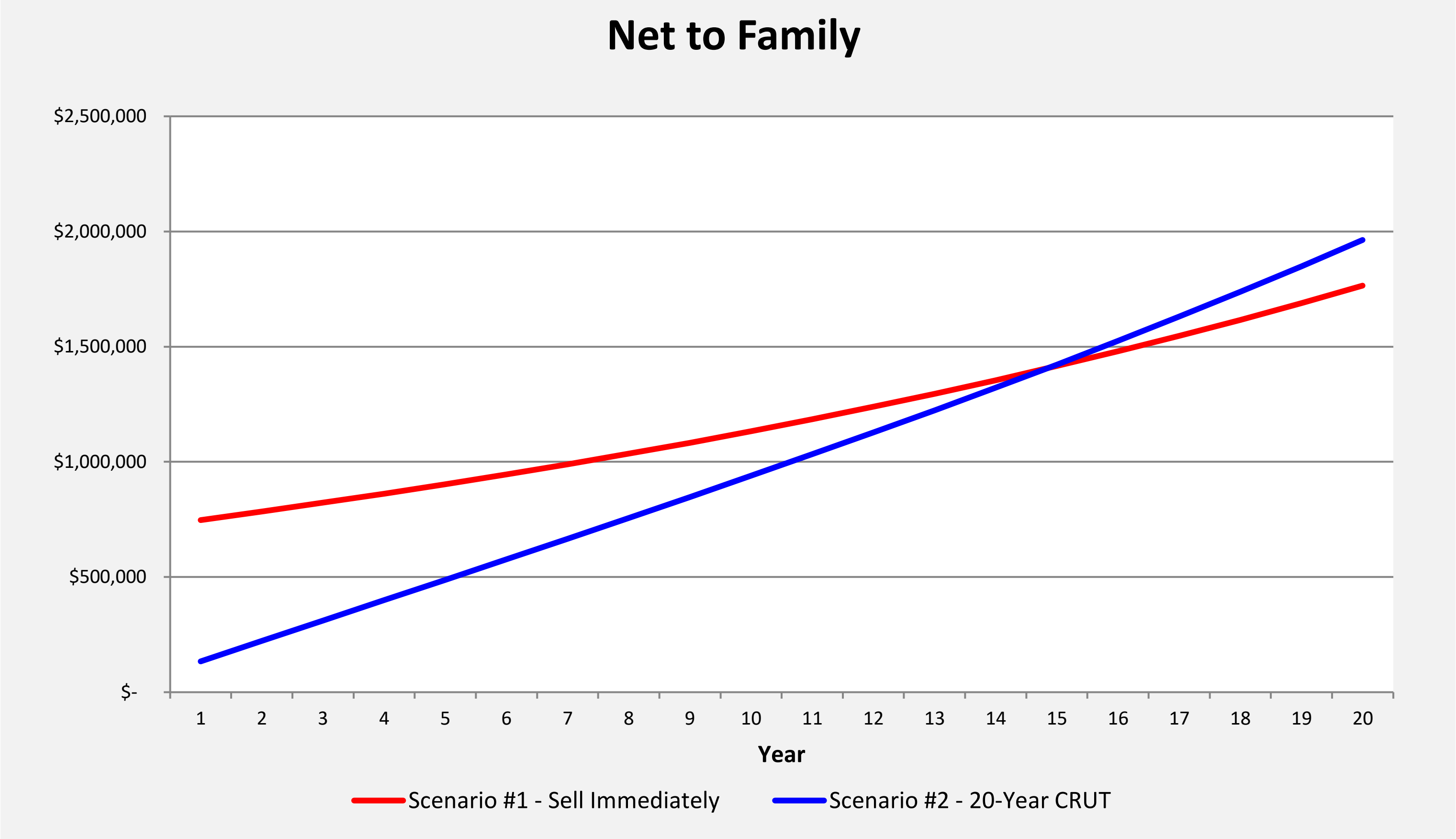
- Scenario 1 – T sells the entire position, incurring 20% capital gains tax, 3.8% net investment income tax, and 5% state tax.
- Scenario 2 – T moves the entire position to a 20-year CRUT.
  - The CRUT is assumed to distribute at 11.093%* rate per year after 1 year.
  - Tax savings from charitable donation is reinvested

*In both scenarios, a 4% growth rate and 1.5% yield is assumed for assets

*In the second scenarios, a 7520 Rate of 2%

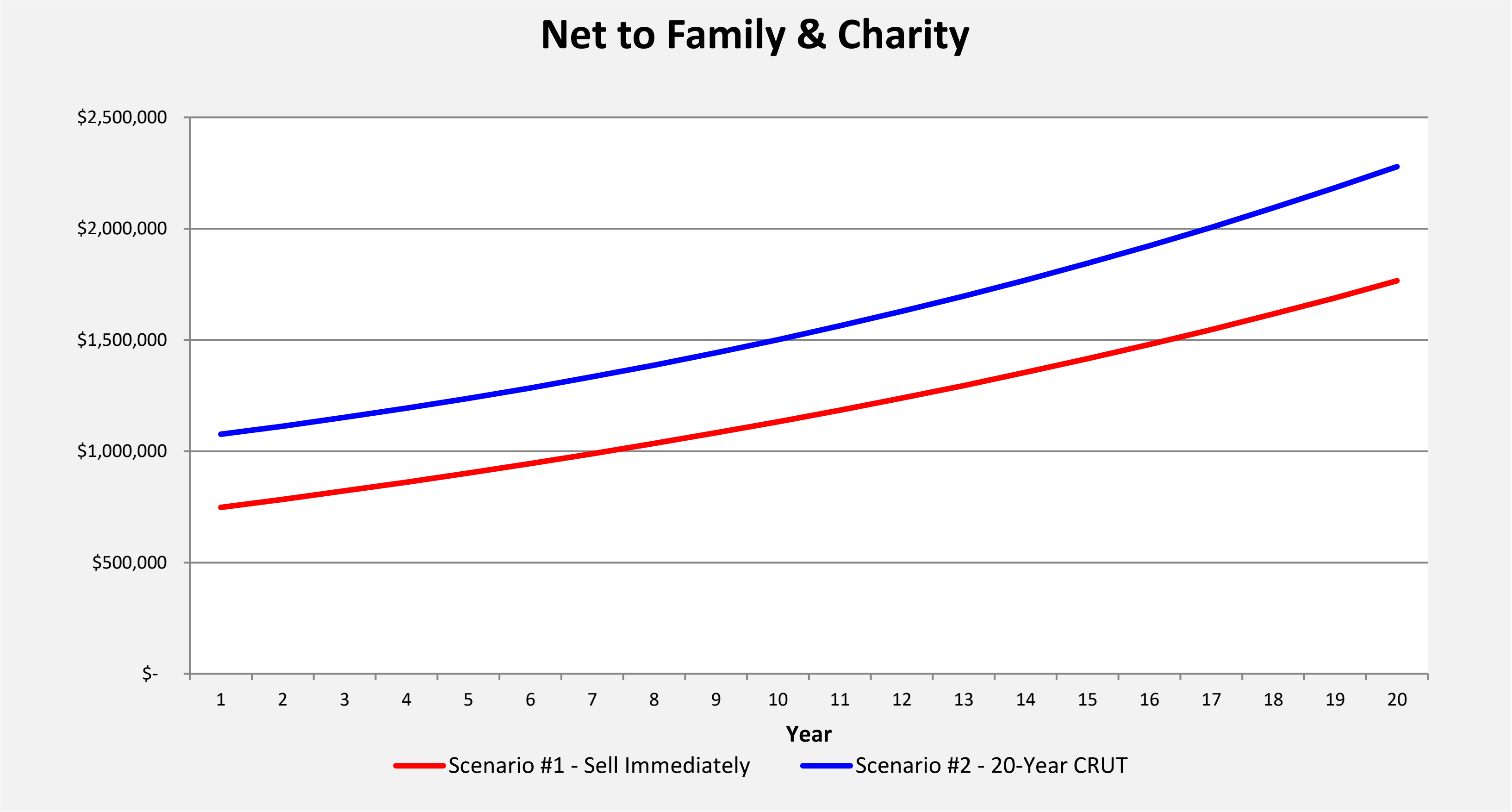
#5 Substantial Sale CRT

Example (continued)



#5 Substantial Sale CRT

Example (continued)



#7 Roth IRA Conversions and IRA Relocation

#7 Roth IRA Conversions

Roth IRA Benefits

- Lowers overall taxable income long-term
- Tax-free compounding
- No RMDs at age 72 (new RBD)

- Tax-free withdrawals for beneficiaries
- More effective funding of the “bypass trust”
- For purposes of the NIIT, Roth IRA distributions are not included in NII or MAGI

PURPOSE OF STRATEGY (as it relates to the 3.8% NIIT): To lower MAGI below the “threshold amount” over the long-term.

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#7 Roth IRA Conversions

Reasons to Convert

- Taxpayer's marginal income tax rate at the time of the conversion is lower than the taxpayer's expected marginal income tax rate when distributions are to be received.
- Taxpayers have special favorable tax attributes including charitable deduction carry-forwards, investment tax credits, net operating losses (NOLs), high basis non-deductible traditional IRAs, etc.
- Suspension of the minimum distribution rules at age 72 provides a considerable advantage to the Roth IRA holder.

#7 Roth IRA Conversions

Reasons to Convert (continued)

- Taxpayers who can pay the income tax on the IRA from non-IRA funds benefit greatly from the Roth IRA because of the ability to enjoy greater tax-free yields.
- Taxpayers benefit from paying income tax before estate tax (when a Roth IRA election is made) compared to the income tax deduction obtained when a traditional IRA is subject to estate tax.
- Taxpayers making the Roth IRA election during their lifetime reduce their overall estate, thereby lowering the effect of higher estate tax rates.

#7 Roth IRA Conversions

Conversion Types

- *Strategic conversions* – Take advantage of a client's long-term wealth transfer objectives
- *Tactical conversions* – Take advantage of short-term client-specific income tax attributes that are set to expire (e.g., low tax rates, tax credits, charitable contribution carryovers, NOL carryovers, etc.)
- *Opportunistic conversions* – Take advantage of short-term stock market volatility, sector rotation and rotation in asset classes
- *Hedging conversions* – Take advantage of projected future events that will result

#7 Roth IRA Conversions

Mathematics of Conversion

- In simplest terms, a traditional IRA will produce the same after-tax result as a Roth IRA provided that
  - The annual growth rates are the same
  - The tax rate in the conversion year is the same as the tax rate during the withdrawal years
    - A x B x C = D
    - A x C x B = D

#7 Roth IRA Conversions

Mathematics of Conversion (continued)

	Traditional IRA	Roth IRA	Life Insurance
Current Account Balance	$ 1,000,000	$ 1,000,000	$ 1,000,000
Less: Income Taxes @ 40%	-	(400,000)	(400,000)
Net Balance	**$ 1,000,000**	**$ 600,000**	**$ 600,000**
Growth Until Death	200.00%	200.00%	200.00%
Account Balance @ Death	$ 3,000,000	$ 1,800,000	$ 1,800,000
Less: Income Taxes @ 40%	(1,200,000)	-	-
Net Account Balance to Family	**$ 1,800,000**	**$ 1,800,000**	**$ 1,800,000**

(Note: Life Insurance should be held in an ILIT)

#7 Roth IRA Conversions

Mathematics of Conversion

- Critical decision factors
  - Tax rate differential (year of conversion vs. withdrawal years)
  - Use of “outside funds” to pay the income tax liability
  - Need for IRA funds to meet annual living expenses
  - Time horizon

#7 Roth IRA Conversions

Mathematics of Conversion

- The key to successful Roth IRA conversions is to keep as much of the conversion income as possible in the current marginal tax bracket
  - However, there are times when it may make sense to convert more and go into higher tax brackets
  - Need to take into consideration the following:
    - Section 199A limitations
    - The 3.8% NIIT & capital gain brackets
    - Any lurking AMT surprises
    - The SALT deduction cap

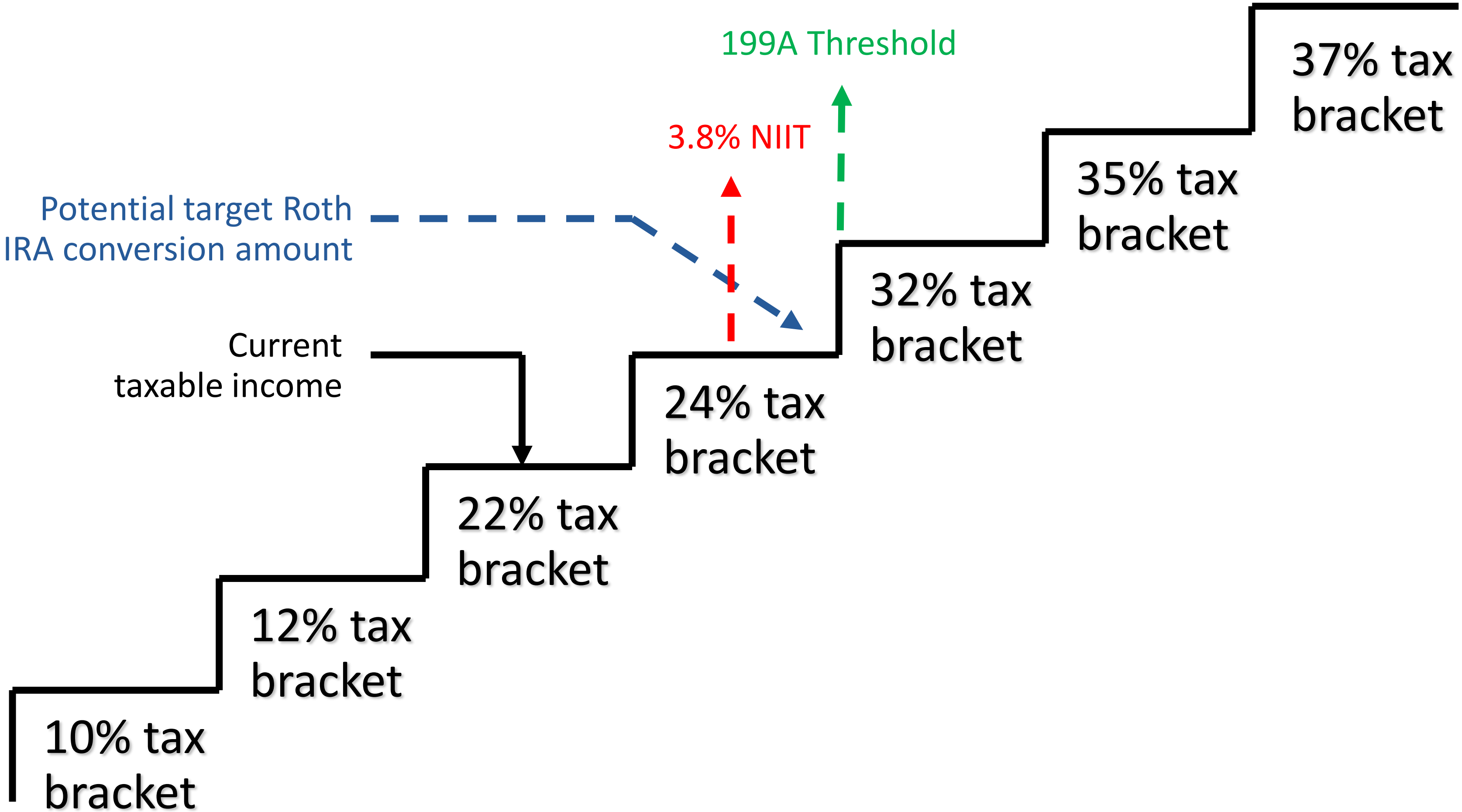
#7 Roth IRA Conversions

Tactical Considerations

- Unused charitable contribution carryovers
- Current year ordinary losses; including PALs available after a disposition
- Net Operating Loss (NOL) carryovers from prior years
- Alternative Minimum Tax (AMT)
- Credit carryovers

#7 Roth IRA Conversions

Target Roth IRA Conversion Amount



#7 Roth IRA Conversions

Steps to Planning

- Step 1: Develop a 10 to 15 year projection of income and deductions and compare these projections to the various taxes

- Step 2: Develop an analysis to determine the client's "permanent tax bracket." Analysis will test whether an "intra-bracket" conversions increase the 3.8% surtax, the AMT, or Section 199A

#7 Roth IRA Conversions

Steps to Planning (continued)

- Step 3: Develop a series of "bracket-crossing conversions" analysis. Each analysis must be measured autonomously standing on its own and take into account the other variables

- Step 4: Repeat the above taking into account changes in value and the opportunity to recharacterize

#7 IRA Relocation

Strategy

- Wealth invested in an IRA, Roth IRA or in a life insurance policy have one thing in common, each of these Congressional devises is a statutory tax shelter

- A life insurance policy has the same basic income tax advantages as a Roth IRA.

- Tax-free withdrawals can be made from both—borrowing or basis-first withdrawals in the case of a life insurance policy and distributions in the case of a Roth IRA

- The starting point for the analysis is a comparison of the IRA owner's current/future income tax brackets

#8 Oil & Gas Investments

#8 Oil & Gas Investments

Key Code Sections

- Intangible Drilling Costs (IDCs) – IRC § 263(c)
- Exception to the Passive Loss Rules – IRC § 469(c)(3)
- IRC § 179 Deduction
- Add back from AMT if IDCs exceed 40% of MAGI

#8 Oil & Gas Investments

Overview

- One way to avoid having taxable income in a higher tax bracket or NII subject to the NIIT is by creating deductions
- Intangible drilling costs (IDCs) provide a large immediate income tax deduction (up to 85% of the initial investment)
  - Losses, if any, created as a result of IDCs will be ordinary (thus lowering a taxpayer's AGI)
    - Must be a general partner in the first year
  - Possible AMT add-back issues if IDCs exceed 40% of AMTI

#8 Oil & Gas Investments

Overview (continued)

- Depletion and other depreciation (including Section 179 expensing) provide for additional deductions during the term of the investment

- Additional tax credits may be available for certain oil & gas ventures

#8 Oil & Gas Investments

Example

- George, a single taxpayer, recently invested $100,000 in a working interest in an oil well.
- According to the oil well driller's accountants, 80% of the initial investment can be deducted in the first year as an "intangible drilling cost" ("IDC").
- Assuming George has $80,000 of net investment income subject to the 3.8% NIIT and is in the 37% marginal income tax bracket, below is a summary of the total tax savings from the oil well investment.

Income tax savings from IDC deduction	$29,600	$100,000 x 80% x 37%
NIIT savings from the IDC deduction	$3,040	$100,000 x 80% x 3.8%
Total tax savings	$32,640	

#9 Two-Year Installment Sale

#9 Two-Year Installment Sale

Overview

- An installment sale is a type of sale in which the seller sells an asset to another person in exchange for a promissory note paid over a period of time. If executed correctly, the taxable gain recognized by the seller will be deferred until payments are made on the principal of the note.

PURPOSE OF STRATEGY (as it relates to the 3.8% NIIT): To level "net investment income" over a longer period of time so as to keep MAGI below the "threshold amount".

Note: the sale of a non-passive interest in a trade or business is not subject to the NIIT. (See Section 1411(c)(4) and Reg. Section 1.1411-7)

#9 Two-Year Installment Sale

Overview (continued)

- IRC § 453 allowed for deferral of taxation on Installment Sales
  - $5,000,000 annual limitation
  - $10,000,000 annual limitation for married couple
- Gain is generally deferred until payment occurs
  - Depreciation recapture provisions – IRC § 453(i)

#9 Two-Year Installment Sale

Increase in Basis

- Sale from taxpayer to a non-grantor trust or a child receives a basis increase

- Basis will equal the purchase price

#9 Two-Year Installment Sale

Two-Year Rule

- IRC § 453(e)(2) provides a sale by a related party within two years results in realization of the original deferral

- Therefore, the original buyer must wait at least 2 years and one day to sell the asset to a third-party
  - No realization of the original gain if the sale is at least two years and one day later

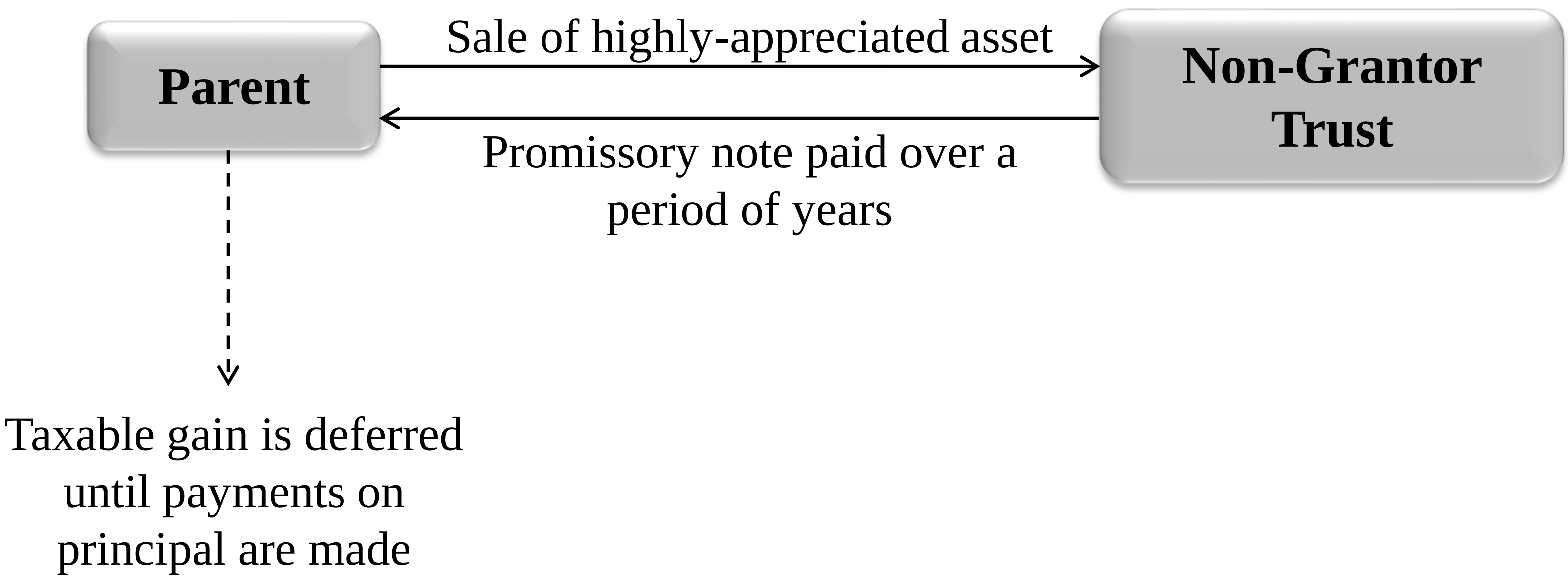
#9 Two-Year Installment Sale

Strategy

- Strategy
  - Parent has an asset with a large capital gain
  - Parent sells it to a nongrantor trust for the benefit of his or her children and takes back an installment note
  - The trust receives a stepped-up basis in the asset
  - Two years and one day later the trust sells the asset, recognizing little, if any, gain
  - Trust makes payments to Parent who spreads the gain out over the period of the installment note

#9 Two-Year Installment Sale

Strategy



#9 Two-Year Installment Sale

Benefits

- Benefits
  - Income smoothing: Avoids the higher tax brackets & NIIT
  - Timing benefit: Children cash in the full appreciated value of the asset before most the gain is recognized by the parents.

<u>**Section 3:**</u>

Income Shifting Strategies

Section 3:
Income Shifting Strategies

12. Income Shifting CRT

13. Family Limited Partnership

#12 Income Shifting CRT

#12 Income Shifting CRT

Overview

- Income Shifting CRT
  – A CRT for the donor's children; i.e., the donor's children are the beneficiaries of the lead annuity or unitrust interest
  – CRT to eliminate or reduce/defer the 3.8% surtax and 5% incremental capital gains rate (15% to 20% bracket) while shifting the incidence of taxation to children and grandchildren

#12 Income Shifting CRT

Strategy

- Strategy:
  - Parent contributes assets to a CRT with the Parent's children as the lead income beneficiaries
  - Therefore reducing or eliminating the Parent's NIIT and income in the higher tax brackets by shifting income to their children
- Effects
  - Shifts ordinary income to family
  - Shift capital gains to family members
  - Benefit charity

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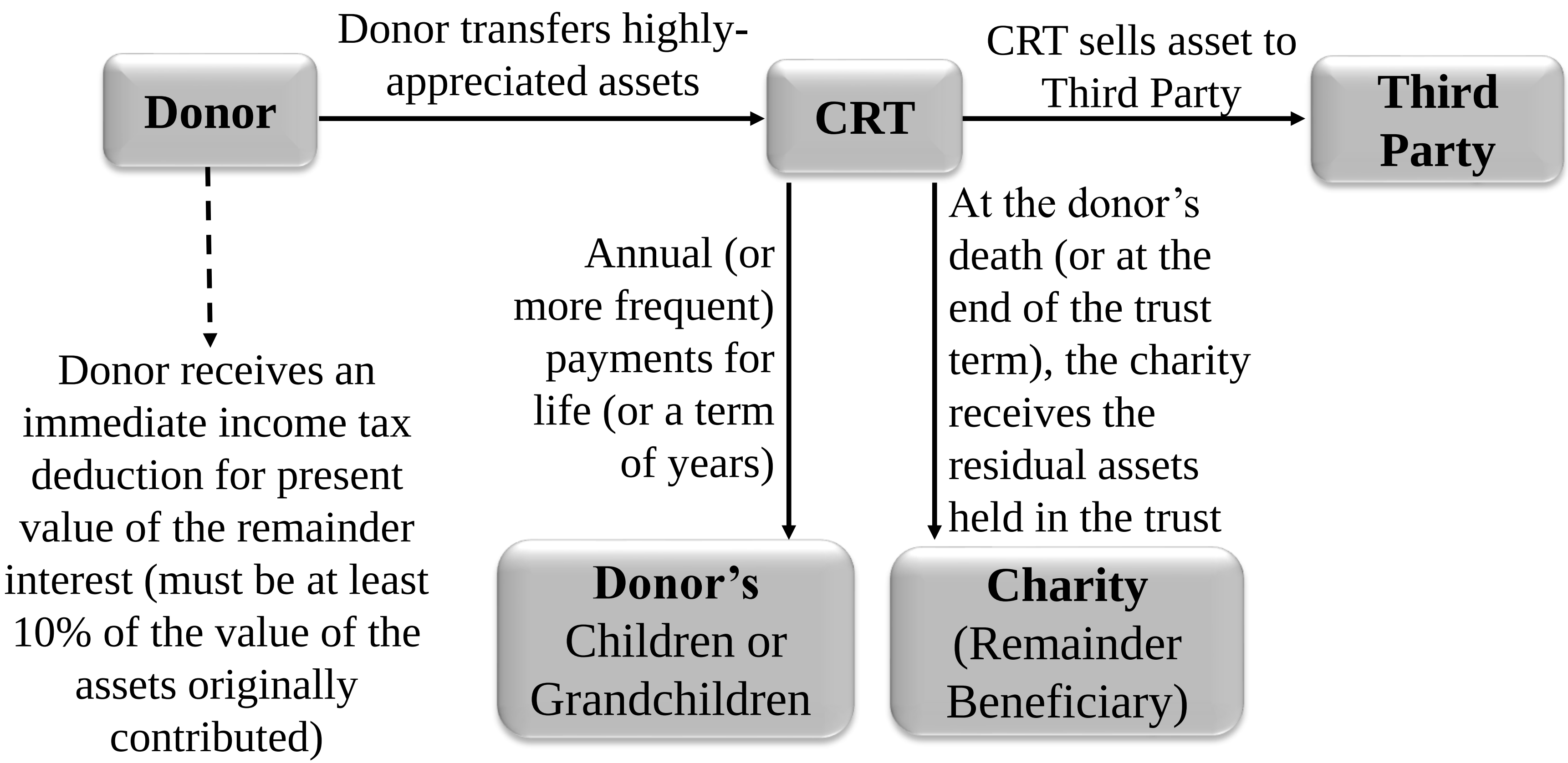
#12 Income Shifting CRT

Strategy



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#12 Income Shifting CRT

Example

T has a $1 million stock position with $0 basis.

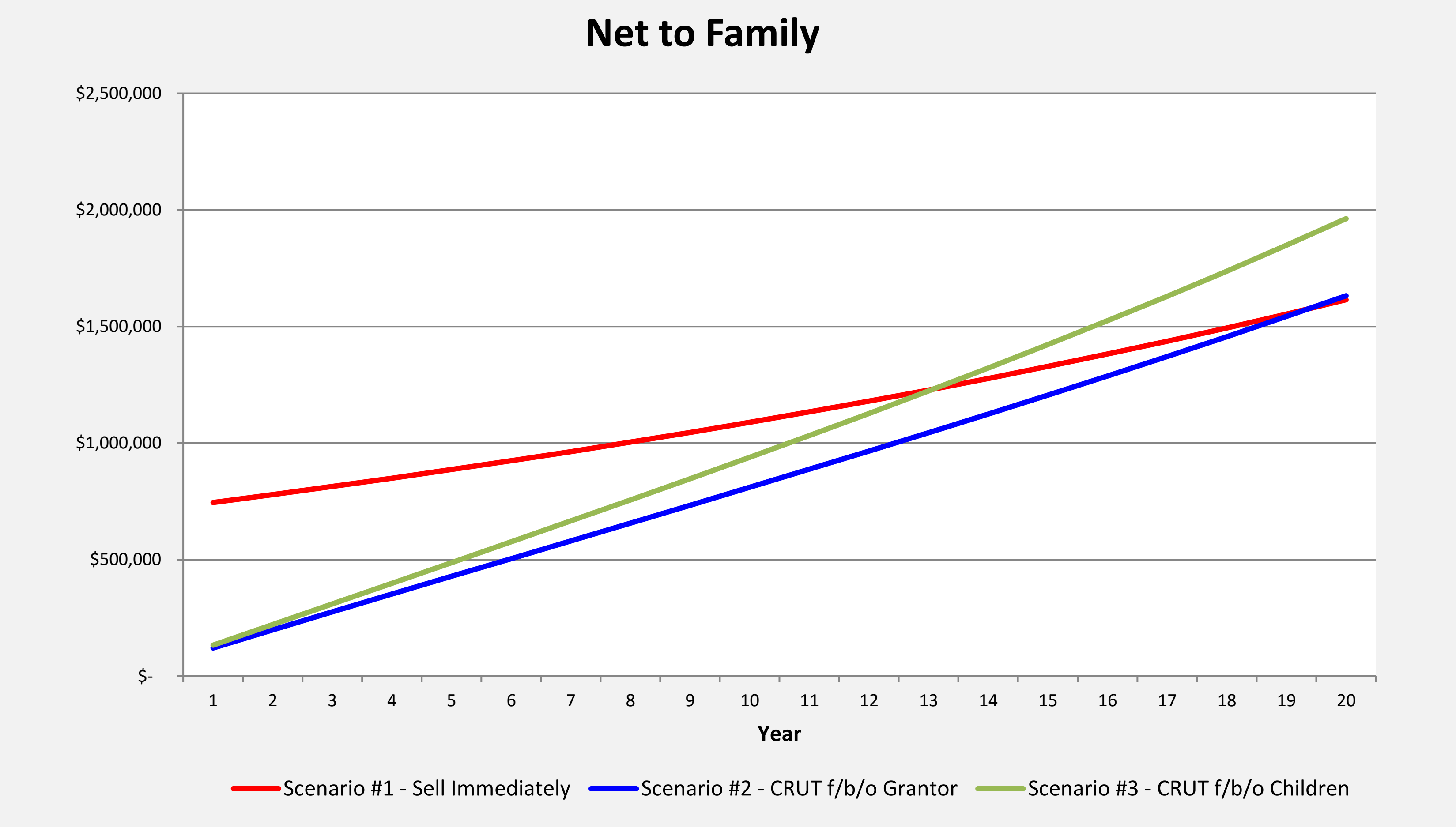
- Scenario 1 – T sells the entire position, incurring 20% capital gains tax, 3.8% net investment income tax, and 5% state tax.
- Scenario 2 – T moves the entire position to a 20-year CRUT, *for his own benefit*
  - The CRUT is assumed to distribute at 11.093%* rate per year after 1 year.
  - Tax savings from charitable donation is reinvested
- Scenario 3 - T moves the entire position to a 20-year CRUT, *for the benefit of his children*
  - The CRUT is assumed to distribute at 11.093%* rate per year after 1 year.
  - Tax savings from charitable donation is reinvested
  - The children will have a 15% rate on Federal Capital Gains.

In both scenarios, a 4% growth rate and 1.5% yield is assumed for assets

*Rate as of 8/13

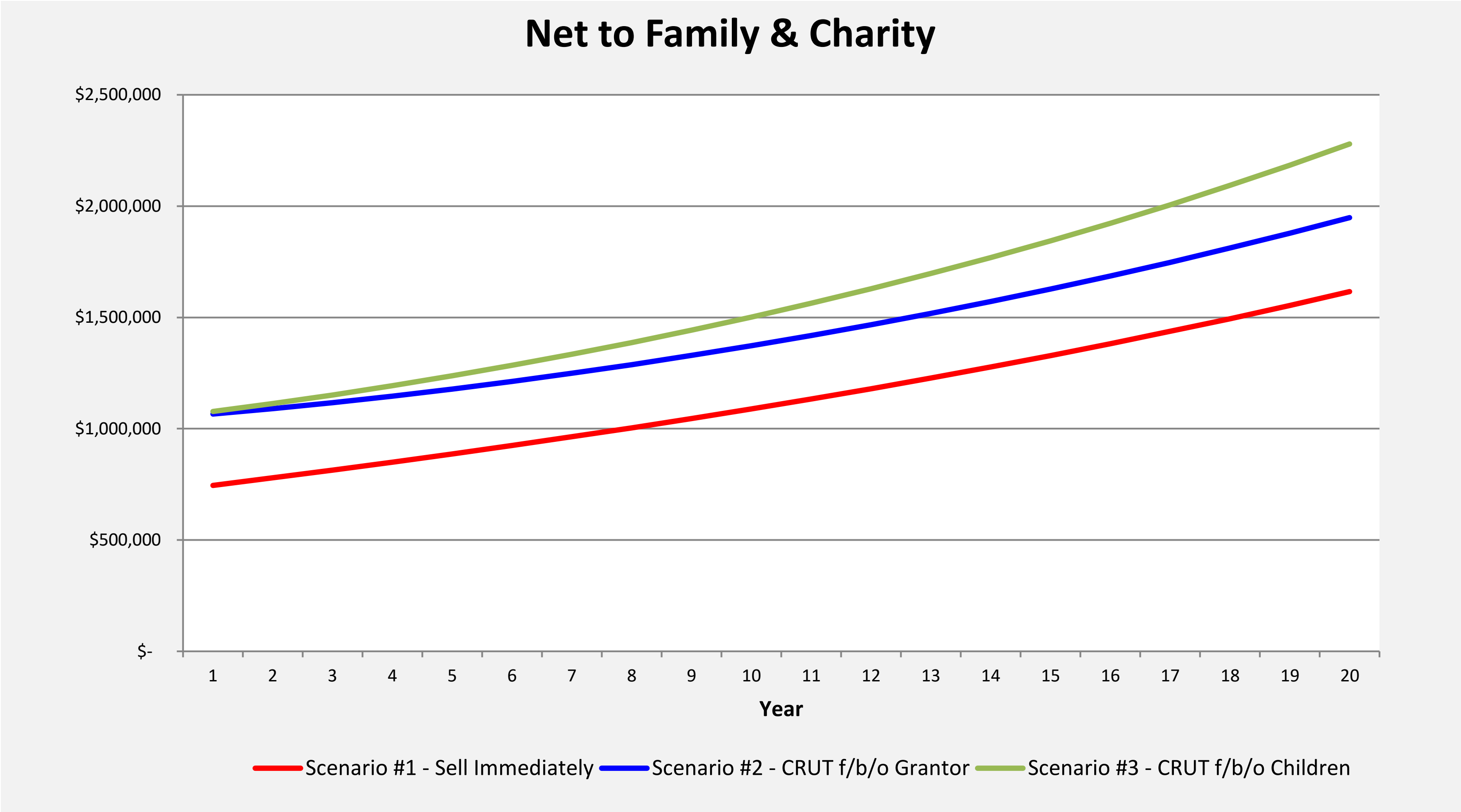
#12 Income Shifting CRT

Example (continued)



#12 Income Shifting CRT

Example (continued)



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#13 Family Limited Partnership

#13 Family Limited Partnership

Strategy

- Strategy:
  - One or both parents create the FLP and serve as the general partner(s), while the children and/or grandchildren serve as the limited partners.
  - Initially, the parents hold both the general partner interests and the limited partner interests.
    - Typically, the general partner interest will be as little as 1% of the total equity in the FLP and the limited partner interest will be the remainder of the equity in the FLP so it can be divided up among the children and/or grandchildren by the parents.

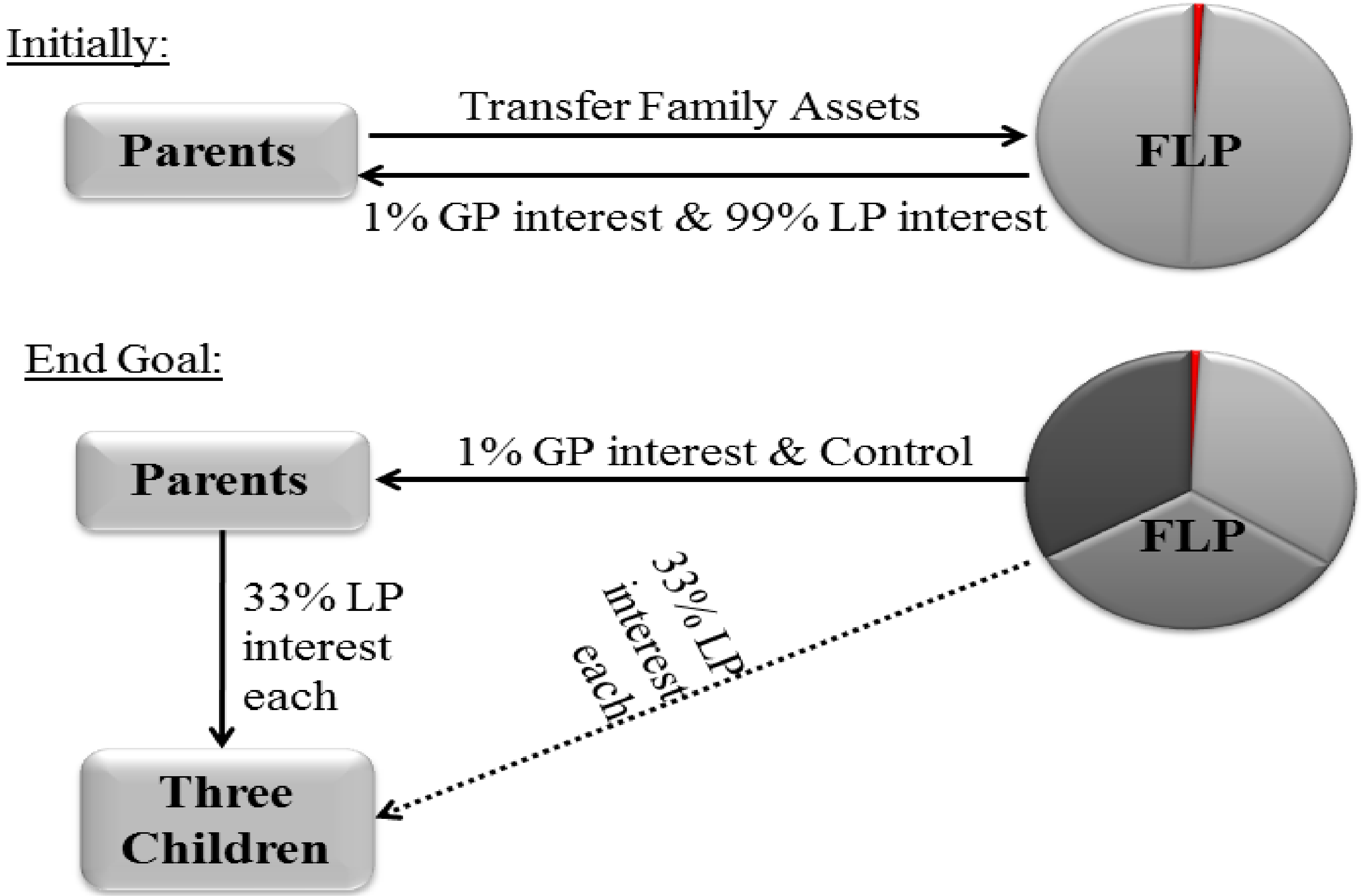
#13 Family Limited Partnership

Strategy (continued)

- Strategy:
  - The parents, as general partners, maintain full and complete control over the FLP while gifting as many of the limited partner units to their children as they desire; thus, reducing their taxable estates.
  - Furthermore, gift tax and use of the applicable exclusion amount can be avoided if the value of the units transferred to each child does not exceed the annual exclusion amount
    - $16,000 per donee in 2022
  - If Parents wish to transfer assets faster, they can still avoid gift tax by using their AEA.
    - $12,060,000 per donor in 2022 ($24,120,000 combined)
  - Valuation discounts allow even more value to be transferred

#13 Family Limited Partnership

Strategy (continued)



#13 Family Limited Partnership

Benefits

- Benefits
  - Parents able to share the value of the assets with children
  - Parents able to maintain control over the assets
  - Assets transferred to the FLP are taken out of the parent's estate, generally at a substantially reduced transfer tax value.
    - Use the annual exclusion amount to avoid gift tax
    - Use the applicable exclusion amount to avoid gift tax
  - Income shifting from parents to children
    - FLP income is distributed to children as limited partners
  - Provides asset protection

Section 4:
Strategies For Reducing Taxable Income

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Section 4:

Strategies for Reducing Taxable Income

14. Tax-Aware Investing

15. Nevada Incomplete Gift, Non-Grantor (NING) Trusts

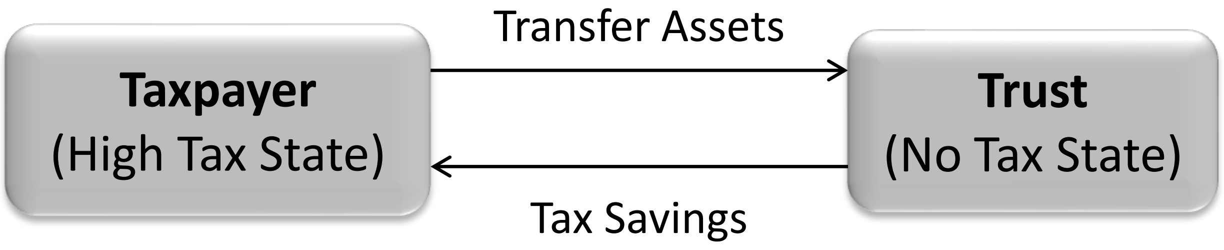
16. Captive Insurance Companies

#15 Nevada Incomplete Gift, Non-Grantor (NING) Trusts

#15 ING Trusts

Overview

- Taxpayers in high tax states should consider transferring assets to a trust in a state that does not tax trust income to avoid income tax in their home state



#15 NING Trusts

Strategy

- Strategy:
  - The trust must be created in a state that does not tax trust income
  - The income from the trust must not be taxable by the grantor’s home state
  - The trust must allow discretionary distributions to the settlor without making the trust a grantor trust
  - Transfers to the trust must be incomplete gifts for federal gift tax purposes without making the trust a grantor trust
    - However, the permanent increase in the applicable exclusion amount and emergence of DAPTs may allow for completed gifts

#15 NING Trusts

Payment of Income Tax – Gift Tax

- PLR 201310002 confirmed that a Nevada incomplete gift, non-grantor trust met all the requirements listed above for creating a trust that avoids state income tax, making it the preferred jurisdiction for setting up a state income tax saving trust, at least for the time being. Such trusts are referred to as Nevada Incomplete Gift, Non-Grantor Trusts, or NINGs.

Section 5:

Specific Strategies for Reducing NIIT

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Specific Strategies for Reducing NIIT

17. **Inter Vivos CLAT**

18. Grouping Business Activities to Create Material Participation

19. Choice of Filing Status

#17 Inter Vivos CLAT

#17 Inter Vivos CLAT

Overview

A Charitable Lead Trust (CLT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is paid out to a named charity. At the end of the trust term, the remainder (whatever is left in the trust) is paid to non-charitable beneficiaries (e.g. children of the donor) that have been designated in the trust document.

PURPOSE OF STRATEGY (as it relates to the 3.8% NIIT): To offset "net investment income" against charitable deductions dollar-for-dollar in a tax-efficient manner.

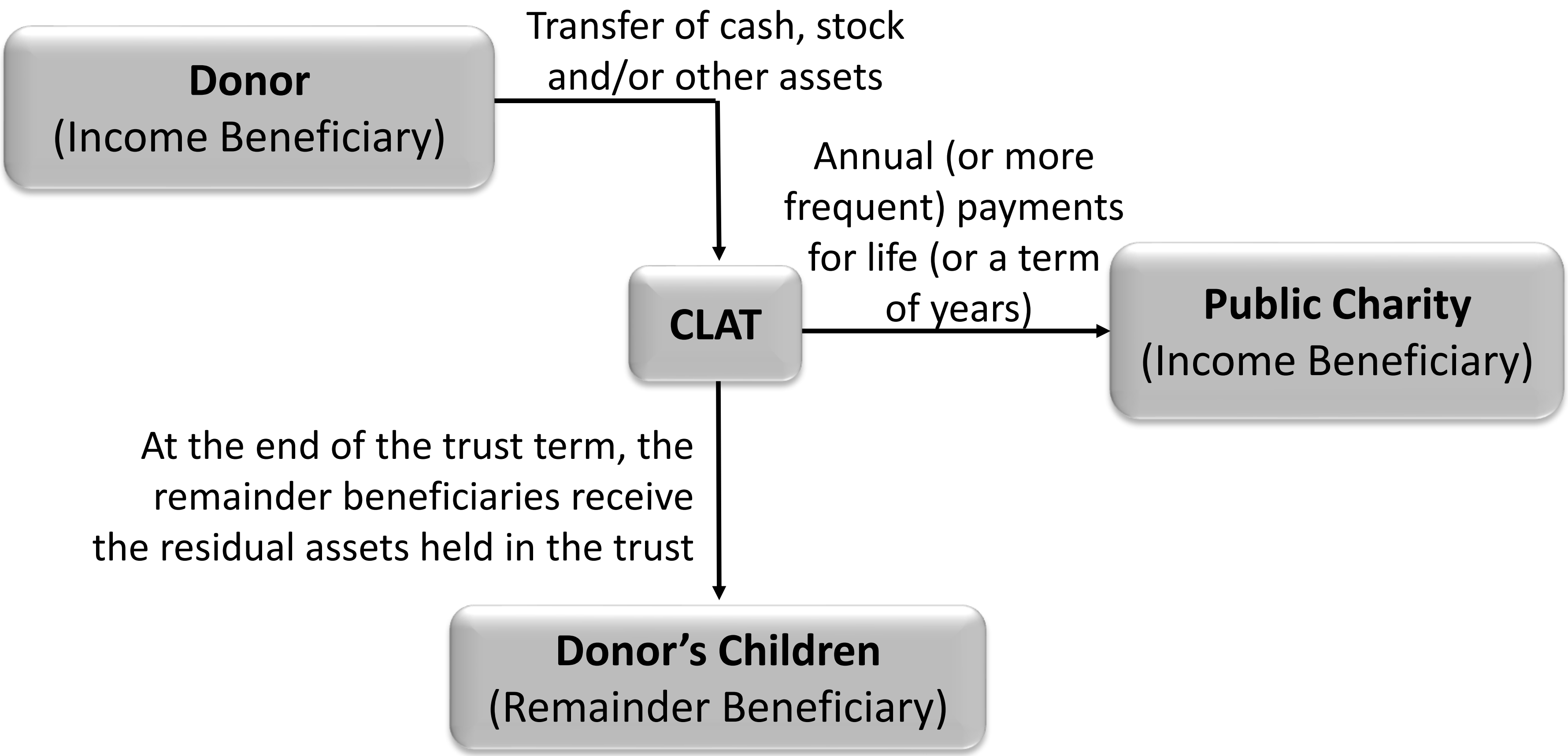
#17 Inter Vivos CLAT

Overview

- The charitable beneficiary receives a stated amount of the initial trust assets each year
  - The amount received is established at the beginning of the trust and will not change during the term of the trust regardless of investment performance (unless inadequate investment performance causes the trust to run out of assets)

#17 Inter Vivos CLAT

Overview



#17 Inter Vivos CLAT

Using the Charitable Deduction to Reduce the NIIT

- Charitable deductions don't help individuals with the NIIT
- They don't reduce MAGI because they are below-the-line deductions taken on line 40 of Form 1040
- They don't reduce NII because only properly allocable deductions paid or incurred to produce the income can be deducted for NIIT purposes and the charitable deduction is not a cost of producing the income
- The income tax charitable deduction can be used to reduce the NIIT on charitable lead annuity trusts (CLTs), however

#17 Inter Vivos CLAT

Using the Charitable Deduction to Reduce the NIIT

- Strategy
  - CLAT receives an income tax charitable deduction under § 642(c) as annuity payments are made
  - Therefore, in effect, the CLAT is only subject to income tax on income in excess of the annuity payment amount
  - Additionally, it's an above-the-line deduction, so it can reduce the amount of NIIT and indirectly benefit the donor

#17 Inter Vivos CLAT

Charitable Deduction and the 3.8% NIIT

Individual IRC §170 Deduction

Wage Income	$260,000
Interest Income	$100,000
Dividend Income	$50,000
MAGI	$410,000
Less: Threshold Exemption	($250,000)
Subtotal	$160,000
Lesser of Excess over Threshold or NII	**$150,000**
NII Tax at 3.8%	$5,700

* Does not reflect PEP, PEASE, or the charitable limitations

Trust - §642(c) Deduction

Interest Income	$100,000
Dividend Income	$50,000
MAGI	$150,000
Less: Charitable Deduction	($150,000)
AGI	$0
NII Tax at 3.8%	$0

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Section 6:
Wealth Transfer Strategies

Section 6:
Wealth Transfer Strategies

20. Intra-Family Loans

21. GRATs

22. Dynasty Trusts

23. IDGT Sale

24. Domestic Asset Protection Trusts

25. Spousal Limited Access Trusts

#20 Intra-Family Loans

#20 Intra-Family Loans

Overview

- When interest rates are very low, intra-family loans can produce substantial tax-free transfers for families with estates subject to wealth transfer tax
- Strategy: Simple rate arbitrage
  - Parents loan money to their children at a low interest rate
  - Children invest the borrowed money at a higher rate
  - The difference represents a tax-free increase in wealth for the children

#20 Intra-Family Loans

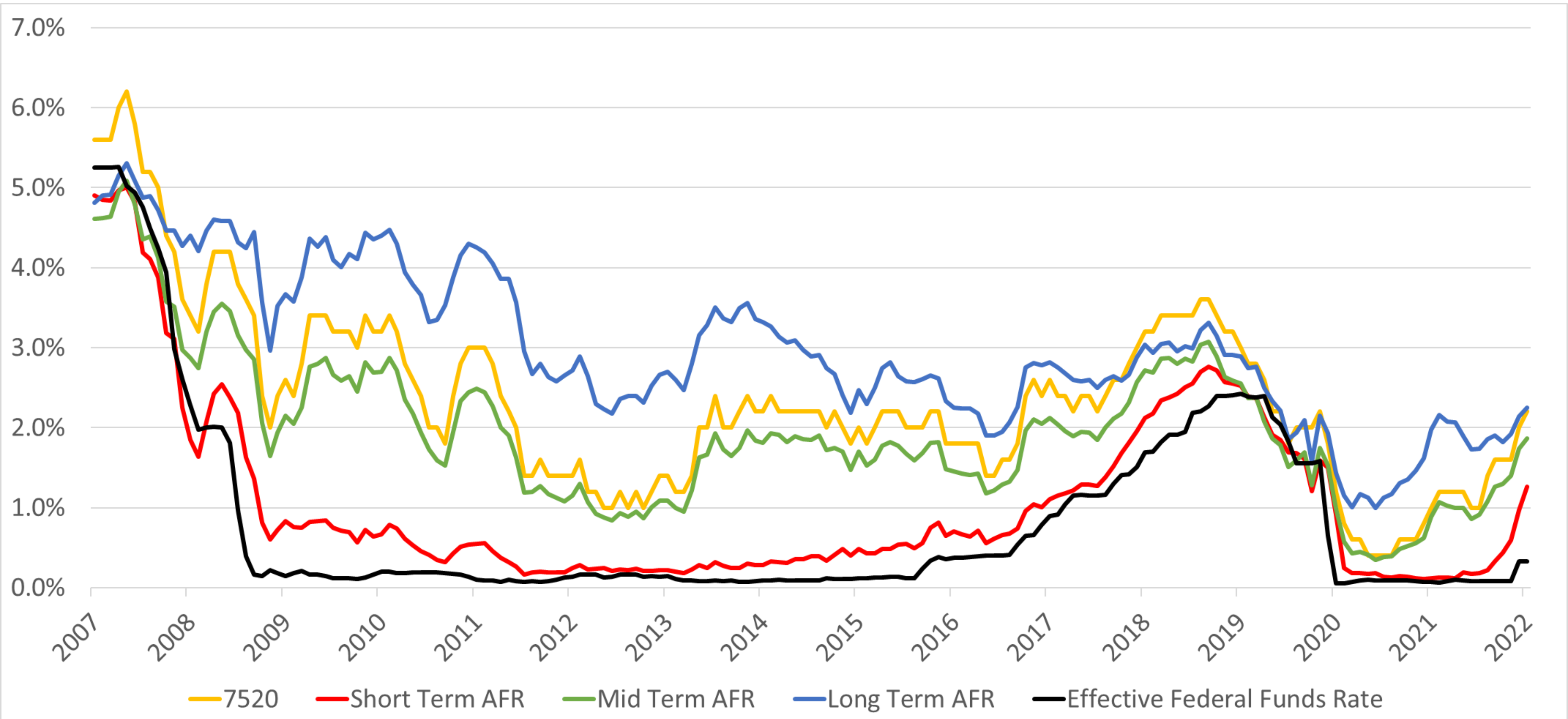
Overview

- The minimum interest rate that must be charged on a note is the appropriate applicable federal rate (AFR) for the month of the transfer.

- These rates are low enough so that children can invest at a rate in excess of the interest rate on the note even without taking any appreciable risk.

#20 Intra-Family Loans

Overview



#21 GRATs

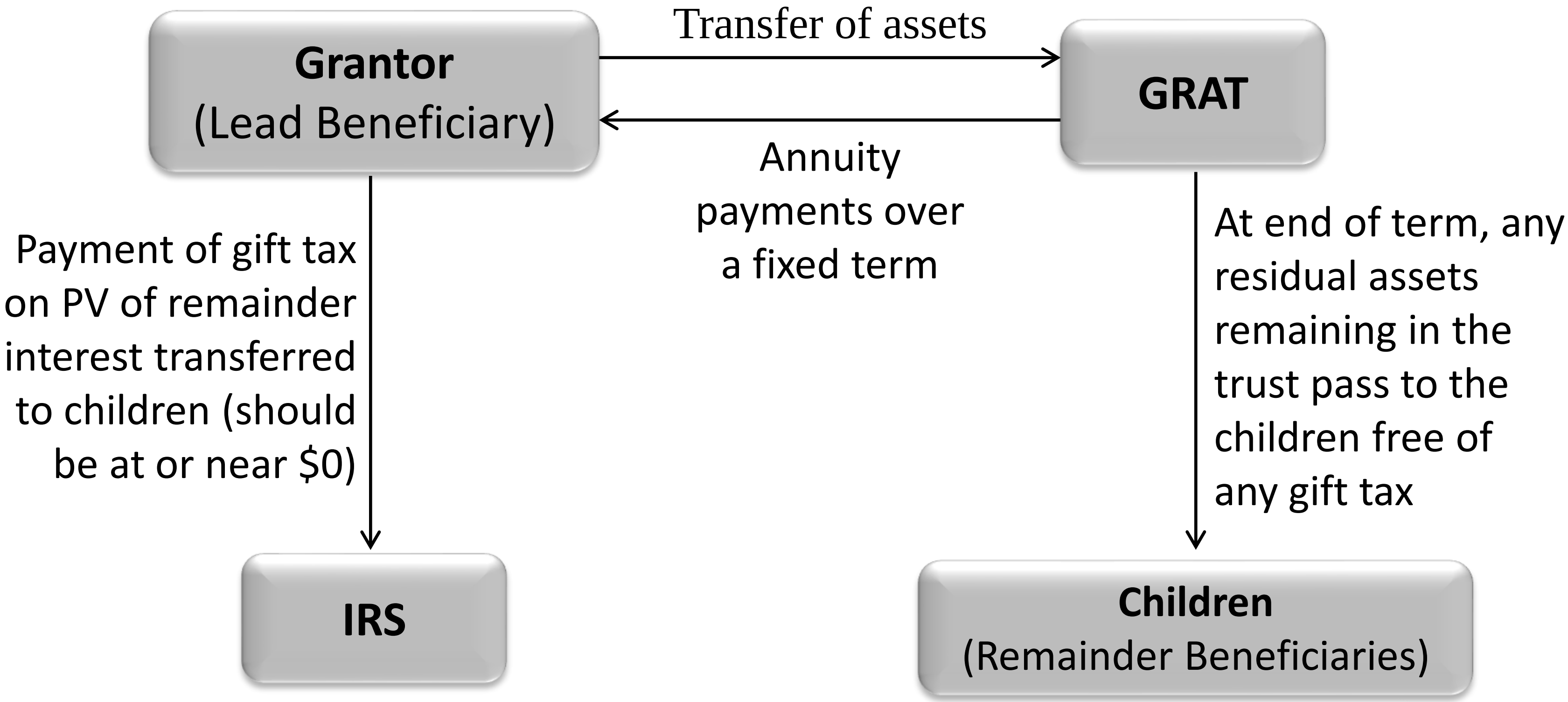
#21 GRATs

Definition

- Split-interest trust where the grantor retains an annuity interest for a term, after which, any assets remaining pass to the remainder beneficiaries
- A GRAT is a type of trust that benefits the grantor's future generations (e.g. children) without the imposition of estate and/or gift tax.
- To the extent that the actual rate of return on the trust's assets exceeds the IRS's rate (a.k.a. IRC Section 7520 rate), the "excess" is transferred to the trust's beneficiaries free of any estate or gift tax.
- All income earned by the trust is taxed to grantor because the trust is "defective" for income tax purposes, thus allowing for a "tax-free" gift to the trust's beneficiaries

#21 GRATs

Overview



#21 GRATs

Example: 10-Year GRAT

Year	Beginning Balance	Taxable Income 10.00%	Annuity Payment $739,075	Ending Balance
1	$ 10,000,000	$ 1,000,000	$ (739,075)	$ 10,260,925
2	$ 10,260,925	$ 1,026,093	$ (739,075)	$ 10,547,943
3	$ 10,547,943	$ 1,054,794	$ (739,075)	$ 10,863,663
4	$ 10,863,663	$ 1,086,366	$ (739,075)	$ 11,210,955
5	$ 11,210,955	$ 1,121,096	$ (739,075)	$ 11,592,976
6	$ 11,592,976	$ 1,159,298	$ (739,075)	$ 12,013,199
7	$ 12,013,199	$ 1,201,320	$ (739,075)	$ 12,475,444
8	$ 12,475,444	$ 1,247,544	$ (739,075)	$ 12,983,914
9	$ 12,983,914	$ 1,298,391	$ (739,075)	$ 13,543,231
10	$ 13,543,231	$ 1,354,323	$ (739,075)	$ 14,158,480

Benefit: $14,534,321 Transferred to Beneficiaries Tax-Free

*Assumes a $7,000,000 (after valuation adjustments) initial contribution

**Assumes a 1% Section 7520 rate

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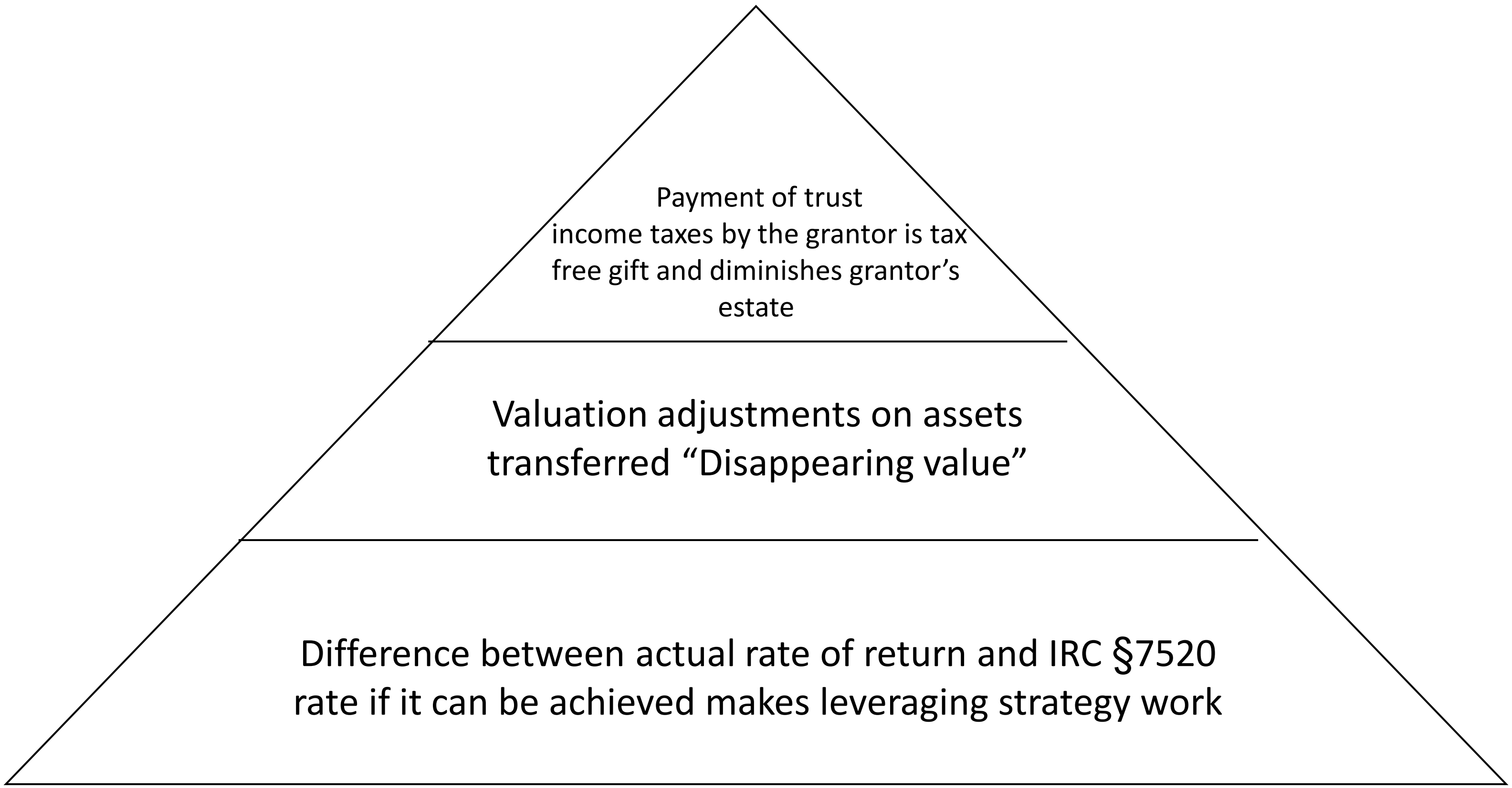
#21 GRATs

Why GRATs Work



#21 GRATs

Advantages

- Annuity payments provide income stream to the grantor
- Ability to make gifts of substantial amounts of property tax-free
- Grantor pays income tax on trust income, leaving more assets in the GRAT for remainder beneficiaries
- Reduces the taxable estate of the grantor
- Valuation adjustments increase effectiveness of sale for estate tax purposes

#21 GRATs

Disadvantages

- If the grantor dies before the end of the GRAT term, a significant portion of the assets held in the GRAT are included in the grantor's estate
- The remainder beneficiaries will have the same basis in the property transferred to the GRAT as the grantor had at the time the property was transferred (no step-up in cost basis)
- Risk that rate of return will not exceed interest rate resulting in no assets being transferred to remainder beneficiaries

#21 GRATs

Funding GRATs

- "Good" Assets
  - Assets with significant growth potential
  - Assets with good cash flow
  - Discountable assets (i.e. S-Corps, LLCs, partnerships)
- "Bad" Assets
  - Raw land
  - Personal property
  - Low growth assets
  - Assets with inadequate cash flow

#21 GRATs

Other GRAT Features/Enhancements

- "Indexed" GRATs
  - GRATs where the current annual payment increases by 20% over the prior year's payment
    - Allows for growth to stay in the GRAT longer
- "Staggered" GRATs
  - Multiple GRATs with different terms
    - Hedges against the risk of premature death and the risk of interest rates decreasing
- "Rolling" GRATs
  - GRATs which are funded with other GRAT payments
    - Hedges against the risk of premature death and the risk of rate of return underperformance

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#22 Dynasty Trusts

#22 Dynasty Trusts

Overview

- Takes advantage of how the generation-skipping transfer tax (GSTT) is applied by passing assets down through successive generations of family

- Other benefits may include: creditor protection, divorce protection, and spendthrift protection

#22 Dynasty Trusts

Strategy

- Strategy
  - Taxpayer uses the gift and GSTT exclusion amount to avoid tax on the initial transfer to the trust
  - No transfer tax is payable at any generation of beneficiaries thereafter because the beneficiaries have only discretionary interests that are not includable in their estates when they die
  - Thus, for trusts created in some states, a one-time use of the gift and GSTT exemption eliminates transfer tax for a family forever

#22 Dynasty Trusts

Overview

Grantor

Gift*

Dynasty Trust

No transfer tax paid

Discretionary Distributions to Children for Life

No transfer tax paid

Discretionary Distributions to Grandchildren for Life

No transfer tax paid

Discretionary Distributions to Great-Grandchildren for life

No transfer tax paid

Future Generations

<u>Advantages:</u>

- Creditor Protection
- Divorce Protection
- Estate Tax Protection
- Direct Descendant Protection
- Spendthrift Protection
- Consolidation of Capital

*Gift should take advantage of any remaining lifetime gift exclusion and lifetime GST exclusion

#22 Dynasty Trusts

Tax Savings From Avoiding Estate Tax

	5% Growth	7% Growth	9% Growth
Value of Trust in 20 years	$ 13,266,489	$ 19,348,422	$ 28,022,054
Estate Tax Savings @ 40%	$ 5,306,595	$ 7,739,369	$ 11,208,822
Value of Trust in 40 years	$ 35,199,944	$ 74,872,289	$ 74,872,289
Estate Tax Savings @ 40%	$ 14,079,977	$ 29,948,916	$ 29,948,916
Value of Trust in 60 years	$ 93,395,929	$ 289,732,134	$ 880,156,460
Estate Tax Savings @ 40%	$ 37,358,372	$ 115,892,854	$ 352,062,584
Value of Trust in 80 years	$ 247,807,205	$ 1,121,171,938	$ 4,932,758,341
Estate Tax Savings @ 40%	$ 99,122,882	$ 448,468,775	$ 1,973,103,336

Initial “investment” of $5,000,000

#22 Dynasty Trusts

Advantages

- Takes maximum advantage of the $12.06M lifetime gift tax exemption
- Takes maximum advantage of the $12.06M GSTT exemption
- Appreciation of assets will be free from estate tax
- Provides a layer of asset protection from the beneficiaries' creditors
- No estate/gift/GST tax will be paid at the death of the grantor's descendants
- Future trustees can be given the discretion to make distributions as appropriate, given the circumstances that exist at the time the distributions are made
- Grantor can use the trust to positively affect future behavior

#23 IDGT Sale

#23 IDGT Sale

Definition

An IDGT is a type of dynasty trust where all income earned by the trust is taxed to the grantor because the trust is “defective” for income tax purposes, thus allowing for a tax-free gift to the trust’s beneficiaries.

#23 IDGT Sale

Overview

- A type of transaction whereby a grantor sells a highly-appreciating asset to an IDGT in exchange for an installment note.
  - However, the grantor should make an initial gift (at least 10% of the total transfer value) to the trust so that it has sufficient capital to make its payments to the grantor.
- To the extent that the growth rate on the assets sold to the IDGT is greater than the interest rate on the installment note taken back by the grantor, the "excess" is passed on to the trust beneficiaries free of any gift, estate and/or GST tax.

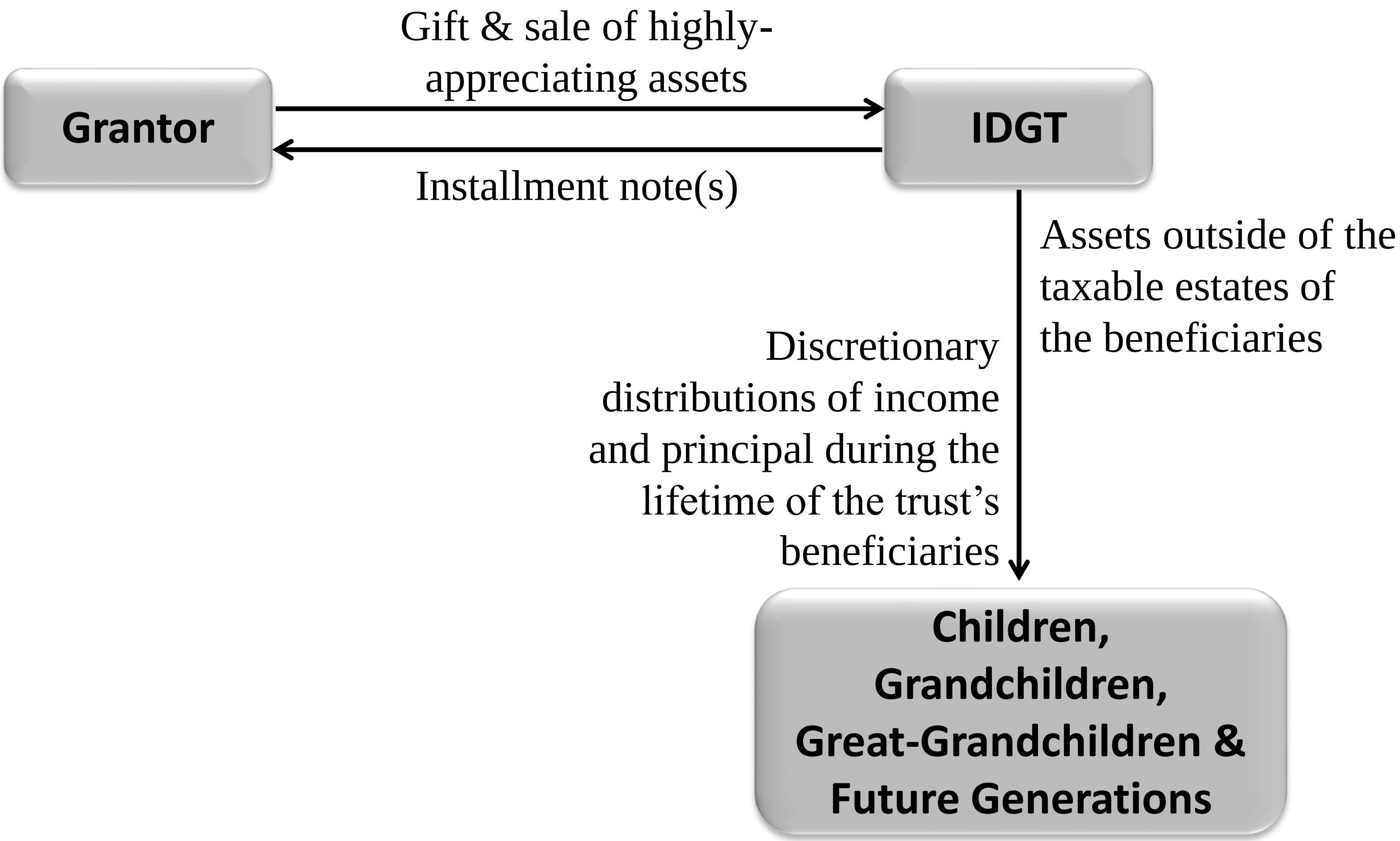
#23 IDGT Sale

Overview (continued)

- No capital gains tax is due on the installment sale to the trust because the trust is “defective” for income tax purposes
- Interest income on installment note is not taxable to the grantor because the trust is “defective” for income tax purposes.

#23 IDGT Sale

Overview (continued)



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#23 IDGT Sale

Current AFRs – April 2022

Time Period	Rate
Short-term AFR (3 years or less)	1.26%
Mid-term AFR (over 3 years, up to 9 years)	1.87%
Long-term AFR (over 9 years)	2.25%

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#23 IDGT Sale

Why an IDGT Sale Works

Long-Term AFR Rate 2.16%

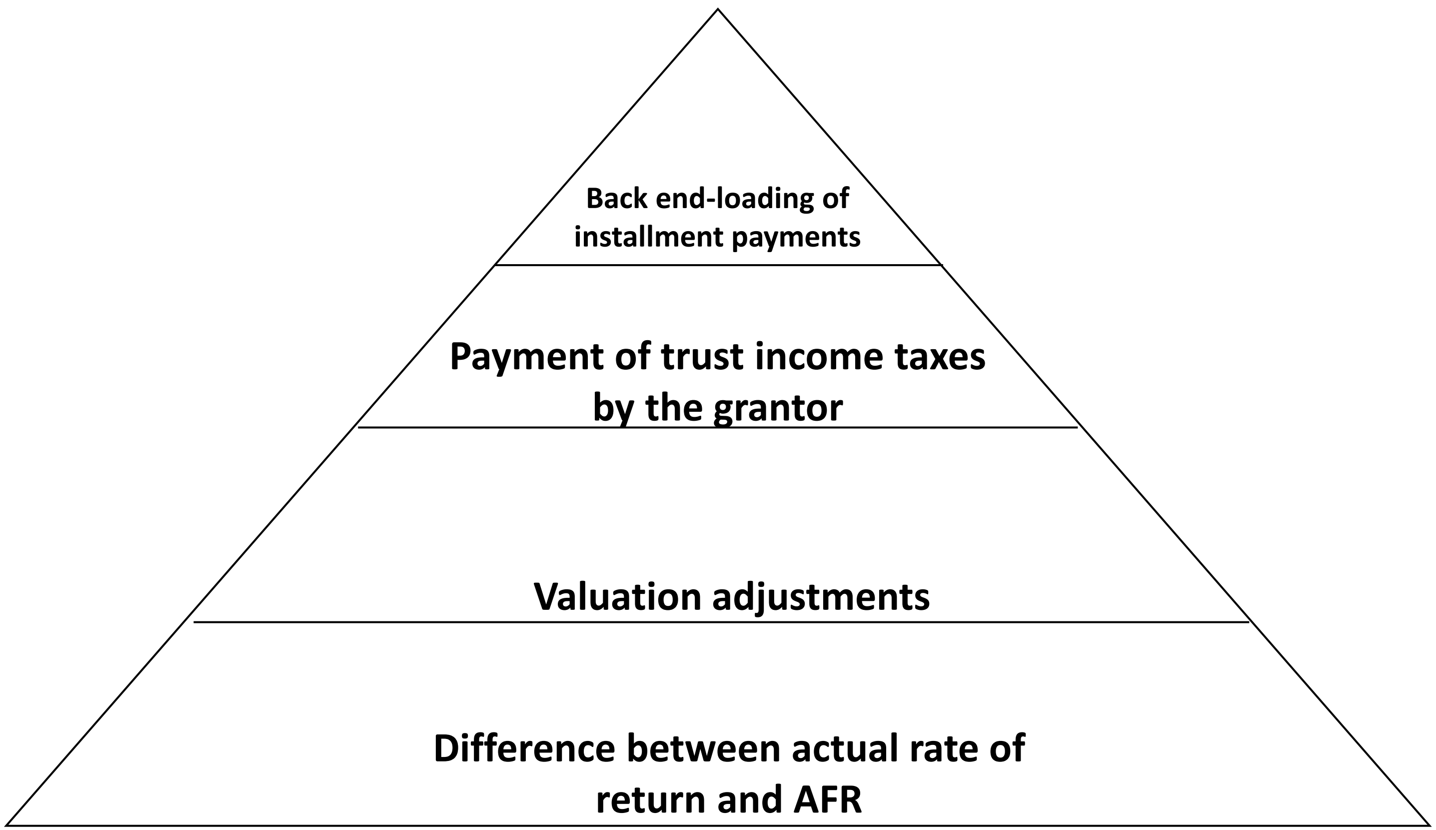
Year	Beginning Balance	Taxable Income 10.00%	Annual Payment	Ending Balance
1	$ 10,000,000	$ 1,000,000	$ (151,200)	$ 10,848,800
2	$ 10,848,800	$ 1,084,880	$ (151,200)	$ 11,782,480
3	$ 11,782,480	$ 1,178,248	$ (151,200)	$ 12,809,528
4	$ 12,809,528	$ 1,280,953	$ (151,200)	$ 13,939,281
5	$ 13,939,281	$ 1,393,928	$ (151,200)	$ 15,182,009
6	$ 15,182,009	$ 1,518,201	$ (151,200)	$ 16,549,010
7	$ 16,549,010	$ 1,654,901	$ (151,200)	$ 18,052,711
8	$ 18,052,711	$ 1,805,271	$ (151,200)	$ 19,706,782
9	$ 19,706,782	$ 1,970,678	$ (151,200)	$ 21,526,260
10	$ 21,526,260	$ 2,152,626	$ (7,151,200)	$ 16,527,686

BENEFIT: $17,687,931 Transferred to Beneficiaries Tax-Free

* Assuming a $7,000,000 (after valuation adjustments) interest only, balloon payment feature installment note with a 2.16% annual interest rate (long-term AFR)

#23 IDGT Sale

Overview



#23 IDGT Sale

Advantages

- Freezes value of appreciation on assets sold in the grantor's taxable estate at the low interest rate on the installment note payable
- No capital gains tax due on installment sale
- Interest income on installment note is not taxable to the grantor
- Grantor pays income tax on trust income, leaving more assets in the IDGT for remainder beneficiaries
- Valuation adjustments increase effectiveness of sale for estate tax purposes

#23 IDGT Sale

Disadvantages

- Estate inclusion of note if grantor dies during term of installment note
- No step-up in basis at grantor's death
- Trust income taxable to grantor during his/her life could cause a cash flow problem if there is not sufficient income earned by the grantor
- Possible gift and estate tax exposure if insufficient assets are used to fund the trust
- Possible taxable gift for amount of loan
- Possible taxable estate inclusion under *Karmazin* (retained life estate)

#24 Domestic Asset Protection Trusts

#24 Domestic Asset Protection Trusts

Overview

- With a $12,060,000 estate tax exemption, many potential clients are putting less focus on estate taxes
- Instead, asset protection is getting more attention (although it always has been just as important)
- The DAPT is gaining more and more popularity
- It enables taxpayers to give away assets and remove future appreciation from their estate while retaining the benefit of the assets if needed

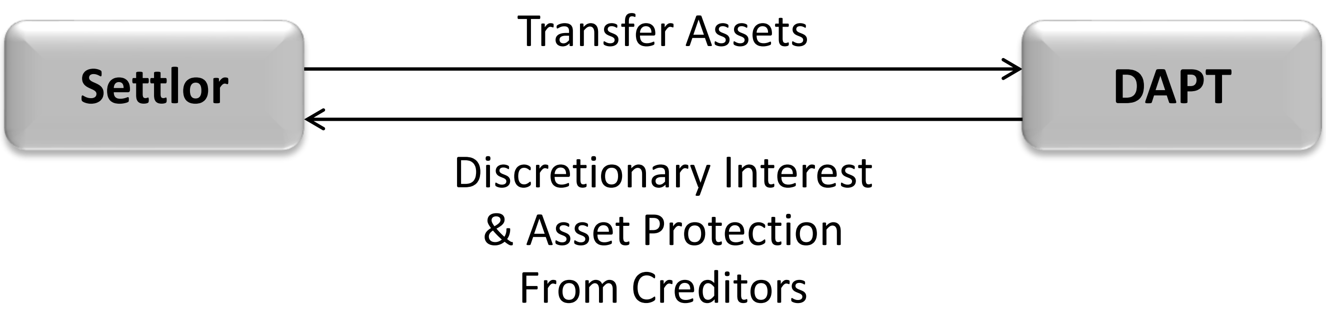
#24 Domestic Asset Protection Trusts

Definition

- A DAPT is an irrevocable trust that is set up under the laws of one of the states that allows a person to be a discretionary beneficiary of his own trust without creditors being able to access it
  - Pick a state with a short statute of limitations
  - Pick a state where no statutory exception creditors can access it

#24 Domestic Asset Protection Trusts

Overview



#24 Domestic Asset Protection Trusts

Strategy

- Strategy:
  - Created in a state that has a law allowing self-settled spendthrift trusts
  - The trust is irrevocable
  - Trustee has absolute discretion to make distributions to the settlor
  - The trust includes a spendthrift clause prohibiting payments to most of the settlor’s creditors
  - The trustee is independent of the settlor and a resident of the selected DAPT state
  - Some or all of the trust assets must be located in the DAPT state
  - Certain special creditors can reach the trust assets

#24 Domestic Asset Protection Trusts

Strategy (continued)

- There is a great strategy which combines a DAPT with two LLCs to create a nearly insurmountable wall
  - Spendthrift trust protection
  - Charging order protection

- This will almost certainly dissuade a potential creditor

#25 Spousal Limited Access Trusts

#25 Spousal Limited Access Trusts

Overview

- A SLAT is a type of domestic asset protection trust (DAPT) in which each spouse creates a trust for the benefit of the other spouse (with the remainder interest passing to his/her heirs).

- The purpose of this trust is to provide a source of cash flow to the spouse-beneficiary while keeping the assets secure from creditors and other legal claims.

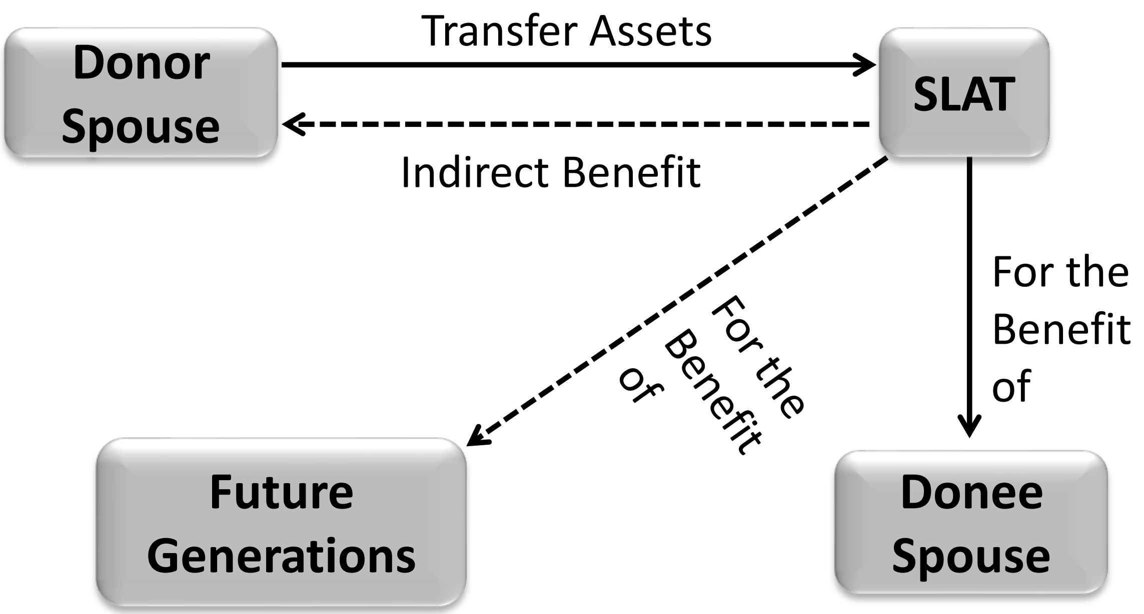
#25 Spousal Limited Access Trusts

Overview (continued)

- Takes advantage of the high applicable exclusion amount
- Removes substantial amounts of appreciation from the estate
- Donor spouse indirectly retains the ability to access the funds if necessary through distributions to the spouse

#25 Spousal Limited Access Trusts

Overview (continued)



#25 Spousal Limited Access Trusts

Caveat

- Caveat: The Reciprocal Trust Doctrine
  - Might apply if both spouses set up a SLAT for the benefit of the other
  - Make the SLATs sufficiently different from each other in order to avoid application of the doctrine

Section 7:
IRC Section 199A Planning

26. IRC § 199A Basics

27. Managing § 199A Limitations

28. Choice of Entity & § 199A

29. Multiple Trusts to Enhance § 199A

30. Aggregating Trades & Businesses

#29 Multiple Trusts to Enhance § 199A

Family Involved in Rental Real Estate – Example

Richard and Delores, a married couple, purchased 500 apartment units between 1975 and 1990. These are managed by others and they pay no wages. The Qualified Business Income from this activity is about $1,900,000 and their total taxable income is about $2,200,000. The original basis of the improvements is fully depreciated so they have a minimal amount of qualified property; about $750,000. Based on these facts, below is a summary of their QBI deduction:

QBI Deduction = Lesser of:

(a) 20% of net business income: $1,900,000 x 20% = **$380,000**

(b) 20% of taxable income: $2,200,000 x 20% = $**440,000**

(c) greater of: (i) 50% of W-2 wages ($0 x 50% = $0) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets: [$0 x 25%] + [$750,000 x 2.5%] = **$18,750**

#29 Multiple Trusts to Enhance § 199A

Family Involved in Rental Real Estate – Example

Richard and Delores, gift interests in the entities which own the properties evenly to 15 trusts set up for each of their four children and 11 grandchildren. The Qualified Business Income and taxable income for each of these trusts is approximately $126,667. This is less than the threshold amount and therefore the limitation does not apply. Based on these facts, below is a summary of their QBI deduction for each trust:

QBI Deduction = Lesser of:

(a) 20% of net business income: $126,667 x 20% = **$25,333**

(b) 20% of taxable income: $ 126,667 x 20% = **$25,333**

Non-Grantor Trust Required

Section 8:

Ten More Must Know Strategies

31. Trust Decanting
32. S-Election to Save Employment Taxes
33. **Portability**
34. **Trusts as IRA Beneficiaries**
35. **Self-canceling Installment Notes**
36. **Qualified Small Business Stock**
37. Opportunity Zones
38. Puerto Rico Tax Incentives
39. Timing NQSO Exercise
40. Cost Segregation

#33 Portability

#33 Portability

Portability Basics

Portability allows the executor to either utilize the decedent's estate tax exclusion amount ($12,060,000 in 2022) or to transfer it to the decedent's surviving spouse.

*However, the new law does not allow the decedent to transfer his/her unused GST tax exemption to the surviving spouse.

See 26 USC 2010(c)(4).

#33 Portability

Portability Basics

Key Issues

The election to transfer the unused estate tax exemption amount ***must be made on a timely-filed estate tax return***

- No election can be made on a late-filed return

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#33 Portability

Mathematics of Portability

"It's a balancing Act"

Estate Tax

Income Tax

#33 Portability

Mathematics of Portability

- Core Concepts – Saving Transfer Tax
  - Estate Tax: 40%
  - GST Tax: 40%
  - Gift Tax: 40%
  - State Estate/Inheritance Tax: 0% - 20%
  - State Gift Tax: 0% - 12%

Core Concepts – Saving Income Tax

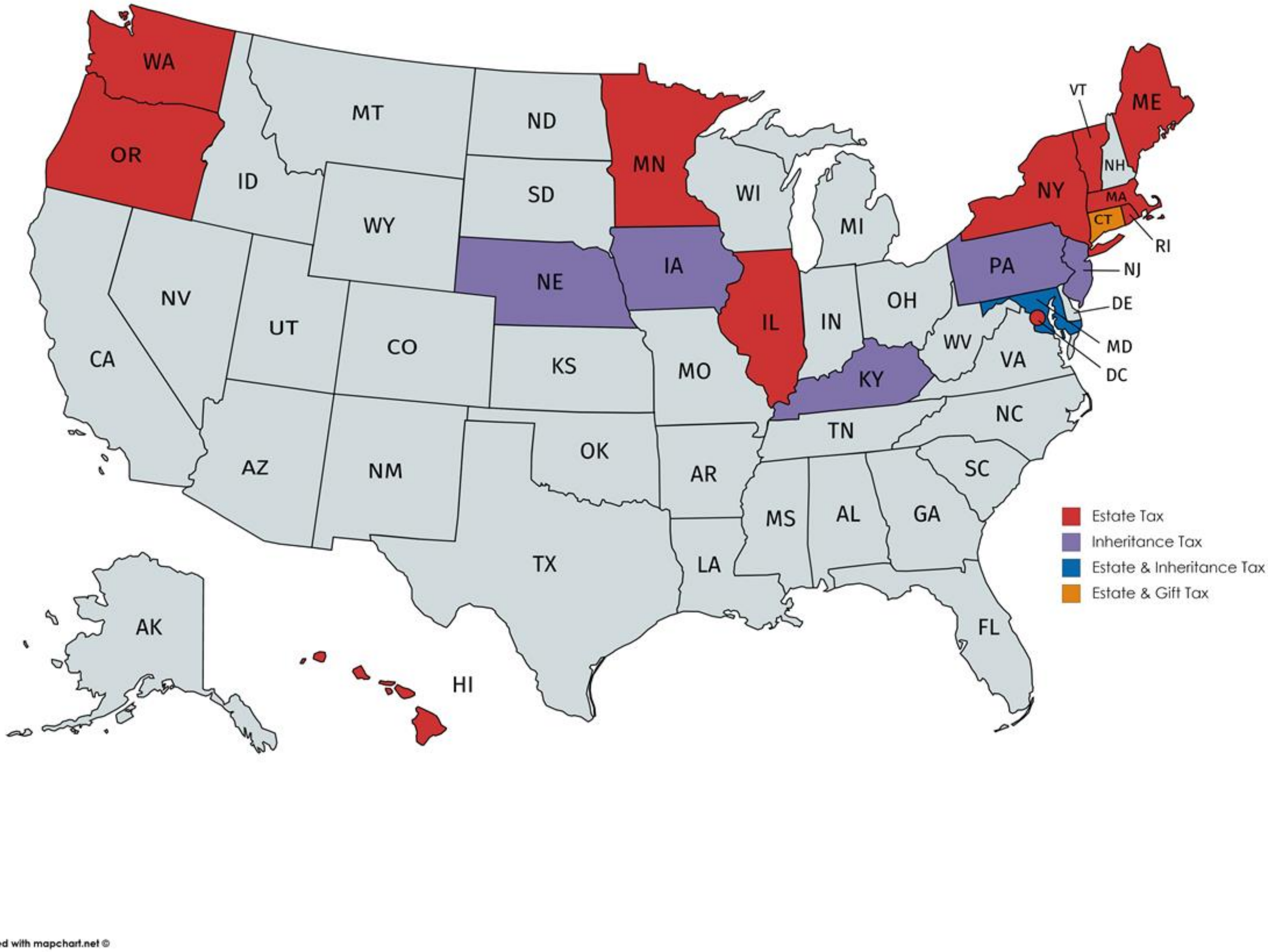
Carryover basis – IRC §1015

Step-up in basis – IRC §1014

Federal Capital Gains Tax

State Capital Gains Tax

Taxation of Trusts and Estates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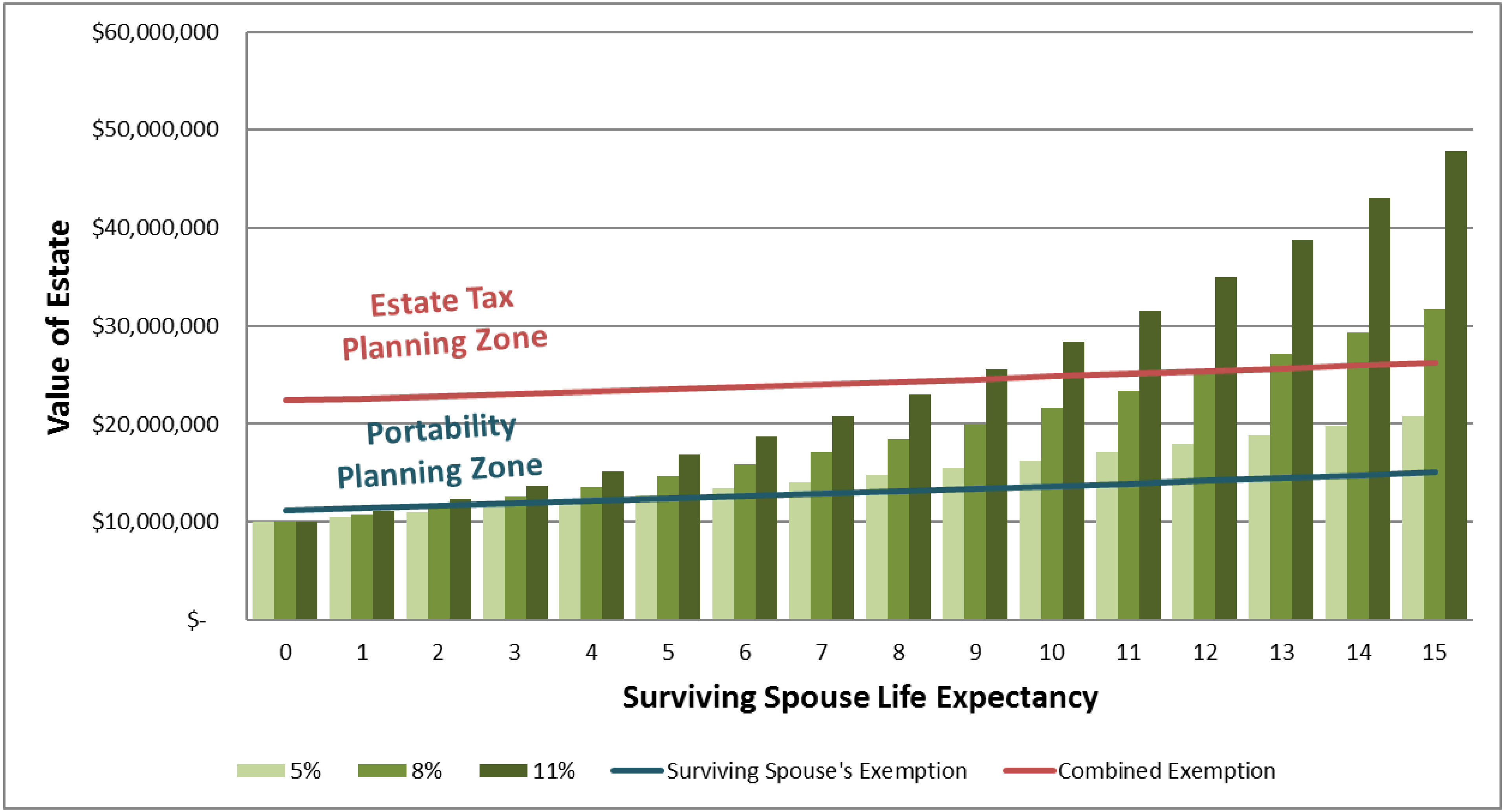


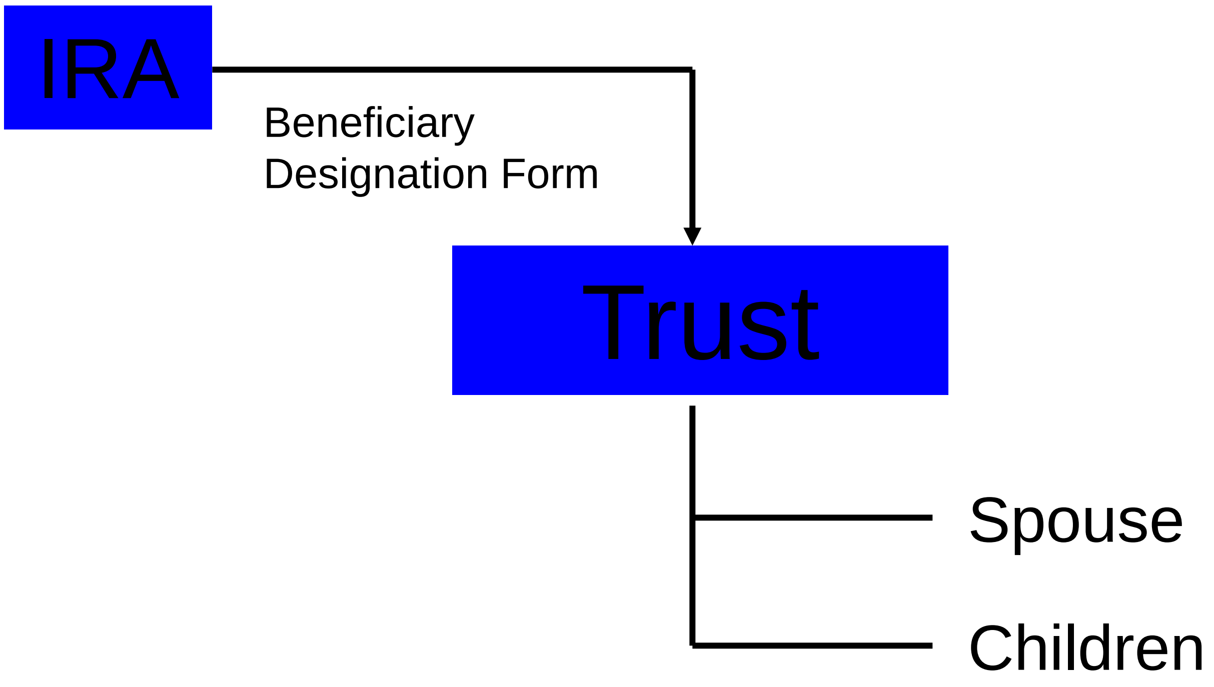
Consider a couple with a combined estate of $10,000,000 and note the effect of a long life expectancy and or a high rate of return.

#34 Trust Named as IRA Beneficiaries

#34 Trust Named as IRA Beneficiaries

Naming a Trust as a “Designated Beneficiary”

An IRA Can Be Payable to a Trust



#34 Trust Named as IRA Beneficiaries
Advantages of Naming a Trust

- Greater assurance distributions will be prudent from a tax perspective
- Greater ability to vary and target distributions by the beneficiary's situation
- Greater assurance the beneficiaries will be named correctly
- Creditor protection
- Dead hand control
- Spendthrift protection
- Divorce protection

#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Balancing Bet-to-Live and Bet-to-Die Strategies

It's a Balancing Act …
Bet to Live? Bet to Die?

#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Balancing Bet-to-Live and Bet-to-Die Strategies

- Transaction similar to an ordinary installment sale to an IDGT
- 9-to-1 debt/equity
- Cancellation-at-death feature added to note
- Premium must be paid, either in the form of additional principal or an increased interest rate to compensate for the cancellation-at-death feature

OBJECTIVE: Reduction of estate tax if premature death occurs

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#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Balancing Bet-to-Live and Bet-to-Die Strategies

- Hedge SCIN—A SCIN designed to hedge against the possibility of death during a bet-to-live strategy (taxable gifts, GRAT, etc. …)

#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Balancing Bet-to-Live and Bet-to-Die Strategies

SINGLE LIFE				JOINT LIFE				
Age	SCIN Risk Premium	AFR	Total Interest Rate	Age 1	Age 2	SCIN Risk Premium	AFR	Total Interest Rate
53	0.867%	2.16%	3.027%	53	53	0.068%	2.16%	2.228%
58	1.340%	2.16%	3.500%	58	58	0.156%	2.16%	2.316%
63	2.033%	2.16%	4.193%	63	63	0.338%	2.16%	2.498%
68	3.173%	2.16%	5.333%	68	68	0.756%	2.16%	2.916%
73	5.101%	2.16%	7.261%	73	73	1.705%	2.16%	3.865%
78	8.186%	2.16%	10.346%	78	78	3.612%	2.16%	5.772%

Assumptions	
Term of Note	10
AFR	2.16%
Payment Frequency	Annually
Type of Note	Interest Only with Balloon Payment

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#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Balancing Bet-to-Live and Bet-to-Die Strategies

Year	Beginning Balance	Taxable Income 10.00%	Annual Payment	Ending Balance
1	$ 10,000,000	$ 1,000,000	$ (724,220)	$ 10,275,780
2	$ 10,275,780	$ 1,027,578	$ (724,220)	$ 10,579,138
3	$ 10,579,138	$ 1,057,914	$ (724,220)	$ 10,912,832
4	$ 10,912,832	$ 1,091,283	$ (724,220)	$ 11,279,895
5	$ 11,279,895	$ 1,127,989	$ (724,220)	$ 11,683,664
6	$ 11,683,664	$ 1,168,366	$ (724,220)	$ 12,127,811
7	$ 12,127,811	$ 1,212,781	$ (724,220)	$ 12,616,372
8	$ 12,616,372	$ 1,261,637	$ (724,220)	$ 13,153,789
9	$ 13,153,789	$ 1,315,379	$ (724,220)	$ 13,744,948
10	$ 13,744,948	$ 1,374,495	$ (7,724,220)	$ 7,395,223

BENEFIT: $8,521,999 transferred to beneficiaries estate/gift tax-free

***NOTE**: Assuming a 78-year-old seller and a $7,000,000 (after valuation adjustments) interest only, balloon payment feature installment note with a 10.346% annual interest rate (2.16% + 8.186% mortality risk premium)**

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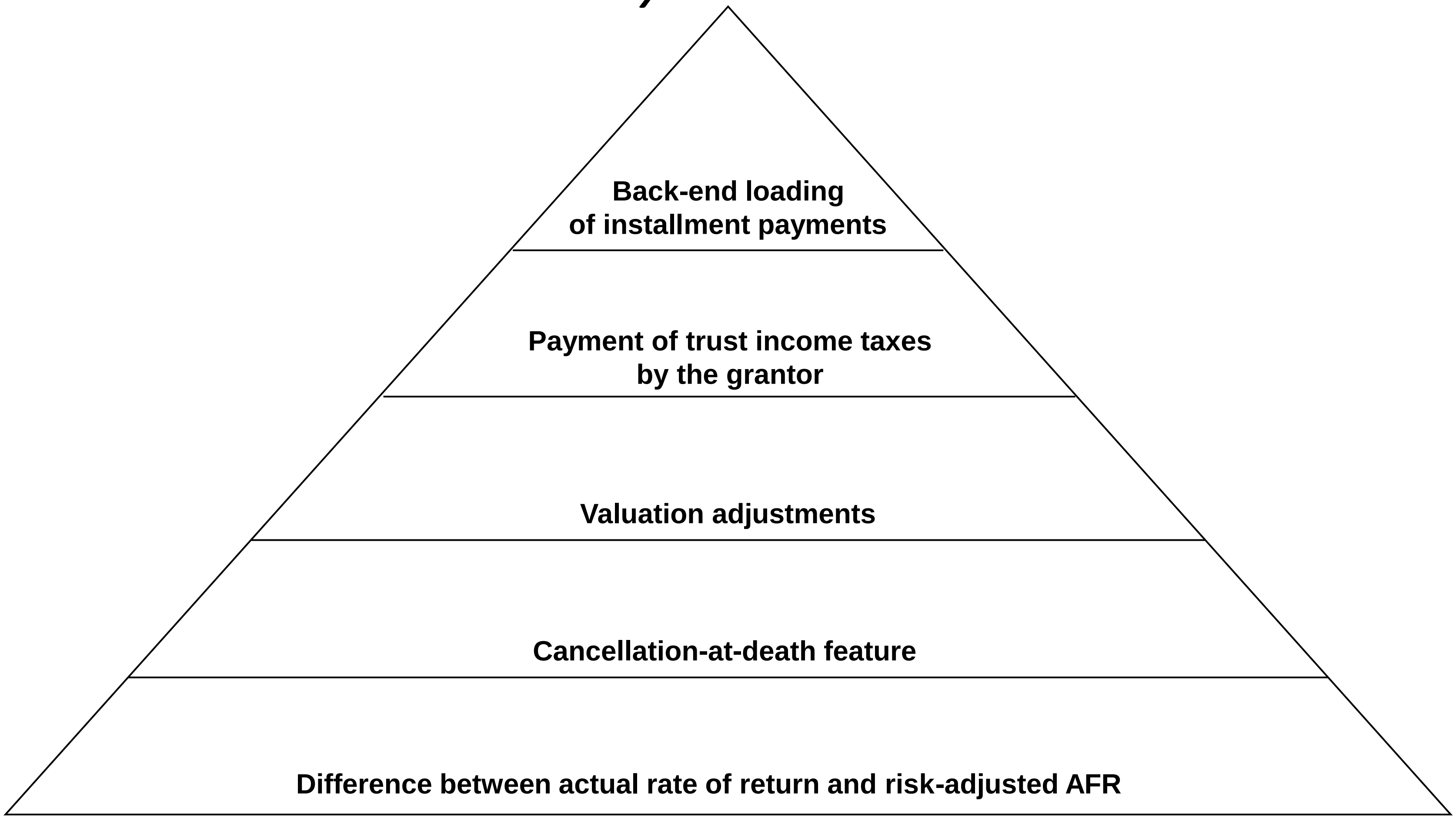
#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Why it works:



#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Advantages

- Future appreciation above the note interest rate, including the risk premium, is removed from the grantor's estate
- Asset not included in grantor's estate in case of premature death during SCIN term
- Value of assets transferred out greatly exceeds value of payments coming back into the estate of the grantor if he/she passes away prematurely

#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Advantages

- No gain or loss on sale
- Trust income taxable to grantor allows for greater appreciation to inure to future generations, thereby creating an additional tax-free gift
- Valuation adjustments increase effectiveness of sale for estate tax purposes

#35 Sales to an IDGT with a Self-Cancelling Installment Note (SCIN) Hedge

Disadvantages

- Complex calculation of risk premium
- Possible gift tax exposure if SCIN risk premium is inadequate
- Possible gift tax exposure if trust is insufficiently funded
- No step-up in basis at grantor's death
- Possible acceleration of capital gain at grantor's death
- Disliked by the IRS

#36 Qualified Small Business Stock

- Taxpayers (other than corporations) may be able to exclude certain percentages of gain on qualified small business stock provided the stock meets the following requirements:
  - Dollar limitation on the amount of gain
  - The stock must be issued after August 9, 1993
  - Must be a C corporation
  - Taxpayer must have acquired the stock at its original issue
  - The stock must be held for more than 5 years
  - The corporation must at all times have gross assets of $50 million or less
  - Must be an active business
  - Must be a qualified trade or business

26 U.S.C. § 1202

#36 Qualified Small Business Stock

Acquisition Period	Exclusion Amount
Aug 9, 1993 - Feb. 17 2009	50%
Feb. 18, 2009 – Sept. 27, 2010	75%
Sept. 28, 2010 and after	100%

Note, there is a 60% exclusion for “empowerment zone businesses”

26 U.S.C. § 1202

#36 Qualified Small Business Stock

Acquisition Period	AMT Add-Back Amount
Aug 9, 1993 - May 6, 2003	42%
May 6, 2003 – Sept. 27, 2010	7%
Sept. 28, 2010 and after	0%

26 U.S.C. § 1202

#36 Qualified Small Business Stock

- The first time the exclusion is claimed it is capped to the greater of:
  - $10,000,000 ($5,000,000 for a married filing separately taxpayer)
  - Ten times the aggregated adjusted basis of the corporations qualified stock disposed by the taxpayer during the tax year (only gain on stock held for ten years is counted)
- – The $10,000,000 limit is reduced in following years by the amount claimed in previous years
- – Adjusted basis is determined without considering any additions to basis after the stock was issued

26 U.S.C. § 1202(b)

#36 Qualified Small Business Stock

- The stock must be in a C corporation
  - "Must be a C corporation during substantially all of the taxpayer's holding period"

26 U.S.C. § 1202(c)

#36 Qualified Small Business Stock

- Qualified small business
  - The corporation must at all times have aggregate gross assets of $50 million or less
  - the term "aggregate gross assets" means the amount of cash and the aggregate adjusted bases of other property held by the corporation
  - the adjusted basis of any property contributed to the corporation shall be determined as if the basis of the property contributed to the corporation were equal to its fair market value as of the time of such contribution
  - members of a parent-subsidiary controlled group (using a more-than-50% ownership test) are treated as a single corporation

26 U.S.C. § 1202(d)

#36 Qualified Small Business Stock

- Active business requirement
  - at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses

26 U.S.C. § 1202(e)

#36 Qualified Small Business Stock

- Working capital
  - Assets held as part of the reasonable working capital needs of the business shall be treated as used in the active conduct of a trade or business
  - Assets held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business shall be treated as used in the active conduct of a qualified trade or business
  - in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business

26 U.S.C. § 1202(e)(6)

#36 Qualified Small Business Stock

- Qualified trade or business requirement
  - any trade or business other than—

(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

(B) any banking, insurance, financing, leasing, investing, or similar business,

(C) any farming business (including the business of raising or harvesting trees),

(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

(E) any business of operating a hotel, motel, restaurant, or similar business.

26 U.S.C. § 1202(e)(3)

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#36 Qualified Small Business Stock

- Eligible corporations
  - any domestic corporation; except that such term shall not include—

(A) a DISC or former DISC,

(B) a corporation with respect to which an election under section 936 is in effect or which has a direct or indirect subsidiary with respect to which such an election is in effect,

(C) a regulated investment company, real estate investment trust, or REMIC, and

(D) A cooperative

26 U.S.C. § 1202(e)(4)

#36 Qualified Small Business Stock

- Maximum real estate holdings
  - No more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business.
  - The ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business

26 U.S.C. § 1202(e)(7)

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Conclusion

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