Updates
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2018 Key Trust & Estate Planning and Corporate Ownership Implications of the New Tax Law

With the passage of Public Law no. 115-97, commonly referred to as the Tax Cuts and Jobs Act of 2017 (the 2017 Tax Act), attorneys in Perkins Coie's Trust & Estate Planning practice, along with our clients running closely held businesses, have already begun reviewing and implementing tax-efficient strategies.

Highlights of the 2017 Tax Act affecting individuals, small businesses, estates and trusts are summarized in a new manuscript, *Understanding the Tax Cuts and Jobs Act* (January 3, 2018), by Georgia State University Professor of Law and Perkins Coie Senior Counsel Samuel A. Donaldson.

Three Areas to Focus On

The 2017 Tax Act provides many new planning opportunities that require special consideration of facts and circumstances. As we move beyond the January 1, 2018 effective date of the law and into implementation, the following are three areas of focus that are of particular interest for individuals, trusts and business owners in this new tax environment.

1. Exemption increase for gifts and estates. The 2017 Tax Act doubles the lifetime gift and estate tax exemption and the generation-skipping transfer (GST) tax exemption to approximately $11.2 million, indexed for inflation. This increase in the exemption amount could have a significant impact on existing estate plans, and individuals should review their current plan with their estate-planning attorney to be sure that their goals are being met.

The increased exemption also comes with an important caveat: it expires after December 31, 2025, when the exemption amount is scheduled to go back to its current level of $5.6 million indexed for inflation. This sunset of the scheduled increase creates a valuable window for planning to use the increased tax exemption amounts. Specifically, people who expect to have a taxable estate after 2025 should consider using the increased exemption that is available to them now by implementing lifetime gift strategies in order to guarantee the use of

the increased exemption prior to 2025. For high net worth individuals who had already implemented gift strategies that used up most or all of their previous gift tax exemption, the 2017 Tax Act now gives those individuals a second chance to customize and further their wealth transfer plans.

One option of particular interest that we are exploring with clients, given the current, albeit temporary, $11.2 million lifetime gift tax exemption, is the creation of spousal limited access trusts (SLATs). If both spouses create a SLAT, the opportunity exists to transfer $22.4 million, free of estate, gift and, potentially, GST taxes, while maintaining a safety valve through which those assets (including any increases in value) may be used if the need arises.

Because the current planning environment is favorable to spousal trust planning, with each spouse creating a trust for the benefit of the other, the judicially created "reciprocal trust doctrine" has become more critical to understand. Such, Dunn & Meneau, *A New Era of Spousal Trust Planning: An Old Concern Arises with Reciprocal Trusts*, Tax Management Estates, Gifts, and Trusts Journal, Vol. 43, no. 1, p. 38 January 11, 2018.

2. Trust taxation and elimination of deductions for expenses/itemized deductions. The 2017 Tax Act has numerous provisions affecting the income taxation of trusts, not all of which are positive. The top individual income tax bracket, which applies to trusts with income exceeding $12,500 in 2018, is now reduced to 37 percent from 39.6 percent. Trusts are also eligible for the deduction for "qualified business" income (see below), with the U.S. Department of the Treasury expected to issue regulations on this topic.

Significantly, however, the 2017 Tax Act eliminates some (but not all) of the deductions for investment advisory and related expenses of trusts. Specifically, trust administration expenses that would not have been incurred if the trust's property were held by an individual (e.g., expenses related to fiduciary accountings, fiduciary income tax return preparation or the distribution of trust property to beneficiaries) should continue to be deductible.

On the other hand, deductions for trust administration expenses that are commonly and customarily incurred by individuals owning the same property, which previously were subject to a 2 percent-of-AGI floor as miscellaneous itemized deductions, are disallowed through 2025.

As a result, it will be very important to properly segregate these costs (including allocating bundled fees) and/or consider whether a trust continues to be the most effective vehicle for asset ownership. Such and Ward, *Deductibility of Investment Advisory Expenses by Individuals, Estates and Non-Grantor Trusts,* 35 Am. C. Tr. Est. Couns. J. 407 (Spring 2010); Such and Milligan, *Understanding the Regulations Affecting the Deductibility of Investment Advisory Expenses by Individuals, Estates and Non-Grantor Trusts,* 50 Real Prop. Tr. Est L. J. ABA, no. 3, 440 (Winter 2016).

3. C corporation versus S corporation or partnership planning. The new flat tax rate of 21 percent on C corporation income is the centerpiece of the 2017 Tax Act and is sure to generate significant cash flow savings for C corporations both privately held and publicly traded.

From a planning perspective, this lower tax rate environment may make C corporations an attractive vehicle to carry on investment activity, particularly for the accumulation and reinvestment of wealth where a regular payout of dividends is not mandated. In order to realize these benefits, however, taxpayers may be required to navigate (a) the 20 percent accumulated earnings tax applicable to a corporation that retains earnings and profits beyond its reasonable business needs for the purpose of tax avoidance by its shareholders and/or (b) the 20 percent personal holding company tax applicable to certain closely held corporations of which at least 60 percent of gross income is passive.

In addition, where C corporations previously had an incentive to pay out significant salaries to shareholder-employees in order to generate a deduction at the corporate level, that deduction is now less valuable due to the

reduced 21 percent tax rate. Accordingly, boards of directors, compensation committees and shareholder employees will need to carefully analyze the opportunity to negotiate the payout of salaries and/or dividends.

Where ordinary income is ultimately being realized, the 2017 Tax Act creates an immense new opportunity for relief in the form of a 20 percent deduction for qualified business income received from a "pass-through" entity, subject to certain limitations. This deduction generally applies to sole proprietorships, partnerships and S corporations, with important limitations on some service providers and investment managers. For certain high-income service providers to qualify for a deduction, the pass-through entity may need to pay wages to employees or own depreciable property. Complexity aside, this deduction is a valuable planning tool for individuals and trusts that generate income.

In light of the foregoing changes, Perkins Coie is assisting clients in analyzing how best to take advantage of the new 21 percent corporate tax rate, including an analysis of whether it makes sense to convert certain pass-through entities to C corporations.

We recommend that you consult with your estate planning attorney, income tax advisor and financial planner to determine whether these opportunities would provide a tax benefit to your individualized situation.

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