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This periodic publication highlights developments and trends in trusts and estates from a practical viewpoint based on IPB's experience. Our goal is to share our insights with wealth and philanthropy advisors, corporate fiduciaries, accountants and other advisors in a way that is accessible and actionable. We welcome feedback and additions to our mailing list (ipb@ipbtax.com).

ESTATE TAX REPEAL: WHAT DOES IT REALLY MEAN?

BY H. CARTER HOOD

On April 26, President Trump unveiled a one-page outline for tax-code overhaul that included a call for repeal of the estate tax. Congress is unlikely to enact the President's tax-reform proposal without major changes (if at all), but if enacted, what would estate tax repeal mean?

First, two caveats: Even if the federal estate tax is repealed, the federal gift tax will likely remain. Otherwise, taxpayers could potentially move assets around as "gifts" and avoid income taxes. Also, state estate and inheritance taxes will remain in place in the states that currently have them.

Given those caveats, the effect of estate tax repeal largely depends on whether a decedent's assets would continue to receive a new tax basis equal to their fair market value at the date of death. This "step-up" (or sometimes step-down) in tax basis effectively eliminates any built-in capital gain (or loss) the decedent may have had in his or her assets.

Carry-Over Basis. During his campaign, President Trump proposed replacing the estate tax with "carry-over" basis at death. If that proposal were enacted by Congress, it would eliminate federal estate taxes but could increase the income taxes that would otherwise be owed by heirs when they sell a decedent's assets. Any capital gains would be subject to federal income tax and, if applicable, to state income tax. In some cases, particularly for California residents, the total income taxes generated by selling an asset under a carry-over basis regime could exceed the estate taxes that would have been owed prior to estate tax repeal.

To mitigate this income tax effect (and the record keeping requirements it would impose), any carry-over basis regime would likely permit a step-up for some assets. For example, the law that applied to certain estates in 2010 (the most recent estate tax "repeal") permitted a step-up in basis for assets with a total value (not a total built-in gain) of $3.5 million per decedent. Such a law would permit step-up for the entire estate of most decedents. However, for the largest estates, if the decedent held highly appreciated assets, such as real estate, stock, and art or other collectibles, the income tax cost effect of estate tax repeal could be significant.

Stepped-Up Basis. If estate tax repeal also includes a new tax basis for the decedent's assets equal to fair market value at death, then the traditional estate planning technique of giving away assets during life would be turned on its head. From an income tax perspective, the incentive would be for the senior-most generation to hold all appreciated assets until death, so that they could receive a step-up in basis, and wipe out built-in gains to avoid capital gains taxes entirely. Moreover, the gift tax will likely remain in place, so large gifts made during life would still be subject to gift tax. This tax could be avoided by waiting until death to make such transfers.

Conclusions. If the federal estate tax is repealed, estate planners will be busy day and night revamping client estate plans. However, the changes they will be making depend largely what "repeal" really means and, in particular, whether or not it includes carry-over basis.

INSIDE THIS ISSUE

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INTERNATIONAL ESTATE PLANNING: U.S. TRANSFER TAX RULES APPLY TO NON-RESIDENTS & NON-CITIZENS

BY DOUG ANDRE

Most tax advisers are aware that U.S. citizens and residents with significant wealth are subject to U.S. gift and estate taxes. Less well known is how the U.S. transfer tax system applies to persons who are neither citizens nor residents of the United States. Given the global mobility of wealth, we believe it is increasingly important for advisors to be familiar with transfer tax rules affecting non-resident aliens ("NRAs").

U.S. Resident for Transfer Tax Purposes. A preliminary question that often arises for international clients is whether an individual will be treated as a U.S. resident for federal gift or estate tax purposes. This question may hinge on an applicable U.S. estate tax treaty, but domestic law applies in the absence of a treaty. Non-U.S. citizens who are residents of the United States are subject to federal gift and estate taxes in the same manner as U.S. citizens (*e.g.*, gifts in excess of the annual exclusion amount are subject to reporting and potentially gift tax, and the individual's worldwide assets owned at death are subject to estate tax).

A "resident" (for gift tax purposes) is an individual who is domiciled in the United States at the time of the gift. A "resident decedent" is an individual who, at the time of death, maintained his domicile in the United States. A person acquires a domicile in a place by living there, for even a brief period, with no definite present intention of moving. Thus it is possible for an individual to be treated as a resident for transfer tax purposes even though he may not be a resident for income tax purposes (*i.e.*, because he is not a lawful permanent resident, has not satisfied the substantial presence test and has not made a first-year election).

Gift and Estate Tax Rules that Apply to NRAs. An NRA or her estate may be subject to U.S. gift or estate tax upon a transfer of "U.S. situs property." U.S. situs property includes real and tangible personal property located in the United States at the time of the transfer. It also includes certain U.S. financial assets (*e.g.*, shares of stock) issued by or enforceable against a U.S. person. Securities and other intangible property are not subject to U.S. gift tax but U.S. situs intangible property will be subject to estate tax if owned by a non-resident decedent at death. Gift and estate taxes are imposed on the fair market value of the transferred property, and marginal tax rates begin at 18% and quickly increase to 40% for all transfers over $1,000,000. Note that absent a treaty provision to the contrary, the applicable exclusion amount for estates of non-resident decedents is $60,000 (as compared with $5.49 million for U.S. persons who die in 2017).

NRA clients can avoid U.S. transfer taxes by making lifetime gifts of U.S. intangible property or holding property that is otherwise U.S. situs property through a non-U.S. holding company. To be effective, the client should respect the non-U.S. company's separate status and operate the company at all times as a genuine business, observing all of the formalities of corporate law in the country where the company is organized.

International Enforcement. NRAs should not rely on their "anonymity" with respect to the reach of the U.S. transfer tax system. U.S. tax claims are enforceable in many foreign jurisdictions as a result of applicable provisions in a bilateral tax treaty or under the provisions of the OECD's "Convention on Mutual Administrative Assistance in Tax Matters." This Convention, which entered into force in 1995, provides for "all possible forms" of administrative co-operation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion.

SMLLC: LESSONS FOR ESTATE PLANNING AND ADMINISTRATION

BY LINDA KOTIS

Scenario. Suppose a Virginia widow calls about a New York single member limited liability company ("SMLLC") she formed several years ago to hold a home she owns in Albany. Her daughter's family now uses the property as their primary residence and pays rent to the SMLLC. The widow was advised to create the SMLLC to avoid ancillary probate and NY state estate tax. She is looking at her estate plan and wants to know how the SMLLC will be treated at her death.

Estate Tax and Probate Consequences. This SMLLC may have costly consequences for the widow's estate. First, a New York state estate tax return will be required, as though the widow owned the property outright. A decedent's membership interest in a NY SMLLC that holds a New York residence is treated as real property, not intangible personal property, for purposes of NY state estate tax. This is the case unless the SMLLC had previously elected to be treated as a corporation for income tax purposes (see TSB-A-16(3)M, a 2016 advisory opinion from the NY State Department of Taxation).

Depending on the property's value and the widow's disposition of her estate, NY estate tax may be due. Filing a NY non-resident estate tax return requires the submission of a NY State Estate Tax Domicile Affidavit. The details required on the affidavit could trigger inquiries from the NY Department of Taxation and Finance into the decedent's residential status at death.

Second, the SMLLC may be subject to dissolution. This may occur when the LLC agreement (i) is silent about what happens to the sole member's interest when she dies and (ii) authorizes dissolution in accordance with the NY LLC Act. The Act states that an LLC is dissolved when there are no members left, unless the LLC agreement provides otherwise. Commentators differ on whether the SMLLC interest could continue to be treated as intangible personal property for probate purposes or if instead, ancillary probate would be required.

Potential Solutions. There are a few solutions to avoid state estate tax. The widow could transfer a small interest in the entity to her daughter now and admit her as a new member. The real property could be owned instead by a partnership, with partnership interests held in a revocable trust. Or the SMLLC could elect now to be treated as a corporation. (A retroactive election after the widow's death cannot be made.) Note that this solution has potential negative income tax consequences. If the real property has appreciated in value and is then sold, the corporation will pay federal and state income tax on the gain. When the sales proceeds are distributed, there will also be tax at the shareholder level.

The dissolution issue can be fixed after death. Even if the LLC agreement is silent on admitting new members, the NY LLC Act allows an executor to become a member in the decedent's place. Note that the agreement to continue the LLC and admit the executor must be done within 180 days of the decedent's death. A client interested in creating a SMLLC should consult a qualified practitioner to review potential tax and probate issues that may adversely affect her estate.

Past Issues of IPB Tax, Trusts & Estates

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Beware the Hotel California Trusteeship: *You Can Check Out Any Time You Want, But You Can Never Leave*

BY KASEY PLACE

We're all familiar with the concept of at-will employment. We can quit our job at any time and can't be forced to provide personal services. The same is not always true of a trusteeship. Many states still follow the common law rule, which requires court approval for a trustee to resign unless the trust agreement says otherwise. *See, e.g.*, MD Est. & Trusts Code § 14.5-705.

This burdensome result can be avoided with proper drafting. Modern trusts typically include a provision like the following: "[t]he trustee may resign at any time, without court approval, by providing at least 30 days' notice to the income beneficiary." However, it is not uncommon to see trusts that are silent on the subject.

In some cases, the ability to resign may be implicit. Even if the trust agreement does not mention resignation, the trustee can arguably resign at will if the agreement names a successor to serve in the event the initial trustee is no longer "able or willing." *See Oregon Bank v. Hendricksen*, 267 Or. 138, 140 (1973).

In other cases, state law may provide flexibility. For example, some states permit resignation without court approval if the beneficiaries consent. *See, e.g.*, CA Prob. Code § 15640. Others permit resignation at will, subject to a notice requirement. *See, e.g.*, VA Code § 64.2-758; UTC § 70.

Nevertheless, such flexibility does little good unless there is a qualified co-trustee or successor trustee who is ready and willing to take over. The resigning individual continues to have all the duties and liabilities of a trustee until he or she delivers the trust assets to a replacement. *See, e.g.*, UTC § 707(a). In other words, the resignation doesn't truly become effective until the successor trustee accepts his or her position.

As a result, individuals should think long and hard before accepting a trusteeship. Unless the trust agreement or state law authorizes resignation at will and there is a qualified successor waiting in the wings, quitting can be much harder than one would expect.

IPB IN THE NEWS ...

- Ten Ivins Attorneys Named as 2017 DC Super Lawyers, including Carter Hood, Doug Andre and Kasey Place
- Ivins Attorney Doug Andre Quoted Regarding First Quarter Expatriation, *BloombergBNA Daily Tax Report*, May 10, 2017
- H. Carter Hood, Panelist: "Back to Basics: Analyzing the Differences Between Fiduciary Accounting Income ("FAI") and Distributable Net Income ("DNI")", American Bar Association 2017 May Meeting, May 11-13, 2017
- Doug Andre, Co-Presenter on "Global Mobility of Employees" Practical Strategies", at Tax Executives Institute Conference in Raleigh, NC, April 28, 2017
- Commentary by Linda Kotis, *LISI Estate Planning Newsletter*, "Reform School - Lessons on Rescuing an Undesirable Tax Plan after Death," April 27, 2017
- "Nonjudicial Settlement Agreements" by Linda Kotis (*Probate and Property)* March/April 2017
- Ivins Attorney Doug Andre Quoted Regarding Expatriation, *BloombergBNA Daily Tax Report*, February 9, 2017

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