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Spousal Limited Access Trusts - Having your Cake and Eating it too

While the 2017 Tax Cut and Jobs Act doubled the lifetime gift and estate tax exemption (presently $11,400,000), the increase is only temporary. In 2026, the increased exemption is set to “sunset”, and the estate and gift tax exemption will revert to its pre-tax cut level. Because the increase is presumably only temporary, certain high net worth individuals have a limited window to reduce their taxable estates by making gifts that utilize all or most of their lifetime exemptions.[1]

In order for a transfer to qualify as a taxable gift (and removed from an individual’s estate for estate tax purposes), the individual making the gift has to surrender sufficient control of, and any beneficial interest in, the assets being gifted. An individual contemplating a gift that will use most or all of the increased exemption will therefore lose the ability to financially benefit from the asset being transferred. For some, the prospective loss of this financial benefit may be

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HHS Announces New Value-Based Primary Care Payment Model Designed For Smaller Practices

The Department of Health and Human Services (HHS) unveiled in late April a new value-based primary care payment model designed for smaller practices. The program is called Primary Care First (PCF). (Another new program, Direct Contracting, is intended for larger practices and other organizations experienced in dealing with financial risk such as accountable care organizations). Together, HHS expects these two new initiatives to ultimately serve more than 25% of the Medicare fee-for-service population.

Under PCF, primary care practices will receive a capitation style flat monthly payment per patient. Practices that specialize in high-needs patients, such as those with complex chronic needs and seriously ill populations, will receive higher payments. In addition, practices participating in the PCF program will be eligible to receive performance-based adjustments of up to 50% of the practice revenue, while also being responsible for downside risk of up to 10% of such revenue. The performance-based adjustments, which will be based on criteria such as controlling high blood pressure, managing diabetes and preventative screenings all of which keep patients out of the hospital, will be measured and paid on a quarterly basis.

The PCF program will commence January 1, 2020. It is a voluntary program and practices that wish to participate need to file applications which should be available this spring. Not all areas of the country will initially be eligible to participate. Local areas which will be eligible to enroll for 2020 include New Jersey and the North Hudson-Capital Region of New York, which includes, among others, Columbia, Dutchess, Orange, Sullivan and Ulster counties. Additional participating regions may be added for 2021 and beyond.

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too costly – they may need the income generated by the gifted assets to maintain their standard of living, or they may fear that they will not be as well off in the future and may later need the gifted asset.

For married individuals that are interested in using the increased exemption but have concerns about losing the financial benefit of the assets being transferred, a Spousal Limited Access Trust (SLAT) may provide a solution. Under the terms of a SLAT, the spouse of the creator of the trust is the primary beneficiary of the trust. Because the spouse is a beneficiary of the SLAT, the creator of the trust (the "Grantor") indirectly benefits from distributions made by the trust. Moreover, the assets that the Grantor transfers to the SLAT are taxable gifts that are removed from the Grantor's estate for estate tax purposes (and all future appreciation of the transferred assets will be outside of the Grantor's estate). A SLAT, therefore, is a middle road for clients that are interested in using their increased estate and gift exemption but are concerned about losing the financial benefit of the asset being transferred.

The terms of the SLAT may be specifically tailored to meet a client's objectives:

- If the client is concerned that the gift may adversely affect his or her standard of living, the SLAT can provide for liberal distributions to the spouse during his or her lifetime, such as mandatory distributions of the trust's income, a right to withdraw the greater of $5,000 or 5% of the trust's principal, and liberal principal invasion standards. The consequence of having principal liberally distributed or withdrawn from the SLAT, however, is that the amounts withdrawn from the trust are added to the spouse's estate and/or prevent the Grantor and his/her spouse from spending down the assets that remain in their respective estates.
- If the client is more concerned about the trust's assets being available only in the event of need – i.e., a rainy day fund – the dispositive provisions can be limited to the "sprinkling" of principal and income, in the trustee's discretion, for the spouse for his or her health, education, maintenance and support. These limited dispositive provisions will preserve the trust's principal, thereby maximizing the efficacy of the gift.

Although SLATs offer the benefits described above, they do have some drawbacks:

- First and perhaps most importantly, a Grantor of a SLAT can only indirectly benefit from distributions from the trust as long as his or her spouse is alive. When the spouse dies, his or her interest in the trust terminates, and the trust becomes payable to the successor or remainder beneficiaries. If the Grantor relied on distributions from the trust, or if the spouse dies prematurely, this will negatively affect the Grantor's standard of living.
- A SLAT is irrevocable and the terms of the trust cannot be changed. Therefore, if a married couple divorced, the trust beneficiary/spouse will continue to benefit from the trust.
- While each spouse may create a separate SLAT, the trusts must be sufficiently different from one another in order to avoid the reciprocal trust doctrine. As a result, one spouse may have more limited access to distributions from the trust.

An estate planning transaction involving a SLAT should therefore involve careful coordination among the client, the attorney, and the client's accountant and/or financial advisor in order to: (a) ensure that a SLAT is an appropriate vehicle for the client; and (b) determine the size and type of gift that should be made to the trust.

Despite these drawbacks, for clients interested in taking advantage of the increased exemption's limited window, a SLAT can be a great way to use the exemption without entirely surrendering the financial benefits of the asset being gifted. It's like having your cake and eating it too.

For more information on SLATs or the increased exemption, please contact us:

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[1] In November 2018, the IRS stated that in the event that the estate and gift tax exemption is lowered to pre-tax cut levels, it will not seek to collect gift or estate taxes for gifts made during this period.

Opportunity Zone Investments
Provide Potentially Attractive Tax Benefits

The Tax Cuts and Jobs Act, enacted in December 2017, includes a new temporary tax incentive intended to encourage investment in low income areas of the United States that are designated as "qualified opportunity zones" (QOZ).

To be eligible for the tax incentive, a taxpayer must:

- incur a capital gain on the sale or exchange of property to an unrelated person, and
- invest all or a portion of the realized gain in a "qualified opportunity fund" (QOF), generally within 180 days after the sale or exchange.

There are several potential tax benefits associated with QOF investments:

- tax on the gain may be deferred until the QOF is sold (or until 2026, if earlier); [1]
- 10% of the deferred gain is permanently excluded if the QOF is held for at least for at least 5 years;
- 15% (10% + 5%) of the deferred gain is permanently excluded if the QOF is held for at least 7 years; and
- tax on the appreciation of the QOF is permanently excluded if the QOF is held for at least 10 years.

These rules are most readily understood through a simple example. Assume that Ed purchased stock in VIP Corp. years ago for $1.5 million. Ed sells all of his VIP stock in February 2019 for $2.5 million cash, realizing a capital gain of $1 million. Ed invests the $1 million in a QOF within 180 days of selling the VIP stock. Ed has use of the $1.5 million recovery of basis immediately while deferring tax on the $1 million that he invests in the QOF. Assume under all circumstances that Ed sells the QOF investment for $4 million. Depending on when Ed sells the QOF, he derives some or all of the tax benefits described above.

Ed sells QOF in:	Recognized gain:	Tax benefit:
March 2023 (QOF held < 5 years)	$4 million in 2023	Deferral of tax on $4 million gain
March 2024 (QOF held ≥ 5 years but < 7 years)	$3.9 million in 2024 $4,000,000 less $100,000 ($1,000,000 x 10%)	Deferral of tax on $3.9 million of gain Elimination of tax on $100,000 of gain
March 2026 (QOF held ≥ 7 years but < 10 years)	$3.85 million in 2026 $4,000,000 less $150,000 ($1,000,000 deferred gain x 15%)	Deferral of tax on $3.85 million of gain Elimination of tax on $150,000 of gain
March 2027 (QOF held ≥ 7 years but < 10 years and sale occurs after December 31, 2026)	$850,000 in 2026 $1,000,000 deferred gain reduced by $150,000 (15% of $1,000,000) $3 million in 2027 $4,000,000 less $1,000,000 basis	Deferral of tax on $3.85 million of gain Elimination of tax on $150,000 of gain
March 2029 (QOF held ≥ 10 years)	$850,000 in 2026 $1,000,000 deferred gain reduced by $150,000 (15% of $1,000,000)	Deferral of tax on $1 million of gain Elimination of tax on $3 million of gain

[1] If the fund is not sold by December 31, 2026, the taxpayer must include the deferred gain in 2026 income. Therefore, one potential drawback of the program can be tax without cash, also known as "dry income" or "phantom income."

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Very generally, a QOF is an entity that satisfies certain rules concerning investment in businesses that operate in a QOZ. For example, a real estate investment fund that invests in real estate located in a QOZ may be structured as a QOF.

QOZs have already been designated for purposes of the program. A list and map of designated QOZs by state, county and census tract can be found here: https://www.cdfifund.gov/pages/opportunity-zones.aspx.

The Opportunity Zone program offers potentially significant tax benefits to investors. Of course, investors must also evaluate potential QOF investments from an overall economic perspective. It is possible that if perceived tax benefits drive many investors to QOFs in a particular geographic area, property prices in that area may become artificially inflated, thereby reducing or perhaps eliminating those potential tax benefits.

If you are considering a QOF investment, please feel free to contact Mark Hamilton, Esq. (mhamilton@dmlawyers.com)

Welcome Expansion of IRS Retirement Plans Correction Program

The Internal Revenue Service's Employee Plans Compliance Resolution System (EPCRS) provides a comprehensive system to correct operational and documentary compliance failures of qualified retirement plans. One of the goals of EPCRS is to encourage plan sponsors to monitor compliance and voluntarily correct instances of noncompliance. Under EPCRS, small failures can be self-corrected by the plan sponsor without making a submission to the IRS. More significant failures can only be corrected by making a submission to the IRS, outlining the mistake and the proposed correction. Newly-issued IRS Revenue Procedure 2019-19 governing EPCRS provides a welcome expansion of plan failures that can be self-corrected by plan sponsors without the need to go to the IRS for approval.

Here are some plan failures that can now be self-corrected:

- A Plan Sponsor can self-correct certain plan document failures, other than an initial failure to adopt a qualified plan. The plan must have a favorable IRS determination or opinion letter, and correction must occur no later than the end of the second plan year following the plan year of the failure.

- A plan sponsor can self-correct an operational failure by amending its plan to conform the terms of the plan to the plan's prior operation if the following conditions are satisfied: (a) the plan amendment results in an increase of a benefit, right, or feature, (b) the increase is available to all eligible employees, and (c) the increase in the benefit, right or feature is otherwise permitted under the tax code and satisfies the general correction principles of EPCRS.

  Example: Although its plan does not permit after-tax contributions, the plan sponsor allows participants to make after-tax contributions in 2018. The plan sponsor discovers this operational failure in 2019. In 2019, the plan sponsor can self-correct by amending the plan, retroactive to 2018, to permit after-tax contributions.

- EPCRS generally allows a defaulted plan loan to be corrected by either or both of: (a) a single-sum corrective payment or (b) re-amortizing the outstanding balance of the loan over the remaining payment schedule. Previously such correction required a submission to the IRS.

- A plan sponsor may now report a defaulted loan on Form 1099-R for the year in which the loan is defaulted, instead of the year in which the failure occurred without having to request such relief fom the IRS. This change allows a defaulting plan participant to avoid having to go back and amend a previously-filed tax return to include the defaulted loan amount.

- A plan sponsor may correct a failure to obtain necessary spousal consent for a plan loan by notifying the affected participant and spouse, so that the spouse can provide spousal consent. If spousal consent is not obtained, the failure must be corrected through a submission to the IRS.

- A plan sponsor that allows a participant to take a number of plan loans that exceeds the number of loans permitted under the plan may self-correct by retroactively amending the plan to permit the number of plan loans that were previously made available, provided that excess number of loans was available to either all participants or to one or more non-highly compensated employees.

These changes to EPCRS are effective immediately.

We would be pleased to assist you with any retirement plan issues that you may have. Please feel free to contact us.

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