2019 Year-End Private Wealth Advisory

November 25, 2019

Overview

In 2019, the Tax Cuts and Jobs Act (the Act) and its resulting tax reform continued to dominate the planning landscape. As outlined in our 2018 Year-End Estate Planning Advisory, the Act made significant changes to individual and corporate income taxes, restructured international tax rules, provided a deduction for pass-through income and eliminated many itemized deductions. Most significantly for estate planning purposes, the Act temporarily doubled the estate, gift and generation-skipping transfer (GST) tax exemptions. Absent legislative action, many of the changes imposed under the Act — including the increased exemptions — will sunset after December 31, 2025, with the laws currently scheduled to revert back to those that existed prior to the Act. Given the uncertain political landscape, practitioners continue to view this temporary increase in exemption amounts as an unprecedented opportunity for valuable estate planning.

This year, the Internal Revenue Service (Service) issued technical corrections and guidance on several provisions of the Act, including addressing differences between the exemption amounts at the date of a gift and exemption amounts at the date of a taxpayer's death (often referred to as "clawback"). Additionally, one of the most significant cases decided in 2019 was the Supreme Court's long-awaited decision in *North Carolina Department of Revenue v. Kimberly Rice Kaestner 1992 Family Trust. Kaestner* was the first case in decades in which the Supreme Court addressed the limits of the constitutionality of state taxation of trusts.

While the permanency of the Act's provisions still remains uncertain, the current environment provides a great deal of opportunity for new planning. We are encouraging clients to build flexibility into their estate plans and to use this window of opportunity to engage in planning to take advantage of the increased estate, gift and GST tax exemptions.

The following are some key income and transfer tax exemption and rate changes under the Act, including inflation adjusted amounts for 2020:

Federal estate, GST and gift tax rates

For 2019, the estate, gift and GST applicable exclusion amounts are $11.4 million. For 2020, the estate, gift and GST applicable exclusion amounts will be $11.58 million. The maximum rate for estate, gift and GST taxes will remain at 40 percent.

Annual gift tax exemption

Each year individuals are entitled to make gifts using the "Annual Exclusion Amount" without incurring gift tax or using any of their lifetime applicable exclusion amount against estate and gift tax. The Annual Exclusion Amount is $15,000 per donee in 2019. Thus, this year, a married couple together can gift $30,000 to each donee without gift tax consequences. In 2020, the annual exclusion for gifts will remain at $15,000. The limitation on tax-free annual gifts made to noncitizen spouses will increase from $155,000 in 2019 to $157,000 in 2020.

Federal income tax rates

- The Act provides for seven individual income tax brackets, with a maximum rate of 37 percent. The 37 percent tax rate will affect single taxpayers whose income exceeds $500,000 (indexed for inflation and $518,400 in 2020) and married taxpayers filing jointly whose income exceeds $600,000 (indexed for inflation and $622,050 in 2020). Estates and trusts will reach the maximum rate with taxable income over $12,500 (adjusted for inflation and $12,950 in 2020).
- A 0 percent capital gains rate applies for single filers with an income up to $38,600 ($40,000 for 2020) or married taxpayers filing jointly with an income up to $77,200 ($80,000 in 2020). A 15 percent capital gains rate applies for income above this threshold up to $425,800 for single taxpayers ($441,450 in 2020) and $479,000 for married taxpayers filing jointly ($496,600 in 2020). The 20 percent capital gains rate applies above these thresholds.
- The standard deduction was increased to $24,000 ($24,800 in 2020) for married individuals.
- In 2019, the threshold for the imposition of the 3.8 percent Medicare surtax on investment income and 0.9 percent Medicare surtax on earned income is $200,000 for single filers, $250,000 for married filers filing jointly and $12,750 for trusts and estates ($12,950 in 2020).

Tax cuts and jobs act

The Act has proven to have many implications for domestic corporate and individual income tax, as well as federal gift, estate and GST tax, fiduciary income tax and international tax implications. Since the Act's enactment, various technical corrections have been issued, as has the Service guidance on certain aspects of the new tax regime. In light of the Act and recent guidance from the Service, it is important to review existing estate plans, consider future planning to take advantage of the increased exemption amounts and maintain flexibility to allow for future strategic planning. Because of the continued importance of the Act's new tax laws, the most significant changes and recent guidance are summarized below.

Gift, estate, and GST exemptions, rates and stepped-up basis

The Act retained the federal estate, gift and GST tax rates at a top rate of 40 percent, as well as the marked-to-market income tax basis for assets includible in a decedent's taxable estate at death.

While the federal gift, estate and GST taxes were not repealed by the Act, fewer taxpayers will be subject to these transfer taxes due to the Act's increase of the related exemption amounts. Under the Act, the base federal gift, estate and GST tax exemptions doubled from $5 million per person to $10 million per person, indexed for inflation. As noted above, the relevant exemption amount for 2019 is $11.4 million per person, resulting in a married couple's ability to pass $22.8 million worth of assets free of federal estate, gift and GST taxes. These amounts will increase each year until the end of 2025, with inflation adjustments to be determined by the chained Consumer Price Index (CPI) (which will lead to smaller increases in the relevant exemption amounts in future years than would have resulted from the previously used traditional CPI). The exemption amount in 2020 will be $11.58 million. Without further legislative action, the increased exemption amounts will sunset, and the prior exemption amounts (indexed for inflation, using the chained CPI figure) will be restored, beginning in 2026.

While the federal estate tax exemption amount has increased, note that multiple U.S. states impose a state level estate tax. The estate tax exemption amount in some of these states matches, or will match, the increased federal estate tax exemption amount. However, in other states, such as Illinois and New York, the state estate tax exemption amount will not increase with the federal estate tax exemption amount, absent a change in relevant state law. Additionally, states may have their own laws that impact planning in that state.

The federal estate tax exemption that applies to nonresident aliens was not increased under the Act. Under current law, the exemption for nonresident aliens remains at $60,000 (absent the application of an estate tax treaty).

"Anti-clawback" regulations

While there is uncertainty about whether future legislation will address the sunset, either by extending the new exemption amounts beyond 2025 or changing the exemption amounts further, the Service has issued guidance on how it will address differences between the exemption amounts at the date of a gift and exemption amounts at the date of a taxpayer's death (often referred to as a "clawback"). In Proposed Regulations REG-106706-18, the Service clarified that a taxpayer who takes advantage of the current lifetime gift tax exemption will not be penalized if the exemption amount is lower at the taxpayer's death. If a taxpayer dies after January 1, 2026, having used more than the statutory $5 million basic exclusion (indexed for inflation) but less than the $10 million basic exclusion (indexed for inflation), the taxpayer will be allowed a basic exclusion equal to the amount of the basic exclusion the taxpayer had used. However, any exemption unused during a period of higher basic exclusion amounts will not be allowed as an additional basic exclusion upon death. Additionally, the Service clarified that if a taxpayer exhausted his or her basic exclusion amount with pre-2018 gifts and paid gift tax, then made additional gifts or died during a period of high basic exclusion amounts, the higher exclusion will not be reduced by a prior gift on which gift tax was paid.

The Proposed Regulations do not permit gifts made during the period that the basic exclusion amount is $10 million (indexed for inflation) to "come off the top" of the higher basic exclusion amount. For example, if a taxpayer who has never made a taxable gift makes a gift of $5 million, and then dies after the basic exclusion amount has decreased back to $5 million, the gift will not be deemed to use the "extra" (indexed) $5 million of basic exclusion amount available until 2026. Instead, the gift would be deemed to use the taxpayer's $5 million basic exclusion amount. The Service could have provided that any gifts prior to 2026 come "off the top" of the $10 million exclusion amount. In that case, a taxpayer who makes a $5 million gift, when the basic exclusion amount is $10 million, could still retain all of the taxpayer's $5 million exclusion amount after the basic exclusion amount is reduced to $5 million in 2026. Additionally, the Proposed Regulations did not address how the reduction in the basic exclusion amount would affect portability of estate tax upon the death of a spouse.

Income taxation of trusts and estates

The Act added new Code Section 67(g), which applies to trusts and estates as well as individuals, and provides that no miscellaneous itemized deductions (all deductions other than those specifically listed in Code Section 67(b)) are available until the Act sunsets after December 31, 2025. While the Act doubled the standard deduction for individuals, taxpayers that are trusts and estates are not provided a standard deduction. Under the Act, trust investment management fees will no longer be deductible. After the enactment of the Act, there was uncertainty about the deductibility of fees directly related to the administration of a trust or estate (e.g., fiduciary compensation, legal fees, appraisals, accountings, etc.). Historically, these fees had been deductible under Code Section 67(e) and without regard to whether they were miscellaneous itemized deductions or not. In Notice 2018-61, the Treasury issued guidance on whether new Code Section 67(g) eliminates these deductions. This Notice provides that expenses under Code Section 67(e) are not itemized deductions, and therefore are not suspended under new Code Section 67(g). Note that only expenses incurred solely because the property is held in an estate or trust will be deductible. While the Notice was effective July 13, 2018, estates and non-grantor trusts may rely on its guidance for the entire taxable year beginning after December 31, 2017.

New Code Section 67(g) may also impact a beneficiary's ability to deduct excess deductions or losses of an estate or trust upon termination. Prior to the Act, it was common tax planning to carry out unused deductions of a trust or estate to the beneficiary upon termination, so the deductions could be used on the beneficiary's personal income tax return. Under new Code Section 67(g), these deductions are miscellaneous itemized deductions, and therefore would no longer be deductible by the beneficiary. Notice 2018-61 notes that the Service and the Treasury recognize that Section 67(g) may impact a beneficiary's ability to deduct unused deductions upon the termination of a trust or an estate, and the Service and Treasury intend to issue regulations in this area and request comments on this issue. In the interim, taxpayers should consult with their advisors about whether it would be prudent to engage in planning to utilize (to the extent permissible) these deductions at the trust or estate level.

Finally, the Act made a number of taxpayer-friendly changes to the taxation of electing small business trusts (ESBTs). Nonresident aliens are now permissible potential beneficiaries of ESBTs, as discussed below. Also, the charitable deduction rules for ESBTs are now governed by Code Section 170 instead of Code Section 642(c), which means that several restrictions imposed by Code Section 642(c) (e.g., that the charitable donation be paid out of income and pursuant to the terms of the trust) no longer apply. Additionally, an ESBT's excess charitable deductions can now be carried forward five years, but the percentage limitations and substantiation requirements will now apply.

Income tax

The Act made significant changes to the federal income tax. While many federal income tax changes under the Act are beyond the scope of this Advisory, some are particularly relevant to estate planning. The deduction for state and local taxes (SALT deduction) was retained but is now limited to $10,000 for jointly filing taxpayers or unmarried taxpayers. The $10,000 limit also applies to trusts. Almost immediately after the Act's passage, a number of states implemented workarounds to the SALT deduction limit by allowing residents to "contribute" to state-controlled charitable funds in exchange for SALT credits. The aim of these workarounds was to allow residents to characterize such contributions as fully deductible charitable contributions for federal income tax purposes, while simultaneously permitting a credit for state or local income, real estate or other taxes for the same contribution. In the final regulations issued in August 2018 and published on June 13, 2019, the Service responded to these workarounds by limiting federal income tax deductions that taxpayers, including trusts or estates, are able to take upon charitable contributions to such state-controlled charitable funds under Code Section 170.

Under the Proposed Regulations, a taxpayer who makes payments or transfers property to an entity eligible to receive tax deductible contributions would have to reduce the taxpayer's charitable deduction by the amount of any state or local tax credit the taxpayer receives or expects to receive. Therefore, a tax credit received in return for the contribution is treated as a quid pro quo benefit for the contribution, reducing the amount of the charitable income tax deduction otherwise available dollar for dollar. However, there is a de minimis exception — if the amount of the SALT credit does not exceed 15 percent of the amount of the contribution, the taxpayer's charitable income tax deduction is not required to be reduced.

In response to inquiries about how these rules would apply to businesses making charitable contributions, Rev. Proc. 2019-12 was issued to provide safe harbors for C corporations and pass-through entities that make charitable contributions, receive a state and local tax credit, and deduct the payments as a business expense. Under the Revenue Procedure, C corporations may deduct the entire payment as a business expense, even if the corporation receives a state tax credit. Pass-through entities may deduct the payment as a business expense if the credit offsets a state or local tax other than an income tax (for example, franchise tax or property tax).

The Act also has implications for married couples who are divorcing or contemplating a divorce. The Act changed prior law to provide that alimony payments will not be deductible by the payor and will not be deemed to be income to the recipient. The Act also repealed Code Section 682, which generally provided that if a spouse created a grantor trust for the benefit of his or her spouse, the trust income would not be taxed as a grantor trust as to the grantor-spouse after divorce to the extent of any fiduciary accounting income the recipient-spouse is entitled to receive. Due to the repeal of Code Section 682, a former spouse's beneficial interest in a trust may cause the trust to be taxed as a grantor trust as to the grantor-spouse even after divorce. These changes to the taxation of alimony and the repeal of Code Section 682 do not sunset after 2025; they apply to any divorce or separation instrument executed after December 31, 2018, or any divorce or separation instrument executed before that date but later modified, if the modification expressly provides that changes made by the Act should apply to the modification.

Charitable deduction

The Act increases the percentage limitation on cash contributions to public charities from 50 percent of the donor's contribution base (generally, the donor's adjusted gross income) to 60 percent. This 60 percent limitation applies if only cash gifts are made to public charities. The deduction limitations remain the same for donations of other assets, such as stock, real estate and tangible property.

Business entities

The Act reduced the top corporate income tax rate to 21 percent. To decrease the discrepancy in the tax rates between C corporations and pass-through entities, the Act also addressed taxation of pass-through entities (partnerships, limited liability companies, S corporations or sole proprietorships) that would typically be taxed at the rate of the individual owners. Generally, new Section 199A provides a deduction for the individual owner of 20 percent of the owner's qualified business income (QBI). This deduction has the effect of reducing the effective income tax rate for an owner in the highest tax bracket from 37 percent to 29.6 percent. The deduction is subject to numerous limitations and exceptions. Notably, the deduction may be limited for taxpayers over a certain taxable income threshold ($315,000 for married taxpayers filing jointly, and $157,500 for other taxpayers, to be adjusted for inflation in future years). For these taxpayers, the deduction may be subject to limitations based on whether the entity is a "specified service business" (an SSTB, which is generally a trade or business involving the performance of services in health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing and investment management, trading or where the principal asset is the reputation or skill of one or more employees), the W-2 wages paid by the business entity and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business. The Service issued Final Regulations on Section 199A on January 18, 2019, followed by a slightly corrected version on February 1, 2019. The Service also issued Rev. Proc. 2019-11, providing guidance on calculating W-2 wages for the purposes of Section 199A and Notice 2019-07, providing a safe harbor for when a rental real estate enterprise will qualify as a business for purposes of Section 199A. The rules surrounding the deduction, as well as the Final Regulations, are very complex, and taxpayers should consult with their tax advisors to determine the implications of the Section 199A deduction. Section 199A is effective until December 31, 2025.

Qualified opportunity zones

The Act provides federal income tax benefits for investing in businesses located in "Qualified Opportunity Zones". Opportunity zones are designed to spur economic development and job creation in distressed low-income communities in all 50 states, the District of Columbia, and U.S. possessions. By investing eligible capital in a Qualified Opportunity Fund (a corporation or partnership that has at least 90 percent of its assets invested in qualified opportunity zone property on two measuring dates each year) that has invested in qualified opportunity zone property in any of these communities, and meeting certain other requirements, investors can gain certain tax benefits, including the deferral or exclusion of existing gain or nonrecognition of gain. The Service issued proposed regulations and Rev. Rul. 2018-29 on October 19, 2018, and a second set of proposed regulations on April 17, 2019, which addressed, among other issues, what transactions would trigger recognition of previously deferred gains. The Qualified Opportunity Zone regime is complex and may impact the tax and estate planning of investors. Taxpayers should consult with their tax and estate planning advisors to discuss the potential tax benefits and implications.

Secure act

As of the date of this Advisory, the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE

Act) is pending in Congress but has not yet been enacted. Under current law, an IRA owner must begin withdrawing required minimum distributions (RMDs) from a traditional IRA by April 1 of the year following the year the account owner turns 70½. The SECURE Act would increase the required minimum distribution age for taking RMDs from traditional IRAs from 70½ to 72. This change would be effective for distributions required to be made after December 31, 2019, for individuals who attain age 70½ after that date.

Additionally, the SECURE Act would change the distributions of retirement accounts after the death of an IRA account owner. Under current law, a non-spouse designated beneficiary of an IRA may be able to take distributions over the beneficiary's own life expectancy. Under the SECURE Act, non-spouse beneficiaries would generally be required to take complete distribution of inherited IRA benefits by the end of the 10th calendar year following the IRA owner's death. The 10-year term would apply regardless of whether the IRA owner died before his or her required beginning date. A designated beneficiary who is a spouse, minor child, disabled or chronically ill person, or person not more than 10 years younger than the IRA owner would be exempt from this rule. However, with respect to a minor child, the benefits must be distributed within 10 years from when the child attains the age of majority. This change would become generally effective for persons dying after December 31, 2019.

Important cases decided in 2019

Constitutionality of state taxation of trusts

North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust, 588 U.S. __ (June 21, 2019)

States have varying requirements to determine whether, and to what extent, a state can tax the undistributed income of a trust. Some states consider the residence of the grantor when the trust was established, some states look at the residence of the trustee, and some states impose tax liability on a trust if one or more trust beneficiaries are residents of that state. However, some attempts by states to impose state income taxation on trusts using existing statutes have been found to violate the U.S. and state constitutions. On June 21, 2019, the U.S. Supreme Court issued an opinion in *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, holding that the North Carolina statute subjecting the trust to state income taxation based solely on a beneficiary's residence in the state violates the Due Process Clause, as applied to that particular trust, where the beneficiaries received no income in the tax years at issue, had no right to demand income in the tax years at issue and had no certainty of ever receiving distributions of income from the trust.

The Kaestner 1992 Family Trust (the Trust) was created in New York and governed by New York law. When the Trust was created, no beneficiaries lived in North Carolina. In 1997, Kimberly Rice Kaestner (the grantor's daughter and a primary beneficiary) became a North Carolina resident. The Trust had no other connections to North Carolina: during the years at issue, the trustee was a Connecticut resident, the Trust records, documents and books were kept in New York, all Trust tax returns and accountings were prepared in New York, the custodians of the Trust's assets were located in Massachusetts, and no Trust income was generated from investments located in North Carolina. All Trust distributions were made in the trustee's sole discretion, so the North Carolina resident beneficiary had no absolute right to the Trust's assets or income. Additionally, no distributions were actually made to the North Carolina resident beneficiary during the years at issue. The trust instrument did instruct the trustee to distribute the assets to the North Carolina resident beneficiary when she reached a specified age, but this did not occur during the tax years at issue.

North Carolina imposes income tax on trusts based on the residence of the beneficiaries. Pursuant to N.C.G.S. Section 105-160.2, "[t]ax is computed on the amount of the taxable income of the estate or trust that is for the benefit of a resident of this State". For the tax years of 2005-2008, the Trust paid in excess of $1.3 million in taxes on its accumulated income to the North Carolina Department of Revenue based on Ms. Kaestner's residence in North Carolina.

The Trust sought a refund of tax previously paid for the tax years 2005-2008, arguing that the relevant portion of the North Carolina statute that imposed a tax on trust income was unconstitutional. When the refund claim was denied, the Trust brought suit challenging the constitutionality of the statute, both on its face and as applied to the Trust. The North Carolina Business Court, the North Carolina Court of Appeals and the North Carolina Supreme Court held that the statute, as applied to the Trust, was unconstitutional.

In evaluating the basis for taxation, the Supreme Court noted that the possession, control and enjoyment of trust assets within a state is a significant factor to support taxation of a trust under the Due Process Clause. In *Kaestner*, the Supreme Court highlighted that, in the years at issue, the in-state beneficiaries had not received any distributions from the Trust and had no rights to control, possess or enjoy the Trust assets or to compel distribution from the Trust. Therefore, the mere residence of the beneficiaries in North Carolina does not supply the required "minimum connection" necessary to support state taxation of the Trust.

This case was significant, as practitioners and taxpayers hoped that the Supreme Court would offer guidance on the factors used by other statutes and other situations in determining whether a state can impose income tax on the undistributed income of trusts. While the decision is a taxpayer victory, the opinion provides little guidance as to the constitutionality of applying those various factors to determine income taxation. However, the opinion does highlight that due process requires "minimum contacts" and an inquiry into the reasonableness of the government's action.

Some points of the Supreme Court's ruling may have implications on other state's laws. The Supreme Court's ruling discussed prior decisions on state income taxation of trusts and reiterated that the relationship between the relevant parties to the trust and the assets of the trust is highly significant in a due process analysis. For example, many states impose state income tax on a trust if the grantor is a resident of that state. While the opinion provides little guidance regarding whether taxation based on that factor alone will satisfy the due process requirements, the Supreme Court did note that prior cases have upheld taxation of a trust based on the grantor's residence when the grantor had the power to control or possess the trust property. However, no resolution was reached on whether a lesser degree of control would pass a due process analysis.

Finally, last year, in *Fielding v. Commissioner of Revenue*, Minnesota Supreme Court, No. A17-1177, July 18, 2018, a Minnesota statute subjecting irrevocable trusts to income tax liability based on the residency of the grantor was found unconstitutional by the Minnesota Supreme Court. On June 28, 2019, the U.S. Supreme Court declined to grant certiorari in this case, which means that the U.S. Supreme Court will not review the decision of the lower court.

Charitable deduction only allowed for value of assets received by private foundation

In *Dieringer v. Commissioner*, 917 F.3d 1135 (9th Cir. Mar. 12, 2019), a decedent's estate planning documents provided that the residuary of the decedent's estate would pass to a private foundation. The primary assets allocated to the residuary estate were comprised mostly of voting and nonvoting shares of stock in a closely held corporation with an aggregate value of approximately $14.2 million. During the administration of the decedent's estate, the corporation redeemed a majority of the shares from the decedent's revocable trust, and the redemption price reflected significant valuation discounts for lack of marketability and lack of control. As a result, when the residuary estate passed to the foundation, the foundation actually received promissory notes with a value of approximately $5.2 million and nonvoting shares with a discounted value of approximately $1.85 million. The estate claimed an estate tax charitable deduction for the undiscounted value of the shares. The Ninth Circuit affirmed the Tax Court's ruling that a charitable deduction would only be allowed for the value of the property that actually passed to the charity. The Ninth Circuit also affirmed accuracy-related penalties that the Service assessed on the estate due to the disallowed portion of the charitable deduction.

Tax court approves tax-affecting for valuing limited partnership and S corporations

In *Estate of Aaron U. Jones v. Commissioner* (T.C. Memo. 2019-101), the taxpayer previously made gifts of voting and nonvoting interests in an S corporation and limited partnership to his children and trusts for their benefit. The taxpayer reported these gifts on a timely filed gift tax return, assigning a value of approximately $21 million; however, the Service issued a notice of deficiency, asserting a value of approximately $120 million and a resulting gift tax deficiency of approximately $45 million. The Tax Court ultimately agreed with the taxpayer's appraiser that the value was approximately $24 million. More significantly, the Tax Court held that "tax-affecting" the earnings of the S corporation and limited partnership was appropriate in determining the values of these entities under the income method. In valuing the entities, the taxpayer's appraiser adjusted for the differences between C corporations and pass-through entities by taking into account the combined federal and state income tax rates that the entities would incur if they were C corporations. Though the Tax Court has been hesitant to accept tax-affecting for almost two decades, in this case, the Tax Court found that tax-affecting was appropriate given the facts.

Important planning considerations for 2019 and 2020

Given the changes implemented by the Act, taxpayers should review their existing estate plans and consult with their tax advisors about how to best take advantage of the higher exemption amounts while they are available. The following is a summary of several items that should be considered.

Review formula bequests

Many estate plans utilize "formula clauses" that divide assets upon the death of the first spouse between a "credit shelter trust", which utilizes the client's remaining federal estate tax exemption amount, and a "marital trust", which qualifies for the federal estate tax marital deduction and postpones the payment of federal estate taxes on the assets held in the marital trust until the death of the surviving spouse. While the surviving spouse is the only permissible beneficiary of the marital trust, the credit shelter trust may have a different class of beneficiaries, such as children from a prior marriage. With the Act's increase in the exemption amounts, an existing formula clause could potentially fund the credit shelter trust with up to the full federal exemption amount of $11.58 million in 2020. This formula could potentially result in a smaller bequest to the marital trust for the benefit of the surviving spouse than was intended, or even no bequest for the surviving spouse at all. There are many other examples of plans that leave the exemption amount and the balance of the assets to different beneficiaries. Taxpayers should review any existing formula clauses in their current estate plans to ensure they are still appropriate given the increase in the federal exemption amounts and the implications of the potential sunset of these exemption amounts. In addition, taxpayers should consider alternative drafting strategies, such as disclaimers, to maintain flexibility in their plans.

Income tax basis planning

Taxpayers should consider the potential trade-offs of utilizing the increased exemption amounts during their lifetimes to gift assets to others, as opposed to retaining appreciated assets until their death so that those assets receive a stepped-up income tax basis. Taxpayers may want to consider retaining low-basis assets, which would then be included in their taxable estates and receive a step-up in income tax basis, while prioritizing high income tax basis assets for potential lifetime gift transactions. In addition, if a trust beneficiary has unused federal estate tax exemption, consideration should be given to strategies that would lead to low income tax basis assets currently held in trust, and otherwise not includable in a beneficiary's taxable estate, being included in the beneficiary's taxable estate, such as:

- granting the beneficiary a general power of appointment over the trust assets;
- utilizing the trust's distribution provisions to distribute assets directly to the beneficiary so that the assets may obtain a step-up in basis upon the death of the beneficiary to whom it was distributed; or

- converting a beneficiary's limited power of appointment into a general power of appointment by a technique commonly known as "tripping the Delaware tax trap".

Consequently, the assets included in the beneficiary's estate would receive a step-up in income tax basis at the beneficiary's death and would take advantage of the beneficiary's unused federal estate tax exemption amount. Whether these techniques should be implemented depends on a careful analysis of the basis of the assets held in trust and the beneficiary's assets and applicable exclusion amounts, and should be discussed with advisors.

529 Plan changes

The Act expanded the benefits of 529 Plans for federal income tax purposes. Historically, withdrawals from 529 Plans have been free from federal income tax if the funds were used towards qualified higher education expenses. Under the Act, qualified withdrawals of up to $10,000 can now also be made from 529 Plans for tuition in K-12 schools. As a result, the owner of the 529 Plan can withdraw up to $10,000 per beneficiary each year to use towards K-12 education. The earnings on these withdrawals will be exempt from federal income tax under the Act. However, because each state has its own specific laws addressing 529 Plan withdrawals, and not all states provide that withdrawals for K-12 tuition will be exempt from state income taxes, taxpayers should consult with their advisors to confirm the rules in their respective states.

Planning to utilize increased federal exemptions

Given that the increased Federal exemption amounts are currently set to sunset at the end of 2025, it may be prudent to make use of these increased amounts before they disappear (with a caveat that the law may, of course, change).

Gifting techniques to take advantage of the increased applicable exclusion amount

Taxpayers may want to consider making gifts to utilize the increased federal exclusion amount. It is less expensive to make lifetime gifts rather than making gifts at death, because tax is not imposed on dollars used to pay gift tax, but estate tax is imposed on the dollars used to pay estate tax. In addition, taxpayers may benefit by removing any income and appreciation on the gift from their estate. However, taxpayers should seek advice if they have used all of their applicable exclusion amount and would pay federal gift tax on any gifts. Making gifts that result in significant gift tax payments may not always be advisable in the current environment.

A countervailing consideration of lifetime gifting is that the gifted assets will not get a step-up in basis upon death (as would assets held at death) and will thus generate capital gains tax if they are subsequently sold for an amount higher than their basis. Accordingly, the decision of whether and how to embark on a lifetime gifting strategy depends on a number of factors, including the bases of the transferor's various assets, their projected income and appreciation, the total amount of the transferor's assets and the transferor's remaining applicable exclusion amount. For individuals with assets far exceeding their applicable exclusion amounts, lifetime gifting of high-basis assets generally may be recommended. However, individuals with total assets close to or below their applicable exclusion amounts should exercise caution before making gifts of low-basis assets. Instead, those individuals should consider holding their assets until death in order to achieve a step-up in basis upon death while minimizing estate taxes. Of course, maintaining a comfortable standard of living is a factor that also must be considered. We are available to discuss this analysis with you in more detail.

If undertaking a gifting strategy, gifts to utilize the increased exemption may be made to existing or newly created trusts. For instance, a taxpayer could create a trust for the benefit of the taxpayer's spouse (a "spousal lifetime access trust" or a "SLAT") and gift assets to the SLAT utilizing the taxpayer's increased federal exemption amounts. The gifted assets held in the SLAT should not be includible in the taxpayer's or spouse's respective taxable estates, and distributions could be made to the spouse from the SLAT to provide the spouse with access to the gifted funds, if needed, in the future. Additionally, gifts could be made by a taxpayer to dynasty trusts (to which GST exemption is allocated), which would allow the trust property to benefit future generations without the imposition of estate or GST tax.

Absent legislative reform, the federal applicable exclusion amount will increase by $180,000 ($360,000 for a married couple) in 2020. Therefore, even if a taxpayer uses some or even all of the available applicable exclusion amount before the end of 2019, additional gifts may be made in 2020 without paying any federal gift tax. Based on current law, the applicable exclusion amount also will be adjusted for inflation in future years. Those resident in Connecticut should be mindful that Connecticut is the only state with a state level gift tax.

Other techniques to take advantage of the increased applicable exclusion amount

In addition to making gifts to utilize the increased exemption, below is a summary of several other widely applicable recommendations:

- Sales to trusts. Taxpayers should also consider utilizing the increased federal exemption amounts through sale transactions to grantor trusts. The increased federal exemption may provide a cushion against any asset valuation risk attendant with such sales. Taxpayers who enter into such sale transactions should consider taking advantage of the adequate disclosure rules to start the three-year statute of limitations running.
- Loan forgiveness. If taxpayers are holding promissory notes from prior estate planning transactions, from loans to family members, or otherwise, they should consider utilizing some or all of the increased federal exemption amounts to forgive these notes.
- Allocation of GST exemption to GST nonexempt trusts. If a taxpayer's existing estate plan utilizes trusts that are subject to GST tax (GST nonexempt trusts), consideration should be given to allocating some or all of the taxpayer's increased GST exemption amount to such trusts.
- Balancing spouses' estates. For married taxpayers, if the value of the assets owned by one spouse is greater than the increased federal exemption amounts and greater than the value of the assets owned by the other spouse, consideration should be given to transferring assets to the less propertied spouse. Such a transfer would provide the less propertied spouse with more assets to take advantage of the increased federal exemption amounts, especially the increased GST exemption, which is not portable to the surviving spouse upon the first spouse's death. Taxpayers should be mindful, however, that transfers to non-U.S. citizen spouses are not eligible for the unlimited marital deduction for federal gift tax purposes, and such transfers should stay within the annual exclusion for such gifts ($155,000 in 2019) to avoid federal gift tax. Note that the annual exclusion for gifts (to donees other than a spouse) is $15,000 in 2019.
- Life insurance. Taxpayers may wish to review or reevaluate their life insurance coverage and needs with their insurance advisors.
- Other planning options. Taxpayers should also consider other means for utilizing the increased federal exemption amounts, such as triggering a transfer under Code Section 2519 of a surviving spouse's qualified terminal interest property in a marital trust or the formation and funding of an entity that purposely violates Code Section 2701, in each case utilizing the increased federal gift tax exemption amount.

Review and revise your estate plan to ensure it remains appropriate

As noted above, any provisions in wills and trust agreements that distribute assets according to tax formulas and/or applicable exclusion amounts should be reviewed to ensure that the provisions continue to accurately reflect the testator's or grantor's wishes when taking into account the higher applicable exclusion amounts. Consideration should also be given to including alternate funding formulas in wills or trust agreements that would apply if the federal estate tax exemption amounts do sunset in 2026.

Additionally, in light of the increased exemption amounts, taxpayers should also consider whether certain prior planning is now unnecessary and should be unwound, such as certain Qualified Personal Residence Trusts (QPRTs), Family Limited Partnerships (FLPs) and split-dollar arrangements.

Allocation of GST applicable exclusion amounts should be reviewed to ensure that it is utilized most effectively if one wishes to plan for grandchildren or more remote descendants. In addition, due to the increased GST exemption amounts available under the Act, allocating some or all of one's increased GST exemption amounts to previously established irrevocable trusts that are not fully GST exempt may be advisable.

Taxpayers should continue to be cautious in relying on portability in estate planning, as portability may not be the most beneficial strategy based on your personal situation. In addition, a Deceased Spouse's Unused Exemption (DSUE) may not be available upon remarriage of the surviving spouse. However, portability may be a viable option for some couples with estates below the combined exemption amounts. Portability can be used to take advantage of the first spouse to die's estate tax exemption amount (which, for taxpayers dying before 2026, should be $10 million adjusted for inflation), as well as obtain a stepped-up basis at each spouse's death. Portability can also be used in conjunction with a trust for the surviving spouse (a "QTIP" trust) in order to incorporate flexibility for post-mortem planning options. Factors such as the asset protection benefits of utilizing a trust, the possibility of appreciation of assets after the death of the first spouse to die, the effective use of both spouses' GST exemption and state estate tax should be discussed with advisors in determining if relying on a portability election may be advisable.

Same-sex couples should continue to review and revise their estate planning documents and beneficiary designations now that same-sex marriages must be recognized by every state as well as the federal government. Same-sex couples may want to ensure that the amount and structure of any bequests to the spouse are appropriate, as well as consider the benefits of split-gifting for gift tax purposes. Same-sex couples should also consider amending previously filed federal estate, gift and income tax returns and state income tax returns, as well as reclaiming applicable exclusion and GST exemption amounts for transfers between the spouses made before same-sex marriages were recognized for federal tax purposes.

Unmarried couples should particularly continue to review and revise their estate planning documents and beneficiary designations, as since the advent of same sex marriage, it is now clear that domestic partners, even if registered as such, do not qualify for the federal (and in many cases state) tax and other benefits and presumptions that are accorded to married couples.

Finally, in view of the potential sunset of many pertinent provisions of the Act, estate plans should provide for as much flexibility as possible. As noted above, formula bequests should be reviewed to ensure they are appropriate under current law and consideration should be given to granting limited powers of appointment to trust beneficiaries to provide flexibility for post-mortem tax planning. A trust protector (or trust protector committee) may also be appointed to give a third party the ability to modify or amend a trust document based on changes in the tax laws or unforeseen future circumstances, or to grant certain powers to trust beneficiaries that may have tax advantages under a new tax regime (such as the granting of a general power of appointment to trust beneficiaries in order to obtain a stepped-up basis in trust assets at the beneficiary's death).

Mitigate trust income tax and avoid the medicare surtax with trust income tax planning

Non-grantor trusts should consider making income distributions to beneficiaries. Trust beneficiaries may be taxed at a lower tax rate, especially due to the compressed income tax brackets applicable to non-grantor trusts. Additionally, a complex, non-grantor trust with undistributed annual income over $12,500 (adjusted for inflation) will be subject to the 3.8 percent Medicare surtax. However, some or all of the Medicare surtax may be avoided by distributing such income directly to beneficiaries who are below the individual net investment income threshold amount for the Medicare surtax ($200,000 for single filers, $250,000 for married couples filing jointly and $125,000 for married individuals filing separately).

Careful evaluation of beneficiaries' circumstances and tax calculations should be made to determine whether trusts should distribute or retain their income.

Transfer techniques

Many techniques that have been utilized in prior years continue to be advantageous planning techniques under the Act. Due to potential sunset of many applicable provisions of the Act, consideration should be given to planning that minimizes the risk of paying current gift taxes but still allows taking advantage of the increased exemptions amounts to shift assets and appreciation from the taxable estate. Additionally, consideration should be given to selling hard-to-value assets due to the increased exemption available to "shelter" any valuation adjustment of these assets upon audit. Lifetime gifting and sales transactions remain very important in providing asset protection benefits for trust beneficiaries, shifting income to beneficiaries in lower tax brackets and providing funds for children or others whose inheritance may be delayed by the longer life expectancy of one's ancestors.

Grantor retained annuity trusts (GRATS)

GRATs remain one of our most valuable planning tools, particularly in times of low interest rates. Due to the current lower interest rates and the fact that prior administrations' presidential budget proposals frequently called for adverse changes in how GRATs may be structured, GRATs should be created as soon as possible. Under current law, GRATs may be structured without making a taxable gift. Therefore, even if one has used all of his or her applicable exclusion amount, GRATs may be used without incurring any gift tax. Because GRATs may be created without a gift upon funding, they are an increasingly attractive technique for clients who want to continue planning to pass assets to their descendants without payment of gift tax in the uncertain tax environment.

A GRAT provides the grantor with a fixed annual amount (the annuity) from the trust for a term of years (which may be as short as two years). The annuity the grantor retains may be equal to 100 percent of the amount the grantor used to fund the GRAT, plus the IRS assumed rate of return applicable to GRATs (which for transfers made in November 2019 is 2 percent). As long as the GRAT assets outperform the applicable rate, at the end of the annuity term, the grantor will be able to achieve a transfer tax-free gift of the spread between the actual growth of the assets and the Service assumed rate of return. Although the grantor will retain the full value of the GRAT assets, if the grantor survives the annuity term, the value of the GRAT assets in excess of the grantor's retained annuity amount will then pass to whomever the grantor has named, either outright or in further trust, with no gift or estate tax.

Sales to intentionally defective grantor trusts (IDGTS)

Sales to IDGTs have become an increasingly popular planning strategy due to the increased exemption amounts under the Act.

In utilizing a sale to an IDGT, a taxpayer would transfer assets likely to appreciate in value to the IDGT in exchange for a commercially reasonable down payment and a promissory note from the trust for the balance. From an income tax perspective, no taxable gain would be recognized on the sale of the property to the IDGT because it is a grantor trust, which makes this essentially a sale to one's self. For the same reason, the interest payments on the note would not be taxable to the seller or deductible by the trust.

If the value of the assets grows at a greater pace than the prevailing applicable federal rate (which for sales in November 2019 is as low as 1.68 percent for a short-term sale), as with a GRAT, the appreciation beyond the federal rate will pass free of gift and estate tax. Due to the current low interest rates, now is an opportune time to structure sales to IDGTs.

The current environment creates a window of opportunity for sales to grantor trusts. The increased federal exemption amounts may provide a cushion against any asset valuation risk attendant to such sales. Additionally, the increased exemption amounts permit the sale of a substantially larger amount of assets to grantor trusts. Typically, grantor trusts should be funded with at least 10 percent of the value of the assets that will be sold to the trust. With the higher exemption amounts, those who have not used any of their exemptions could contribute up to $11.4 million (or $22.8 million, if splitting assets with a spouse) to a grantor trust in 2019. This would permit the sale of up to $102.6 million (or $205.2 million) of assets to the trust in exchange for a promissory note with interest at the appropriate AFR.

Consider a swap or buy-back of appreciated low basis assets from grantor trusts

If a grantor trust has been funded with low-basis assets, the grantor should consider swapping or buying-back those low-basis assets in exchange for high-basis assets or cash. If the grantor sold or gave (through a GRAT or other grantor trust) an asset with a low basis, when that asset is sold, the gain will trigger capital gains tax. However, if the grantor swaps or purchases the asset back from the grantor trust for fair market value, no gain or loss is recognized. The trust would then hold cash or other assets equal to the value of the asset that was repurchased. Alternatively, many grantor trust instruments give the grantor the power to substitute the trust's assets with other assets, which would allow the low-basis assets to be removed from the trust in exchange for assets of equal value that have a higher basis. Then on the grantor's death, the purchased or reacquired asset will be included in the grantor's taxable estate and will receive a step-up in basis equal to fair market value, eliminating the income tax cost to the beneficiaries. Those whose estates may not be subject to estate taxes due to the current high exemption amounts may utilize swaps or buy-backs to "undo" prior planning strategies that are no longer needed in today's environment.

Consider the use of life insurance

Life insurance presents significant opportunities to defer and/or avoid income taxes, as well as provide assets to pay estate tax or replace assets used to pay estate tax. Generally speaking, appreciation and/or income earned on a life insurance policy accumulates free of income taxes until the policy owner makes a withdrawal or surrenders or sells the policy. Thus, properly structured life insurance may be used as an effective tax-deferred retirement planning vehicle. Proceeds distributed upon the death of the insured are completely free of income taxes. Taxpayers should consider paying off any outstanding loans against existing policies in order to maximize the proceeds available tax free at death, although potential gift tax consequences must be examined. Note that the decision to pay off such loans requires a comparison of the alternative investments that may be available with the assets that would be used to repay the loans and the interest rate on the loans.

Use intra-family loans and consider refinancing existing intra-family loans

Because interest rates are currently low (and the exemption amounts are so high), many techniques involving the use of intra-family loans should be considered, including:

- The purchase of life insurance on the life of one family member by an irrevocable life insurance trust, with premium payments funded by loans from other family members.
- The creation of trusts by older generation members for the benefit of younger family members, to which the older generation members loan funds. The spread between the investment return earned by the trust and the interest owed will create a transfer tax-free gift.
- Forgiving loans previously made to family members. The amount that is forgiven in excess of the annual gift tax exclusion amount will be a gift, and thus will use a portion of one's applicable gift tax and/or GST tax exclusion amount. This may be a beneficial strategy considering the increased exemption amounts.

Installment sale to third-party settled GST tax-exempt trust

Unique planning opportunities and transfer tax benefits may be available if a relative or friend of the taxpayer has an interest in creating and funding a trust for the benefit of the taxpayer and/or the taxpayer's family. For example, a third-party grantor (e.g., a relative or friend of the taxpayer) could contribute cash to a trust for the benefit of the taxpayer, allocate GST tax exemption to that gift, and then that trust could purchase assets from the taxpayer in exchange for such cash and a secured promissory note in the remaining principal amount of assets purchased. While this sale could result in payment of capital gains tax to the taxpayer (ideally at an earlier, lower value), this planning could present the following potential benefits:

- there should be no transfer tax concerns for the third-party grantor if the grantor's other assets, even when added to the value of the foregoing gift, would not be sufficient to cause the estate tax to apply at the grantor's death (this depends on what the estate tax exemption amount is at the grantor's subsequent death);
- the taxpayer could receive a step-up in basis as of the date of the initial sale;
- the taxpayer could be a beneficiary, hold a limited power of appointment over and control who serves as trustee of the trust; and
- the appreciation in the value of the asset being sold from the date of the initial sale above the interest rate on the promissory note (e.g., 1.59 percent is the mid term AFR in November 2019) would accrue transfer tax free for the benefit of the taxpayer and/or the taxpayer's family; and
- the trust could be structured in such a way as to provide protection from the taxpayer's creditors and remove the trust assets from the taxpayer's and his/her family members' taxable estates.

In order to achieve the foregoing benefits, it is important that only the third-party grantor makes any gratuitous transfers to the trust and that the third-party grantor not be reimbursed for any such transfers.

Purposely triggering application of Code Section 2701

A taxpayer may desire to utilize the increased gift and estate tax exemption prior to the scheduled sunset and may also desire to shift appreciation on this amount to a trust for the benefit of the taxpayer's children that is removed from the estate tax system. This desire may be met with hesitation to part with $11.4 million of assets. The taxpayer may also be concerned about losing cash flow from the transferred assets and not having the option of taking the property back if needed in the future. Finally, the taxpayer may also have concerns that assets available for transfer have a low income tax basis, which will carry over if a traditional gift is made.

A planning alternative exists which can potentially address each of these concerns. The strategy is to create and fund a preferred partnership which is structured to purposely violate Code Section 2701.

Assume a taxpayer gifts $1.1 million to an irrevocable trust for the benefit of the taxpayer's children (the Family Trust). Taxpayer and Family Trust create a preferred partnership (PP). Taxpayer transfers to the PP $9.9 million of low-basis assets in exchange for a preferred interest entitling the taxpayer to a 5 percent noncumulative preferred return and the right to put the preferred interest to the PP for an amount equal to its associated capital account. The Family Trust contributes $1.1 million to the PP in exchange for a common interest entitling the Family Trust to all cash flow above the 5 percent payment made to the preferred interest and all appreciation on the PP's assets.

Structuring the preferred interest in this manner violates Code Section 2701. The result is a deemed gift of $9.9 million, which combined with the taxpayer's gift of $1.1 million to the Family Trust means the taxpayer has consumed $11 million of gift and estate tax exemption. Also, when the taxpayer dies, the preferred interest will be included in the taxpayer's estate under Code Section 2033, resulting in an income tax basis step-up of the preferred interest. The estate tax calculation will include a reduction in the taxpayer's tentative taxable estate of $9.9 million to account for the prior taxable gift and avoid double taxation.

This structure has addressed each of the taxpayer's concerns. The taxpayer has consumed the increased exemption amount, but has done so in a manner that preserves an income tax basis step-up. The taxpayer has also retained a 5 percent return on the preferred interest and the right to put the interest back to the PP and take back the value of the taxpayer's capital account. Finally, cash flow above the 5 percent preferred return and appreciation on the PP's assets have been shifted to the Family Trust free of transfer taxes.

Consider charitable planning

As noted above, the Act increased the AGI percentage limit for cash contributions to public charities from 50-60 percent. Because of the increased percentage limitation, consideration should be given to accelerating charitable giving to possibly obtain a current income tax deduction and potentially reduce one's taxable estate (of both the contributed asset as well as future appreciation).

A planning tool that is very effective in a low interest rate environment is a Charitable Lead Annuity Trust (CLAT), which combines philanthropy with tax planning. A CLAT is an irrevocable trust that pays one or more named charities a specified annuity payment for a fixed term. At the end of the charitable term, any remaining assets in the CLAT pass to the remainder, noncharitable beneficiaries. As with a GRAT, to the extent the assets outperform the IRS-assumed rate of return (2 percent for November 2019), those assets can pass transfer tax free to the chosen beneficiaries. Alternatively, a strategy that works better in a high interest rate environment is a Charitable Remainder Annuity Trust (a CRAT). A CRAT is an irrevocable trust that pays an annual payment to an individual (typically the grantor) during the term of the trust, with the remainder passing to one or more named charities. The grantor may receive an income tax deduction for the value of the interest passing to charity. Because the value of the grantor's retained interest is lower when interest rates are high, the value of the interest passing to charity (and therefore the income tax deduction) is higher. A CRAT may become an attractive option if interest rates rise.

The Qualified Charitable Distribution rules were made permanent by the Tax Hikes (PATH) Act of 2015 on December 18, 2015. The PATH Act permanently extended the ability to make IRA charitable rollover gifts, which allow an individual who is age 70½ or over to make a charitable rollover of up to $100,000 to a public charity without having to treat the distribution as taxable income. Other types of charitable organizations, such as supporting organizations, donor advised funds or private foundations, are not eligible to receive the charitable rollover. Therefore, if a taxpayer needs to take a required minimum distribution for 2019, he or she may arrange for the distribution of up to $100,000 to be directly contributed to a favorite public charity and receive the income tax benefits of these rules. Due to new limitations on itemized deductions (i.e., the cap on the state and local tax deduction), some taxpayers may no longer itemize deductions on their personal income tax returns. Without itemizing deductions, these taxpayers could not receive the income tax benefit of a charitable deduction for charitable contributions. The Qualified Charitable Distribution rules allow taxpayers who are claiming a standard deduction to still obtain a financial benefit from charitable donations.

Year-end checklist for 2019

In addition to the above planning ideas, consider the following before 2019 is over:

- Make year-end annual exclusion gifts of $15,000 ($30,000 for married couples).
- Make year-end IRA contributions.
- Create 529 Plan accounts before year-end for children and grandchildren, and consider front-loading the accounts with five years' worth of annual exclusion gifts, taking into account any gifts made during the year to children and grandchildren.
- Pay tuition and nonreimbursable medical expenses directly to the school or medical provider.

- Consider making charitable gifts (including charitable IRA rollovers) before year-end to use the deduction on your 2019 income tax return.

Below is an overview of national, international and local developments that occurred in 2019.

International developments in 2019

As highlighted in the 2018 Year-End Estate Planning Advisory, the Act had sweeping implications on private client international tax planning. Much of the impact on this planning involved the substantially revised rules related to controlled foreign corporations (CFCs). Such changes included the expansion of what constitutes a U.S. shareholder, the new tax on Global Intangible Low-Taxed Income (GILTI), the removal of the rule that a foreign corporation must be a CFC for an uninterrupted period of 30 days before a U.S. shareholder had a Subpart F income inclusion, the expansion of the constructive ownership rules to allow downward attribution from a non-U.S. person to a U.S. person (the Downward Attribution Rule), and the addition of a repatriation tax. A smaller (but yet important) change permitted a nonresident alien to indirectly constitute a shareholder of an S corporation via an electing small business trust (ESBT). By and large, in the United States, 2019 has been marked by the Service and Treasury working to provide much-needed guidance on both the international tax changes implemented by the Act and legacy international tax provisions needing more clarity. As for the rest of the globe, throughout 2019 jurisdictions (including the United States) continued to pass broad legislative and regulatory measures designed to foster increased transparency.

Proposed and final treasury regulations were issued in respect of Subpart F income and GILTI to address how the attribution principles should be applied where a U.S. person indirectly invests in a CFC through a domestic partnership. In short, the regulations adopt an aggregate approach for determining a partner’s Subpart F or GILTI inclusion with respect to a CFC owned through a U.S. partnership. In each case, however, the domestic partnership is treated as an entity for purposes of determining whether a partnership and its partners are U.S. shareholders for purposes of CFC qualification, as well as whether the foreign corporation at issue is a CFC.

The Treasury promulgated proposed regulations that expand the application of the high tax exception election in determining a CFC’s tested income for purposes of GILTI. Prior to the proposed guidance, the high-tax exception election in respect of GILTI only applied to income that was otherwise characterized as foreign insurance income or foreign base company income under the Subpart F rules. However, the proposed regulations provide that the exception covers any gross income subject to foreign income tax at an effective rate greater than 90 percent of the U.S. corporate income tax rate (e.g., 18.9 percent based on the current 21 percent rate). Once made, the election applies to all subsequent years unless revoked. If revoked, unless an exception applies, the election may not be made again for at least 60 months.

The Downward Attribution Rule, as implemented by the Act, (inadvertently) resulted in many foreign corporations constituting CFCs despite U.S. persons directly or indirectly owning nominal interests. Legislative history made it clear that the Downward Attribution Rule was to be limited in scope and narrowly targeted to apply to certain abusive transactions. In light of this legislative intent, recently issued proposed regulations seek to clarify situations — on a code section by code section basis — as to how the Downward Attribution Rule should be applied to prevent unintended CFC qualification; that said, such guidance in our view provides limited relief. Rev. Proc. 2019-40 accompanied the foregoing proposed regulations to provide, among other guidance, U.S. persons with a safe harbor for determining CFC status. That is, the Service will not challenge a U.S. person’s determination that a foreign corporation is not a CFC where: (1) the U.S. person does not have actual knowledge, has not received information and cannot obtain reliable public information to determine whether a foreign corporation constitutes a CFC and (2) if the U.S. person directly owns an interest, such person inquires of the foreign corporation whether it is a CFC and asks for information relevant to whether any subsidiaries could be CFCs.

The Treasury issued final regulations in respect of nonresident aliens within the class of permissible potential current beneficiaries of an ESBT. The regulations ensure that all of an S corporation's income will continue to be subject to U.S. federal income tax for a shareholder that is a grantor trust deemed to be owned by a nonresident alien and constituting an ESBT. In essence, the final regulations preclude the grantor trust rules from trumping the ESBT rules where the owner of the grantor trust is a nonresident alien. Without this rule, S corporation income earned by such a grantor trust could escape U.S. federal income taxation.

The Treasury issued proposed regulations that address longstanding issues involving passive foreign investment companies (PFICs). Specifically, the PFIC rules expressly incorporate the Subpart F income rules for determining whether income earned by a foreign corporation constitutes passive income. The proposed regulations clarify to what extent the exclusions under the Subpart F income rules apply when determining whether a foreign corporation is a PFIC. In providing such clarity, the proposed regulations deny various look-through rules that typically apply under the Subpart F provisions for PFIC testing purposes. In addition, consistent with the aggregate treatment discussed above, the proposed regulations take a top-down approach in determining the extent of a U.S. partner's indirect ownership in a PFIC through a domestic partnership. Effectively, the rule attempts to disregard the partnership when determining a U.S. partner's indirect interest in a PFIC.

Turning to the rest of the world, participating jurisdictions under the so-called "Common Reporting Standards" (CRS) — including European Union jurisdictions — guided by the Organisation for Economic Co-operation and Development (OECD), continue to legislate and regulate expansive rules to foster increased transparency. Much debate and discussion revolves around the potential implementation of the OECD's mandatory disclosure rules (MDR). The MDR requires intermediaries in CRS jurisdictions ultimately adopting the MDR to disclose information in respect of certain so-called "CRS Avoidance Arrangements" or "Opaque Offshore Structures". Taken largely from the principles of the OECD's MDR, the European Union adopted Directive 2018/922 (Directive), which requires disclosure by intermediaries of certain cross-border arrangements bearing certain "hallmarks" enumerated under the Directive, provided one of the parties of such arrangement is from the European Union. Notably, each EU member state is required to implement the Directive into its local law by December 31, 2019.

Although the United States is not a signatory to CRS, the U.S. Congress has shown an appetite to legislate increased transparency. In late October, the U.S. House of Representatives passed the Corporate Transparency Act of 2019 (CTA), the goal of which is to require the disclosure of beneficial owners of U.S. corporations and limited liability companies. The stated purpose of the CTA is to prevent the use of U.S. corporations and limited liability companies for criminal activities (such as money laundering). Under current draft legislation, the beneficial ownership information would be reported to FinCEN and not accessible to the general public. However, the information would be available to governmental bodies and federal agencies for certain limited uses (e.g., law enforcement, national security, or intelligence purposes), as well as to financial institutions — with the customer's consent — to foster compliance with due diligence requirements imposed under the Bank Secrecy Act, the USA PATRIOT Act and other applicable federal, state or tribal laws.

In light of the continuing, complex and rapid changes in international tax planning, taxpayers should consult their international private client advisors for assistance and guidance in navigating these issues.

Local developments in 2019: state-specific considerations

California

Undue influence presumption for care custodians expanded

On June 26, 2019, Governor Newsom approved Assembly Bill 328, which extends the presumption of undue influence to donative transfers made to caregivers who subsequently marry their adult dependents. This legislation closes a prior loophole which allowed a caregiver who received gifts from a dependent to avoid the presumption of undue influence by becoming a spouse, cohabitant or domestic partner. Effective January 1, 2020, the presumption of undue influence would extend to a caregiver who marries a dependent adult while providing services to that dependent adult or within 90 days after those services were last provided. The presumption will apply to (a) any gift or bequest made by a dependent adult to his or her caregiver within six months of their marriage, cohabitation or domestic partnership and (b) any omitted spouse doctrine claims under Probate Code Section 21611 raised by a caregiver if the dependent adult spouse dies within six months of the marriage. The presumption of undue influence can be rebutted by clear and convincing evidence.

Increased dollar limitation for small estate procedure

On July 30, 2019, Governor Newsom approved Assembly Bill 473, raising the dollar limitation for an estate to qualify for disposition without a full probate administration. Effective January 1, 2020, the "small estate" limitation will increase from $150,000 to $166,250, to be adjusted for inflation on April 1, 2022, and every three years thereafter. In addition, the interest penalties owed to a person with a superior claim to property received under the small estate procedure have been reduced from 10 percent to 7 percent and the courts have been given discretion to waive interest penalties if the small estate procedure was used in good faith.

Proposed California transfer tax fails to come to vote

On March 26, 2019, California State Senator Scott Weiner introduced Senate Bill 378, which proposed to impose an estate tax, gift tax and GST on California residents. The proposed transfer taxes would mirror federal taxes and be subject to a rate of 40 percent. However, the exemption for California purposes would be $3.5 million per person and would phase out entirely at the federal exemption amount, which is currently $11.4 million per person. The Bill never came out of committee for a floor vote.

Trustees must terminate trust if trust agreement provides for mandatory distribution

In *Trolan v. Trolan*, six siblings became cotrustees of an irrevocable trust with the power to act by majority vote on their mother's death. The trust provided that on the mother's death, the trust was to be divided into equal shares with each sibling's share to be distributed outright to him or her at age 30. At the time of the mother's death, each sibling was over the age of 30.

Five of the siblings wanted to continue to hold the assets of the trust in trust, while the sixth sibling wanted her share distributed outright in cash. After several disagreements over the value of the sixth sibling's share, the trustees petitioned the court to determine the value of her share and to leave the other five siblings' shares in trust. The trial court (a) ruled that the mandatory distribution at age 30 provision required the trustees to distribute the shares outright to the siblings; (b) on its own motion removed the siblings as trustees for failing to liquidate the trust and appointed a professional fiduciary as successor trustee; and (c) ordered the trustee to liquidate the trust, pay the expenses, attorneys' fees and costs of both sides from the trust and then distribute the trust's corpus.

The five siblings subsequently appealed arguing that the trial court erred in finding that the trust had to be liquidated and distributed pursuant to the mandatory provision requiring distribution at age 30. The California Court of Appeal affirmed the trial court's ruling that distribution was mandatory at age 30, but found that the trial court abused its discretion when it required the liquidation of trust assets prior to distribution because the trust instrument allowed the trustees to make distributions in cash or in-kind. Consequently, the trial court order mandating the removal of the trustees was reversed because the sibling trustees did not breach their duty by failing to liquidate the trust.

Unsigned interlineations do not constitute valid trust amendment

In *Pena v. Day*, the settlor of a trust made handwritten interlineations to his trust and affixed a signed sticky note instructing his attorney to incorporate such changes into a new trust amendment. The settlor died prior to the attorney preparing the amendment. The California Court of Appeal found that the handwritten interlineations to the trust did not validly amend the trust because the trust required amendments to be in a signed writing and there was no signature. The California Court of Appeal further found that the signed sticky note affixed to the interlineated trust was a separate writing rather than part of the amendment itself because the sticky note merely contained instructions for the settlor's attorney to draft an amendment to be executed at a later point.

Gift of life insurance policy can be conveyed by reference in trust

In *Dudek v. Dudek*, the California Court of Appeals found that listing a life insurance policy as an asset of an irrevocable trust was sufficient to transfer ownership in that policy despite the settlor's failure to perfect such transfer with the life insurance company. In 2009, settlor established a life insurance trust and listed a life insurance policy as an asset of the trust under the trust's schedule of assets. The settlor then submitted forms to the life insurance company transferring the policy to the trust and naming the trust as the beneficiary. The life insurance company rejected the forms due to the settlor failing to initial certain changes and corrected forms were never resubmitted. Six years later, without the trustee's knowledge, the settlor filed updated beneficiary designations naming the respondents as beneficiaries of the policy.

On the settlor's death, the respondents received the life insurance proceeds and the life insurance company rejected the trustee's claims under the policy. The trustee subsequently filed a petition seeking an order directing that the respondents transfer the life insurance proceeds to him as trustee of the trust. The trial court ruled in favor of the respondents and found that the settlor failed to fund the trust by not filing documents with the life insurance company naming the trust as the owner and beneficiary of the policy.

The trustee appealed claiming that the trial court erred and claimed that the trust agreement irrevocably transferred the policy from the settlor to the trust. To determine whether the policy was transferred to the trust, the California Court of Appeal analyzed whether the following elements of a gift under California law were satisfied: (a) intent; (b) delivery (actual or symbolic); and (c) acceptance. It found that: (a) the trust agreement evidenced an intent to make an immediate and irrevocable transfer to the trust; (b) there was a symbolic delivery when the settlor delivered the trust agreement to the trustee; and (c) there was acceptance when the trustee signed the trust agreement. As a result, the later change in beneficiary designations naming the respondents was ineffective because the settlor no longer owned of the policy. Therefore, the trustee was allowed to pursue his claims against the respondents to recover the life insurance proceeds previously distributed to them.

Death of trustee will not cause dissociation from partnership

In *Han v. Hallberg*, the California Court of Appeal found that a living trust did not dissociate from a partnership on the death of its settlor because the trust was deemed to be the partner. In 1975, four dentists entered into a partnership agreement providing that certain buy-out provisions would apply on a partner's death. In 1994, the partnership was amended to reflect the assignment of one of its partners — Dr. Hallberg — to his living trust and to substitute the trustee of the living trust as a general partner of the partnership. When Dr. Hallberg subsequently died, the other partners tried to exercise the buy-out provisions and purchase Dr. Hallberg's interests. The trial court found in favor of the other partners because it concluded that Dr. Hallberg was a partner at the time of his death.

The California Court of Appeal reversed the trial court's decision and found that the trustee of the trust — not Dr. Hallberg — was and remained the partner at the time of Dr. Hallberg's death. The California Court of Appeal based its decision on the Uniform Partnership Act of 1994's definition of a "person" which includes a trust and concluded that a trust does not dissociate from a partnership upon the death of a trustee. Rather, a trust dissociates by distribution of its entire transferrable interest in the partnership and not by the substitution of a successor trustee.

California Superior Court reverses long-standing franchise tax board position on trust taxation

In *Paula Trust v. California Franchise Tax Board*, the San Francisco County Superior Court reversed the California Franchise Tax Board's long-standing position that all of a trust's California source income is fully taxable and not subject to the apportionment regime.

California's apportionment regime is a two-tier regime used for determining whether a trust's income is taxable in California based on the residence of the trust's fiduciaries and noncontingent beneficiaries. Taxable income is first apportioned in proportion to the number of California fiduciaries over the number of total fiduciaries. The amount remaining after applying the first tier is then apportioned in proportion to the number of California noncontingent beneficiaries over non-California noncontingent beneficiaries.

In *Paula*, a trust was created for a California beneficiary which provided for discretionary distributions. Moreover, the trust had two trustees — a California resident and a non-California resident. The trust was funded with business interests that were subsequently sold. The sale resulted in a capital gain of $2.8 million which was treated as California source income. The trustees reported the entire amount as a capital gain on the trust's California return.

Several years later, the trustees filed a claim for refund claiming that only 50 percent of the $2.8 million gain was taxable in California under California's apportionment regime since only 50 percent of the trustees resided in California and there were no noncontingent beneficiaries because the sole beneficiary was only entitled to discretionary distributions. The Franchise Tax Board denied the claim for refund on the ground that all of a trust's California source income is fully taxable. The trustees filed suit in California Superior Court. The Superior Court held that the sourcing rules are not intended to apply to trusts and that the apportionment rules apply in determining a trust's California income — whether such income is California source or not. Therefore, the trustees' claim for refund was granted.

The Franchise Tax Board appealed the Superior Court's decision and the matter is currently pending before the California Court of Appeal.

Illinois

Illinois Trust Code

On July 12, 2019, Illinois House Bill 1471 was signed into law as Public Act 101-0048 and is known as the Illinois Trust Code. This law is effective January 1, 2020. Adoption of the Illinois Trust Code represents the most significant statutory overhaul with respect to the field of trusts in many years. The Illinois Trust Code is modeled after the Uniform Law Commission's Uniform Trust Code, which has been adopted in 34 states (including Illinois) and the District of Columbia. The Illinois Trust Code updates and revises many aspects of trusts created and administered in Illinois and brings Illinois law concerning trusts in-line with a majority of the other states. Adoption of the Illinois Trust Code caused the repeal of many statutory compilations governing the administration of trusts, including the Trusts and Trustees Act, the Trusts and Dissolutions of Marriage Act, the Uniform Powers of Appointment Act (which was adopted by Public Act 100-1044 just last year), the Statute Concerning Perpetuities, the Perpetuities Vesting Act and the Trust Accumulation Act. Additionally, corresponding changes have been made to many other statutory compilations including the Public Use Trust Act, the Township Code, the Corporate Fiduciary Act, the Community-Integrated Living Arrangements Licensure and Certification Act, the Title Insurance Act, the Illinois Funeral or Burial Funds Act, the Mental Health and Developmental Disabilities Code, the Illinois Marriage and Dissolution of Marriage Act, the Probate Act of 1975, the Illinois Power of Attorney Act, the Common Trust Fund Act, the Religious Corporation Act and the Illinois Pre-Need Cemetery Sales Act.

The adoption of the Illinois Trust Code was welcome news to the vast majority of practitioners in Illinois, and represents the culmination of years of introducing similar legislation unsuccessfully. Because of the sweeping changes which will be enacted by the Illinois Trust Code, existing trusts should be reviewed to determine compliance with the new statutory compilation and, if planning is desired, evaluate any planning in light of the new statutory compilation, as the Illinois Trust Code provides opportunities to deal with trusts that existing law may have prohibited.

Amendment to Probate Act of 1975

On August 2, 2019, Illinois House Bill 347 was signed into law as Public Act 101-0182. This Public Act amends the Probate Act of 1975 to expand the list of actions perpetrated against an elderly person that would deem the perpetrator to have predeceased such elderly person (i.e., the perpetrator would be deemed to have predeceased the decedent for estate planning purposes and therefore be unable to collect any property of the decedent). Effective January 1, 2020, if an individual commits assault, aggravated assault, battery or aggravated battery (in addition to enumerated actions existing prior to the adoption of Public Act 101-0182) against an elderly person, then the perpetrator will be deemed to have predeceased the elderly person unless it can be proven by clear and convincing evidence that the victim of that offense knew of the conviction and subsequent to the conviction expressed or ratified his or her intent to transfer the property to the person convicted of the crime. The crime need not directly or indirectly cause the death of the decedent, and as a result, special care should be taken in drafting estate plans where this may be relevant.

Chicago Police Sergeant's Association v. John Pallohusky, 2019 Il APP (1st) 181194 (March 29, 2019)

The *Pallohusky* case arose as a result of the Chicago Police Sergeant's Association Policemen's Benevolent & Protective Association, Unit 156A (the Association) attempting to satisfy a judgment against John Pallohusky obtained on July 31, 2013. Initially, the court found that Mr. Pallohusky was embezzling money from the Association and ordered Mr. Pallohusky to pay the Association $619,215.17 in damages. The Association was able to locate real property held in trust for the benefit of Mr. Pallohusky which was placed in trust upon Mr. Pallohusky's wife's death in July 2010, and the Association sought to use the real property to satisfy its judgment against Mr. Pallohusky. With respect to the trust in question, Mr. Pallohusky was named as the initial trustee and distributions of income and principal were authorized to Mr. Pallohusky for any reason whatsoever. In what appears to be an attempt to separate himself from the corpus of the trust, Mr. Pallohusky resigned as the trustee of the trust approximately five years after his wife's death and, thereafter, the real property was formally deeded by a different trustee to the trust for the benefit of Mr. Pallohusky. The Association argued that the trust should not provide Mr. Pallohusky any protection against its judgment and, therefore, the trust assets should be used to satisfy the Association's judgment.

Initially, the trial court found that the trust was a sham because Mr. Pallohusky's now deceased wife clearly intended to vest Mr. Pallohusky with absolute control of the trust assets, which was evidenced by Mr. Pallohusky's wide discretion to distribute the trust assets to himself. Additionally, because Mr. Pallohusky had waited about five years to resign as the sole trustee, the court determined that he waited "unreasonably" long to resign. After the trial court's order, the trustee of the John Pallohusky Trust appealed the order requiring it to turn over the real property owned by the trust to satisfy the Association's judgment.

The appellate court agreed with the trial court in determining that the trust in question was a sham. The court, citing the golden rule of testamentary instruments — to determine the intent of the decedent — held that Mr. Pallohusky's wife intended to grant him with absolute power over the trust assets and the ability to dispose of the trust assets without regard to any other person (including the class of individuals that were to receive the property upon Mr. Pallohusky's death), and therefore, the interests of Mr. Pallohusky as trustee of the trust and the interests of Mr. Pallohusky as the sole current beneficiary of the trust, merged together to create outright ownership in Mr. Pallohusky, which, could be used to satisfy Mr. Pallohusky's judgment creditors.

Practitioners in Illinois have been somewhat vocal in their disagreement with the decision in *Pallohusky*. The court seems to disregard the remainder beneficiaries of the trust (Mr. Pallohusky's wife's heirs) in determining that Mr. Pallohusky was the sole beneficiary of the trust. Practitioners are concerned that this case represents an unwarranted expansion of the "merger doctrine" (where the interests of the trustee and the beneficiary merge), as the interests of the remainder beneficiaries were disregarded. This case stands for the practical proposition that care must be taken when drafting trusts for individuals with certain creditor issues, and that attempting to correct a problem after the fact may not be a viable option in certain circumstances. Additionally, after Pallohusky, care should be taken in having the sole current beneficiary of a trust be the sole trustee as well, as this may pose creditor-protection issues in Illinois.

In re Estate of Carol Mattson, 2019 Il APP (1st) 180805 (April 30, 2019)

In *Mattson*, a non-attorney, Daniel Houlihan, petitioned the court to open an estate for his mother, and to appoint him as the administrator of his mother's estate. Mr. Houlihan's petition was denied because, as a non-attorney, Mr. Houlihan could not represent the legal interests of his mother's estate. Mr. Houlihan attempted on numerous occasions to petition the court pro se to be appointed administrator of his mother's estate, and each time the court continued the case so that Mr. Houlihan could arrange for an attorney to appear and petition on behalf of his mother's estate. The trial court eventually denied Mr. Houlihan's petition and Mr. Houlihan appealed pro se.

The appellate court, agreeing with the trial court, reasoned that under Illinois law, a pro se litigant is entitled to represent his personal interests, but a non-attorney cannot represent the legal interest of an estate. The appellate court adds that Mr. Houlihan is not entitled to initiate the current appeal because he is not a party to the lawsuit (i.e., the estate of Carol Mattson cannot be represented in the appellate action by Mr. Houlihan because Mr. Houlihan is not an attorney).

In a dissenting opinion, Justice Hyman reasons that at such a preliminary stage, Mr. Houlihan is representing his own interests in serving as administrator of his mother's estate, but is not yet representing his mother's estate because he has not yet been appointed as the administrator. Justice Hyman does seem to note that upon Mr. Houlihan's appointment as administrator of his mother's estate, he would then need to engage an attorney to represent the interests of the estate.

Nichols v. Fahrenkamp, 2019 Il 123990 (June 20, 2019)

In *Nichols*, the Plaintiff, Alexis Nichols, obtained a settlement for injuries obtained in an automobile accident when she was a minor. Because she was a minor, Ms. Nichols' mother was appointed as her guardian to administer the funds for the benefit of Ms. Nichols and a guardian ad litem was appointed. After attaining the age of majority, Ms. Nichols sued her mother claiming that funds from the settlement were used for Ms. Nichols' mother's personal benefit and not the benefit of Ms. Nichols. The trial court agreed, but limited Ms. Nichols' recovery from her mother based on the fact that Ms. Nichols had a "guardian ad litem who approved the estimates and expenditures". The issue in this case is what duty, if any, does the guardian ad litem owe to the minor ward under these circumstances? The trial court determined that a guardian ad litem is entitled to quasi-judicial immunity because the guardian ad litem acted according to the appointing court's decision and had the limited role of providing recommendations to the court regarding Ms. Nichols' best interest. The appellate court reversed, holding that in this case the guardian ad litem had a duty to advocate on behalf of Ms. Nichols, and thus immunizing the guardian ad litem from tort liability would be inconsistent with this duty.

The Supreme Court of Illinois holds that in this case, the guardian ad litem was acting as a branch of the judiciary, and thus entitled to quasi-judicial immunity. Notwithstanding that the guardian ad litem in *Nichols* was appointed under the Probate Act of 1975, which states in relevant part that "[i]n any proceeding for the appointment of a standby guardian or a guardian the court may appoint a guardian ad litem to represent the minor in the proceeding", the court holds that the duty of the guardian ad litem duty more closely aligned with a function of the court as opposed to a representative of Ms. Nichols. The Supreme Court of Illinois does note that the order appointing the guardian ad litem will ultimately determine the duties of that guardian ad litem and signals to the lower courts that more specificity may be required to determine the guardian ad litem's duties with respect to the court and with respect to the ward. Nonetheless, after *Nichols*, "guardians ad litem who submit recommendations to the court on a child's bests interests are protected by quasi-judicial immunity".

McCarthy v. Abraham Lincoln Reynolds, III, 2006 Declaration of Living Trust, 2019 Il 123622 (June 20, 2019)

The *McCarthy* case represents a matter of first impression in the state of Illinois   whether a court may impose sanctions in the form of attorney fees under Illinois Supreme Court Rule 137(a) to compensate an attorney defending himself or herself against a frivolous cause of action. Historically, Illinois courts have disallowed attorneys from charging fees for professional services in prosecuting or defending a case where the attorney is representing himself or herself. Deviating from the historical norm, the Supreme Court of Illinois holds that a court is authorized to impose sanctions in the form of attorney fees under Illinois Supreme Court Rule 137(a) against a plaintiff to compensate an attorney defending himself against a frivolous cause of action.

New York

2019 has been an active year for legislative reform in this area. A brief summary of 2019 changes follows.

Gender neutral language

Multiple provisions of the Estates, Powers and Trusts Law and the Surrogate's Court Procedure Act have been amended to describe intergenerational familial relations using gender neutral terms to reflect the provisions of the Marriage Equality Act requiring that marriages of same-sex and different-sex couples are to be treated equally under the law.

Lifetime trusts and "pour over" wills

A testator's will may dispose of part or all of a testator's estate by directing the transfer or "pour over" of assets to a trust that had not been funded during the testator's lifetime, provided, however, that such trust was executed prior to or contemporaneously with the testator's will and such trust agreement is identified in the will. Such trust will be deemed to exist if it was signed by at least one trustee prior to the testator's death, unless the testator is the sole trustee of such trust.

The protections provided by the attorney-client privilege have been extended to lifetime trustees.

Health care proxies

The authority to serve as a patient's health care agent, to witness a health care proxy and to determine whether a principal lacks capacity to make health care decisions has been extended to nurse practitioners.

Estate administration and estate taxation

For individuals dying on or after January 1, 2020, the basic exclusion amount will be equal to the federal basic exclusion amount indexed annually, but without regard to the passage of the Act (i.e., $5,850,000 in 2020).

The gift add-back provision that had expired on December 31, 2018, was reinstated by the New York Legislature in 2019. There will be a gift add-back for individuals dying on or between January 16, 2019, and December 31, 2025. The gift add-back provision provides that in calculating the value of a decedent's gross estate for New York estate tax purposes, the value of any gifts made by the decedent within three years of his or her death are generally included in the decedent's gross estate. There is no gift add-back for individuals dying on or between January 1, 2019, and January 15, 2019.

The executor of an estate is required to make a QTIP election on the estate's New York estate tax return if such QTIP election is made on the estate's federal tax return. If no QTIP election is made on an estate's federal estate tax return when a federal estate tax return is required to be filed, no QTIP election is allowed to be made for New York State purposes. This act was passed in response to the holding in Matter of Seiden (Hogan), in which the first-to-die spouse (the Husband), died in 2010 and the Husband's estate was not subject to a federal estate tax. The executor of the Husband's estate made a QTIP election on a pro forma federal return that was filed with the New York estate tax return and the marital deduction for New York estate tax purposes was allowed. Upon the 2014 death of the surviving spouse (the Wife), the executor of the Wife's estate excluded the marital trust property from the Wife's gross estate for New York estate tax purposes because New York law defines "gross estate" entirely by reference to the federal gross estate, and such property was properly excluded from the Wife's federal gross estate as a result of no federal marital deduction claim having been made in the Husband's estate. The court found in favor of the Wife's estate that the marital trust property did not need to be included in the Wife's New York gross estate. This act was passed to prevent similar outcomes in the future.

The law that eliminated the requirement to create a Qualified Domestic Trust (QDOT) if no federal estate tax return has been extended until July 1, 2022.

Eligible beneficiaries are entitled to consent to the appointment of an administrator or administrator c.t.a. of an estate, and if there are no eligible beneficiaries of the estate, an administrator or administrator c.t.a. may be appointed on the consent of all beneficiaries.

Fiduciary commissions

Donees of powers in trust (powers in trust to manage property vested in an incapacitated person) and donees of powers during minority (a power during minority to manage property vested in an infant) shall receive commissions under the same guidelines governing commissions paid to trustees, rather than the guidelines governing commissions paid to fiduciaries other than trustees.

Real estate

New York State and New York City impose an additional tax on the sale of high-end residential properties (a Mansion Tax) on sales in which the consideration paid exceeds $1 million. While the New York City Mansion Tax has historically mirrored the New York State Mansion Tax (i.e., a 1 percent tax on the sale price of the property), the New York City Mansion Tax rate has been increased for residential properties in New York City for which the consideration paid is $2 million or more in accordance with a sliding scale dependent upon sale price, up to 2.9 percent for residences selling at or above $25 million.

New York City also established a supplemental real estate transfer tax on the transfer of real property in New York City when the consideration for such conveyance exceeds $3 million for residential real property and $2 million for all other real property.

Residential real property includes any premises that is or may be used in whole or in part as a personal residence and includes: one-, two- or three-family houses; individual condominium units; and cooperative apartment units.

New York amended its tax laws to provide for additional disclosures in the conveyance of real property to provide for the full disclosure of the ultimate ownership by natural persons of real property. Any joint return filed by a grantor and grantee for the conveyance of real property shall not be accepted for filing when the grantor or grantee of a deed for residential property containing one- to four-family dwelling units is a limited liability company (LLC), unless such return is accompanied by a document identifying the names and business addresses of all members, managers and any other authorized persons, if any, of the LLC and the names and business addresses or, if none, the business addresses of all shareholders, directors, officers, members, managers and partners of any LLC or other business entity that are to be the members, managers or authorized persons, if any, of such LLC.

Birth certificates of adopted persons

Adopted persons who reach the age of 18 years, or the direct line descendants or legal representatives of deceased adopted persons, may obtain a certified copy of the adopted person's original long form birth certificate without the requirement of a judicial hearing. The adopted person, or the direct line descendants or legal representatives of a deceased adopted person, will be able to access all of the information included on the birth certificate, including the identifying information of any listed birth parents.

Child support

The incarceration of a child support obligor will not be treated as voluntary unemployment in the establishment or modification of a child support order unless such incarceration is the result of either the nonpayment of a child support order or an offense against the child or custodial parent who is the subject of such child support order. This change also provides that the incarceration of a child support obligor shall not be a bar to establish a substantial change in circumstances, barring the aforementioned incarceration as a result of the nonpayment of a child support order or an offense against the child or custodial parent who is the subject of such child support order.

Not-*for-profit organizations*

Not-for-profit organizations, including private foundations, are restricted from participating or intervening in any political campaign or on behalf or in opposition to any candidate running for public office. The New York law shall be interpreted in the same manner as Section 501(c)(3) of the Internal Revenue Code of 1986 governing not-for-profit organizations.

E-filing

Pursuant to an Administrative Order of the Chief Administrative Judge of the Courts dated May 31, 2019, for some matters commenced on or after June 3, 2019, some New York counties now mandate or allow for the use of electronic means for the filing and service of documents (e-filing). Due to the variety in e-filing requirements and availability among New York counties, those charged with commencing a matter in New York courts should reference the Administrative Order to determine whether e-filing of a particular matter is mandatory or available in the county in which the proceeding will be brought.

Pending legislative updates

As of the time of writing, there are several bills that have passed the New York Senate and the New York Assembly, but have yet to be signed by Governor Cuomo. Relevant to our practice are the following items of proposed legislation:

The enactment of the Uniform Voidable Transactions Act (UVTA) to replace the 1925 Fraudulent Conveyances Act and to create greater consistency, efficiency and predictability regarding property that is exempt from creditors. The enactment of the UVTA would make New York law consistent with federal bankruptcy laws and improve upon the provisions of New York law for determining insolvency, as well as clarify terminology, choice-of-law determinations, and the burden of proof of each party.

An increase in the value of an estate considered to be a "small estate" from $30,000 to $50,000 to provide greater access to New York's small estate $1 "do-it-yourself" program available through the court, allowing more lower and middle class New Yorkers access to this program.

An amendment establishing that the guidelines governing commissions payable to donees of powers in trust (powers in trust to manage property vested in an incapacitated person) and donees of powers during minority (a power during minority to manage property vested in an infant) shall be identical to the guidelines governing commissions paid to trustees, rather than the guidelines governing commissions payable to fiduciaries other than trustees.

The enactment of the Uniform Anatomical Gift Act which provides that when there is a conflict between a health care directive or proxy document and the express or implied terms of a potential anatomical gift with regard to the administration of procedures necessary to ensure the medical sustainability of the potentially donated part, the potential donor's attending physician and the potential donor shall confer to resolve such conflict. If the potential donor is incapable of resolving the conflict, and the declaration, directive or proxy document did not expressly reject the patient being a donor, then the health care proxy acting shall act for the potential donor to resolve any such conflict.

The enactment of the Uniform Partition of Heirs Property Act to prevent predatory real estate speculators from taking advantage of individuals owning a stake in residential property owned by heirs, by purchasing an heir's stake in the residential property, and using such ownership stake to file a partition action to dispossess the other family members of the property through a forced sale, oftentimes at a price significantly below the value of the property.

North Carolina

In addition to the *Kaestner* decision, discussed above, this year, North Carolina has also implemented legislative changes impacting estate planning.

Year's allowance

A surviving spouse may generally claim a statutory allowance from the estate of a deceased spouse (referred to as a "year's allowance"). In 2019, this amount was increased from $30,000-$60,000. N.C.G.S. § 30-15 was also clarified to provide that a surviving spouse may claim the year's allowance if either the decedent or the surviving spouse was a resident of North Carolina. This change allows a year's allowance, which is exempt from creditor's claims, to be claimed by a surviving spouse regardless of the fact that the spouses may have resided in different states (so long as one spouse is a resident of North Carolina).

No statute of limitations for action to reform, terminate or modify a trust

The North Carolina Uniform Trust Code permits, under certain circumstances, the reformation, termination or modification of irrevocable trusts. N.C.G.S § 1-56.1 was added by Session Law 2019-113 to clarify that no statute of limitations applies to an action to reform, terminate or modify a trust pursuant to N.C.G.S. § 36C-4-410 through § 36C-4-416 of the North Carolina Uniform Trust Code. This Section does not change prior law, as no applicable statute of limitations was established in the North Carolina Uniform Trust Code for such actions. The new statute now clarifies that the 10-year statute of limitations in N.C.G.S. § 1-56 does not apply to trust reformations, terminations or modifications pursuant to N.C.G.S. § 36C-4-410 through § 36C-4-416.

Tenancy by the entirety protections for real property held in trust

Under North Carolina law, real property may continue to receive the separate creditor protections of tenancy by the entirety if the property is first owned by spouses as tenants by the entirety and later conveyed (i) to a joint trust or (ii) in equal shares to two separate trusts, provided that (1) the husband and wife remain married, (2) the real property continues to be held in the trust or trusts and (3) the husband and wife are current beneficiaries of the joint trust (if the real property is conveyed to that trust) or of each separate trust (if the real property is conveyed in equal shares to their separate trusts). In Session Law 2019-178, a new notice provision was added as N.C.G.S. § 39-13.7(f), which allows, but does not require, a statement to be included in the deed, when the subject property is conveyed to a joint trust or in equal shares to separate trusts, indicating that the real property retains the separate creditor protections of a tenancy by the entirety and that, as of the date of conveyance, the trust meets the requirements set forth above. Additionally, new subsection N.C.G.S. § 39-13.7(g) gives lenders, creditors and title searchers an avenue to discover whether a property is subject to separate creditor claims. This new subsection provides protection for those persons entering into a transaction involving real property held in trust under that section, providing that such person may request confirmation from the trustee whether the requirements of the statute providing immunity from the claims of separate creditors are met at the time of the transaction.

We Can Help

We hope that this Advisory helps you with your year-end estate and gift tax planning and also provides you with some interesting ideas to consider for the future. As always, the Private Wealth practice stands ready and able to assist you with these matters at any time.

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