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Planning for Success: Planning After the 2017 Tax Act

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Today's Presenter:

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Disclaimer

- This outline is intended to generate thought and is for general educational purposes only. Before adopting ideas discussed in this outline or by Mr. Schroeder in his remarks, you should consult with qualified advisors, as each situation is unique. There are risks involved in all planning strategies, and the details of each transaction bear on such risks.

- Any U.S. federal tax information contained in this outline or in comments made by Mr. Schroeder is not legal advice, but merely general education, and is not intended to be used, and cannot be used, by any person for the purposes of (1) avoiding penalties that may be imposed by the Internal Revenue Service or (2) promoting, marketing, or recommending to another party any transaction or matter addressed herein.

Polling Question

1. In 2018, approximately how many estates/trust estates owed estate tax?
   a. 1,700
   b. 5,500
   c. 7,700
   d. 10,300
   e. 15,400

Polling Question

2. Percent of Iowa farmland owned by people over age 65?

   a. 40%

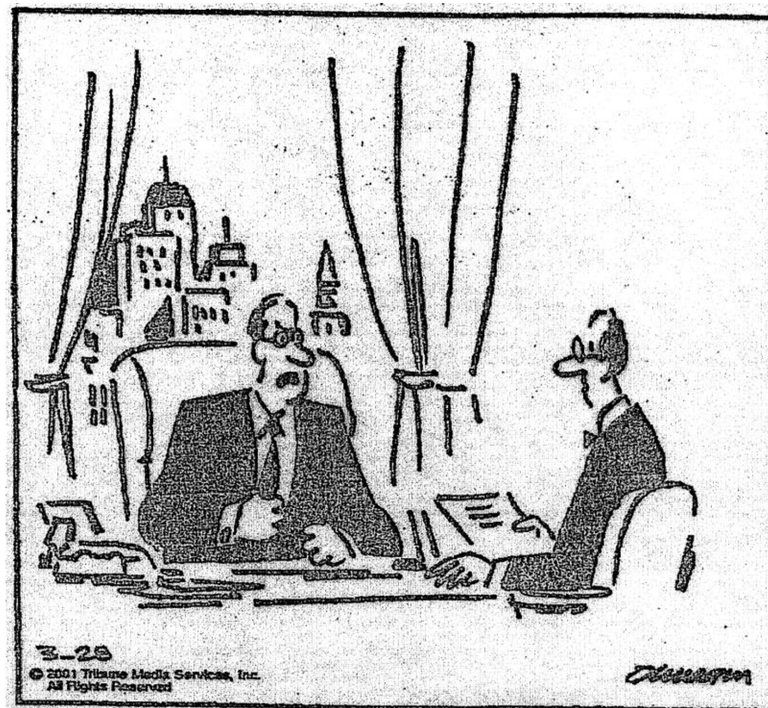
   b. 50%

   c. 60%

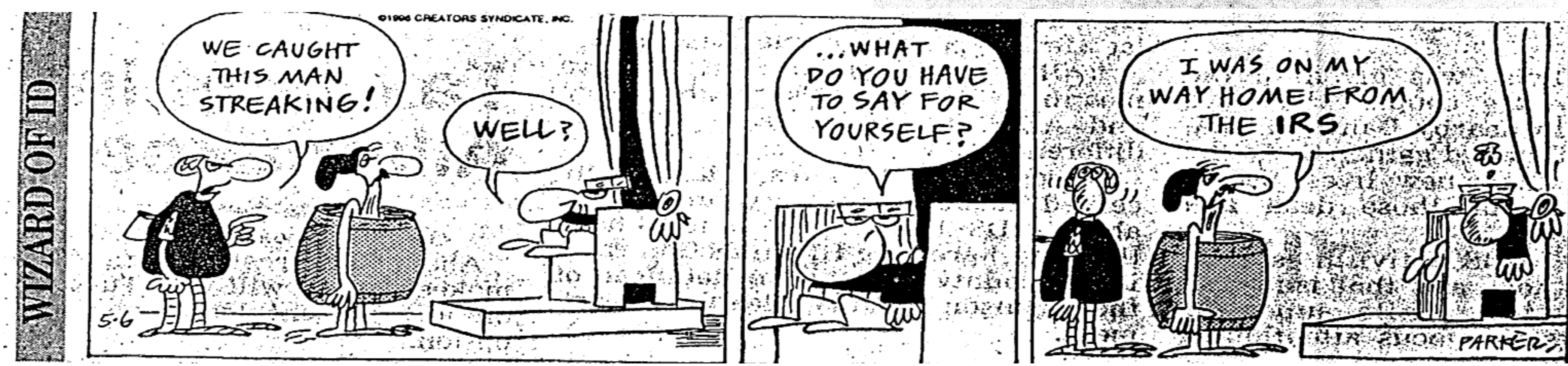
   d. 70%

   e. 80%

The hazards of poor estate planning



"Darn it! I've spent too much money on ways to avoid the estate tax to have it end now!"



Federal Estate Tax Exemptions 2019 and Beyond

Per Individual

2019: $11,400,000

2020-2025: $11,400,000 plus inflation

2026: $5,700,000 (plus 8 years inflation increases)

Per Married Couple

2019: 22,800,000

2020-2025: $22,800,000 plus inflation

2026: $11,400,000 (plus 8 years inflation increases)

Important Tax Rates

Federal Gift/Estate Tax Rate

- 40% (deductions for gifts to spouse & charity)
- GST Tax rate is the same

Iowa Estate Tax Rate

- 0% on gifts/bequests to spouse, children, grandchildren, etc.
- 10%-15% on gifts/bequests to others

Federal Income Tax Rates

- 10%, 12%, 22%, 24%, 32%, 35%, and 37%
- Top rate begins at $612,350 ($510,300 for single)

Iowa Income Tax Rates

- 8.53% top rate (income over $73,710)
- Rates reduced somewhat under new tax law starting in 2019

Federal QBI Deduction

- 20% of QBI (phase outs begin at $321,400 joint taxable income and $160,700 single taxable income)

Iowa Income Tax Rates

- 25% of Federal QBI Deduction (starting in 2019)

Federal Tax Law Changes (except corporate tax rate) – Expire 12/31/2025

Important Tax Rates, *cont.*

Federal LT Capital Gains Tax Rates

- As high as **23.8%**
  - 0% on income below $78,950 ($39,475 for single)
  - 15% on income between $ 78,950 and $488,850 ($39,475 and $434,550 for single);
  - 20% on income above $488,850 ($434,550 for single)
  - Additional 3.8% Medicaid Tax on lesser of (a) net investment income and (b) excess of modified AGI over $250,000 ($200,000 for single)

Iowa Capital Gains Tax Rates

- 8.53% top rate (income over $73,710)
- Iowa Capital Gains Exclusion

Federal Corporate Tax Rates

- 21% flat rate (permanent)

Iowa Corporate Tax Rates

- 12% top rate (income over $250,000)
- Rates reduced under new tax law starting in 2021

- **Kiddie Tax:** Applies to children under age 18 and to young adults 18 or older who are unmarried and a full-time student. Net unearned income allocated to such persons is now taxed at trust and estate rates (rather than parent rates), which hit 37% after $12,750 of income. Gifting of grain, pass-through entity interests, and other income producing assets to minors is now less tax efficient.

Overview

1. **Planning Idea #1** - Use of Revocable Trusts (rather than Wills) to avoid probate

2. **Planning Idea #2** - Clayton QTIP) or Disclaimer Plan and Other Flexibility to Include in Revocable Trust/Will

3. **Planning Idea #3** - Obtaining Basis Step-Up on Assets Placed into Trust at death of First to Die Between Mom and Dad

4. **Planning Idea #4** - S Elections and Basis Step-Up Planning for Landholding Corporations

5. **Charitable Planning Ideas**

Estate Planning – Idea #1

- **What is a "Revocable Trust" a/k/a "Living Trust"**
  - Usually the Trustor is the initial Trustee and initial Beneficiary
  - The Trustor Can Amend or Revoke (undo) the Trust at any time
  - The Trust is Not a Separate Taxpayer
  - Gifts to the Trust Have No Tax Implication Whatsoever
  - Upon the Trustor's Death, Incompetence, or Resignation, the Trust Continues with a Successor Trustee
  - Upon the Trustor's Death, the Trust Continues With New Beneficiaries, According to the Terms of the Trust, Which at That Point Become a Will Substitute.
  - It is important that every Revocable Trust be Back-stopped with a Valid Will. A "Pour-Over Will" provides that any property owned by the Trustor (and not by the Trustor's Revocable Trust) at Death pours into the Revocable Trust.

Continued…

Estate Planning – Idea #1, *cont.*

- **Why Would Somebody Create a Revocable Trust as Opposed to Only Having a Will?**
  - If Trust owns all of the Trustor's property at his death (other than property passing by beneficiary designation or joint tenancy arrangement), then court-supervised probate is avoided. Avoiding probate:
    - Reduces attorney fees at death (court involvement complicates things)
    - Executor fees avoided (trustee fees are less)
    - No court costs (0.2% of gross estate value)
    - If real estate is owned in multiple states, avoids court-supervised probate in multiple jurisdictions, which is expensive
    - No court file so privacy is enhanced. Nosy persons can't go to the court to see what you owned, what it was worth, or who you left it to. (Heirs and creditors and beneficiaries still have rights to certain notice)
    - Streamlines decision making during incapacity prior to death.
  - When is it worth the effort and complexity, and why?
    - The wealthier you are, the more beneficial it is (greater savings at death)
    - The more that privacy matters to you, the more beneficial it is
    - If you own property in multiple states or may move between states, it may be worth considering

Estate Planning – Idea #2

With current higher gift/estate tax exemption amounts, availability of portability (ability to have unused gift/estate tax exemption of first spouse to die to be added to exemption of surviving spouse), and continuously changing tax laws, estate plans should be drafted to have maximum flexibility.

- **Disclaimer Plan (Contingent-Tax Plan):**
  - Assets are left to surviving spouse, with surviving spouse having ability to disclaim (within 9 months of deceased spouse's death – hard deadline) assets to the Family (Bypass) Trust created by deceased spouse (surviving spouse would be trustee and primary beneficiary of such Trust).
  - Allows Flexibility for Post-Mortem Planning: Disclaim to Fund the Trust and Get an Estate Tax Freeze? Or Spouse to Receive Assets and Get a Second Step-up? Either way, no estate tax exemption is wasted. Assets passing to Family Trust by way of disclaimer by surviving spouse cannot be subject to a spousal second look power over the Family Trust.
  - Optimal Plan for Many or Most "First Marriage" Clients Well Below the $22,800,000 Threshold (as Second Step-Up in Basis will often be Optimal) and who have no non-tax reasons for utilizing a Trust. *Continued…*

Estate Planning – Idea #2, *cont.*

- Not Optimal Plan For (a) folks approaching or above the $22,800,000 Threshold, where the estate tax freeze may be more attractive than the possibility of a Second Step-Up (especially with appreciating assets (farms) that are not likely to be sold by heirs but rather retained as legacy assets), (b) folks that have non-tax reasons for utilizing a Trust, or (c) folks who desire to do generation skipping transfer ("GST") Tax Planning.

- **Clayton QTIP:**
  - Assets are allocated between a Family (Bypass) Trust and Marital Trust based on the extent to which the Trustee makes a QTIP election. Portion of assets for which QTIP is elected will be allocated to Marital Trust and remaining portion of assets will be allocated to Family Trust. Marital Trust and Family Trust can provide for the same or different dispositive terms. This type of plan may provide additional post-mortem planning opportunities than traditional Marital Deduction Formula Plan.
  - Optimal Plan For (a) folks approaching or above the $22,800,000 Threshold where availability of valuation discounts will be important, (b) folks that have non-tax reasons for utilizing a Trust, or (c) folks who desire to do GST Tax Planning.

- Income Tax Considerations When Developing Marital Plan:
  - Stepped-Up Basis, Avoiding Trust Income Tax Rates, Phantom Income Issues, Etc.

Estate Planning – Idea #2, *cont.*

- **Clayton QTIP Plan**
  - Trustee (and sometimes an Independent Trustee) decides what portion of Trust is elected as QTIP. This decision can be based on family wealth situation, tax law in place at the time the first spouse has died, and other factors.
  - QTIP portion will get second step-up in basis at death of surviving spouse, but will be included in taxable estate of surviving spouse. These assets will be held in trust for the sole benefit of surviving spouse during surviving spouse's life.
  - Non-QTIP portion will not be included in taxable estate of surviving spouse and will not get second basis step-up. These assets will be held in trust for the benefit of surviving spouse (and, if desired, simultaneously for the benefit of children and grandchildren) during surviving spouse's life.
  - The Trustee would likely make a QTIP election under two circumstances:
    - **<u>If estate taxes turn out to be an issue for you</u>.** If deceased spouse's assets exceed deceased spouse's available tax-free amount (currently $11,400,000 less taxable lifetime gifts made by deceased spouse), then an election would be made as to the excess assets (*i.e.*, those assets in excess of the available tax-free amount) to avoid estate taxation at deceased spouse's death. *Continued…*

Estate Planning – Idea #2, *cont.*

- **To obtain a second basis step-up on assets at surviving spouse's subsequent death.** Even if estate taxes are not an issue for you, the Trustee may want to make an election as to a portion of the Residual Trust assets in order to obtain a second basis step-up on such assets at surviving spouse's subsequent death in order to re-depreciate such assets or minimize the taxable gain that may occur on the subsequent sale of such assets by your children (*i.e.*, facilitates the ability of the trustee to engage in post-mortem income tax planning) However, the Trustee would not want such assets to appreciate so much that an otherwise avoidable estate tax problem is created at surviving spouse's subsequent death. The opportunity for a second basis step-up is possible because the assets with respect to which the QTIP election is made will pass to the Marital Trust, and the assets of the Marital Trust will be included in surviving spouse's taxable estate at his/her subsequent death and receive a second step-up in basis. In Rev. Proc. 2016-49, the IRS clarified that a QTIP election will be respected where it is coupled with a portability election, even if it was not necessary to reduce or avoid federal estate taxation upon the first spouse's death.

  – At least if the QTIP Trust is different from the Non-QTIP Trust, it appears that a QTIP election would have to be made by an independent executor/trustee (such as a bank). Surviving spouse and the children (as executor/trustee) would not be able to make the election under such circumstances for tax reasons. *Continued…*

Estate Planning – Idea #2, *cont.*

- **Additional Provisions to Maintain Flexibility:**
  - Trustee's Power to "Sprinkle" or "Spray" income and/or principal of Family Trust among a specified class of beneficiaries during surviving spouse's life – provides flexibility for Trustee to manage taxes and direct funds to persons who need them.
  - Surviving Spouse's Second Look Power (Limited Power of Appointment) – provides surviving spouse with flexibility to change the distribution of trust assets that will occur after death of surviving spouse (can be narrow or broad).
  - Power to remove and replace Trustees given to beneficiaries.
  - Power to Amend Trust given to Independent Trustee or Trust Protector (for tax reasons, to carry out grantor's intent, to corrects errors, etc.).
  - If assets will remain in trust for multiple generations, give each generation power of appointment to create some flexibility (for tax reasons, for changes in family, etc.).
  - Give Independent Trustee or Trust Protector the Power to bring Family Trust Assets back into the Surviving Spouse's estate to receive a step-up in basis at Surviving Spouse's Death if Estate Taxation will not be a Problem. *Continued…*

Estate Planning – Idea #2, *cont.*

- **Additional Provisions for Irrevocable Trusts:**
  - Consider giving the Grantor a swap power, if grantor trust status is appropriate.
  - Where appropriate, give an Independent Trustee or Trust Protector an "early termination" power (which could be exercised if the estate tax were repealed, for example, or where the exemptions have grown so large that the estate tax is no longer an issue for this family, and where there are no important non-tax reasons for continuing the trust).

CLAYTON QTIP PLAN

Operation of Husband's Revocable Trust Following Husband's Death

(Assuming Husband Dies First)

Husband's Revocable Trust Assets
Except those assets held in joint tenancy or passing by beneficiary designation

1 Non-Business Tangible Personal Property listed in written memo → **Individuals named in Memo**

2 Distribution of Non-Business Tangible Personal Property not listed in written memo to Wife, outright and free from trust. This would be in addition to joint tenancy property and the IRAs, 401ks, and life insurance of which Wife is the named beneficiary. → **Wife**

3 Primary Residence (subject to any debt) and likely farm operating assets (subject to any debt) and possibly building sites or certain business interests → **Wife**

4 Portion of Husband's remaining assets with respect to which no QTIP Election is made by the Trustee. All or portion of Husband's available tax-free amount ($11,400,000 in 2019, less the amount previously applied to lifetime transfers) is applied to such assets. → **Family Trust**

5 Portion of Husband's remaining assets with respect to which a QTIP Election is made by the Trustee → **Marital Trust**

Family Trust

Not taxed in Husband's Estate (sheltered from estate tax by his tax-free amount)

Not included in Wife's Taxable Estate

Marital Trust

Not taxed in Husband's Estate (sheltered from estate tax by marital deduction)

Included in Wife's Taxable Estate (to which she can apply her tax-free amount)

Operation of Husband's Revocable Trust Following Husband's Death (<u>Assuming Husband Dies First</u>)

Husband's Assets

Portion of remaining assets with respect to which no QTIP Election is made by the Trustee.

Husband's Family Trust

Portion of remaining assets with respect to which a QTIP Election is made by the Trustee

Husband's Marital Trust

Administration of Family Trust and Marital Trust During Wife's Life

<u>Administration of Family Trust During Wife's Life</u>:

- Trustee shall distribute all or such portion of the income of the Family Trust to Wife as is necessary (after considering all other funds and resources available to her) to provide for her health, education, maintenance, and support. <u>If Wife is serving as Trustee of the Family Trust</u>, the Trustee (i.e., Wife) may distribute to or for the benefit of your descendants all or as much of the net income not distributed to Wife in a given year as is necessary (after considering all other funds and resources available to them) to provide for their health, education, maintenance, and support (distributions need not be equal as among your descendants). <u>If Wife is not serving as Trustee of the Family Trust</u>, any net income not distributed to Wife in a given year may be distributed to or for the benefit of your children, per stirpes. The needs of Wife (both short-term and long-term) should take precedence in the Trustee's calculus over the needs of the other beneficiaries. Additional restrictions apply to assets passing to the Family Trust as a result of a disclaimer by Wife.
- Trustee shall also distribute as much of the principal of the Family Trust as necessary (after considering all other funds and resources available to Wife) to provide for Wife's health, education, maintenance, and support, <u>provided</u> that farm assets/business assets shall only be distributed to her by a disinterested trustee to facilitate desired transfer or income tax planning. Wife's access to principal distributions from the Family Trust will cease if she gets remarried without first obtaining a valid prenuptial agreement containing certain required provisions protecting the family assets.
- Wife will have right to use and enjoy residences held by Family Trust and the authority to direct the Trustee to sell any residence and to reinvest the sale proceeds in a new residence or other investment.
- All minimum distributions from a Deferrable Retirement Benefit (IRA, 401k) held by the Family Trust are paid to Wife each year.

<u>Administration of Family Trust After Wife's Death</u>:

- All remaining assets of the Trust (including assets pouring in from the Marital Trust) will be distributed as provided on the subsequent pages of this summary.

<u>Administration of Marital Trust During Wife's Life</u>:

- Trustee annually distributes all income generated by the assets of the Marital Trust to Wife (required for marital deduction).
- Trustee may also make distributions of the principal of the Marital Trust as necessary (after considering all other funds and resources available to Wife) to provide for Wife's health, education, maintenance, and support, <u>provided</u> that farm assets shall only be distributed to her by a disinterested trustee to facilitate estate tax or income tax planning. Wife's access to principal distributions from the Marital Trust will cease if she gets remarried without first obtaining a valid prenuptial agreement containing certain required provisions protecting the family assets.
- Wife will have right to use and enjoy residences held by Marital Trust and the authority to direct the Trustee to sell any residence and to reinvest the sale proceeds in a new residence or other investment.
- All minimum distributions from a Deferrable Retirement Benefit (IRA, 401k) held by the Marital Trust are paid to Wife each year.

<u>Administration of Marital Trust After Wife's Death</u>:

- The assets of the Marital Trust will pour into the Family Trust.

Operation of Wife's Revocable Trust Following Wife's Death (Assuming Husband Dies First)

Wife's Assets
Except those assets held in joint tenancy or passing by beneficiary designation

1

Non-Business Tangible Personal Property listed in written memo

Individuals named in Memo

2

Your Non- Business Tangible Personal Property <u>not listed</u> in written memo will pass to your children on a roughly per stirpes basis. This would be in addition to joint tenancy property and the IRAs, 401ks, and life insurance of which your descendants are the named beneficiaries.

Children, *per stirpes*

3

All remaining assets available for distribution after payment of any and all taxes will pass to Wife's Family Trust.

Wife's Family Trust

Operation of Revocable Trusts at Death of Second of You

(For purposes of this illustration assume that Wife is the second to die)

Husband's Family Trust

Husband's Marital Trust

Wife's Family Trust

At Wife's death (assuming she is the survivor), Wife will have the power (to be exercised in her will or revocable trust) to reallocate the remaining assets of Husband's Family Trust (including those assets pouring into Husband's Family Trust from Husband's Marital Trust or otherwise) in any manner she sees fit among your descendants or trusts created exclusively for your descendants (provided that surviving spouses of your deceased descendants may receive income and principal, except for Farm Assets/Business Assets). This power allows Wife to adjust Husband's estate plan should the situation or needs of your descendants change after Husband's death. At Wife's death (to the extent she does not exercise this power) the assets of both of your Trusts would be distributed as set forth below.

All Remaining Assets

Combined Family Trust (Farm Assets and Non-Farm Assets)

Children, *per stirpes*

Scenario 1

FACTS:

- Husband and Wife, both age 60
- Husband dies with a net financial worth of $20,000,000
- Wife has $10,000,000 of her own assets

RECOMMENDATION RE ESTATE PLAN STRUCTURE TO IMPLEMENT PRIOR TO DEATH:

- Should use a Clayton Plan or if desired an Optimal Marital Formula Plan. Should not use a Disclaimer Plan.
- Maximum amount ($11,400,000) to Bypass Trust
- Elect QTIP on Rest (preferably using Marital Trust rather than outright marital share.)
- Consider including a sprinkle power over income in the Bypass Trust, and consider given surviving spouse power of appointment over Bypass Trust and Marital Trust.

Scenario 2

FACTS:

- Husband and Wife, both age 75
- Husband dies with a net financial worth of $2,000,000
- Wife has $1,000,000 of her own assets
- First marriage, no children from a prior relationship

RECOMMENDATION RE ESTATE PLAN STRUCTURE TO IMPLEMENT PRIOR TO DEATH:

- Should use a Clayton Plan. Should not use a Disclaimer Plan. Would only use a Optimal Marital Formula Plan if client wanted assets to pass to a Family Trust where the income could be sprinkled among spouse and client's children.
- Use a Marital Trust for the QTIP share rather than outright marital share.
- Unless client wanted income sprinkled, make the Bypass Trust and Marital Trust the same.
- With Clayton Plan, executor/trustee will almost certainly elect QTIP on all of Husband's assets.
- Likely would not give spouse power of appointment over Bypass Trust and Marital Trust.

Scenario 3

FACTS:

- Husband and Wife, both age 35
- Husband dies with a net financial worth of $7,000,000
- Wife has $7,000,000 of her own assets
- First marriage, no children from a prior relationship.

RECOMMENDATION RE ESTATE PLAN STRUCTURE TO IMPLEMENT PRIOR TO DEATH:

- Because their financial picture at Husband's death and the future tax law when they reach life expectancy are unknown, a Clayton Plan provides more flexibility than an Optimal Marital Formula Plan.
- Could consider Disclaimer Plan, unless concerns related to subsequent marriages.
- With Clayton Plan, executor/trustee may or may not elect QTIP on some or all of Husband's assets.
- Consider including a sprinkle power over income in the Bypass Trust, and consider given surviving spouse power of appointment over Bypass Trust and Marital Trust.

Scenario 4

FACTS:

- Husband and Wife, both age 60
- Husband dies with a net financial worth of $20,000,000
- Wife has $20,000,000 of her own assets
- First marriage, no children from a prior relationship.
- Husband died with a Disclaimer Plan already in place

RECOMMENDATION RE POST DEATH PLANNING:

- Instead of Wife disclaiming to a Bypass Trust that was drafted years earlier and is no longer optimal, Wife could opt to accept Husband's $20,000,000 and receive Husband's unused exemption of $11,400,000. This would result in Wife having a combined exemption of $22,800,000.
- Wife then could gift all of Husband's $20,000,000 (which received a stepped-up basis) to an intentionally defective grantor trust ("IGT" or "IDGT"), perhaps in ways that generate valuation discounts.
- All growth on gifted assets is outside of Wife's taxable estate (similar to Bypass Trust), but this growth is leveraged as Wife continues to pay the taxes on the Trust's income which helps to reduce her taxable estate over time. Wife can also sell additional assets to the Trust on an installment contract, which can freeze the value of the assets sold and lock in current low interest rates. *Continued…*

Scenario 4, *cont.*

Advantages:

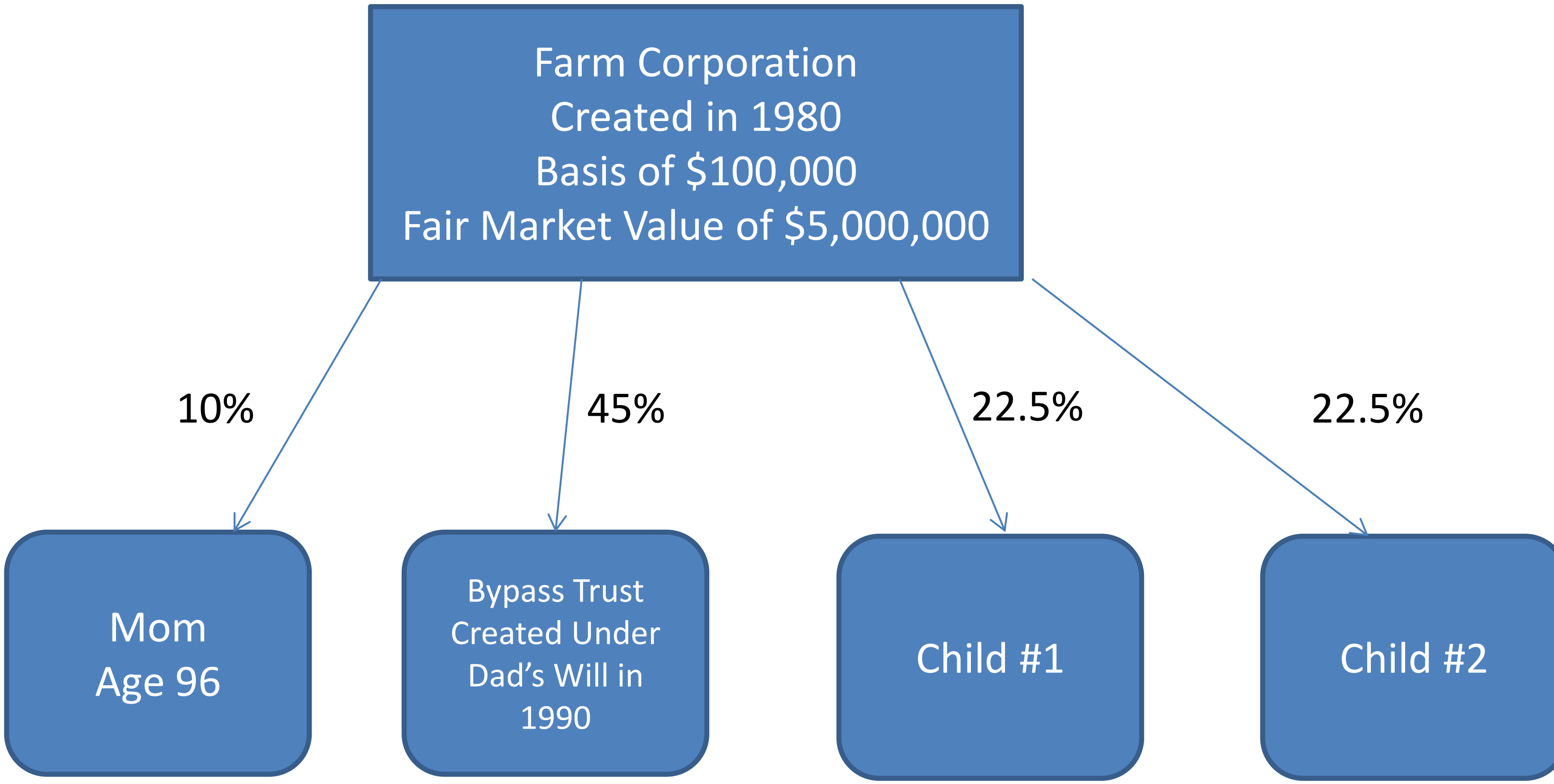
- All growth on gifted assets is outside of Wife's taxable estate (similar to Bypass Trust), but this growth is leveraged as Wife continues to pay the taxes on the Trust's income which helps to reduce her taxable estate over time.
- Wife can also sell additional assets to the Trust on an installment contract, which can freeze the value of the assets sold and lock in current low interest rates.

Disadvantages:

- Generation-skipping transfer tax ("GST tax") exemption is not portable from Husband to Wife, so this doesn't work well for "dynasty trusts."
- Wife could not be a beneficiary of a trust that she creates after Husband's death, but could be a beneficiary of the Bypass Trust, so this only works where Wife has significant other assets and is willing to part with the Husband's assets.

Estate Planning – Idea #3

Irrevocable (Bypass) Trust created at mom/dad's prior death for the benefit of the surviving spouse may be frustrating rather than advancing the goal of tax-efficiency. Should consider whether such Trusts can and should be terminated or modified to make it possible to step up the basis of the assets when the surviving spouse dies.



Estate Planning – Idea #3, *cont.*

Facts: Dad died in 1990, and left a Bypass Trust for Mom, who is now 96.

- The Bypass trust holds low-basis shares of a farm corporation (45%).
- Children own another 45% of the Farm Corporation. Mom owns 10%.
- In 2026, Mom would be 104.
- The Bypass Trust will not receive a step-up in basis at Mom's death.
- Kids' shares will not receive a step-up in basis at Mom's death.
- The Bypass Trust allows distributions of income but not principal.
- Mom's remaining shares should theoretically be valued at a discount.
- There is no way that Mom's assets, augmented by the assets of the Bypass Trust and augmented by the Children's shares of the Farm Corporation, will exceed $11,400,000. The Bypass Trust that was important when created no longer serves any purpose.   *Continued…*

Estate Planning – Idea #3, *cont.*

Potential Strategy to Obtain Step-Up in Basis:

1. Use the Iowa Trust Code to have the Court amend the Trust to allow distributions of Principal to Mom for her general welfare and happiness, in the discretion of the Trustee.
2. All beneficiaries (after being informed of the risks) will need to consent to the Trustee distributing all assets of the Bypass Trust to Mom for her General Welfare and Happiness. If desired, ask the Court to approve this Trustee action.
3. If the Trust already allowed distribution of Principal to Mom for her health, education, maintenance, and support (HEMS), consider a family agreement that Mom needs all assets for HEMS and releasing and indemnifying the Trustee for exercising its discretion to make such distribution. This would avoid court involvement.
4. Need to disclose risks to beneficiaries (Mom could change her ambulatory estate planning documents, she could remarry, she could be a victim of elder abuse or end up with creditor issues, such as medical expenses).
5. If necessary, amend Mom's will/revocable trust to ensure that the shares passing to her from the Trust pass to the beneficiaries of the Bypass Trust in similar shares (and if on different terms, on terms the beneficiaries accept).
6. Consider amending Mom's will/revocable trust to provide that any shares of the Farm Corporation gifted to her after January 1, 2019 will be bequeathed to the party that makes the gift. Children can then be given the opportunity to gift shares back to Mom if desired to obtain a step-up in basis, and each can make his or her own decision independently. *Continued…*

Estate Planning – Idea #3, *cont.*

Results:

1. Bypass Trust shares should receive a step-up even if Mom dies immediately after receipt of them.
2. Shares gifted by children to Mom will obtain a step-up if she lives more than a year after receipt of such gifts.
3. Mom will die owning all of the Farm Corporation, avoiding issues related to potential discounts, and optimizing the potential for a sale or liquidation/dissolution following her death (particularly if this is a S corporation).
4. Children will have to file a gift tax return related to their gifts of stock to Mom, and a wealthy child might choose to prioritize preservation of exemption over capital gains planning. Children should consult their own advisors regarding whether their consent to the application to amend the trust has gift tax implications for them.
5. There will be a happy ending unless Mom changes her Will and disinherits one or all of the kids, or develops creditor problems, or remarries without a prenup.

Continued…

Estate Planning – Idea #3, *cont.*

What if the Mom is Likely to Live until 2026?

- If Mom is only 70 (especially if her assets are such that there might be an estate tax issue if the exemptions revert to 2017 levels ($5,700,000 per person or so)), consider waiting for 5-7 years and revisiting this issue closer to 2026.
- Changed tax law could impact the need or desirability of doing this, and the tax law will likely change at least once more before Mom dies;
- At 70, there is a greater chance that Mom could remarry here or that there could be a "slip between cup and lip" resulting in disappointed remainder beneficiaries. There needs to be a balance of trust and non-trust factors bearing on these decisions.
- *It might be possible to amend the Trust with Court approval to give Mom a general power of appointment over the largest share of the Trust that would not cause estate taxation in her estate which would result in a basis step-up on that portion of the Trust assets.*

Other Planning Ideas:

- Revisit Irrevocable Life Insurance Trusts (ILITS) and other Irrevocable Trusts that no longer serve a tax purpose (terminate or amend).

Estate Planning – Idea #4

S Elections and Basis Step-Up Planning for Land Holding Corporations

- For clients who have corporations that primarily hold land, consider making an S Election.
  - Pass through taxation, avoids double tax on distributions, and qualifies for QBI deduction. This will help provide cash flow to older clients during retirement years and will make future co-ownership by the client's children easier. Provides a better tax structure if land in the corporation will be sold in the future or if the corporation is going to be liquidated/dissolved in the future.
  - Conversion period is now 5 years for both federal and state (starting in 2019)
  - If corporation has "hot assets" that would otherwise be sold during conversion period, corporation will need to "bleed off" the hot assets before converting
  - If the corporation has accumulated E&P from C corporation years, the passive income limitations will apply during S corporation years (if passive income represents more than 25% of gross receipts, excess passive income could be subject to a 35% corporate passive income tax rate). If the accumulated E&P and excess passive income persists for three consecutive years, the corporation could lose its S Corporation status.

- For clients who do not want their children to have to deal with the corporation in perpetuity or for clients who want to have specific parcels of land in the corporation pass to different children, consider making an S Election and also ensuring all stock of the corporation obtains a basis step-up at client's death. *Continued…*

Estate Planning – Idea #4, *cont.*

- If the client's estate plan is properly structured so that all of the corporation stock receives a basis step-up (preferably at the same time) and a timely s election is made, the corporation will be well positioned following the death of the client to liquidate/dissolve and distribute its assets in-kind to its shareholders (all in the same tax year) virtually tax-free. The land will then be owned outside the corporation with a stepped-up basis.

- Other Planning with Corporations:
  - Footprint Leases when the Ownership of Land and the Ownership of the Structures on the Land is Different. Under the Lease, Structures revert to Landowner after Term of Years and Facilitates Basis Planning (Corporate Structures revert to Personal Landowner). A similar lease can be used when client's children own structures on client's land (Child's Structure revert to Parent Landowner).
  - Annual Exclusion Gifting of Entity Ownership to all Children (rather than just those Children involved in the Business) may not be the Best Plan. Annual exclusion gifting (for estate planning purposes) no longer necessary in general for many clients.

Charitable Planning Ideas

1. BE A “LUMPY GIVER”.

2. USE DONOR-ADVISED FUNDS AT COMMUNITY FOUNDATIONS TO SMOOTH OUT GRANT-MAKING.

3. MAXIMIZE IOWA CREDITS FOR CHARITABLE GIVING.

4. DIRECT IRA CHARITABLE ROLLOVERS AND FUNDING CHARITABLE BEQUESTS WITH TAX-DEFERRED RETIREMENT ACCOUNTS.

5. USE OF CHARITABLE REMAINDER TRUST WHEN SELLING ASSETS.

6. USE OF “ZERO ESTATE TAX” PLAN.

Charitable Planning Ideas, *cont.*

BE A LUMPY GIVER:

1. The standard deduction for married couples filing jointly has been increased to $24,000.
2. On the other hand, state and local tax are no longer fully deductible ($10,000 cap applies to such deductions even for married couples filing jointly), so there are fewer itemized deductions.
3. As a result of #1 and #2, most folks without a large mortgage would not itemize except in years they give to charity.
4. For philanthropic clients, the tax-optimal solution is to make "lumpy gifts." Lumping charitable gifts into every third or fifth year allows one to take the charitable deduction in the other years. If you can pay your property taxes (18 months of property taxes in a single calendar year) in "lumpy" fashion as well, you can minimize the opportunity cost involved in taking the standard deduction in the years you don't itemize.
5. Note that the Pease limitation on itemized deductions was repealed as has the AMT for most individuals. So in the years you itemize, there will be less "slippage" than was previously the case.

Charitable Planning Ideas, *cont.*

USE DONOR-ADVISED FUNDS AT COMMUNITY FOUNDATIONS TO SMOOTH OUT GRANT-MAKING.

1. If you gift $100,000 in Year 1 to a *Non-Endowed Donor Advised Fund*, for example at a community foundation, you can distribute the underlying assets out to your ultimate charitable beneficiaries over 5 years ($20,000 per year) and take the large standard deduction in years 2-5. Then repeat.

2. Alternatively, every five years add $100,000 to an Endow Iowa Fund at a community foundation, and watch that fund distribute 4.5% to 5% annually to your selected charitable recipients. This makes your legacy permanent, and gives you a 25% Iowa income tax benefit in addition to your federal deduction (although you may not get your credit until a subsequent year as the credits have been used up early each year for the last several years).

Charitable Planning Ideas, *cont.*

MAXIMIZE IOWA CREDITS FOR CHARITABLE GIVING.

1. Iowa income taxes are no longer fully deductible on the federal return. Which means that Iowa credits for charitable giving no longer reduce the federal deduction for state taxes paid like they did in past years. However, proposed regulations issued by the IRS on August 27, 2018 would reduce a federal charitable tax deduction dollar for dollar by the amount of a state charitable tax credit that exceeds 15%.

2. Iowa Tax Credits: (1) The 25% Endow Iowa Credit for gifts to qualified endowed funds (including qualified donor-advised funds); (2) the 50% credit for qualified "conservation gifts" including qualifying gifts of conservation easements, land for conservation, and remainder interest in land to be held for conservation; and (3) the 65% credit for qualifying gifts to qualified school tuition organizations (Raises tuition grant funding for eligible low-income Iowa students who enroll in accredited nonpublic schools in Iowa. STO must encompass more than one school, 90 percent of its revenue must go toward tuition grants for eligible Iowa (low-income) children attending a qualified school selected by their parents, and no earmarking for family members is allowed.)

Charitable Planning Ideas, *cont.*

DIRECT IRA CHARITABLE ROLLOVERS AND FUNDING CHARITABLE BEQUESTS WITH TAX-DEFERRED RETIREMENT ACCOUNTS.

1. For clients over age 70.5, consider an annual direct IRA rollover to fund gifts to desired charities (annual maximum of $100,000).

2. For farmers, consider annual gifts of grain to fund desired charitable gifts as the farmer will avoid including the grain as income.

3. Fund charitable bequests/gifts at death first with tax-deferred retirement assets (IRAs and 401ks). Make sure that the Will or Revocable Trust back-stops the desired charitable bequests/gifts, however.

4. Considering including provisions in planning documents (Revocable Trust, Will, and Power of Attorney) to allow advancements of charitable bequests to be made during life. More powerful to give during life from an income tax standpoint.

Charitable Planning Ideas, *cont.*

USE OF CHARITABLE REMAINDER TRUST WHEN SELLING ASSETS.

1. When selling a business or land, consider first gifting part of it to a Charitable Remainder Trust benefiting your favorite charity. This allows you to (1) obtain at least some deduction in the year of the sale (except on zero-basis depreciated property or inventory); and (2) avoid capital gains tax in the year of sale (although you will recognize tax as distributions come out to you in the future from the Trust). You will spread the taxable income over the term of your retained interest, potentially at lower rates than if you realized it all at once.

2. This concept may also be utilized with the sale of farm equipment and grain/livestock for retiring farmers.

Charitable Planning Ideas, *cont.*

USE OF A ZERO ESTATE TAX PLAN.

1. Clients could consider leaving amounts beyond his/her estate tax exemption amount ($11,400,000 or $22,8000,000 for couples) to one or more charities.

2. Or leave the excess beyond the estate tax exemption amount to a zeroed-out charitable lead annuity trust that pays a unitrust amount to your charities for a term of 15 or 20 years with the remainder passing to your children. If the total return exceeds IRS assumptions (currently about 3 or 3.5%), an additional amount will pass to your children tax-free at the end of the 15 or 20 years.

3. In the alternative, leave your children the "fruit" but give the "tree" to your favorite charities via a testamentary charitable remainder unitrust that pays at least 5% to your children for their lives. As long as the CRUT is properly structured and the actuarial value of the children's interest is less than $11,400,000, this is another way to create a zero-estate-tax plan.

Entity Planning and QBI

1. In most cases, closely-held businesses are still better off taxed as a partnership or s-corporation (even though c-corporations now have a permanent 21% flat tax rate). This analysis will change on 1/1/26 if the individual and pass-through tax changes expire.

2. Qualified Business Income (QBI) Deduction Issues.
   A. Self-rental paid from personal or a family pass-through entity qualifies for the QBI and still avoids SE tax (at least in the 8th Circuit – includes Iowa).
   B. Self-rental paid from family c-corporation qualifies for the QBI (2018 only) and still avoids SE tax. After 2018, such rent only qualifies for the QBI if landowner works at least 250 hours in managing real estate and this may then subject landlord to SE tax.
   C. Rent paid from unrelated parties will only qualify for QBI if landowner works at least 250 hours in managing real estate and this may then subject landlord to SE tax.
   D. Opportunities to utilize trusts to take advantage of QBI.

Questions?

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