GreenspoonMarder LLP

From the desk of:
Carl H. Linder, Esq., LL.M, Co-Chair
International Wealth and Asset Planning
Lindsay Miller, Paralegal
600 Brickell Avenue, Suite 3600
Miami, Florida 33131
Phone: 305.789.2770
Email: carl.linder@gmlaw.com
Email: lindsay.miller@gmlaw.com
www.gmlaw.com

From the desk of:
Edward D. Brown, Esq., LL.M, CPA, Co-Chair
International Wealth and Asset Planning
Jacqueline Z. Fox, Esq., LL.M
Andrew Bechel, Esq., LL.M
Sue Pledger, Paralegal
1401 Lawrence Street, Suite 1900
Denver, Colorado 80202
Phone: 303.741.1111
Email: ed.brown@gmlaw.com
Email: jackie.fox@gmlaw.com
Email: andrew.bechel@gmlaw.com
Email: sue.pledger@gmlaw.com
www.gmlaw.com

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PRIVILEGED COMMUNICATION
PERSONAL AND CONFIDENTIAL

Greetings once again from the Denver and Miami offices of Greenspoon Marder LLP.

"If I Had More Time I Would Write a Shorter Letter." This quote is attributed to Mark Twain from a letter he wrote on June 15, 1871 to James Redpath in Elmira, New York. But in our case this year, even though we usually prefer to share these communications on or before the beginning of February, we took some extra time this year to be able to prepare a shorter letter.

To facilitate your reading and review of this letter, we have organized it into the four sections, noting that Section II. this year is different in that it is designed to include helpful agenda items for a highly recommended annual meeting to revisit any existing integrated estate plan ("IEP") design. This year's four sections are:

I. **TAX AND FILING REQUIREMENTS** – Various requirements for you to bear in mind in 2019 for any reportable 2018 activities.

II. **ANNUAL REVIEW BENEFITS** – As noted above, Section II. is new this year and serves as an agenda for regular (e.g., annual) meetings that we strongly encourage you and the other parties to the IEP (e.g., trustees) to schedule with us. If more than a year has passed since the last such meeting, now would be a good time to make arrangements for one. Section II. can serve as an agenda for such a meeting. This is also an opportune time for us to review some of the trust's more important provisions with the trustees so everyone is aware of the purposes of these provisions and what actions to avoid.

III. **SELECT GOOD IDEAS AND REFRESHERS** – In Section III., we present some ideas and refreshers on how to enhance an overall IEP structure.

IV. **DEVELOPMENTS** – Some of the more material asset protection, tax and estate planning developments from this past year or so are summarized in this section for you.

Please keep in mind, however, that in the above-described four sections of this letter, for sake of capsulizing the breadth of information in an efficacious manner, we have only captured the essence of a number of points to be made. Therefore, the information in this letter is not intended to cover the various details of each item, and does not constitute legal advice, especially since every client's situation is unique.

Remember that a letter of this nature cannot be all-encompassing due to space and other limitations, and that there is no substitute for personal professional advice. Also, the placement of an item in a particular section does not necessarily mean it could not have been appropriately included under another section instead.

Your CPA, other advisors, and any domestic trustee of the trust(s) you have settled should find this letter to be useful and relevant, so you should consider providing each of them with a copy. Alternatively, if you would like us to send any of them a copy of this letter, please provide us with their current electronic mailing information, and we would be happy to do so on your behalf at no additional charge.

I. TAX AND FILING REQUIREMENTS

The tax and filing requirements that are of particular relevance to U.S. citizens and U.S. residents who have settled an integrated estate planning trust (an "IEPT") appear on the Attachment to this letter.

II. ANNUAL REVIEW BENEFITS

1. **Time to Cut Those Strings.** Perhaps you have had an IEP structure in place for some time now and are much more comfortable with the idea of placing significant confidence in the foreign professionals who play vital roles in any IEP design (such as the corporate trustees, corporate protectors, foreign banking custodians and asset managers). If your confidence level has reached this point, this would be the time to disconnect the U.S. components that can otherwise place assets and persons within the reach and control of the U.S. legal system. The vulnerable U.S. components include: (i) U.S. trustees (even more so if they are related or subordinate to you and/or if you have the power to remove or replace them); (ii) U.S. protectors (even more so if that person is you or persons who are related or subordinate to you and/or if you have the power to remove or replace them); (iii) U.S. assets (whether liquid or immovable assets); (iv) U.S. signatories on any financial accounts; (v) U.S. general partners, managers or other controlling parties of any entities; (vi) U.S. entities (such as partnerships, LLCs, corporations); and even (vii) U.S. beneficiaries. Although you may not be willing or able to cut all these strings, keep in mind that any of these can be the weakest (and therefore vulnerable) link in the chain. As such, each of these should be strongly re-considered. Therefore, perhaps consider cutting strings with regard to only some of the IEP assets and have just those particular assets held as a separate trust or subtrust.

2. **Letter of Wishes.** Protecting inheritances from creditors, divorce, bankruptcy and lawsuits is important, but a trust can do so much more. You may consider preparing a Letter of Wishes to express your visions and goals as to how the trust assets should be used, with the hopes that the trustees would act in ways that achieve such goals. These goals can include ideas that are designed to motivate future beneficiaries to make more of themselves.

3. **Individual vs. Corporate Professional Trustees.** The role of an IEPT's domestic (U.S.-based) trustee is an extremely important position and how the position is carried out can be an important factor in whether the IEPT will or will not be respected, whether by a court one day in litigation or otherwise. The domestic trustee can be a friend, relative or colleague (typically, a non-beneficiary) or a professional corporate trustee in a protective state (such as Nevada). Serious considerations should be given to utilizing the services of a professional corporate domestic trustee for a number of reasons:

a. Distancing Factor. The more distance between the settlors and trustees, the better perception of the settlors not retaining any control over the IEPT, resulting in greater protection of the IEPT's assets.

b. Banking Opportunities. Some of the corporate trustees with whom our clients work provide automatic bank account services for the IEPT as well as banking connections that allow for the opening of bank accounts for the IEPT's underlying entities.

c. Corporate Trustees in Nevada. Our analysis is that Nevada is among the states with the strongest domestic asset protection laws in the U.S. If you would like to add a Nevada-based corporate trustee, the IEPT can be amended and thereby benefit from the protections of the offshore jurisdiction and Nevada. Our firm has a long working history with several Nevada corporate trustees who are intimately familiar with and understand the IEPT's provisions and purpose. This knowledge and experience can provide for better administration of the IEPT.

Keep in mind, however, that this does not mean the points made in item 2 above, "Time to Cut Those Strings," are any less relevant, meaning having only a foreign trustee with no domestic co-trustee can ultimately be more protective.

4. **Handy Summary of IEPT Structure.** We have recently been asked to prepare for many of our clients a summary of the pertinent aspects of their IEPT. This convenient summary benefits not only the client but their family, trust fiduciaries, professional advisors, bankers and the like. It is a quick reference tool that addresses the most frequent questions encountered regarding the IEPT. For example, the summary addresses such pertinent items such as:

- Identity and contact information of your advisors (e.g., personal/local legal counsel, CPA, financial advisor, bank custodians, healthcare advisor);
- Procedures to amend the IEPT;
- Information regarding the assets owned by the IEPT; and
- Information regarding the annual maintenance items, fees, and associated deadlines for the IEPT and its underlying entities.

Please let us know if you would like for our office to prepare a Summary of your IEP. A related diagram of the structure would also be included.

5. **Transaction Review.** The way assets are owned and how beneficiary designations are set up may determine the degree of success of an IEP. A trust can be properly funded to minimize or avoid the probate process and maximize protection so that the IEP works the way intended. It would be a good idea to review your personal holdings and for us to discuss together whether it is time to transfer additional assets into the planning structure you created. A summary list of to-do reviews is below:

- Review the purchase of any real estate, stocks, bonds or other investments during this past year. Should it be added to the trust structure now to gain the benefits for such asset that the trust structure provides? Should the asset instead be titled in a separate entity under the trust to better isolate any liability that may be associated with the asset? Having real estate in such an entity can, in certain cases, enhance the asset protection of the trust in general, over and above the isolation factor just mentioned.

- Review refinancing of any real estate. If the real property was temporarily removed from the trust or underlying entity during the refinance, verifying that the property was transferred back into the trust (if allowed under the loan documents) once the refinance was complete is advisable. If it was not, a deed should now be prepared to place the real estate back into the trust.

  - Worth noting here is that it is preferable from a protection standpoint to avoid such temporary removals of real property from an IEPT, and therefore, the trustees, before taking such action, should first talk this through with legal counsel.

- Review acquisition of any other assets with “title certificates.” Are the titles in the name of the trust? Are such certificates custodied with the trustee?

- Review purchases of life insurance. Are the beneficiaries properly designated? In many states, it may be preferable to designate the IEPT as a beneficiary or owner versus an individual; however, state law should be considered before making such a designation because naming a non-individual beneficiary may cause one to forfeit an exemption of the policy’s cash value that may have been otherwise available under state law. Please call our office if you are unsure, as we can review the policy itself to see if any protections would be expressly vitiated under the policy terms if placed into an IEPT.

- Any transfer documentation to an IEP should be reviewed prior to execution to determine whether the character of the asset is separate, community, marital, or some other type of property, so that unintentional commingling of assets does not occur.

6. **Double Tiered Protection.** Consider adding a Nevis or Cook Islands LLC to the assets owned by the IEPT. Nevis law, for example, provides that if any judgment is ever issued against you or the IEPT, and if the creditor then attempts to enforce that judgment against any assets held in a Nevis LLC in which you are a member, directly or indirectly, “charging order” limitations are imposed that keep the creditor from reaching into the LLC to seize any

assets. These charging order laws are superior to any similar laws with regard to U.S. LLCs for three reasons: (1) Nevis courts are not prone to "bending the rules" or "substance over form arguments" in the creditor's favor when a judge or jury may feel the facts warrant giving the creditor the benefit of the doubt; (2) U.S. courts have no jurisdiction to enforce any judgment against a Nevis manager who has custody of the LLC assets; and (3) a creditor's charging order expires in three years under Nevis law and cannot be renewed (unlike U.S. laws in which judgments can last for decades). For cases in which the U.S. courts can take broad interpretive liberties regarding access to LLC assets, consideration should be given to establishing offshore LLCs holding offshore assets as opposed to having U.S. entities with U.S. assets.

7. **State Law Nuances.** It is always recommended that any assets that are being transferred first be confirmed by "local" counsel as not having to meet any particular state law requirements that may pertain to transfer taxes, franchise taxes, margin taxes, valuation reassessments, and other possible unintended consequences. For example, if the IEPT owns or will own California real estate or an entity that owns California real estate, the provisions should be revisited sooner versus later. In fact, if you have transferred or intend to transfer such assets to the IEPT, the trustees or you should check the definition of "Trust Period" or "Trust Term" of the IEPT to see whether the IEPT's term is going to expire in the next year or two. If so, we should be contacted well in advance of the expiration of the term.

Examples of state law nuances are as follows:

- California's Proposition 13 provides that, subject to a number of exceptions, transfers involving California real estate result in an adjustment to the value of the real estate, causing an increase in the property taxes. To qualify for one of the exceptions when making such a transfer, the trust must contain certain language.

- If the IEP owns any California real estate, but does not have an expiring Trust Period as mentioned above, possible new trends (especially in bankruptcy situations) may warrant having the IEPT amended now to better protect the California real estate. It is important to update IEPTs in this respect to keep ahead of such creditor law developments.

- Texas law also requires certain language to be in the IEPT to maintain homestead tax and protection benefits before your Texas homestead is placed in the trust.

- Florida real estate and certain assets that can be held as "tenants by the entirety" should also be addressed, since IEPT ownership of such assets could be problematic.

Please check with us prior to making any transfers, in case there may be special considerations such as these.

8. **Document Transfers to and From Trusts and Entities.** Remember that whenever funds are placed into or transferred out of a trust, LLC, partnership or other entity, documentation of the transfer of the asset should be signed so that all parties have a record that all structure formalities have been followed. Copies should also be provided to us and others who need to be kept informed as to what the structure owns.

Confirming that any needed annual LLC or partnership registration renewals have been filed is also a good agenda item to check off each year, since we are frequently not notified by the registration officials as to when renewals are due or are about to expire.

Remember also to have the authorized parties be the persons who execute documents on behalf of the respective entities. For example, if a home owned by a trust is being refinanced, the trustee as opposed to a settlor or general partner should be the one entering into the loan documents.

Also, prior case law highlights the importance of a lease with arm's length terms being in place when the family home, a vacation home and/or a second (or third, etc.) home is owned by the trust or a related entity. You or the trustees should check to make certain this paperwork is in place. In fact, if you have such documentation in place (such as an occupancy agreement) that is older than four (4) years, that documentation needs updating to better withstand more recent increased scrutiny that has become evident in some case law.

Specifically, previously prepared Occupancy Agreements should be replaced with updated Lease Agreements, as there has been some recent case law development where discussion has occurred that an Occupancy Agreement may not be viewed as an arm's length contract, unlike the more typical Lease Agreement that we are currently preparing for our clients.

The Lease Agreement provides that the occupants write a check to the record owner of the property (the IEPT or an underlying LLC) each month (or quarterly, semi-annually or annually) to pay the fair market rental value (based on Zillow.com rent "Zestimates") (or at a minimum the difference between fair market rental value and other expenses currently paid by the occupant such as monthly maintenance, homeowner fees, property taxes, utilities, related loan payments, if any, etc.). We believe this arrangement to provide the most protection for a settlor-occupied residence under current case law.

Alternatively, but perhaps less effectively, we can document by trust resolution when funds have been placed into the Trust or underlying entity and are to be treated as pre-paid rent for the next year or number of years.

The least attractive option (which we do not recommend but is better than doing nothing) would be to prepare a resolution whereby the trustee(s) ratify and approve that any non-payment of rent is to be treated as a "distribution" to the beneficiary for being allowed to use the IEPT or underlying LLC assets (i.e., the value of the occupancy of the residence).

9. **Stretch IRAs and Retirement Plans.** Trusts have been viewed in the past mostly as vehicles that avoid or minimize estate taxes. However, with married couples now having a combined $22.8 million exemption from such taxes, trusts that offer other advantages take the spotlight. Trusts are now being created to optimize both (i) income tax deferral (the "stretch") and minimization, and (ii) asset protection for both the person creating the trust and his or her spouse and other family members. The IEPT you created may need new language to maximize these aspects.

10. **Avoid Mixing Hot Assets and Cool Assets.** Over the course of time, the makeup of assets held in a planning structure will change. Sometimes the change is from, say, cash to a mix of

cash and real estate. Sometimes an airplane or yacht is acquired. When these situations come to our attention, clients almost always see the advantages in our advice that the low risk/no risk assets (we call them "cool" assets, for example, cash) be segregated from the high risk assets (we call them the "hot" assets, for example, real estate, airplane, etc.). The reason is that despite the value of certain assets, they can also carry risk. For example, even a limited partner interest that could be subjected to a capital call could become a hot asset. The main goal is to keep a liability that may emanate from a hot asset isolated and separate from the cool assets. Periodically it is a good idea to review what is held and how it is held, and to consider adjustments as appropriate.

11. **Being a Responsible Trustee.** Being a trustee is a position that should not be taken lightly. It is an important position and how the position is carried out can be an important factor in whether the trust will or will not be respected, whether by a court one day in litigation or otherwise.

Here are some important points that the trustee should keep in mind in the course of being a good trustee:

- The provisions of the trust should be understood. The trust should be read by the trustee, or at a minimum, the trustee should read an outline of the trust, which we can prepare.
- A trustee should not simply rubber-stamp requests. When carrying out trustee duties and when responding to requests, questions should be asked and independent judgment should be exercised. For example, when a distribution to a settlor is being considered, any restrictions that appear in the IEPT should be given close attention.
- Trust formalities should not be ignored, and transactions of the trust should be documented.
- The trust should not be treated as the settlor's back pocketbook. Assets of the trust should not pass back and forth between the settlor and the trust.
- The trust should be administered consistently with its original intent and design; that is, as a family trust for the benefit of the family as a whole.
- Tax reporting and other tax compliance obligations for the trust fall partially upon the shoulders of the trustee.
- A bank account for the trust should be maintained.
- It is a rare case wherein the trustee on behalf of the IEPT would be signing a loan document or executing a guarantee or like obligation, or carrying on an active business. The trustee should seek professional advice before so doing.
- The trustee should be familiar with all trust assets.

13. **Being a Responsible Settlor.** Being a responsible settlor is also a great idea. There are certain things the settlor should do so as to assist with the IEPT being respected if and when it is challenged one day, or otherwise. For example:

- The settlor should not describe or reference or represent the trust (or planning structure) as his or her own, whether on financial statements or otherwise.

- The settlor should not sign on behalf of the trustee.

- The settlor should bear in mind that his or her solvency must be maintained, separate and apart from the IEPT, both in terms of assets less liabilities, and in terms of liquidity to pay debts as they come due.

- The settlor should spend or consume unprotected assets held in the settlor's name before requesting or otherwise turning to protected trust assets.

- The settlor should keep in mind that liquid and other moveable assets are the easiest assets to protect; the range of options that exists for the protection for illiquid or immovable assets like real estate is narrower than exists with regard to liquid and moveable assets.

- The settlor should not retain any "back door" access to IEP assets, such as through a line of credit or internet account transfer capabilities.

14. **Protector Powers.** If there is a protector serving in connection with the IEPT, attention should be given to whether the protector needs to reflect in writing that the protector is waiving or asserting any veto powers over a trustee's actions. Recall that the protector has veto power over most of the trustees' more significant powers.

15. **Single-Member LLC for Home Ownership.** If the IEPT owns the family home(s) and/or the family vacation home(s), protections are already in place to provide an element of protection. There is another level of protection that might have application to such property. This involves having the IEPT create a single-member LLC, to be wholly owned by the IEPT. The IEPT would then transfer the property (if no local law or tax issues) into that LLC. Ideally, the LLC would own certain other assets as well. This helps shield the IEPT's other assets from liability that may arise from an incident that takes place at the property (such as a slip and fall). It can also facilitate more direct control over the property via the client being a manager of the LLC (although some trade-offs exist).

    The use of an LLC in this case also provides benefit to the IEPT under U.S. legal principles that mandate how the offshore "choice of foreign law" designation in the IEPT is to be applied. Furthermore, the LLC can be designed as a disregarded entity for IRS purposes, meaning (among other things) a federal tax return may not be required for that entity.

16. **Review and Update Language in Older Planning Structures.** It would be a good idea to have all IEPs reviewed and updated as appropriate. Not only should changes in planning goals be reflected, but newer and updated language that has been developed should be considered, along with tax law changes.

Examples of newer provisions include clauses that allow: (i) for a step up in tax basis (that can eliminate capital gains); (ii) income and gains to be taxed at a lower tax rate and/or avoid state income tax; and (iii) a trusted "fiduciary" to change beneficiaries, change the applicable law to a more favorable jurisdiction, or to amend the trust to make sure the initial goals will be carried out even after the settlor's death.

New provisions could also be added to forever exclude over $22 million from any gift, estate and generation-skipping transfer taxes.

17. **Caution if a Trustee or Protector Resigns or Dies.** When a domestic trustee or third-party domestic protector of a domestic trust dies or resigns, the trust may remain a domestic trust for U.S. tax purposes *only if* a new trustee or protector, who is a U.S. person, is appointed within 12 months of the trustee's or protector's death or resignation. If a new trustee or protector is not appointed within the 12-month period, then generally the trust will retroactively be classified as a "foreign" trust for U.S. tax purposes, resulting in additional tax filing requirements (as described in the Attachment mentioned in Section I. above) and exposure to fines and penalties for non-compliance. There is also a potential income tax issue should a trust's settlor die while the trust is classified as a foreign trust for U.S. income tax purposes. *Accordingly, please notify our office as soon as possible upon the death or resignation of either a trustee and/or protector, so that we may assist you with any needed timely and proper appointment of a successor.*

If the desire is to keep the trust domestic, we recommend that a successor domestic trustee or domestic protector be effectively appointed prior to or at the same time that the then-serving domestic trustee or protector, as the case may be, was removed. This can be done by completing an "Appointment of Successors" instrument.

If by chance the IEPT was designed as a grantor trust that is also a completed gift trust, and is a foreign trust, and the settlor passes away, there can be income tax consequences at that time unless the IEPT is amended in advance to maintain the grantor trust status (under IRC Section 678) of the IEPT.

III. SELECT GOOD IDEAS AND REFRESHERS

1. **Green Light on Locking in Gift-Tax Free Transfers – No Recapture Tax.** In case you have not heard, as covered in several of our blog posts, the United States Treasury has announced that if you take advantage of the $11,400,000 exemption from any gift taxes while such generous exemption amount is allowed, then even if the exemption later decreases (which it is slated to do *drastically* by the year 2026), the IRS will not recapture (claw back) the taxes you should have otherwise paid. This is good news since there had been an ongoing concern that when a person dies after these exemptions decrease, the IRS would be able to charge the taxes you had previously saved.

You can lock in such a tax savings if (before 2026, or possibly earlier depending on Washington D.C. changes in administration) you complete gifts in the meantime in excess of the possible later-diminished amount. For example, if you gift $11,400,000 today, you pay no gift tax, and then at death, even if the estate tax exemption is then below $11,400,000, none of that amount (including all the income and appreciation that occurred thereon after the gift

was made) will be subject to the estate tax. In essence, this is truly a window of opportunity that may be closing.

a. <u>SLATs and Power of Appointment Trusts</u>. Some of the tools being recommended in light of this planning strategy is to create a spousal lifetime access trust (SLAT), or if you are not married, a power of appointment trust that captures this allowed gift tax exemption. If set up using the appropriate applicable/governing law and provided spouses' respective SLATs are not mirror images of one another, such trusts can provide superior gift/estate tax savings as well as asset protection. The "lifetime access" or power of appointment aspects of such trusts further provide for your eligibility to regain ownership of the trust assets in the prescribed (as set forth in the trust document) circumstances. We build in safeguards here to better insure that such trusts are not "self-settled" trusts, such as building in certain "seasoning" periods that the trusts endure before certain powers are able to be exercised. For example, if you were able to regain access to trust assets in the first ten years of the trust's existence, and during that time you fall into bankruptcy, there is a higher likelihood the bankruptcy court could exercise certain asset-clawback powers.

In any event, these trusts can also include provisions that allow you to replace trust assets that have a low tax basis with your personal assets that have a high tax basis (including cash or borrowed funds) so that the low basis assets get a step up in basis (i.e., a fair market value adjustment) under the estate tax laws so that your family members who outlive you can then sell those assets income tax free.

Further desirable features can be built into these trusts, such as a trustee's authority to loan you trust funds at any time that you have the financial wherewithal to borrow such funds.

2. **<u>Basis – Double Talk</u>.** If you do not live in a community property state (i.e., Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington or Wisconsin) (each of which allows a full adjustment to the tax basis at the death of the first of two spouses to die, allowing the surviving spouse to sell any or all of their collective assets income tax free), this does mean you and your spouse cannot achieve similar basis adjustments (also known as double "step up in basis"). To save space, we do not give an example of the strategy in this letter, but upon request we would be happy to send you our "Double Step Up Spousal Trust Example" that lays out the particulars.

3. **<u>The Hybrid Trust – Rethink being a Beneficiary of a Trust you Create</u>.** A common element seen in "asset protection trusts" is the trustmaker (a/k/a, the "settlor") retaining the right to be a beneficiary of the trust he/she created from the get-go (known as a "self-settled" trust as opposed to a "third party" trust). Creditors challenge such self-settled trusts as being unfair because a trustmaker could still have access to the trust assets as a beneficiary while the creditor cannot access those trust assets. The fact that the trustmaker is a beneficiary of the trust invites scrutiny regarding the effectiveness of such trusts. This has led some advisors to suggest that the trusts be created only for a beneficial class that does not include the trustmaker, as doing so can better insulate the trust assets from creditors of both (i) the trustmaker, and (ii) the beneficiaries. A trustmaker, however, may not be keen on the idea of creating such "third-party trusts" if the trustmaker wants to be eligible to receive assets back from the trust.

Best of both worlds? Just suppose, however, that the trustmaker can create a third-party trust (i.e., a trust that does not name the trustmaker as a beneficiary) but still be eligible to receive benefits from the trust someday. This is possible today now that many states have adopted statutes allowing third party trusts: (1) to reimburse a trustmaker for personal income tax obligations that arise from trust income; (2) to be decanted to other trusts; (3) to be modified, restructured or reformed; (4) to grant powers of appointment to other persons, which can result in the trustmaker becoming in essence a beneficiary at any point (so long as this is not pre-agreed upon); (5) to be revised through non-judicial settlement agreements; and (6) to appoint non-fiduciary protectors who can adapt a trust to changing circumstances.

Also, a new trend is developing in which trust designers are building in provisions in which the trustmaker may be added as a beneficiary, but only if certain events first take place that have sufficient independent significance that the possibility of such eventuality occurring is not tantamount to (in fact, it may be a far cry from) the trust being a self-settled trust, and therefore avoid the undesired fate that may otherwise be dictated by a judge who believes he or she is just “doing the right thing” in the given circumstances. Examples of events of significant independence could include the trustmaker’s divorce (and has not remarried), the death of the trustmaker’s spouse, the trustmaker’s net worth diminishing to less than half of what it was immediately after a trust is created, the trustmaker’s investments predominantly in real estate all being liquidated into safer investments; or the trustmaker no longer being able to fly an aircraft (the risk he was protecting against) due to any loss of a pilot’s license. The less control that the trustmaker has over such events, or the less likely such events would occur anytime soon, the better.

4. **State Law Exemptions.** Keep in mind that the various states provide protections from creditors in a number of ways. For example, owning property in Florida, even if you do not reside in Florida, can be very well protected if it is held by a married couple as “tenants by the entirety”

   Also, life insurance can be well protected, both as to the cash value and the ultimate proceeds payable at death. For this reason, it is important to consider whether such protection can be adversely affected if the ownership of such policies is placed into an IEPT, LLC or partnership. If your planning structure owns any life insurance, this should be revisited to confirm whether this is the best placement.

5. **Guarantor Obligations.** If a trust anticipates executing any guarantor obligations, consideration should first be given to a division of the trust to better isolate which assets will be subject to collection claims by the lender. Also, a review of the trust may be in order to determine if it is authorized to enter into the specific guarantor obligation. This is also true for entering into any loan obligations by the trust.

6. **State Estate Taxes.** Entering into 2019, there are twelve states and the District of Columbia that have a state-level estate tax. If you were to die as a domiciliary of one of these states, it is important that you have specially drafted provisions in your estate planning documents that ensure you have minimized such tax to the extent it is avoidable and yet in line with your estate planning goals. Those twelve states are: Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and

Washington. In fact, Washington State's 20% rate is the highest estate tax rate in the nation; most of the other states and D.C. are next with a top rate of 16%.

Many of the above listed states had, until recently, lower state estate tax exemption amounts than the Federal estate tax exemption amount. This meant that assets that may pass free from Federal estate tax would still be subject to a state level estate tax. Over the last few years, many of these "decoupled" states began to raise their estate tax exemption amount to match the federal exemption, in essence "recoupling" their exemption with the federal exemption. At the end of 2017, however, Congress doubled the federal estate tax exemption amount (now $11.4 million per person). Many of the states that had "recoupled" their estate tax exemption passed legislation to again decouple from the federal exemption. Maryland, for example, passed legislation to limit the state estate tax exemption to $5 million per person beginning in 2019.

As a result, persons living in states with a state estate tax need to reevaluate their estate plan to ensure that the current plan does not inadvertently trigger state level estate taxes. This may occur, for example, when a "credit shelter trust" is funded based upon the Federal estate tax exemption amount rather than the lower state estate tax exemption amount. This is especially important for everyone who executed new estate planning documents or amended older estate planning documents after their state had initially "recoupled" to the Federal exemption. If you live in a state with a state estate tax, we would be more than happy to briefly review your planning documents to determine whether you need to amend your documents to address potential state estate tax issues.

7. **Alaska, Tennessee and South Dakota's Community Property Law.** Married persons who live in non-community property states can place assets into a trust created in one of these states and have that property treated as community property. The advantage of doing this is to obtain a double step-up in tax basis upon one spouse's death (leaving a surviving spouse), with the idea that the surviving spouse would incur no capital gains tax upon any of those trust assets being sold soon after the first spouse-to-die's death.

8. **Dings, Nings, SDings and Wings are Still the In-Thing.** There have been numerous private letter rulings issued that demonstrate how a trust can be set up in a state that has no income tax on trust income (such as Delaware, Nevada, South Dakota, and Wyoming). Creating a trust in one of these states allows the trust to sell assets without being subject to any state income tax, even though the person who set up the trust is not a resident of that non-taxable state, or even possibly when the asset sold is an LLC or other entity that owns assets or operates a business located in that taxable state. Also, certain existing trusts can be changed that can remove such trusts from being subject to state income taxes.

You may hear that these trusts do not work for New York residents. This is true because New York will treat these as grantor trusts. However, if you modify the trust to make it a "completed gift" trust versus an "ING" trust, the state tax-free nature can be achieved.

IV. DEVELOPMENTS

1. Select Federal Developments.

a. Favorable Income Tax Rules. This year, the Internal Revenue Service ("IRS") released final regulations for deductions taken under section 199A of the Internal Revenue Code ("IRC").

i. *New Tax Code Section 199A:* The new section 199A regulations apply to taxable years ending after the date of its publication in the Federal Register (i.e. February 8, 2019). However, the preamble to the final regulations provides that for taxable years ending in 2018, taxpayers have an option to rely on the final regulations or to rely on the proposed regulations that were promulgated in their entirety on August 16, 2018. These regulations describe the recent allowable "section 199A deductions." It should be noted, however, that the amount of qualifying income that can benefit from the section 199A deduction is subject to certain limitations and exceptions that are fully described in these final regulations. More specifically, if a taxpayer's taxable income exceeds the threshold amount of $315,000 for a married couple filing a joint return, or $157,500 for individual taxpayers or non-grantor trusts, then such taxpayers' ownership in a specified service trade or business ("SSTB") (i.e., trade or businesses involving the performance of services such as in health, law, accounting, consulting, financial services, investing and investment management, etc.) would not constitute a qualified trade or business eligible for the section 199A deduction.

ii. *Limitation on Tax Deductions:* The desire to avoid exceeding the above threshold amounts has opened up a new tax planning strategy of having multiple non-grantor trusts own various SSTB flow through entities and take advantage of the section 199A deduction. Congress has become aware of this, resulting in the new final regulations establishing anti-abuse rules to prevent taxpayers from establishing multiple nongrantor trusts or contributing additional capital to multiple existing nongrantor trusts in order to avoid Federal income tax.

iii. *Disregarding Nongrantor Trusts:* The final regulations specifically implement the anti-abuse rules by stating that if a trust is "formed or funded with a principal purpose of avoiding, or of using more than one threshold amount for purposes of calculating the deductions under section 199A, [each such trust] will not be respected as a separate trust entity…"

iv. *How to Avoid Having the Nongrantor Trust Disregarded:* Despite the limitations created by the regulations under section 199A, there are still reasons to use nongrantor trusts. One such reason is for asset protection (as opposed to the primary motive being tax driven).

v. *Asset Protection Motive?* Asset protection is not an artificially contrived motive. Nongrantor trusts in fact serve as strong asset protection vehicles for the following reasons:

a. The typical power to cause a trust to be a nongrantor trust when you want to be a beneficiary of the trust, which many clients prefer (known as a self-settled trust), is to allow distributions (to you as a beneficiary of the trust you created and funded) only with the consent of another beneficiary. This removes the taint of the more typical self-settled trusts (that are subject to higher scrutiny) that allow distributions to you as a beneficiary in the sole discretion of a non-beneficiary trustee. Non-beneficiary trustees have no skin in the game in allowing you to receive a distribution, where in contrast, in the nongrantor trust scenario, a beneficiary is depleting his or her own funds from the trust to the extent the consenting beneficiary allows distributions to you. Therefore, the asset protection element is stronger because someone has to give up something to allow funds to flow to you.

b. Furthermore, having the trust be a nongrantor trust makes the trust responsible for paying income taxes on its income. Grantor trusts on the other hand result in the trust income being taxable to you as the settlor/grantor. Many grantor trusts (by the trust provisions or by state statute) allow the trust to reimburse the settlor/grantor for any such resulting income taxes. Having the trust pay the settlor's taxes has been cited in case law as evidence of a retained control/benefit over the trust, thereby allowing a court to rule that a creditor can pierce the asset protection design of the trust. Nongrantor trusts avoid such an attack.

c. The nongrantor trusts that we recommend can be set up as offshore trusts (e.g. having an offshore co-trustee) combined with "asset protection state law" (e.g. having a U.S. co-trustee) and as such, will be considered U.S. trusts for IRS purposes so that the trusts meet the nongrantor trust rules. This "asset protection state law" is necessary because otherwise, foreign trusts set up by a U.S. settlor for any U.S. beneficiaries are partially grantor trusts.

d. The offshore design (i.e. having an offshore co-trustee) is also a very strong evidentiary element that shows the trust is created for asset protection more than for purposes of any tax reduction.

e. Lastly, as intimated above, we can layer in one of the asset protection state laws for the nongrantor trust (such as Nevada, South Dakota, Wyoming, Alaska, Delaware) so that the trust avoids state income taxation. This should not be considered as one of the proscribed tax motives because section 199A only refers to the *federal* code section 199A deductions.

In light of these factors, avoiding the perceived tax-avoidance motive (and hence possibly avoiding of trusts that disallow the tax benefits) is much more likely. Please contact our office if you are interested in discussing how you are affected by these regulations or would like to delve further into the various planning options and designs.

v. *Willing to Argue in the Alternative that there WAS a tax motive?* If the creditor is not the IRS, then perhaps that would be the time to dig out the file notes that the trust was at least partially designed for tax planning (even if not the primary motive). This can go a long way in avoiding a private-party creditor successfully arguing that the "asset protection" trust was nothing more than a transparent attempt to hinder creditors and try to paint you in a bad light to gain bias from a judge or jury.

b. Effect of Section 199A. Section 199A potentially (1) allows individuals, trusts, and estates to deduct up to 20% of qualified business income ("QBI") received from a pass-through trade or business (such as S-corporations, partnerships, limited liability companies taxed as partnerships, and sole proprietorships) in which it has an ownership percentage; and (2) further allows deduction of up to 20% of an eligible taxpayer's combined qualified real estate investment trust ("REIT") dividends and qualified publicly traded partnership ("PTP") income. The sum of these two amounts is referred to as the combined QBI amount.

Section 199A was created as a workaround to certain problems that pass-through businesses would have faced under the new tax law following its implementation of a lower top marginal tax rate for corporations at 21% while rates largely remained higher for individual taxpayers. That is because in a pass-through type entity, the entity itself does not pay income tax on the entity level; rather, income and expenses of the business pass through the entity and are treated as the responsibility of the individual owner(s). For this reason, the section 199A deduction is intended to create a more level playing field for owners of such pass-through entities by effectively reducing the new top 37% marginal income tax rate for business owners to approximately 29.6% (i.e., 80% of 37%).

c. Discovery Rules Regarding Data. On March 23, 2018, the Clarifying Lawful Overseas Use of Data Act (the "CLOUD Act") was enacted. This law amended the Stored Communications Act to specifically provide that data held overseas by electronic communication service providers can be reached by federal authorities. Previously, it was unclear whether Federal authorities could request data held overseas. Under the new law, Federal authorities can request any and all records in a service provider's possession, custody, or control whether those records are maintained within or outside of the United States.

Although this law may not have a significant impact on most individuals, everyone needs to be aware that simply storing data overseas does not limit the Federal authorities' ability to reach the overseas data. Consequently, everyone should be cognizant of this fact when sending any form of electronic communication, particularly if such communication contains sensitive information.

d. Select Federal Gift, Estate and Other New Limits for 2019.

i. *Gift and Estate Tax Exemption:* The applicable exemption amount is the amount a taxpayer can give away during life or at death and not incur any gift or estate tax. The applicable exemption amount may also include the unused applicable exemption amount of your last deceased spouse (if "portability" is elected by filing a Form 706: Federal Estate Tax Return and the deceased spouse was a U.S. citizen or resident). The 2019 exemption amount is now $11,400,000, an increase from the $11,180,000 exemption in 2018. To the extent the applicable exemption amount is not used up during life by lifetime gifts, what is left will apply to transfers at death. If lifetime gifts or death-time transfers exceed the applicable exemption amount (or the unused portion thereof), any applicable tax is calculated at a 40% tax rate with respect to the excess amount. If co-spouses "gift-split," this exemption figure increases to $22,800,000. This tax law is set to sunset in 2025 so that on January 1, 2026, the exemptions will return to the pre-2018 exemption levels (i.e., $5,000,000 basic exclusion amount per person, plus additional amounts to account for adjustments for inflation). Until then, the exemption amount of $11,400,000 is scheduled to increase annually until the end of 2025 for purposes of accounting for annual adjustments of inflation.

ii. *Annual Exclusion—Non-U.S. Spouse:* Gifts between U.S. spouses can be made to an unlimited extent, without any gift or estate tax consequences. However, if the recipient is not a U.S. person, then a $155,000 annual exclusion applies during 2019 (an increase of $3,000 from 2018).

iii. *Gift Tax Annual Exclusion:* This exclusion is the amount a person can give away to any number of individual recipients each year without any resulting gift tax consequences. In 2019, the gift tax annual exclusion will remain unchanged from its current amount of $15,000, and $30,000 if "gift-splitting" by spouses.

iv. *Generation-Skipping Transfer Tax Exemption:* This exemption is the amount that can pass free of the 40% generation-skipping transfer tax over one's lifetime. Without this exemption, transfers to a grandchild or more remote individual (or a trust whose beneficiaries are comprised of only such persons) would be subject to this tax. During 2019, the exemption amount will increase to $11,400,000 (increase from the $11,180,000 exemption from 2018). Unlike the estate tax exclusion amount, a deceased spouse's unused generation skipping transfer tax exemption cannot be used by a surviving spouse unless certain elections are available and made.

v. *Foreign Gift Reporting Threshold:* A gift from a foreign person must be reported if it exceeds a certain value. During 2019, the threshold amount remains at $100,000 for aggregate gifts during the year from a foreign donor.

vi. *Foreign Earned-Income Exclusion:* During 2019, the first $105,900 in income earned abroad by an individual is excluded from taxable income for U.S. income tax purposes.

vii. *Alimony:* Alimony payments will not be deductible and will not be income to the recipient. This provision is effective for any divorce or separation instrument executed after December 31, 2018 and any divorce or separation instrument executed before that date but modified after that date if the modification expressly states that the new law applies to such modification. This provision does not sunset after 2025. Divorce negotiations will be impacted dramatically. Marital settlement agreements in the past have generally included provisions that allow a deduction for alimony to the payor spouse and a shifting of income to the recipient spouse's lower income tax brackets. The inability to now shift income tax responsibility for alimony payments will alter final negotiated amounts. Also, with personal exemptions being repealed under the new law, these will no longer be traded in settlement agreements for offsetting benefits.

viii. *Partnership Audit Rules:* As noted in prior Annual Client Letters, effective January 1, 2018, the audit process for partnerships, limited partnerships, multi-member limited liability companies, and other multi-member non-corporate entities (collectively referred to as "partnerships") was dramatically altered. Additional tax liability determined in an audit is now assessed against the partnership rather than the individual partners, which can significantly alter the burden of any liabilities assessed. Also, the concept of the tax matters partner has been eliminated and replaced with the "partnership representative," which can essentially be any U.S. person or entity. If a partnership does not name a partnership representative, the IRS has the power to name one for the partnership. These changes were intended to enable the IRS to audit additional partnerships each year, thereby increasing the audit risk associated with partnerships.

In order to address these changes and the numerous complicated elections and exceptions provided under the new law, **every partnership agreement, multi-member LLC operating agreement, etc., must be amended**. If an agreement is not amended now to address these changes, the partnership may neglect to take advantage of potentially beneficial elections under the new law and may shift the tax burden of an audit to current partners even if such partners were not partners in the year under audit. If you have not amended your agreements already, please contact us so that we can ensure that your agreements are up to date.

2. Select State Law Developments.

a. Limits on the State Income Taxation of Trusts. It is without question that trust income distributions to beneficiaries are taxable to the beneficiaries in whatever state they reside. However, the issue arises when states attempt to tax an out-of-state trust on its undistributed income, which will be distributed to the beneficiary.

Among those states that have ruled against the taxation of out-of-state trusts is North Carolina. In *North Carolina Department of Revenue v. Kaestner Family Trust,* the court held that the state's tax was unconstitutional as applied to the Kaestner Family Trust. The Kaestner Family Trust was established by Mr. Kaestner in 1999 to benefit his three children. In 1997, one of the daughters moved to North Carolina. In 2002, the trust was split into three separate trusts, one for each child. Despite the trustee being domiciled in Connecticut and the assets being managed by a firm in Boston, North Carolina taxed the undistributed income of one daughter's trust, based on her living in North Carolina. Subsequently, the trust sued the North Carolina Department of Revenue upon their denial of a $1.3 million refund in taxes. The case is currently before the United States Supreme Court.

b. California. California passed a Senate Bill which allows trustees to modify provisions of an irrevocable trust through "decanting" without the consent of the settlor, beneficiaries, or court approval. Modifying a trust, in essence through the "decanting" process allows irrevocable trusts in California to obtain more favorable provisions as opposed to being locked into an outdated instrument.

c. Colorado. A property-tax exemption is available in Colorado for (i) senior citizens who are 65 years or older, (ii) the surviving spouses of senior citizens who are 65 years or older, (iii) disabled veterans, and (iv) active military service personnel. For those who qualify, 50% of the first $200,000 in actual value of their primary residence is exempted from property taxation. The state pays the exempted portion of the property tax.

d. Florida. In 2018, Florida voters struck down a constitutional amendment that sought to increase the maximum homestead property tax exemption to $75,000. Thus, the maximum exemption currently remains at $50,000. Florida property owners can therefore continue to reduce up to $50,000 from their property's taxable value if such property constitutes their permanent residence or the permanent residence of their dependents.

3. Recent Case Law.

a. Be Careful Not to Engage in Fraudulent Non-Transfers. We have always recommended that no one participate in any fraudulent transfers (i.e., transfers made with any intent to hinder or delay a creditor). An issue that arose recently in the press was whether a fraudulent transfer could be deemed to occur in the absence of any apparent transfer. This leads to the question, what exactly is a "transfer" for purposes of fraudulent transfer law?

In the recent case of *UBS Financial Services, Inc. v. Lacava,*[1] Mr. Lacava, aware of creditor issues on the horizon, convinced his wife to contribute funds to his 100% owned LLC. Specifically, she received a 94.8% ownership interest in the company in exchange for a $140,000 capital contribution.

[1] *UBS Fin. Servs. Inc v. Lacava*, 2018-Ohio-3276.

Typically, a 100% owner of an LLC may welcome a second non-debtor member to buy into the LLC, thereby reducing the original owner's investment in the LLC and causing charging order protections to kick in. The added, but possibly misperceived, accomplishment here is that the debtor made no transfer. Instead, it was a third party member buying into the LLC for fair consideration, which thereby appears to cloak the initial member with protection from his/her creditors. This can certainly work if all occurs for business or investment reasons at a time that no creditor is already on the trail of the "debtor."

However, in the case of Lacava, the court found that Lacava's wife could not show (1) that her husband received full consideration for his passing an interest in the LLC over to her and (2) that she acted in good faith. Because she could not meet these requirements, she was unable to defeat the fraudulent transfer claim against her husband. The timing alone was a big contributor to this result.

Interestingly, with regards to the first factor, although Lacava technically did not make a "transfer," he did in effect "transfer" a large interest in his LLC to his wife for her contribution of $140,000. However, he did not receive the $140,000, instead that money went into the LLC. Thus, the court viewed such "transfer" as one in which the husband received no consideration (only the LLC received consideration). A transfer therefore can be deemed to have occurred when no actual transfer occurred when the facts show, such as in this case, that a transaction was engaged in with the intent to defraud creditors.

The bottom line is, any transactions that occur after creditor issues arise may be scrutinized as fraudulent transfers, regardless of whether a transfer technically occurred.

b. FBAR Reporting. The recent case *Kimble v. United States*[2] illustrates the high penalties for failure to report foreign bank accounts. In *Kimble,* the taxpayer held Swiss accounts at both HSBC and UBS and was not aware until 2008 that she was obligated to report them to the IRS on her tax return and on Foreign Bank Account Report Forms (FBARs). She initially applied to the U.S. Government's offshore voluntary disclosure program, and as part of the program, she filed amended tax returns disclosing the foreign investment income that she had failed to report in prior years, resulting in a total underpayment of nearly $100,000 in taxes between 2003 and 2008. As part of a proposed Consent Agreement, in addition to back taxes and interest, the IRS planned to impose a miscellaneous penalty of $377,309. Kimble withdrew from the program prior to completing it. Subsequently, the IRS imposed maximum willful FBAR penalties on her equal to $682,832, or 50% of the UBS account balance.

This case reminds us of the importance to report the existence of any foreign accounts on our Form 1040s and to timely file FBARs.

c. Alaska Trust Got Baked (but we really mean burned). New case law in Alaska effectively limited the utility of domestic asset protection trusts ("DAPTs"),

[2] *Kimble v. United States,* No 17-421, Court of Claims Opinion.

especially when the settlor of the trust is subject to a cause of action, that was not derived under the law of the state in which the DAPT was created. In *Toni 1 Trust v. Wacker,*[3] the Tangwall family lost a countersuit in Montana and then tried to transfer some assets to an Alaska DAPT. The Wackers then brought a fraudulent transfer action in the Montana court. The trustee of the DAPT defended against any remedy action being taken against the DAPT by asking the Alaska court to rule that the Montana actions and attempts to claw back fraudulent transfers to the Alaska DAPT had no bearing in Alaska because Alaska has the exclusive jurisdiction over matters affecting Alaska DAPT assets.

The Alaska Supreme Court ruled that Montana courts do not need to give full faith and credit to Alaska's law with regard to what remedies may be available to the creditor against the Alaska DAPT. This is bad news for DAPTs because if the settlor of one of these trusts does not live in the state in which it was created, or can in any way be subject to the jurisdiction of a court from a state that does not have DAPT legislation, then the trust is vulnerable to creditors in fraudulent transfer and certain other cases. Thus, if a fraudulent transfer cause of action occurs outside of the jurisdiction of the state in which the DAPT is created or if such cause of action or its remedy is actionable under federal law, the court can virtually ignore the laws of the DAPT state's jurisdiction.

Foreign asset protection trusts (FAPTs), on the other hand, are safer from U.S. court decisions because they are completely under the jurisdiction of another country that is not required to consider any other jurisdictional state laws (though it is safer still for a settlor to limit his or her role in the trust to that of not being a beneficiary). Although no option is entirely without risk, foreign asset protection trusts can be far more secure than domestic asset protection trusts.

d. <u>Homestead Laws</u>. There has been recent case law that illustrates both the limitations and the expanding application of the homestead exemption. The first of these cases is *Dean White v. Julie Dawn White*. Here, Dean and Julie White owned a Utah residence that was placed into an LLC as its sole asset. Ultimately, the court held in this case that the state's homestead exemption applied only to a residence that was owned by an individual, not by an LLC. The court further found that fact that the home was held in a single-member LLC, which defaults to being a totally disregarded entity for tax filing purposes, was completely irrelevant.

Similar to the holding in White, in February of 2018, the Florida District Court of Appeals held in *Dejesus v. A.M.J.R.K. Corp*. that a residence owned by a business entity (specifically a corporation) does not qualify for Florida homestead protection.

Of particular interest, however, is a recent bankruptcy case out of the Middle District of Florida, *In Re Oyola*, wherein the court's holding demonstrated the creative uses of the homestead exemption for purposes of sheltering wealth from the claims of creditors. This Florida case involved a debtor that was neither a U.S. citizen nor a U.S. permanent legal resident; rather, the debtor simply resided in Florida with her

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[3] *Toni 1 Trust v. Wacker,* 2018 Alas. LEXIS 27, 1 (Alaska 2018).

daughter and granddaughter. The debtor filed for bankruptcy under Chapter 7 and claimed that the property was exempt from bankruptcy as her Florida homestead. While it was undisputed that the debtor resided on the property with the required subjective intent under state law to make such property her permanent residence, the court had to analyze whether the objective fact that the debtor was a foreign national lacking U.S. permanent residency barred her from claiming the homestead exemption. Further, the court looked at the impact of the debtor's intent that her family reside on the property permanently.

Even though the court found that the debtor could not legally intend to reside on the property permanently given that the debtor was not a U.S. permanent resident, the court ultimately held that the debtor could successfully claim the property as her homestead thereby exempting it from the bankruptcy proceeding because the debtor intended to make the property her family's permanent residence and her family was composed of at least one permanent U.S. resident.

e. Is Jail Time the Nuclear Attack that Creditors have Against Offshore Asset Protection Trusts? The popular press on DAPTs (again especially for those living outside of a DAPT state) has been covering cases that may lead readers to feel that these trusts are "not as advertised" with respect to being the formidable barrier to creditors seeking a debtor's assets. The proponents of offshore asset protection trusts point out that the foreign nature of an offshore trust avoids many of the arguments used to invade the DAPTs. Therefore, courts may find an action for contempt (i.e. threaten jail time) is the only enforcement power it has to persuade a debtor to turn over assets to a creditor.

Further analysis of the cases will reveal that the contempt remedy for creditors is typically only in situations where there is a close nexus in time between (1) the person creating and funding the offshore trust (or having control and access to the trust assets), and (2) the legal process being engaged by the plaintiff in pursuing the debtor.

In *FDIC v. Lewis*, the debtor guaranteed certain debt obligations when he had a net worth of more than $100 million. In 2008, the borrowers were no longer solvent and therefore unable to satisfy the underlying loans. The guarantor created an offshore trust in September of 2008. The timing of the creation of the trust makes the fraudulent transfer aspect of this matter suspect. It is therefore no surprise that a court is willing to hold the debtor in contempt for creating his own impossibility to gain access to the assets, when such maneuver was implemented at a time that the connection to the plaintiff's action was so evident.

f. State Estate Taxation of QTIP Trusts. In *Treasury v. Taylor* (Maryland) and *In re Estate of Seiden* (New York), the respective courts held that a QTIP trust created by the first-to-die spouse decedent who died at a place or time in which no state level estate tax was applicable is not subject to state estate tax when the surviving spouse dies.

g. Fraudulent Transfer and the Statute of Limitations. In October 2018, the Wisconsin Court of Appeals ruled against a bankrupt debtor that had transferred assets prior to filing bankruptcy. The Wisconsin statute allows a creditor to claw back fraudulent transfers if a claim or legal action is commenced within one year of discovering that a transfer took place. The one year period had already run, so the debtor was hopeful that the claim by the creditor was forever barred. The creditor however argued the one year period should not commence until the creditor could have reasonably determined that the transfer was in fact fraudulent (versus the simple fact that a transfer was made). The court agreed. The court even went further and ruled that it only takes a single creditor (in a multi-creditor context) who had no reason to know of the fraudulent nature of a transfer to toll the commencement of the running of the one year statute.

h. Inherited IRAs. In the recent case of *In Re Todd*, the United States Bankruptcy Court for the Northern District of New York held that a debtor's inherited Individual Retirement Account ("IRA") is property of the debtor's bankruptcy estate and consequently not exempt from creditors under New York law. First, the court found that since the debtor in this case had unfettered access to the inherited IRA funds they did not fall within the circumstances in which IRAs may be exempt from the judgment of a creditor under New York law. Secondly, the court found that the debtor's inherited IRA was not exempt as a qualified retirement account under New York statute, N.Y. C.P.L.R. §5205 because (i) inherited IRA holders cannot contribute to the account, and thus "cannot be used to actively save money for retirement"; (ii) funds in inherited IRAs can be "accessed at any time without penalty"; and (iii) "inherited IRA holders are under an obligation to draw down their accounts."

In addition, the Court noted that while many other state legislatures (such as Alaska, Arizona, Florida, Missouri, North Carolina, Ohio, and Texas) have amended their state exemption statutes to specifically exempt inherited IRAs, the New York legislature has not done so.

Given that inherited IRAs are typically not protected, proper IRA planning that utilizes a trust may offer several advantages including protecting an inherited IRA from creditors and spendthrift beneficiaries, while assuring realization of long term tax deferral. Moreover, if there is no pressing need for cash, leaving the IRA in a trust allows the trustee of such trust to ensure that only the minimum required distributions are taken so that the account isn't quickly depleted in the case of a spendthrift beneficiary. Lastly, placing one's IRA in a trust may also reassure the owner of such IRA that the people he or she desires to inherit the IRA asset will in fact inherit such assets. This in turn would avoid the possibility of the IRA owner's surviving spouse (or that of a beneficiary) passing the IRA assets to a future spouse or to children of a subsequent marriage.

i. Colorado Adopts the Uniform Trust Code. Effective as of January 1, 2019, Colorado enacted the Uniform Trust Code. The Uniform Trust Code has been enacted in at least thirty-three states, meaning that Colorado has now joined the vast majority of states by enacting the Uniform Trust Code. It is important to note that, generally, the

Uniform Trust Code is a default statute, meaning that the terms of the Code only apply to the extent that the trust agreement itself is silent on a specific issue.

The Uniform Trust Code made the following important changes to Colorado law:

- The Uniform Trust Code specifically allows non-judicial settlement agreements to settle trust disputes. While non-judicial settlement agreements were previously used under Colorado law, the Uniform Trust Code provides clear requirements to ensure that the agreement is binding and valid.

- The Uniform Trust Code specifically allows a settlor to include provisions for alternate dispute resolution in the trust agreement. This can require that disputes between trustees and beneficiaries go through mediation or arbitration before any action can be brought in court. This may result in disputes being resolved more efficiently.

- Trust registration is no longer required in Colorado unless a beneficiary requests that such registration be made. Under prior Colorado law, trust registration was mandatory even though trustees often neglected to do so. The Uniform Trust Code continues to allow trust registration, which is fairly unique to Colorado, while recognizing the reality that many trusts will never be registered even if there is a requirement to do so.

- The Uniform Trust Code allows a trust settlor and all of the beneficiaries to consent to the modification or termination of a trust even if such modification or termination is contrary to a material purpose of the trust. Although courts had already allowed trust modifications and terminations, the Uniform Trust Code codifies this rule and provides explicit guidance concerning how it operates. Since this provision allows irrevocable trusts to be amended, it can be extremely helpful when personal circumstances or changes in law occur after an irrevocable trust has been created, thereby frustrating the original intent.

j. No Contest or "In Terrorem Provisions." You may want to consider adding No Contest, or "In Terrorem," clauses into your plan if your plan does not already contain them. A No Contest clause, essentially, provides that any person that challenges any aspect of a will or a trust is automatically disinherited. This can be particularly valuable if you believe that any beneficiary will be displeased with their inheritance or if there is tension between any of your beneficiaries.

Many states do, however, provide limits on how broad these clauses can be. Oftentimes, the No Contest clause is disregarded when valid claims are brought that meet the standard of probable cause. Wyoming, however, in the recent case of *EGW and AW v. First Federal Savings Bank of Sheridan* held that a No Contest clause barred even claims that did meet the standard of probable cause. If other states begin to follow suit, No Contest clauses will become an even more powerful tool to ensure that your property passes according to your wishes and without challenge from any of your beneficiaries.

Even in states that have not gone as far as Wyoming, however, No Contest clauses can be particularly useful because the mere presence of the clause can have a chilling effect on any potential litigation. Considering the fact that it may be difficult to ascertain whether any claim actually meets the standard of probable cause before such claim is litigated, the beneficiaries may not be willing to risk bringing the claim at all. Consequently, regardless of the law in your state, the inclusion of No Contest clauses can help ensure that probate or trust administration operates in an efficient manner and pursuant to your wishes without undue interference from your beneficiaries.

k. The Clash Between Family Limited Partnerships and Section 2036. As we mentioned in last year's Annual Client Letter, the recent Tax Court case of *Estate of Powell v. Commissioner*[4] significantly increased the risk that the full value of family limited partnerships and family limited liability companies will be included in your estate even if you gifted the majority of the interests in such company before your death. In *Powell*, the Tax Court ruled that gifted assets of a limited partnership were includable in a decedent's estate because the decedent retained a 1% interest in the limited partnership, which allowed the decedent to participate in a decision to liquidate the partnership, thereby allowing the decedent to join together with the other partners to designate the persons that will possess or enjoy the property of the limited partnership in violation of Code Section 2036.

The facts in *Powell* were particularly bad since it was clear that the transactions were last-minute death bed transactions that had no valid non-tax purpose for occurring. However, despite these bad facts, the case has significantly impacted the use of family entities and increased the risk that the IRS will not respect discounts associated with family entities and may even pull prior gifts back into a decedent's estate if that decedent retained any controls or voting rights over the entity as a manager, member, or in any other capacity.

Consequently, the time is now to review your limited partnership and limited liability company agreements, especially if you have gifted or plan on gifting any interests in those entities, to ensure that we eliminate any problematic powers that you may have retained over such entity. Although each entity has unique facts, we have developed a general approach to eliminating any problematic retained powers and would be more than happy to discuss this approach with regards to your entity. Once all such retained powers have been relinquished however, you will need to survive that date by at least three years.

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We have updated our "end-user-friendly" guide to asset planning structures and planning entitled "Effective Asset Protection Planning – Foreign and Domestic". We strongly advise you request a copy since it likely identifies aspects of any existing IEP of which you may not be aware. Being unaware can lead to a failure to remedy any shortcomings (whether due to the evolution of an area of law or due to improper or less than optimal administration of existing plans) before a legal

[4] *Estate of Powell v. Commissioner*, 148 T.C. No. 18 (May 18, 2017).

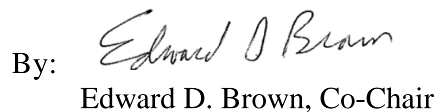
action is identified, which could then preclude any ability to do any effective protective positioning at that "too-late" stage. If you would like us to email you a PDF copy, please let us know.

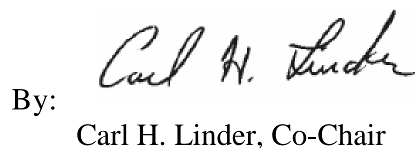
Please be sure that our office has your current email address. Of course, if you prefer not to receive any periodic updates, alerts or educational information from us by email, please let us know. If you have any questions about anything contained in this letter, please email or call. In closing, we want to sincerely thank you for allowing us to be of service and for the history that we so much appreciate having shared with you.

This letter is for your general information. The discussion of any asset protection and/or estate planning strategies, alternatives, and other observations herein are not intended as legal or tax advice and does not consider the asset protection goals, estate planning objectives, financial situations, or needs of individual clients. This letter is based upon information obtained from various sources that the authors believe to be reliable, but the authors make no representation or warranty with respect to the accuracy or completeness of such information. Views expressed herein are current opinions only as of the date written, and are subject to change without notice. Suggested outcomes may not be realized due to a variety of factors, including changes in law or regulations.

Very truly yours,

GREENSPOON MARDER LLP

By: 
Edward D. Brown, Co-Chair

By: 
Carl H. Linder, Co-Chair

GreenspoonMarder LLP

ATTACHMENT TO
GREENSPOON MARDER LLP
ANNUAL CLIENT LETTER
February 25, 2019

1. <u>General Federal Tax Reporting</u>:

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 1041, U.S. Income Tax Return for Estates and Trusts	**Form 1041** must be prepared and filed in a timely manner for each integrated estate planning trust ("IEPT") that you have settled.	This form can usually be a simplified version, completed by inserting zeroes on the first page and leaving the remaining three pages blank. A separate statement with the name and tax identification number of each grantor, and the IEPT's items of income and expense would then be attached.	April 15, 2019
IRS Form 1065, U.S. Return of Partnership Income	**Form 1065** must be prepared and filed for each limited partnership, LLC, and the like, unless the entity is a "disregarded entity" for federal tax purposes.	In many cases, the ownership interests in the partnership or LLC are designed to remain at 1% for the general partner(s)/manager(s) and 99% for the limited partner/ member (the IEPT). This is pursuant to the "Affidavit of Intent" you executed when the IEPT and partnership/ LLC documents were signed.	March 15, 2019

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 709, United States Gift (and Generation-Skipping) Tax Return	**Form 709** needs to be filed to reflect any transfers made by you during 2018 to the planning structure.	This return is typically informational in nature (with no tax due), since under the usual structure established by our firm any such transfers are incomplete for federal gift tax purposes under Treasury Regulations Section 25.2511-2, and as such there are no gift tax implications.	April 15 following the close of each year a transfer is made to the IEPT or any underlying entities (April 15, 2019). Any extension of time granted for filing your calendar year 2018 federal income tax return will also automatically extend the time to file your 2018 federal gift tax return.
U.S. Department of Agriculture/Farm Service Agency Form FSA 153, Agricultural Foreign Investment Disclosure Act Report	**Form FSA 153** must be filed if the planning structure you created owns any ranch, farm, or other agricultural property.	Note that ***the definition of "ranch, farm or other agricultural property"*** for this purpose ***is very broad***. Please contact us if you would like to discuss this broad definition. ***If a new title deed needs to be prepared for any reason,*** there is a good possibility that the Report will need to be filed. Also note that ***this is the case whether the IEPT itself is considered a foreign trust or a domestic trust*** for federal tax purposes. Finally, a timely filing of Form FSA-153 is tied to the date of the acquisition, the disposition, and/or change in trustee, and not to the end of the calendar year.	**Within 90 days** of either: (i) the acquisition of such property by any component of the overall planning structure; (ii) any disposition or transfer of such property by any component of the overall planning structure; or (iii) any change in trustee name in recorded title.

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 8822-B, Change of Address or Responsible Party	Use **Form 8822-B** to notify the Internal Revenue Service if you are a responsible party. A responsible party includes a domestic trustee of an IEPT or a general partner/manager of a partnership or LLC.		Within 60 days of the date of change of address or the identity of a responsible party

2. **Tax Reporting for Foreign Entities:**

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 3520, Annual Return to Report With Foreign Trusts and Receipt of Certain Foreign Gifts	Required if the planning structure you established includes an IEPT that is considered a foreign trust for U.S. tax purposes (rather than considered a domestic (U.S.) trust for tax purposes).	The settlor of the IEPT must annually file a **Form 3520**, and the penalty for a late-filed **Form 3520** is the greater of the following: (i) $10,000; or (ii) 35% of the value of the transferred assets. If the **Form 3520** is timely filed, the foregoing penalties still apply to any unreported or underreported contributions and distributions.	April 15 (or October 15 if your Form 1040 was extended).

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 3250-A, Annual Information Return of Foreign Trust with a U.S. Owner	Generally, if the IEPT has a foreign based protector, and/or no protector, and/or only a foreign-based trustee, then this filing requirement will apply.	Penalties will be imposed if this Form is filed with incomplete information or is filed late. The penalties for a late-filed or incomplete **Form 3520-A** is the greater of $10,000 or 5% of the value of the trust assets treated as owned by the U.S. person. Please contact us for information on the reporting requirements for (a) U.S. beneficiaries and (b) contributors to an IEPT.	March 15, 2019

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships	Use **Form 8865** to report the information required under Code Section 6038 (reporting with respect to controlled foreign partnerships), Code Section 6038B (reporting of transfers to foreign partnerships), or Code Section 6046A (reporting of acquisitions, dispositions, and changes in foreign partnership interests).	In addition to any income tax return requirements, certain foreign corporations, foreign partnerships, and foreign LLCs are required to file annual information returns (e.g., if a U.S. person owns 10% or more of a foreign partnership, **Form 8865** must be filed annually). With respect to transfers made to a foreign partnership or to a foreign LLC that is in fact classified as a foreign partnership for tax purposes, if the amount transferred exceeds $100,000 of cash or property during the year, the transferor must report the transfer on **Form 8865**, even if an annual **Form 8865** is not otherwise required.	The date your individual income tax return is due (including extensions)
IRS Form 8832, Entity Classification Election	An eligible entity uses **Form 8832** to elect how it will be classified for federal tax purposes, as a corporation, a partnership, or an entity disregarded as separate from its owner.	If timely filed, a foreign LLC with two or more members can be classified for United States tax purposes as a partnership rather than a corporation; otherwise, it will by default be taxed as a corporation.	Generally, an election specifying an eligible entity's classification cannot take effect more than 75 days prior to the date the election is filed, nor can it take effect later than 12 months after the date the election is filed.

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities	**Form 8858** is for certain U.S. persons that own a foreign disregarded entity directly or in certain cases indirectly or constructively.	**Form 8858** is required to be attached to the owner's annual tax return to disclose that such person owns an interest in the entity.	The date the owner's income tax return is due (including extensions).
IRS Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation	Use **Form 926** to report certain transfers of tangible or intangible property to a foreign corporation as required by IRC Section 6038B.	In regard to certain transfers made to a foreign corporation or to a foreign LLC that is classified as a foreign corporation for tax purposes, if the amount of cash or fair market value of the property exceeds $100,000 or if the transfer results in the transferor directly or indirectly owning at least 10% of the foreign corporation, such transfer must be reported on **Form 926**.	Must be filed with the U.S. transferor's income tax return for the tax year that includes the date of the transfer.
IRS Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations	**Form 5471** is used by certain U.S. citizens and residents who are officers or directors in certain foreign corporations or a 10% shareholder in a foreign corporation.	Generally, if a U.S. person owns 10% or more of a foreign corporation, **Form 5471** needs to be filed on an annual basis.	Attach **Form 5471** to your individual tax return (or, if applicable, partnership return) and file by the due date (including extensions) for that return.

3. Reporting Foreign Held Assets (Whether or Not in Trust):

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
FinCEN Form 114, Report of Foreign Bank and Financial Accounts	Required to be e-filed each year by any United States person who has a financial interest in or signature authority over one or more foreign bank, securities, brokerage or other foreign financial accounts, that in the aggregate exceed the amount of $10,000.	The definition of a "financial account" also includes an insurance or annuity policy with cash value, a commodity futures or options account, and shares in a mutual fund or similar pooled fund. Remember that the Form's filing requirement applies to a United States person who has more than a 50% present beneficial interest in the assets or income of the IEPT for the calendar year if such IEPT owns a foreign financial account. Also, if an IEPT that is treated as a grantor trust for U.S. tax purposes owns the foreign financial account, the United States person who is the settlor is also required to file the Form.	April 15 with respect to accounts existing in the prior calendar year. However, the 1040 filer receives an automatic six-month extension if FinCEN 114 is received by October 15. This form must be filed electronically. **It is imperative that the Form be timely e-filed to avoid the substantial civil and criminal penalties, fines and other sanctions that can apply.**

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 8938, Statement of Specified Foreign Financial Assets	Use **Form 8938** to report your specified foreign financial assets if the total value of all the specified foreign financial assets in which you have an interest is more than the reporting threshold.	**Form 8938** is required to be filed by certain individuals and certain entities to report owned foreign financial assets if the total value of those assets exceeds an applicable amount (e.g.,$100,000 for married taxpayers filing jointly; $50,000 for a single taxpayer) on the last day of the year, or (for individuals) more than $150,000 at any time during the year for married taxpayers filing jointly ($75,000 for a single taxpayer). Specified foreign financial assets generally include assets such as any financial account maintained by a foreign financial institution, and to the extent held for investment and not held in a financial account, any stock or securities issued by someone that is not a U.S. person, any interest in a foreign entity, any financial interest or contract with an issuer or counterparty that is not a U.S. person, and certain commodities held offshore.	Attach **Form 8938** to your individual (or entity, if applicable) income tax return and file by due date including extensions for that return. Failure-to-file and accuracy-related penalties apply. Filing **Form 8938** does **not** relieve one from the requirements to file **FinCEN Form 114**.

4. Reporting a Gift or Inheritance from a Foreign Person:

Form Number and Name	Purpose of Form	Miscellaneous Comments	Due Date
IRS Form 3520, Annual Return to Report Transaction With Foreign Trusts and Receipt of Certain Foreign Gifts	A U.S. person must report the receipt of gifts from a foreign individual or the receipt of an inheritance from a foreign estate if the total amount received during the 2018 tax year was more than $100,000.	If the U.S. person received more than $16,389 in "purported" gifts, in the aggregate, during 2018 from a foreign partnership and/or a foreign corporation, **Form 3520** must be filed. The penalty for not timely filing **Form 3520** is 5% per month (not to exceed 25%) with respect to gifts and inheritances.	April 15, 2019 (including any extensions)

PLEASE NOTE: Depending on local law, certain state or local returns may need to be completed and filed. Either your CPA or our firm can verify any state or local compliance requirements for you. It is ultimately your responsibility as taxpayer to confirm that all required forms are filed in a timely manner. Failure to file or failure to file timely may come with significant penalties. Please consult immediately with your CPA related to all required filings. We are available to discuss the requirements as listed above.

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