AVOIDING DEATH TAXES
AND
INCOME TAXES, TOO

The 2017 Tax Act and the New Strategies It Provides

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Lawrence Kamin is a mid-sized, Chicago-based law firm. We tailor sophisticated, cost-effective legal advice and tax and estate planning strategies to meet the goals of wealthy individuals, families and business owners. Planning for the accumulation, conservation and ultimate distribution of wealth is a focus area of Lawrence Kamin.

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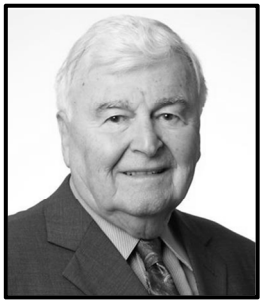

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Ray centers his practice around corporate structure, business transactions, mergers and acquisitions, income tax, trusts, estate and gift tax (including cross-generational transfer and ownership of business). While Ray is technically proficient as a Certified Public Accountant, his strength lies in is his pragmatic approach and ability to craft effective strategies to address complex problems.

Education

Northwestern University School of Law, J.D., *cum laude*, 1956
Order of the Coif, Editor, Northwestern University Law Review
Northwestern University, B.S., Accounting, *cum laude*, 1953

Honors

Illinois Silver Medal, 1954 CPA Examination (2nd highest score in Illinois)
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Education

New York University School of Law, L.L.M. Taxation, 1986
The John Marshall Law School, J.D., 1985
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Honors

The John Marshall Law School, J.D., 1985, High Distinction; Law Review Honors; National Moot Court Competitor; Mugel Tax Competition – 4th best brief, 1985

Bar Admissions & Court Admissions

State of Illinois; United States Tax Court

Professional Memberships & Affiliations

American Bar Association; Illinois State Bar Association; Chicago Bar Association South Suburban Estate Planning Council, 1992-present

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Overview
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Education
Northwestern University School of Law, J.D., 1991
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Bar Admissions & Court Admissions
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Overview

Ted A. Koester takes a pragmatic and preventative approach to developing comprehensive and cost-efficient solutions for clients. He primarily focuses on estate and asset preservation, helping individuals and business owners devise strategic plans to protect their wealth and assets, plan for the future of their businesses, and avoid unnecessary taxes, administration and legal fees. Ted often provides legal representation for clients embroiled in estate and trust administration matters. He has experience representing both fiduciaries and beneficiaries through numerous probate and non-probate proceedings.

Education

Seton Hall University, School of Law, J.D., 1998
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Bar Admissions & Court Admissions

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Professional Memberships & Affiliations

American Bar Association
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Education
Valparaiso University Law School, J.D., *summa cum laude*, 2007
The Boston Conservatory, Masters of Music in Musical Theater, 1999
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Bar Admissions
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Professional Memberships & Affiliations
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Education

Chicago Kent College of Law, L.L.M. Taxation, with honors, 2012
Golden Gate University, School of Law, J.D., 2005
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Bar Admissions & Court Admissions

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Education

Northwestern University School of Law, L.L.M., Taxation, 2007
Chicago Kent College, J.D., 2001
University of Illinois, B.S., Finance, 1996

Bar Admissions & Court Admissions

State of Illinois; United States Supreme Court

Professional Memberships & Affiliations

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Chicago Bar Association
North Suburban Bar Association

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Inez Saunders, the wife of Ray Saunders, provided the inspiration and motivation for both this book and the 2014 book *Avoiding Death Taxes*. For *Avoiding Death Taxes,* Inez contributed the very apt subtitle, "You Can't Take It With You". She suggested that the present book answer a much more important concern: "Give me more funds to spend during my lifetime" by reducing income taxes. The Tax Cuts and Jobs Act enacted in December 2017 answered her wish.

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Introduction

In the conclusion to our 2014 book Avoiding Death Taxes, we compared the struggle between wealthy individuals and U.S. governments over the disposition of their wealth to the famous battle between David and Goliath.[1] In December 2017, Congress passed and President Trump signed the Tax Cuts and Jobs Act (the "Tax Act"), thereby changing many rules. By passing the Tax Act, Goliath introduced new weapons and strategies into David's already extensive arsenal. In this book we will review this expanded arsenal, arming the taxpayer to defeat the government's quest for income and estate taxes.

[1] Some scholars believe the story of David and Goliath was written in the sixth century BC, but that it actually took place much earlier. According to Hebrew scholars, the most popular legends about David, including his killing of Goliath, his affair with Bathsheba, and his ruling of a United Monarchy of Israel rather than just Judah, are the creation of those who lived generations after him. Archaeologists have established that Gath, traditional home of Goliath, was destroyed in the ninth century BC, which means the story is set in the ninth century or earlier. David appears to be quite a young man, probably in his teens, when he slew Goliath. Since David's birth is conventionally placed around 1040 BC, the battle of David and Goliath probably took place around 1020 BC.

Chapter 1

Increase in the Estate Tax, Gift Tax and Generation Skipping Tax Exemption

For transfers made and decedents who pass after 2017, the exemption has doubled from approximately $5.6 million to $11.2 million per individual ($22.4 million for a married couple)[2] and will be indexed to increase for inflation. As a practical matter, this will remove many individuals from the federal estate tax roll.

Gifts by Children of Appreciated Assets

What strategies emerge from this substantial increase in the lifetime exemption? Many taxpayers whose wealth exceeded the former exemption thresholds made gifts of appreciated stock or real estate to their children in order to stay below those exemption levels. Since the Tax Act did not change the provision that permits a step-up in basis for income tax purposes for assets included in a decedent's estate, the children can now gift these

[2] The exemption is $11.18 million per individual and $22.36 million for married couple. To simplify, we have rounded to $11.2 million and $22.4 million.

assets back to their parents, and upon the death of their parents the children can step-up the income tax basis to the fair market value as of the date of death. If the children hold on to the appreciated assets, their basis will be the same as the cost to their parents. Upon sale of these assets, the children will incur income taxes on all of the appreciation in value.

Allocate Assets to the Marital Trust

Another strategy that has become popular due to the Tax Act involves the allocation of assets between the marital trust and the non-marital trust upon the death of the first-to-die of a married couple. Prior to passage of the Tax Act, the usual approach was to allocate the maximum amount of the lifetime exemption to the non-marital trust in order to maximize the wealth that would be exempt from federal estate tax on the second-to-die of the married couple. This still is applicable if a federal estate tax is foreseeable. But this maximum funding of the non-marital trust meant that the basis of these assets would be the value at the death of the first-to-die of the married couple. By increasing the allocation of assets to the marital trust upon the death of the first-to-die, with a corresponding decrease in the amount of assets allocated to the non-marital trust, and by

utilizing the increased $22.4 million exemption, the federal estate tax can be avoided and the children can take a stepped-up basis reflecting the value of the marital trust as of the death of the second–to-die.

The Provisions for the Increased Exemption Will "Sunset" in 2025

There are, of course, pitfalls to be avoided. The Tax Act did not make the new exemption permanent. It will "sunset" and terminate at the end of 2025 when the exemption will revert to $5 million per individual plus inflation adjustments since 2011. Clients concerned about the "sunset" might consider making gifts during the intervening period to lock in the exemption. Other clients might take a calculated risk that the federal estate tax exemption never will be rolled back to its prior level, in which case the best strategy is to retain non-cash appreciated assets in order to achieve the step-up in basis that remains an important part of the tax code.

For those who are concerned that the estate tax exemption may be subsequently reduced following the 2025 "sunset," we direct you to the following statistics that we believe indicate that the Goliath, the U.S. government, no longer is

interested in collecting revenue upon the death of moderately wealthy taxpayers. In 1998, when the lifetime exemption was $675,000 per individual, the number of estates subject to federal estate tax was approximately 50,000, about 2.25% of the number of adult deaths during that year. By 2013, when the exemption had been raised to $5.25 million per individual, the number of estates subject to federal estate tax shrank to slightly over 5,000, even before the introduction of the increased exemption of $11.2 per individual under the Tax Act. The usual arguments against the federal estate tax – stigmatizing it as a "death tax" requiring a visit to the undertaker and tax collector on the same day, or as a "double tax" duplicating the income tax and therefore amounting to a punishment for working hard and becoming successful – seem to have prevailed. It is likely that in the future the federal estate tax will continue only for the very wealthy in order to avoid creating a large class of "idle rich" and as a driving force to promote charitable gifts by the super-rich.

CHAPTER 1

Move to a Different State

Although the federal estate tax exemption has increased to $22.4 million per couple, Illinois has not changed its $4 million exemption per individual. Also, if a couple is not subject to federal estate tax, the Illinois estate tax, with a maximum rate of 16%, is not deductible against any federal estate tax. The message of the Goliath in this case is clear and unambiguous. If you can, change your residence to one of the many states that do not impose an estate or inheritance tax.[3]

[3] Thirty-two states do not have an estate or inheritance tax, including Illinois' neighboring states of Indiana, Michigan, Missouri and Wisconsin, and favored destinations Arizona, California and Florida.

Chapter 2

Reduction of the Corporate Income Tax Rate for C Corporations

For the years after 2017, the corporate tax rate for C Corporations has been substantially reduced, from 35% to 21%. This reduction is permanent, i.e. there is no "sunset," but of course it is subject to change if Congress and the President decide to do so. Also, the Alternative Minimum Tax ("AMT") for corporations was repealed by the Tax Act.

New tax savings opportunities and strategies have emerged. Consider the following for a wealthy doctor, lawyer, investment advisor, consultant or other taxpayer who has been operating as a partner, proprietor or shareholder of an S Corporation: if no change is made, the taxpayer will pay federal income taxes of approximately 56% on the first $120,000 of taxable income and 40% on the balance.[4] By transferring his or

[4] The maximum rate under the Tax Act is 37%. To this, we have added 3.8% imposed under the Affordable Care Act and 16% imposed on the first $120,000

her interest to a C Corporation, the individual's federal income tax will be reduced to 21%. This, of course, assumes that the taxpayer will not require payment of a salary or dividends from the C Corporation, and that the taxpayer will continue the C Corporation until his or her death, at which time the C Corporation can be liquidated tax-free.

This strategy is available to taxpayers who have other funds to finance their ongoing day-to-day living expenses. A taxpayer should consider withdrawing funds from his or her retirement account to finance ongoing living expenses. If the C Corporation technique begins to present any cash flow problems for the owner, it should be possible to elect to become an S Corporation and thereafter withdraw all of the current earnings.

Every individual, partnership or S Corporation should consider how to trap all or a part of its taxable income into a C Corporation at a 21% rate. The most likely candidates to use a

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as the employer's and employee's share of FICA. The maximum rate to individuals might be greater if the Alternative Minimum Tax is applicable since this continues to apply to individuals even though it was repealed for corporations. This disparity might be reduced if the taxpayer's income qualifies for the 20% Deduction for Business Related Income from Pass-Through Entities.

C Corporation are typically doctors, lawyers, investment advisors, consultants and other service providers. But other non-service businesses can employ this strategy as well. This might take the form of a transfer of assets to a C Corporation with a lease back to the transferor, or a transfer of only a portion of a business to a Corporation. Alternatively, you can form a management company that will manage the business, operate as a C Corporation and pay a mere 21% corporate federal income tax on its income.

The taxpayer's arsenal of weapons extends far beyond David's stone and sling. The taxpayer now has nuclear and inter-continental missile capabilities.

Chapter 3

Overcoming the New Limitation for State and Local Taxes

The Tax Act imposed a $10,000 per year limitation on the amount of the deduction for all state and local taxes. Thus, if the aggregate of all real estate taxes and state income taxes exceeds $10,000 in 2018 or any subsequent year, the excess is not deductible. This will seriously impact taxpayers in states with high income taxes, e.g. California and New York – perhaps not coincidentally states that voted for the Democratic candidate in the 2016 presidential election. While it might be impossible to completely overcome this $10,000 per year limitation, significant benefits can be obtained by diverting income to trusts, even multiple trusts, or to C Corporations that will be eligible to pay and deduct state income taxes, thereby avoiding the limitation imposed by the Tax Act. Another strategy, particularly effective for a decedent's estate or other taxpayer who owns more than one parcel of residential property, is to transfer parcels of residential property to more than one trust so the applicable real

estate taxes are not aggregated with other taxes in calculating the $10,000 limitation. If a decedent's estate owns two residences and divides into a marital trust and a non-marital trust, one residence can be transferred to each trust.

Chapter 4

The 20% Deduction for Business Related Income to Owners of Pass-Through Entities

One of the most complicated provisions of the Tax Act, Section 199A of the Internal Revenue Code, provides a Qualified Business Income Deduction (the "QBI Deduction"). This enacts a totally new concept applicable to income from certain Pass-Through entities, e.g., sole proprietorships, single member and multi-member LLCs, partnerships, S Corporations and REITs. For individual taxpayers, the QBI Deduction is a deduction from Adjusted Gross Income and can be claimed in addition to the standard deduction or itemized deductions. The QBI deduction also can be claimed by trusts and estates. However, the QBI Deduction is phased out for owners of professional service businesses and financial service providers whose taxable income exceeds $315,000, and for married couples filing jointly, and is unavailable if the taxable income of the married couple exceeds $415,000. The threshold amounts of taxable income referred to

above include all taxable income, i.e. dividends, interest, etc., not merely the income of the Pass-Through entities.

Below is a brief summary of some of the strategies that owners of professional service businesses and financial service providers can use to preserve their entitlement to the QBI Deduction:

- Divert sufficient income to entities such as complex trusts or C Corporations that are not Pass-Through entities to bring your taxable income below the above described threshold amounts.

- Create new Pass-Through entities that are not service businesses and will be eligible for the QBI Deduction without being subject to the limitations if taxable income exceeds the threshold amounts. For example, income earned by a Pass-Through entity formed by a medical practice or a law firm that owns and leases furniture and equipment to a medical practice or law firm should qualify

for the QBI Deduction irrespective of the amount of a taxpayer's income.

- A family office or a similar management company that manages the investments of the family should qualify as a business Pass-Through and be entitled to the QBI Deduction. In addition, this management company should be able to deduct investment advisory fees, attorneys' fees and accounting fees that no longer can be claimed as miscellaneous deductions by individuals.

Chapter 5

Other Benefits and Limitations of the Tax Act

Although we do not intend to address all of the various benefits and limitations mandated by the Tax Act, several of these limitations deserve mention:

- In determining gain or loss on the sale of securities that were acquired on different dates or at different prices, the Tax Act eliminated the taxpayer's ability to identify the shares being sold. Under the Tax Act, the shares sold are deemed to be the earliest acquired shares ("FIFO" or "first-in, first-out"). The FIFO rule also applies to gifts to trusts, family members and charities. But if shares of stock that were purchased at different prices are segregated in accounts with different brokers, taxpayers should be able to return to the former procedure of specifically identifying the shares that are being sold or gifted. Also, if a taxpayer is married and wants to sell shares of stock that were the last shares purchased and have the greatest cost,

consider first gifting all of the shares to the spouse, except those that taxpayer intends to sell.

- The Tax Act attempted to put an end to the ability to make a tax-free like kind exchange of art. To date, we have not heard of or thought of a plan for addressing this limitation, but there are many talented tax practitioners who represent wealthy collectors of art. Someone will devise a plan.

- The Tax Act increased the amount of the deduction for annual cash gifts to public charities. Under prior law, the deduction was limited to 50% of the taxpayer's Adjusted Gross Income. The Tax Act increased that limit to 60% of Adjusted Gross Income for tax years 2018 to 2025.

- Under the Tax Act, an income tax deduction no longer will be allowed for payments to a college or university if the taxpayer receives the right to purchase tickets for athletic events in a preferred seating area.

- Under prior law, the so-called “Pease rule,” named for the representative that introduced this provision, required that all deductions including the charitable deduction be reduced by 3% of the amount by which the taxpayers’ Adjusted Gross Income exceeded certain limits, $313,800 for married joint filers and $261,500 for single filers. The Tax Act repealed the “Pease rule” for 2018 through 2025.

Chapter 6

Other Weapons in Taxpayer's Arsenal

Many other tax savings techniques available to the estate planner were mentioned but not elaborated upon in our 2014 book *Avoiding Death Taxes*: grantor retained annuity trusts ("GRATs"); private annuities; self-cancelling installment notes; and qualified personal residence trusts ("QPRTs"). We intend to address these in future publications along with other important estate planning topics: asset protection planning; community property; income taxation of estates and trusts; duties and responsibilities of fiduciaries; trust decanting; problems of non-citizens and estate and gift tax treaties with foreign countries; U.S. taxation of foreign estates, trusts and beneficiaries; operations of private foundations and public charities; probate administration of estates and trusts; and ante-nuptial agreements.

Conclusion

The dramatic confrontation between David and Goliath that occurred about 1020 B.C., when the Israelites faced the Philistines, continues on as a struggle between wealthy taxpayers and governments. The recent Tax Act enacted by the government Goliath introduced new weapons for use by taxpayers.

Numerous battles will be fought between taxpayer David and the government Goliath. Each side will achieve occasional wins and losses. We doubt there will ever be a cessation of hostilities or even a temporary truce. This is an ongoing struggle between patriotic well-intentioned citizens and the governments that they love and seek to uphold. Thus, despite the great pride that we have in our U.S. citizenship and the great affection we have for our country, we predict that this battle with the U.S. government over disposition of wealth will never end. However, the weapons and strategies will continue to change.

CONCLUSION

This book serves as a battle cry to all those faced with the struggle against government-imposed tax laws to preserve their wealth and protect their legacy. Although the government Goliath is large and mighty, it is passive and cannot manage the nimble strategic moves of estate planners who are resourceful and familiar with numerous weapons that can help you meet your objectives. We urge you to seek out and actively participate with an astute estate planning attorney in formulating an estate plan to slay, or significantly weaken, the Goliath you are confronting.