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2018 Year-End Estate Planning: Part 4

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The Tax Cuts and Jobs Act and its resulting tax reform have dominated the legislative and planning landscape for much of 2018. The act made noteworthy changes to the individual and corporate income taxes, as well as significantly affecting estate planning considerations by temporarily doubling the estate, gift and generation-skipping transfer tax exemptions. In this four-party estate planning article, the authors have discussed **income and transfer tax exemption and rate changes**, highlighted **important estate tax cases and planning considerations** and suggested **advantageous transfer techniques**. In this final installment, the authors outline international as well as state and local developments.

Year-End Checklist for 2018

In addition to the above planning ideas, consider the following before 2018 is over:

- Make year-end annual exclusion gifts of $15,000 ($30,000 for married couples);
- Make year-end IRA contributions;
- Create 529 plan accounts before year-end for children and grandchildren, and consider front-loading the accounts with five years' worth of annual exclusion gifts, taking into account any gifts made during the year to children and grandchildren;
- Pay tuition and non-reimbursable medical expenses directly to the school or medical provider; and
- Consider making charitable gifts (including charitable IRA rollovers) before year-end to use the deduction on your 2018 income tax return.

Below is an overview of national, international and local developments that occurred in 2018.

International Developments in 2018

Additional Implications of the Act Relevant to International Tax Planning

Under the Tax Cuts and Jobs Act, there were major implications for private client international tax planning. Specifically, with respect to U.S. individuals who own interests in foreign corporations, those foreign corporations may be classified as controlled foreign corporations, or CFCs, pursuant to a new definition of CFC. A foreign corporation will be classified as a CFC if more than 50 percent by vote or value is owned by U.S. "shareholders." U.S. "shareholders" are now defined as U.S. persons owning 10 percent or more by vote or value of the foreign corporation. The prior definition of "shareholder" was 10 percent or more by vote only of the foreign corporation. In addition, previously, an individual was only taxed on problematic "Subpart F" income of a CFC if he or she owned the stock of the CFC for 30 days or more. The 30-day period has now been eliminated by the TCJA. This change may alter, for example, post-mortem planning for U.S. beneficiaries of foreign grantor trusts with foreign holding companies upon the death of the foreign grantor.

In addition, a new tax on all shareholders of CFCs called global intangible low-taxed income, or GILTI, will disproportionately impact individual shareholders of CFCs. For U.S. corporate shareholders of CFCs, there will be a deduction against GILTI that will apparently not be available to U.S. individual shareholders of CFCs.

The categorization of a foreign company as a CFC is also more likely, as the definition of a CFC has been expanded to allow constructive attribution through foreign entities to U.S. persons beginning in 2017.

Finally, due to the fact that the U.S. corporate tax rate has been permanently reduced to 21 percent, foreign families purchasing U.S. real estate interests may choose to protect themselves from U.S. estate tax exposure through two-tiered corporate rather than partnership structures. Also, foreign clients with U.S. corporations should check with home-country advisors to see if the U.S. corporations may be recharacterized as CFCs under their local law rules.

The continuing global regulatory focus on anti-money laundering, or AML, and countering the financing of terrorism, or CFT, has led governments to strengthen regulatory regimes worldwide. In the European Union, the Fourth Anti-Money Laundering Directive 2015/849/EU — the United Kingdom implementation of which came into effect in June 2017 — resulted in a number of changes to the way firms and regulators deal with AML/CFT issues.

In addition, in December 2017, the EU reached an agreement to amend the Fourth Anti-Money Laundering Directive. As opposed to the Fourth Anti-Money Laundering Directive, which gave countries the decision on whether to publish their beneficial owner registries or not, the amended directive will require all EU member states to establish public beneficial owner registries for companies by 2020. EU countries will also have to establish beneficial owner registries for trusts managed by a local trustee, or with business relationships or that acquire real estate in the EU but access to this information will be subject to a legitimate interest test. On May 1, the U.K. Parliament approved an amendment to the sanctions and anti-money laundering bill, which requires British Overseas Territories (e.g., Cayman Islands, British Virgin Islands, etc.) to establish public beneficial owner registries by 2020.

Ironically, the EU's General Data Protection Regulation is now in effect as well. The GDPR is a historically significant piece of data protection legislation and impacts any organization that processes personal data in connection with goods or services offered to an EU resident or monitors the behavior of persons within the EU. The GDPR strengthens individuals' privacy rights through tighter limits on processing of their personal data, significantly expanding their rights over their data and providing increased transparency into the nature, purpose and use of it.

Not surprisingly, given the inherent tension between the beneficial owner registries, trends toward transparency and the GDPR, at least one lawsuit has been initiated, with more presumably to come. In May, an Italian-domiciled woman lodged an official complaint with the U.K.'s information commissioner, alleging that the disclosure of her personal and financial information to other countries under the Organization for Economic Cooperation and Development's Common Reporting Standard infringes the GDPR.

Local Developments in 2018: State-Specific Considerations

California

Communications Between Trustee and Attorney Not Always Shielded by Attorney-Client Privilege

In Morgan vs. Superior Court, the appellate court found that a trust may not permit a former trustee to withhold from a successor trustee communications between the former trustee and the former trustee's attorney and any trust provision seeking to do so is in violation of public policy and is, therefore, unenforceable. Thomas Morgan acted as successor trustee of his mother, Beverly's, trust after her death. Beverly's daughter filed petitions to invalidate the trust and remove Thomas as trustee. In response, Thomas filed an inadequate accounting, which led to the court suspending him as trustee and ordering him to turn over all trust records to the interim trustee. Thomas refused to produce attorney-client communications by relying on a trust provision, which allowed the trustee to withhold privileged communications from a successor trustee.

The appellate court ruled against Thomas, requiring him to turn over to the interim trustee communications that were attorney-client privileged. The court reviewed the law applicable to a trustee's liability, confirming that the trustee may not be absolved in cases of intentional misconduct, gross negligence, or acts taken in bad faith or with reckless indifference to the interests of the trust beneficiaries. The court found that, as a matter of public policy, the trust agreement may not prevent the disclosure to the successor trustee of the records that might be used to establish such liability. Attorney-client communications between a trustee and the trustee's attorney will only be privileged to the extent the trustee retains separate counsel to differentiate personal advice from advice obtained in a fiduciary capacity. Because Thomas did not retain separate counsel for that purpose, he was ordered to produce all trust records, including attorney-client communications, to his successor.

Update Beneficiary Designations Upon Divorce

In Estate of Post, the California Court of Appeal found that if a decedent does not change his or her life insurance beneficiary designation to exclude his or her ex-spouse, then the decedent's ex-spouse will remain the rightful beneficiary of the insurance proceeds upon the decedent's death. Jerome Norman Post purchased a life insurance policy during his lifetime and named his then-wife, Angela Post, as the primary beneficiary of the policy. Jerome named his two sons from a prior marriage, Kenneth Post and Eric Post, as the secondary beneficiaries of the policy. Subsequently, Jerome and Angela were divorced and Jerome executed a codicil to his will stating that he intended that Angela receive nothing from his estate upon his death, including by beneficiary designation. Jerome did not, however, change the beneficiary on his life insurance policy.

Relying on the codicil to Jerome's will, after Jerome's death, Kenneth and Eric sought a court order designating them as the rightful beneficiaries of the insurance policy. The trial court found in their favor. The Court of Appeal reversed based on the finding that a beneficiary of an insurance policy takes under a contract and not under the probate laws of succession. Since the decedent's estate had no interest in the life insurance policy, the trial court had no jurisdiction over the life insurance proceeds and its order was void.

California Adopts New Decanting Laws

California's new Uniform Trust Decanting Act takes effect on Jan. 1, 2019. The act applies to all California trusts, whenever executed, unless the trust states otherwise. Decanting allows a trustee of an existing irrevocable trust to transfer, or decant, the trust assets into a new irrevocable trust, in order to incorporate different trust provisions, ranging from more useful administrative terms to modifying certain dispositive provisions. The terms of the new trust and whether a decanting is permissible depends on the terms of the existing/original trust and the purpose for the potential changes. That said, this procedure provides a significant opportunity for trusts to address needed changes in a streamlined manner.

A trustee of an existing trust with distributions limited to an ascertainable standard (e.g., where distributions may be made only for a beneficiary's health, education, maintenance and support) may not decant to a new trust that materially changes the dispositive provisions of the existing trust, but may decant only to a new trust that modifies the administrative provisions, such as the trustee powers. On the other hand, a trustee of an existing trust with the power to make unrestricted principal distributions to a beneficiary may decant to a new trust that changes certain dispositive provisions, including eliminating a beneficiary, changing the standard for distributions, granting powers of appointment and extending the duration of the trust. There are limitations on modifications related to trustee compensation, trustee liability, and the removal and replacement of a trustee in order to mitigate self-dealing. Further, there are extensive limitations regarding any modifications to charitable interests. Finally, tax benefits under an existing trust may not be jeopardized.

In order to decant, a 60-day advance notice must be provided to various parties, including (a) the trust's settlor, if living: (b) each qualified beneficiary: (c) each holder of a currently exercisable power to appointment: (d) each holder of the current right to remove or replace the trustee; (e) all trustees of the existing trust other than the decanting trustee; (f) each trustee of the new trust; and (g) the California Attorney General, if the existing trust contains charitable interests. Qualified beneficiaries are current distributees and permissible distributees, those who would be current distributees or permissible distributees if the interests of the actual current distributees were terminated, and those who would be distributees of income or principal if the trust terminated immediately. Unless the existing trust provides otherwise, a court-appointed guardian ad litem is required to represent minor, unborn and unascertainable qualified beneficiaries.

The enactment of the Uniform Trust Decanting Act provides greater flexibility to trustees in California to meet the needs of beneficiaries and modernize outdated trusts.

Illinois

Uniform Powers of Appointment Act

On Aug. 23, Illinois House Bill 4702 was signed into law as Public Act 100-1044 and is known as the Uniform Powers of Appointment Act. This law is effective Jan. 1, 2019, and unless otherwise specifically stated in the legislation to the contrary, applies to all powers of appointment governed by Illinois law (whether such power was created before the effective date or after). Enacted in only eight other states thus far, the Uniform Powers of Appointment Act aims to streamline the creation and exercise of powers of appointment. A common problem throughout the United States was the patchwork common-law and statutory system of determining the legalities of the creation and exercise of powers of appointment; in an attempt to streamline and harmonize the creation and exercise of powers of appointment throughout the United States, the Uniform Powers of Appointment Act was created by the Uniform Law Commission. For example, in Illinois, powers of appointment were governed in part by common law, in part by the Probate Act (concerning the exercise of testamentary powers of appointment in 755 ILCS 5/4-2), in part by the Powers of Appointment Exercise Act (concerning the exercise of non-testamentary powers of appointment in 765 ICLS 320) and in part by the Termination of Powers Act (concerning the release of powers of appointment in 765 ILCS 325). In furtherance of the goal of harmonizing this field, all of those statutory provisions were repealed.

Frail Elderly Individual Family Visitation and Protection Act

On Aug. 14, Illinois House Bill 4309 was signed into law as Public Act 100-0850 and is known as the Frail Elderly Individual Family Visitation and Protection Act (the Kasem/Baksys Visitation Law). This law is effective Jan. 1, 2019. This act provides certain family members with recourse in the event that a family caretaker of a frail elderly individual unreasonably withholds visitation from such family member. Importantly, the act does not apply if the frail elderly individual is under guardianship or if the family caretaker is acting on behalf of the frail elderly individual under a power of attorney.

Amendment to Illinois Dissolution of Marriage Act

On Aug. 14, Illinois Senate Bill 2437 was signed into law as Public Act 100-0871. This Public Act amends the Illinois Marriage and Dissolution of Marriage Act to provide that if a judgment of dissolution of marriage is entered into after an insured has designated his or her spouse as the beneficiary under a life insurance policy, then the designation in favor of the insured's spouse will be ineffective unless special enumerated circumstances apply. In the event that the designation of the insured's spouse is ineffective, the life insurance proceeds will flow to the alternate designee, or in the event there is none, then to the insured's estate. It is important to note that Illinois law remains somewhat inconsistent in determining when a testamentary transfer to a former spouse will be deemed ineffective (for example, transfers to a former spouse and fiduciary appointments of a former spouse in a will and revocable trust will be deemed ineffective after the divorce is finalized, but there may not be similar statutory provisions with respect to assets flowing outside of a decedent's will and/or revocable trust such as assets passing pursuant to beneficiary designation (like retirement accounts and irrevocable trusts). As a result, it is often a good idea to contact your estate planning attorney if contemplating a divorce or once a divorce is initiated to make sure that all consequences of the divorce from an estate planning perspective can be analyzed and dealt with.

Collins vs. Noltensmeier

In Collins,[1] Billy D. Collins named his longtime romantic partner as his power of attorney for property. The power of attorney specifically authorized Billy's agent to "change beneficiaries under any beneficiary form or contractual arrangement." Collins passed away on Jan. 23, 2011, but prior to his passing, Collins' agent under the property power of attorney changed the beneficiary designation of Collins' IRA to herself. The court held that an agent under a property power of attorney is not authorized to self-deal (i.e., exercise the agency in favor of himself or herself) unless expressly authorized to do so in the power of attorney. Additionally, where no express authorization is given, the self-dealing creates a rebuttable presumption of fraud that the agent can overcome if the agent can show that the agent exercised good faith and did not betray the confidences placed in her. In Collins, the agent was unable to rebut the presumption of fraud as the record contained no suggestion that the agent acted under the direction of Collins, that Collins received separate counsel relating to the decision to change the beneficiary of his IRA or even that Collins intended to change the beneficiary of his IRA. Therefore, summary judgment in favor of the plaintiffs was affirmed.

New York

2018 was not a particularly active year for legislative reform in this area but there are still some items of note:

- The existing prohibition against exonerating trustees of testamentary trusts from liability for failure to exercise reasonable care was extended to trustees of inter vivos trusts.
- Standby guardianships are now available not only to parents who are terminally ill but also to parents who are incarcerated.
- The authority to execute “do not resuscitate” and similar orders has been extended to nurse practitioners.
- For individuals dying on or after Jan. 1, 2019, the basic exclusion amount will be equal to the federal basic exclusion amount indexed annually but without regard to the passage of the TCJA (i.e., $5.74 million in 2019).
- New York source income of a nonresident individual has been expanded to include the gain or loss from the sale of co-ops. There will be no gift add-back for individuals dying on or after Jan. 1, 2019.
- The law that eliminated the requirement to create a qualifying domestic trust, if no federal estate tax return was required, is set to sunset on July 1, 2019, absent further legislative action.
- New York has decoupled from the federal treatment of alimony and itemized deductions, retaining the pre-TCJA treatment.

North Carolina

In addition to the Kaestner decision, discussed in part two of this article, North Carolina has also implemented important legislative changes impacting estate planning:

North Carolina Uniform Power of Attorney Act (S.L. 2017-153)

The North Carolina Uniform Power of Attorney Act became effective Jan. 1. The new legislation was codified as Chapter 32C of the North Carolina General Statutes. This act establishes a comprehensive legal framework for the creation and use of powers of attorney and provides specific guidance and protections for principals, agents and third parties. It also seeks to identify and remedy abuse of a power of attorney by an agent.

Among the most important changes under the new act are (1) a presumption of durability, (2) requiring acknowledgement of a power of attorney and (3) new agent anti-abuse requirements. A power of attorney created pursuant to the new Act will be presumed to be durable. Therefore, the incapacity of the principal shall only cause the power of attorney to terminate if the instrument contains explicit language to that effect. The new act also specifically requires that a power of attorney be acknowledged, which is not a requirement for validity under current North Carolina law. Finally, the act creates a two-tiered grant of authority system meant to curb abuse by agents acting under a power of attorney. Under this system, agents are generally prevented from dissipating the principal’s property or altering the principal’s estate plan without “specific” authority, which can only be granted through express language in the power of attorney itself. The new Section 32C-2-201(a) contains a list of actions for which such specific authority is required in the document.

Reformation and Correction of Wills and Trusts (S.L. 2017-152)

Effective as of Jan. 1, S.L. 2017-152 provides for judicial modification of wills and trusts under particular circumstances. The law first amended Chapter 31 by allowing courts to amend wills (1) to correct mistakes and (2) to achieve testator's tax objectives. Under the new provision, the court may reform the terms of a will to conform to the testator's contrary intent, but only if the original terms are ambiguous and such contrary intent is proved by clear and convincing evidence. The amended statute also gives the court the power to modify the terms of a will to achieve a testator's tax objectives, provided such modification is not contrary to the testator's probable intent.

The law also limits the situations in which a court may reform the terms of a trust, specifically amending Section 36C-4-415 of the N.C. Uniform Trust Code. Whereas the statute previously allowed the court to reform trust terms to conform to the settlor's intent even if the original terms are unambiguous, the amended provision will only allow for judicial reformation when the original terms are ambiguous. Similar to the new requirements for judicial correction of mistakes in wills, reformation of a trust will require clear and convincing evidence of the settlor's actual intent, along with proof that the original terms were affected by a mistake of fact or law, whether in expression or inducement.

Conclusion

We hope that this article helps you with your year-end estate and gift tax planning, and also provides you with some interesting ideas to consider for the future.

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[1] Collins vs. Noltensmeier, 2018 IL App (4th) 170443 (April 5, 2018)
