Changes to Business Entities and New Trust Opportunities Due to 2017 Tax Act and the SECURE Act

I. Notable Changes in the Act
   A. Corporate tax rate changed to 21% flat rate
   B. Individual income tax changes
      1. Personal exemption eliminated
      2. Standard deduction changed
      3. New qualified business income deduction
   C. Estate and gift tax exclusion and GST exemption were increased
      1. Changes sunset December 31, 2025
      2. Estate and gift tax exclusion amount increased to $11,400,000 (2020 increase to $11,590,000 – married couple has $23,180,000
      3. Portability continues

II. Changes to Business Entity Agreements
   A. Many shareholder, operating, and partnership agreements include restrictions on transfer of ownership and buy-sell valuation provisions that cause discounts in value of interests
      1. In some cases, discount provisions were deliberately included for estate and gift tax reasons
      2. In other cases, the provisions were part of the attorney's standard agreement
      3. The resulting discounts reduce basis step-up on the shareholder, member, or partner's death and increase income tax exposure for the children and other recipients of the interests
      4. With the increase in the estate and gift tax exclusion amount, estate or gift tax reduction in value is no longer needed for many of these entities
   B. Solutions to eliminate or reduce the unneeded discounts
      1. Liquidate and dissolve the entity
         a. If the entity is a LLC or partnership, dissolve the entity and distribute the assets to the owners – assets will receive full step-up on owner's death
         b. Most LLCs and partnerships can be dissolved with assets distributed to owners without taxable event
         c. S-Corporations cannot dissolve and distribute assets to owners without tax unless only one owner and outside basis equals or exceeds value of assets
      2. There may be significant non-tax reasons to continue the entity
         a. Creditor protection for the owners
         b. Restrictions on transfer of family business interests
         c. Exposing younger family members to business management
         d. Sharing family business income with younger, lower tax bracket family members
   C. Change the terms of the agreement to try to eliminate or reduce discounts

1. Lessen restrictions on transfer of interests
   a. If you still want to restrict the ability of the transferee to transfer full voting right interest, make them an assignee without voting rights – IRS position has been assignee status does not support any additional discount
2. Give owners ability to force buy-out (put right), but extend term of buyout with low initial payment
3. Provide buy-out is to be for full value – value of assets divided by percentage of interest
4. Provide limited withdrawal right for gifted interests to children
5. IRS has challenged estate and gift tax value discounts for years, winning some challenges and losing most of them – will they switch tactics and argue for discounts to increase income taxes?

D. Impact of 754 election
1. When a partner or LLC member dies, the basis of his or her partnership or LLC interest is stepped up to its date of death value
2. By making an election under IRC 754, the basis of partnership property may be increased by the amount of basis increase in the deceased partner or LLC member's interest under IRC 743(b)
3. If partnership or LLC property is thereafter sold, the new owner of the deceased partner or member's interest will have less or no gain with respect to his or her share of the sale proceeds
4. If the value of the deceased partner or LLC member's interest is discounted, the amount of basis increase to partnership property will be less and the transferee will have more gain on a sale of partnership property

III. § 4-10-604 (a) Limitation on action contesting validity of revocable trust

A. Subject to the rights of persons dealing with a fiduciary as provided in W.S. 4-10-1013, a person may commence a judicial proceeding to contest the validity of a trust that is revocable during the settlor's life or an amendment thereto within the earlier of:
1. Two (2) years after the settlor's death; or
2. **One hundred twenty (120) days after the trustee sent the person a copy of the trust instrument and a notice informing the person of the trust's existence, of the trustee's name and address and of the time allowed for commencing a proceeding.**

B. After trust is created for client (during their lifetime), send notice of trust to beneficiaries and other potential heirs and copy of trust, 120 days starts

C. Advantages:
1. Prevents potential contest after death (which can occur when a client disinherits child or provides unequally to children)

D. Disadvantages:
1. Would have to notify again if dispositive provisions of trust are amended
2. Children would be aware of unequal distributions on death

IV. Setting Every Community Up for Retirement Enhancement Act (SECURE Act)

A. Effective January 1, 2020

B. IRA contributions can continue after age of 70½, if there are wages or earnings

C. Qualified charitable distributions from IRA still begin at 70½

D. RMDs for plan participant begin at age 72 instead of 70½

E. No RMDs for beneficiary of inherited IRA – ten year withdrawal required, except for following Eligible Designated Beneficiaries (EDB)

1. If surviving spouse or conduit trust for spouse is the beneficiary, the distributions may be made over the spouse's life expectancy, ten year withdrawal required after spouse's death.
2. If a minor child or a conduit trust for a minor child is the beneficiary, the distributions may be made using the minor's life expectancy, but only to age of majority at which point the ten year withdrawal is required. If child has not completed a specified course of education, this exception may continue until the age of 26 years.
3. If a disabled or chronically ill person or a conduit or accumulation trust for the disabled or chronically ill person is the beneficiary, the distributions may be made using the person's life expectancy, but on death of the person, the ten year withdrawal is required.
   a. Disabled applies IRC § 72(m)(7) - Social Security disability
   b. Chronically ill applies IRC § 7702B(c)(2) - unable to perform at least two of daily living functions
4. If a person who is no more than ten years younger than the plan participant or a conduit trust for such a person is the beneficiary, the distributions may be made using the person's life expectancy, but on the death of the person the ten year withdrawal is required.

F. Ten year withdrawal does not require annual withdrawals. Entire account balance may be taken in last year.

G. The default five year or life expectancy of plan participant rules still apply

1. If participant dies before required beginning date (now 72), with no designated beneficiary, a five year withdrawal is required
2. If participant dies after required beginning date with no designated beneficiary, withdrawals may be taken over life expectancy of participant as if he or she is still alive

H. Conduit trusts other than those for four classes of EDBs may require changes. If a conduit trust requires the trustee to limit withdrawals from account to RMDs, there will be no RMDs. Instead all of account must be withdrawn in ten years.

I. Planning for surviving spouse

1. Surviving spouse as outright beneficiary provides opportunity for spouse to roll the account balance to his or her own IRA, defer distributions to age 72 and take over life expectancy.
2. Take as beneficiary beginning December 31 of year following participant's death or when participant would have reached age 72
3. If second spouse and participant wants spouse to receive in trust, the QTIP conduit trust still works - spouse gets greater of income or RMD

4. An accumulation trust for surviving spouse would not qualify for marital deduction as a QTIP trust and would not qualify for life expectancy RMDs; however could preserve more of account for children?

J. Planning for children or grandchildren other than disabled or chronically ill
   1. If child is a minor, a conduit trust will allow life expectancy RMDs until majority or complete education
   2. If beneficiary is a grandchild or a trust for a grandchild, the withdrawals must be completed in ten years
   3. Accumulation trusts for children even when child is sole lifetime beneficiary do not allow life expectancy withdrawals even though child is a minor. No longer have to limit beneficiaries to those younger than designated beneficiary. Withdrawals must be completed in ten years regardless of age of oldest beneficiary.
   4. Possible options:
      a. Conduit trusts for minor children that distribute for the benefit of child RMDs until majority. RMD conduit language no longer valid after age of majority. Provide trustee or trust protector discretion to remove conduit language or take withdrawals other than as RMDs and not pass through withdrawals.
      b. Designate multiple trusts for children and grandchildren as beneficiaries of account and spread the tax payable during the ten year withdrawals.
      c. Provide withdrawal rights for trust beneficiaries to withdraw trust income annually. IRC § 678 will cause IRA distribution income to be taxable to beneficiary rather than being taxed at trust. Distribute amount necessary to pay beneficiary's tax due to withdrawal right.
      d. One pot accumulation trust for children that allows trustee discretion to make unequal distributions to consider needs and different tax brackets of children during ten year withdrawal period and provide for equalization distributions after completion of ten year withdrawal period.

K. Using a charitable remainder trust
   1. Distribution of entire account balance at participant's death will be income tax-free
   2. Trust may pay income interest to spouse or child for life or term of years
   3. Trust will pay specified percentage of trust asset value to beneficiary, annually, quarterly, or monthly
   4. Cannot be used for young beneficiaries because will violate 10% remainder requirement – CRAT @ 5% age 58; CRUT @ 5% age 30
   5. Beneficiary may receive less than would have received after taxes with ten year withdrawal
   6. CRATs and CRUTs do not permit distributions in addition to CRAT or CRUT payments