PLANNING IN A PERIOD OF UNCERTAINTY, INCLUDING USES OF DEFINED VALUE CLAUSES

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Estate Planning in a Period of Uncertainty, Including Uses of Defined Clauses

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1. Introduction

The possibility of tax reform and the repeal of the estate tax (or substantially increasing the exemption amounts) has resulted in a great amount of uncertainty in planning for clients, including testamentary planning structures and in transfer planning. After describing the current status of the legislative developments surround tax reform, suggestions of planning approaches during this period of uncertainty are highlighted including ways for maximizing flexibility. The desire to avoid paying gift taxes in an environment in which the estate tax may be repealed places increased significance on the use of defined value transfers. Planning concerns with FLPs and LLCs in light of the recent *Powell* cases are summarized. An intriguing new approach is described for structuring trusts as grantor trusts as to the trust beneficiaries (termed the "BDOT") that avoids many of the uncertainties and complexities of the "BDIT" plan.

2. Legislative Developments

a. **Presidential Election**. With the election on November 8, 2016, Republicans now hold the Presidency and majorities in the House and Senate, making tax reform a very realistic possibility for 2017. In light of the significant possibility of repeal of the estate and GST tax, estate planning considerations for clients were changed overnight on November 8.

b. **House Republicans and Trump Proposals Regarding Tax Reform (Including the Transfer Tax); Process for Tax Reform Changes**.

House Republican Blueprint (June 2016). The House Republican tax reform package is described in a document published on June 24, 2016 entitled "A Better Way" (and referred to as a Blueprint for Tax Reform"). The Report says that it is premised on addressing the broken tax code, the broken Internal Revenue Service, and the need for stronger economic growth. The tax reform measures include:

- Individual: Top rate-33%; capital gains and dividends-50% exclusion (equivalent to a top rate of 16 ½%); no itemized deductions except mortgage interest and charitable deduction; no AMT; no 3.8% tax on NII; "continue the current tax incentives for [retirement] savings;"
- Tax simplification for individuals, proposing a "Simple, Fair 'Postcard' Tax Filing:"

1. Wage and compensation income _____
2. Add ½ of investment income _____
3. Subtract contributions to specified savings plans _____
4. Subtract standard deduction OR [lines 5-6] _____
5. Subtract mortgage interest deduction _____
6. Subtract charitable contribution deduction _____

7. Taxable income _____
8. Preliminary tax (from tax table) _____
9. Subtract child credit _____
10. Subtract earned income credit _____
11. Subtract higher education credit _____
12. Total tax _____
13. Subtract taxes withheld _____
14. Refund due/taxes owed _____

- Business: Corporate top rate-drop from 35% to 20%; pass through business income top rate of 25% (with a requirement that "businesses will pay or be treated as having paid reasonable compensation to their owner-operators"); immediate write-off of business investments in tangible and intangible assets (but not land); no corporate AMT;
- Border adjustment provisions (taxing certain imports but not exports), which accounts for substantial revenue to offset partially the large tax cuts in other parts of the plan; replacing the "outdated worldwide tax system" with a territorial tax system; and
- Repeal estate and GST tax.

Trump Campaign Proposal. The Trump/Pence campaign website summarized the Trump tax reform campaign proposals, which include:

- Individual: Top rate-33%; capital gains and dividends-20%; cap itemized deductions at $200,000 (joint), $100,000 (single); no AMT; no 3.8% tax on NII;
- Business: Corporate top rate-drop from 35% to 15%; pass through business income top rate of 15% (in the first Trump plan); and
- Transfer tax: "repeal the death tax, but capital gains held until death and valued over $10 million [presumably that is per couple] will be subject to tax to exempt small businesses and family farms. To prevent abuse, contributions of appreciated assets into private charity established by the decedent or the decedent's relatives will be disallowed." (The last sentence presumably would eliminate the charitable deduction for gifts of appreciated assets to a private foundation created by the donor or the donor's family.) [Observe: That phrase about carryover basis or realization at death has not been repeated in any of the Trump administration's summary proposals about repealing the estate tax.]

  The proposal does not clarify whether the $10 million exemption is applied per couple or per individual. Also, the proposal is not clear as to whether it would impose capital gains at death or merely establish a carryover basis on gains. Informal reports are that the Trump campaign confirmed for one inquirer that the intent was to propose a carryover basis approach, not realization at death.

  Interestingly, Hillary Clinton also announced a rather startling proposal on September 22, 2016 regarding transfer taxes *and* gain realization for gifts and

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