Proskauer

newsletter

Wealth Management Update

March 2018

in this issue

A monthly report for wealth management professionals.

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As part of our ongoing efforts to keep wealth management professionals informed of recent developments related to our practice area, we have summarized below some items we think would be of interest. Please let us know if you have any questions.

March Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

The March § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 3.0%, up 0.2% from February. The March applicable federal rate (“AFR”) for use with a sale to a defective grantor trust, self-canceling installment note (“SCIN”) or intra-family loan with a note having a duration of 3-9 years (the mid-term rate, compounded annually) is 2.57%, up from 2.31% in February.

The relatively low § 7520 rate and AFR continue to present potentially rewarding opportunities to fund GRATs in March with depressed assets that are expected to perform better in the coming years.

The AFRs (based on annual compounding) used in connection with intra-family loans are 1.96% for loans with a term of 3 years or less, 2.57% for loans with a term between 3 and 9 years, and 2.88% for loans with a term of longer than 9 years.

Thus, for example, if a 9-year loan is made to a child, and the child can invest the funds and obtain a return in excess of 2.57%, the child will be able to keep any returns over 2.57%. These same rates are used in connection with sales to defective grantor trusts.

2017-2018 Priority Guidance Plan Update

On February 7, 2018, the Treasury Department and the IRS released the second quarter update to the 2017-2018 Priority Guidance Plan. The second quarter update reflects additional projects, including those that have become near-term priorities as a result of the Tax Cuts and Jobs Act legislation enacted on December 22, 2017 (the “2017 Tax Act”). The Priority Guidance Plan contains guidance projects that are intended to be complete prior to June 30, 2018.

The 18 projects identified as related to initial implementation of the 2017 Tax Act are:

- Guidance on certain issues related to the business credit under § 45S with respect to wages paid to qualifying employees during family and medical leave.
- Guidance under §§ 101 and 1016 and new § 6050Y regarding reportable policy sales of life insurance contracts.
- Guidance under § 162(m) regarding the application of the effective date provisions to the elimination of the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit.
- Guidance under § 162(f) and new § 6050X.
- Computational, definitional, and other guidance under new § 163(j).
- Guidance on new § 168(k).
- Computational, definitional, and anti-avoidance guidance under new § 199A.
- Guidance adopting new small business accounting method changes under §§ 263A, 448, 460, and 471.
- Definitional and other guidance under new § 451(b) and (c).
- Guidance on computation of unrelated business taxable income for separate trades or businesses under new § 512(a)(6).
- Guidance implementing changes to § 529.
- Guidance implementing new § 965 and other international sections of the TCJA (published 01/22/18 in IRB 2018-04 as Notice 2018-07 (released 12/29/17)).
- Guidance implementing changes to § 1361 regarding electing small business trusts.
- Guidance regarding Opportunity Zones under §§ 1400Z-1 and 1400Z-2.
- Guidance under new § 1446(f) for dispositions of certain partnership interests (to be published 02/12/18 in IRB 2018-07 as Notice 2018-08 (released 12/29/17)).
- Guidance on computation of estate and gift taxes to reflect changes in the basic exclusion amount.
- Guidance regarding withholding under §§ 3402 and 3405 and optional flat rate withholding.
- Guidance on certain issues relating to the excise tax on excess remuneration paid by “applicable tax-exempt organizations” under § 4960.

Section 199A Clarification

Section 199A, added to the Internal Revenue Code by the 2017 Tax Act, generally allows certain taxpayers to deduct 20% of their qualified business income received from pass-through entities (and sole proprietorships). In order to be entitled to the deduction, the income must derive from a qualified trade or business, which includes any trade or business other than a “specified service trade or business.”

A specified service trade or business is defined as a business in the fields of health, law, consulting, athletics, financial services, or brokerage services, or ***any trade or business***

where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.

Architects and engineers were removed from the list of service businesses that would not qualify for the deduction shortly before the 2017 Tax Act was enacted into law. However, there was apparent confusion in the professional community as to whether architects and engineers may nevertheless fall under the catch all provision in bold italics above.

On February 2, 2018, a Treasury official clarified that architects and engineers will qualify for the 20% deduction on their business income under new Section 199A and will not be pulled back into the exception by the catch all provision.

New York Governor to Propose Decoupling State Income Tax

New York Governor Andrew M. Cuomo has proposed a measure to decouple major provisions of the State's personal income tax code from the Internal Revenue Code to prevent the State from reaping a $1.5 billion windfall from the 2017 Tax Act.

Under current New York law, an individual claiming the standard deduction on his or her federal income tax return is required to claim the standard deduction on his or her New York State income tax return. The proposal would eliminate this requirement and allow individuals filing a New York State income tax return to itemize their deductions on their New York State income tax return even if the standard deduction is claimed on their federal income tax return.

The 2017 Tax Act increases the standard deduction to $12,000 per individual and eliminates miscellaneous itemized deductions. As a result, a significantly larger number of individuals will claim the standard deduction on their federal income tax returns, which currently would prevent them from claiming itemized deductions on their New York State income tax returns (although such deductions remain deductible for New York State income tax purposes).

SALT Payments Recast as Charitable Contributions

The 2017 Tax Act limits the state and local tax ("SALT") deduction to $10,000, which has prompted high-taxed states, such as New York and California, to consider legislative proposals that would allow their residents to avoid the new limitation.

One proposal currently being considered by at least three states–California, New York and New Jersey–is recasting the SALT payments as charitable contributions and providing state tax credit up to the full amount of the contributions, in effect providing an end-run around the $10,000 annual deduction limitation on SALT payments that does not apply to charitable contributions.

California already has introduced legislation – SB 227, the "Protect California Taxpayers Act."

It is currently unclear whether a purported charitable contribution to a state is deductible under current tax law in light of the donor's receipt of a quid pro quo benefit in the form of state tax credits in return for the contribution to the charitable fund. If the contribution is considered to lack donative intent and not to have been made voluntarily, the contribution will be characterized as the equivalent of a state tax payment and, therefore, subject to the $10,000 SALT deduction limitation.

Green v. United States – Charitable Contribution Deduction under Section 642(c)

The 10th Circuit Court of Appeals addressed the question of the amount a trust can claim as a charitable contribution deduction under Section 642(c)(1) when it donates appreciated property.

In *Green*, the taxpayer, an irrevocable non-grantor trust created by the founder of Hobby Lobby, purchased real estate through a limited liability company wholly owned by the trust (and disregarded for income tax purposes). The real estate was purchased using current and accumulated gross income of the trust. In subsequent years, after the real estate had appreciated in value, the trust (through the LLC) contributed the real estate to various charitable organizations. Distributions to charitable organizations were permitted under the terms of the trust.

The taxpayer claimed a charitable income tax deduction under Section 642(c)(1) for the contributions in an amount equal to the appreciated fair market value of the property at the time of contribution. The IRS challenged the amount of the deduction, taking the position that the deduction was limited to the adjusted basis of the property. The District Court hearing the case ruled in favor of the taxpayer, allowing a deduction for the full appreciated value of the property.

Reversing the District Court, the 10th Circuit Court of Appeals held that Section 642(c)(1), which allows trusts a charitable deduction without limitation for any amount of *gross income* paid for a charitable purpose, does not allow a trust a charitable deduction for the excess of fair market value over adjusted basis of property contributed to a charity, where the property had been purchased by the trust with the trust's gross income. Because unrealized appreciation is not included in gross income until a realization event has occurred, the value of such property in excess of adjusted basis is not treated as an amount of gross income for Section 642(c)(1) purposes.

Lender Management, LLC v. Commissioner

The Tax Court ruled that a family office, Lender Management, LLC, was "carrying on a trade or business" as an investment manager rather than serving as a passive investor and therefore was entitled to deduct expenses under Section 162 rather than Section 212.

This is a favorable decision because trade or business expenses generally can be deducted under Section 162 without limitation. In contrast, expenses deductible under Section 212 are miscellaneous itemized deductions, which, under the 2017 Tax Act, are no longer deductible through 2025.

The Private Client Services Department at Proskauer is one of the largest private wealth management teams in the country and works with high-net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

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