



NORTHERN
TRUST

Top Planning Ideas Today

(COVID-19, CONGRESS & CHARITY)

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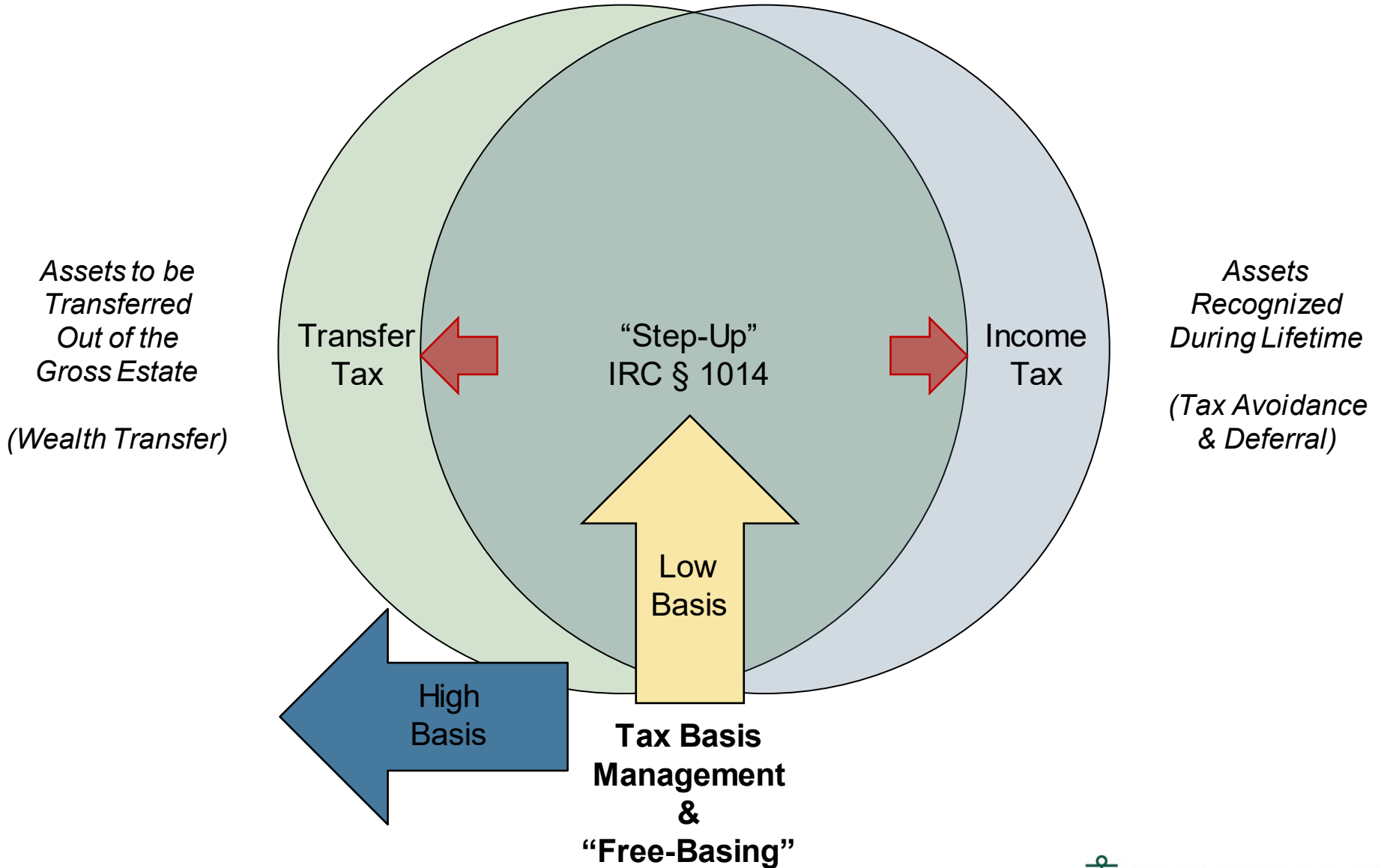
October 2022



*Expiring Tax Provisions,
Enacted Tax Acts,
&
Potential Future Legislation*

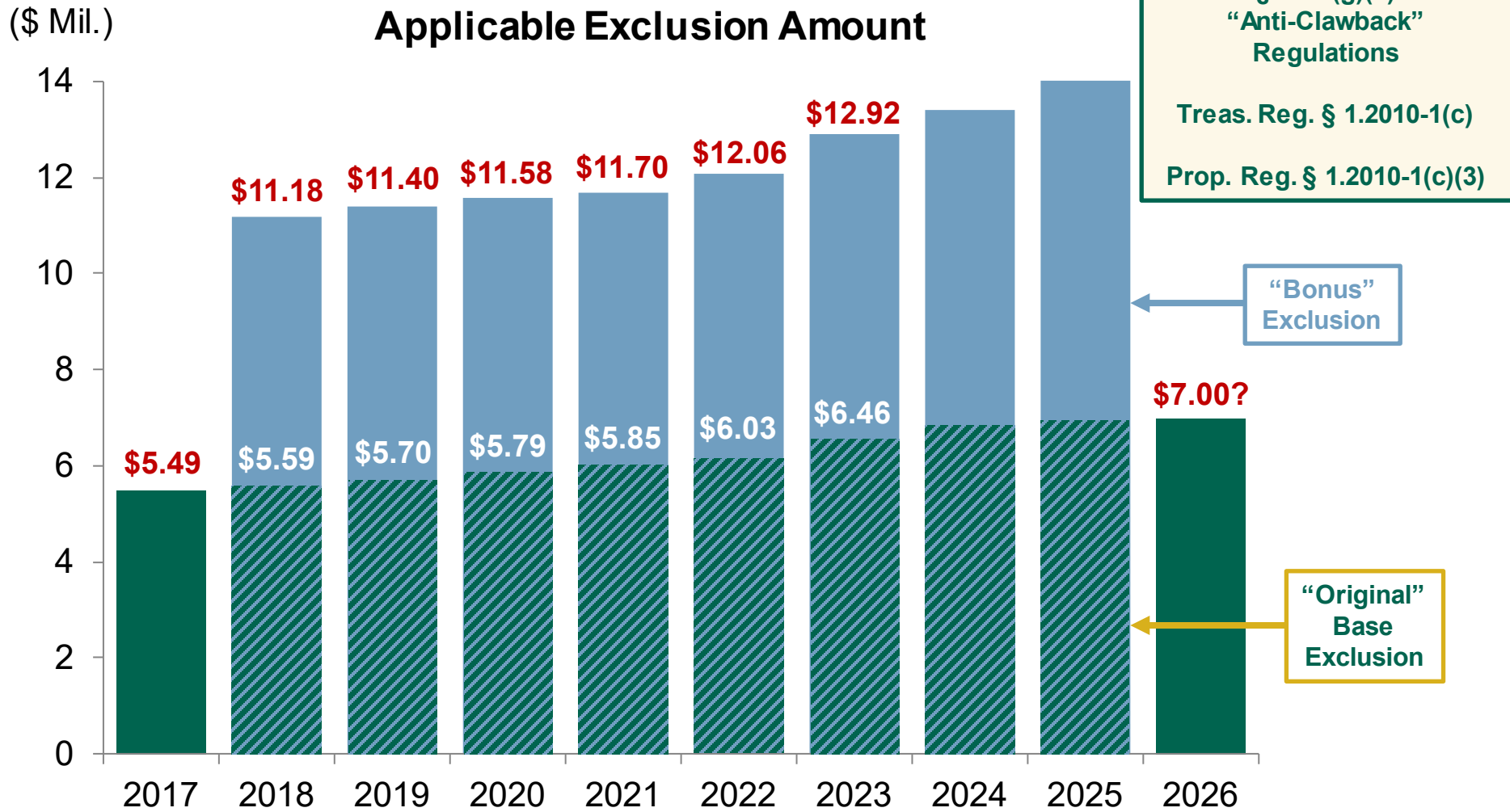


The Temporary TCJA Transfer Tax Landscape: Venn Diagram





2012 All Over Again?





Build It Up... Back Down... Better? Income Tax, Pt. 1

	BBB (H.R. 5376)	2023 Greenbook
Rates for Individuals, Trusts & Estates	<ul style="list-style-type: none"> • 5% surcharge on MAGI >\$10 Mil./ \$200K T&E • § 642(c) deduction allowed in MAGI • 3% on MAGI >\$25 Mil./\$500K T&E • SALT cap of \$80,000 	<ul style="list-style-type: none"> • 39.6% (\$400K Single/\$450K Joint)
Long-Term Capital Gains Rates		<ul style="list-style-type: none"> • 37%/39.6% > \$1 million taxable income • Includes qualified dividends • Eff. date of enactment
Recognition Events		<ul style="list-style-type: none"> • Gift or transfer on death is a recognition event (deductible for estate tax purposes) • Trust, partnership, or other non-corporate entity every 90 years (since 12/31/1939 = first recognition would occur 12/31/2030) • Includes transfer to or from trusts and partnerships (if gift) • Exceptions for transfers to U.S. spouses and charity (partially for split-interest trusts), tangible personal property (excluding collectibles) • \$5 mil. exclusion (portable & indexed after 2022) + Base Exclusion Amount • \$250K exclusion on personal residences would be applicable • QSBS exclusion would be applicable • Election to defer recognition on family-owned and –operated businesses until sold or no longer family-owned and –operated. • 15-year fixed rate payment plan on transfers at death (other than liquid assets)
“Billionaire” Tax		<ul style="list-style-type: none"> • Minimum 20% tax on total income, including unrealized capital gain, for taxpayers with wealth greater than \$100 Mil. • Minimum 20% tax would be fully phased-in for taxpayers with wealth greater than \$200 Mil. • Elect to pay first year in 9 equal, annual installments, 5 annual installments in subsequent years • Taxpayers above \$100 Mil. required to report to IRS on annual basis • Non-tradeable assets would be valued at the greater of adjusted cost basis, last valuation event, or other methods approved by IRS with adjustments at conservative floating return in between valuations • “Illiquid” taxpayers (tradeable assets less than 20% of wealth) may elect to include unrealized gain of only tradeable assets (subject to deferral charge not to exceed 10% of unrealized gains)



Build It Up... Back Down... Better? Income Tax, Pt. 2

	BBB (H.R. 5376)	2023 Greenbook
IRAs & Qualified Plans	<ul style="list-style-type: none"> Prohibition on Roth conversions with \$400/\$450K AGI—Eff. 1/1/32 Prohibition on Roth conversion from qualified plans, unless taxable Prohibition of contributions to large qualified accounts (\$10 Mil.)-\$400K/\$450K AGI Mandatory distributions (50%) from mega-IRAs (\$10-\$20 Mil.) then 100% (\$20+)-\$400K/\$450K ATI 	
Corporate Taxes	<ul style="list-style-type: none"> 15% (alternative minimum tax) on corporations with adjusted financial income > \$1 billion 1% tax on share repurchase of publicly-traded companies 	<ul style="list-style-type: none"> 28%
Net Investment Income Tax	<ul style="list-style-type: none"> NIT on all passthrough business income of trusts, estates, and individuals with MAGI >\$400K 	<div style="border: 1px solid black; padding: 5px; display: inline-block;"> <p>Inflation Reduction Act Aug. 16, 2022</p> </div>
QSBS	<ul style="list-style-type: none"> 100% & 75% exclusion disallowed for individuals with AGI of \$400K or more and trusts & estates—Eff. sales after 9/13/21 	
Carried Interest		<ul style="list-style-type: none"> Income from “Investment Services Partnership Interest” is treated as ordinary income if taxable income > \$400K (§ 1061 still applicable for partners < \$400K in taxable income)
Basis Shifting		<ul style="list-style-type: none"> Prohibit any partner in the partnership that is related to the distributee partner from benefiting from a basis increase until distributee partner has a taxable sale of the property
Like-Kind Exchanges		<ul style="list-style-type: none"> Gains from like-kind exchanges in excess of \$500K (\$1 Mil. joint) would be recognized
Recapture		<ul style="list-style-type: none"> § 1250 recapture treated as ordinary income to the extent of depreciation deductions taken after effective date for taxpayers with AGI of \$400K or above



Build It Up... Back Down... Better? Transfer Tax

	BBB (H.R. 5376)	2023 Greenbook
GRATs		<ul style="list-style-type: none"> • Term of at least 10 years and not more than life expectancy of the grantor plus 10 years • No decreasing annuities • Taxable gift equal to the greater of 25% or \$500K • Eff. trusts created on or after enactment
Grantor Trusts		<ul style="list-style-type: none"> • Transfer of an asset for consideration between grantor trust and its deemed owner as one that is regarded for income tax purposes (recognizing gain), including sales as well as the satisfaction of an obligation (i.e., annuity or unitrust payment)—Eff. all transactions on or after enactment • Payment of income tax on grantor trust income is a gift on 12/31 of that year, immediately before death, or owner's renunciation of reimbursement right—Eff. all trusts created on or after enactment
Promissory Notes		<ul style="list-style-type: none"> • Promissory notes with sufficient interest to avoid income and gift tax consequences must be valued for transfer tax purposes by limiting the discount rate to the greater of the actual rate of interest, or the applicable minimum interest rate for the remaining term of the note on date of death—Eff. valuation dates or after introduction
GST Tax		<ul style="list-style-type: none"> • GST Exemption applies only to: (1) direct skips and taxable distributions to beneficiaries no more than two generations below the transferor, and to younger generation beneficiaries who were alive at the time of the creation of the trust; and (2) taxable terminations while any person described above is a beneficiary of the trust • No "reset" of generation assignment • Eff. on or after enactment, but pre-enactment trust treated as created on date of enactment
Conservation Easements		<ul style="list-style-type: none"> • Qualified conservation deduction by a partnership is limited to 250% of each relevant partner's basis in the partnership, unless a 3-year holding requirement is satisfied • Limitation does not apply to pass-through entities where substantially all of the interests are held, directly or indirectly, by an individual and family members • Eff. contributions after 12/23/16 (12/31/18 for certified historic structures)
Special Use Valuation		<ul style="list-style-type: none"> • Increase maximum reduction on "qualified real property" to \$11.7 Mil. (from \$1.23 Mil. in 2022) • Eff. decedents dying on or after enactment
Trust Reporting		<ul style="list-style-type: none"> • Trusts administered in the U.S. will be required to report annually with information including name, address, and TIN of each trustee and grantor, and general information regarding the nature and estimated total value of trust's assets • Each trust with total value > \$300K or gross income > \$10K



Build It Up... Back Down... Better? International Planning

	BBB (H.R. 5376)	2023 Greenbook
Section 250 Deduction	<ul style="list-style-type: none"> Deduction for global intangible low-tax income (GILTI) reduced from 50% to 28.5% and foreign-derived intangible income (FDII) reduced to from 37.5% to 24.8% 	<ul style="list-style-type: none"> Increase C corporation rate to 28% with GILTI deduction constant under a BBB Act baseline (effective 20% applied on country-by-country basis)
CFCs	<ul style="list-style-type: none"> Repeal of 1-month deferral of taxable year of CFCs (majority U.S. shareholder); Eff. taxable years after 11/20/22 Deduction under § 245A (deduction for foreign-source dividend) limited to CFCs (not 10-percent owned foreign corporations) Restore § 958(b)(4) (stock owned by foreign person not attributed downward to U.S. person) New § 951B added applying subpart F to foreign controlled U.S. shareholder (U.S. shareholder owning more than 50% of foreign corporation and downward attribution from foreign persons apply) 	
Foreign Tax Credit	<ul style="list-style-type: none"> Any amount paid by a dual capacity taxpayer to a foreign country for any period is not considered a tax (a) if such foreign country does not impose a generally applicable income tax, or (b) to the extent such amount exceeds the amount which would be paid by the taxpayer under generally applicable income tax imposed by such country if the taxpayer were not a dual capacity taxpayer Foreign tax credit limitations applied on a country-by-country basis (on a taxable unit basis) 	
GILTI	<ul style="list-style-type: none"> Country-by-country application of GILTI on a CFC taxable unit basis Reduction of net deemed tangible income return from 10% to 5% (except property located in a U.S. possession) Elimination of exception for foreign oil and gas extraction income from CFC tested income Increases deemed foreign taxes paid from 80% to 95% (100% for foreign income taxes paid to a U.S. possession) 	
Other Provisions	<ul style="list-style-type: none"> Base erosion and anti-abuse tax (BEAT) applicable to all taxpayers with gross receipts greater than \$500 million making payments to foreign related parties (no longer limited to corporations with a 3% base erosion percentage or higher); Eff. taxable years after 12/31/23 	<ul style="list-style-type: none"> Repeal BEAT. Replace with undertaxed profit rule (UTPR). Reporting groups that have global revenue of \$850+ million, UTPR domestic corporations and branches would be disallowed U.S. tax deductions by reference to low-taxed income of foreign entities. Effective rate of at least 15% in the foreign entities; Eff. taxable years after 12/31/23 Expand retroactive QEF election for PFIC shareholders

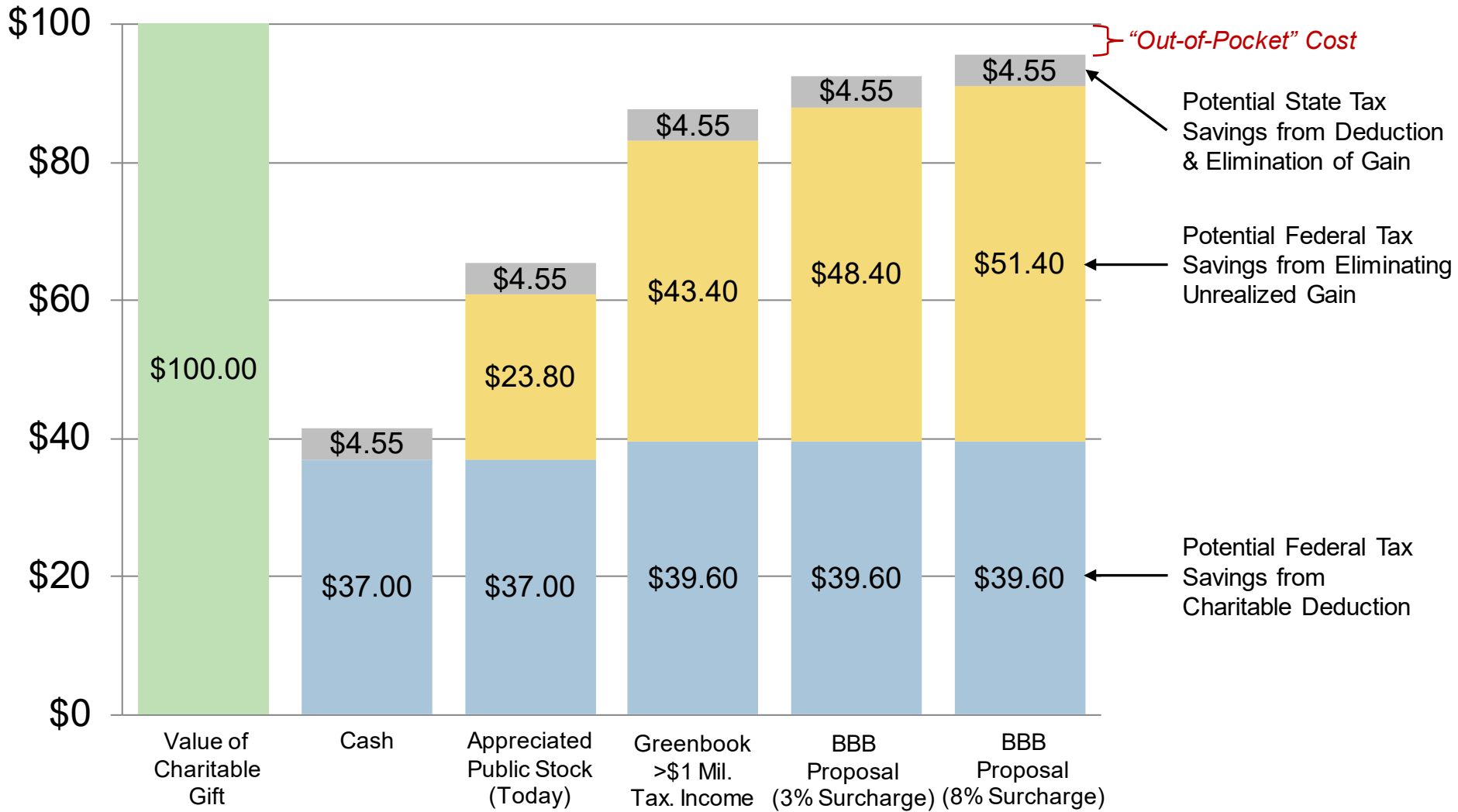


Build It Up... Back Down... Better? Focus on Charity

	BBB (H.R. 5376)	2023 Greenbook
Private Foundations & Donor Advised Funds		<ul style="list-style-type: none"> • Distributions by a private foundation to a donor advised fund is not a qualifying distribution • Exception if (a) DAF funds are expended as a qualifying distribution by the end of the following year, and (b) the private foundation maintains adequate records showing that the DAF made such timely qualifying distribution
Conservation Easements		<ul style="list-style-type: none"> • Qualified conservation deduction by a partnership is limited to 250% of each relevant partner's basis in the partnership, unless a 3-year holding requirement is satisfied • Limitation does not apply to pass-through entities where substantially all of the interests are held, directly or indirectly, by an individual and family members • Eff. contributions after 12/23/16 (12/31/18 for certified historic structures)
Surcharge on Trusts & Estates	<ul style="list-style-type: none"> • 5% surcharge on MAGI > \$200K Non-Grantor Trusts and Estates • 3% on MAGI > \$500K Non-Grantor Trusts and Estates • § 642(c) deduction allowed in MAGI 	
Recognition Events		<ul style="list-style-type: none"> • Gift or transfer on death is a recognition event • Exceptions for transfers charity and the charitable portion of split-interest trusts



In the Future, Gifts to Charity May Cost Even Less...



Assumes highest Federal ordinary income tax rate of 37% or 39.6%, net investment income tax of 3.8%, capital gain tax rates of 20.0% or 39.6%, and estimated tax rate for state income taxes of 4.55% (combined state income tax savings on the charitable deduction and savings on unrealized tax). Assumes full use of the charitable deduction without any reduction or inability to use the deduction.



If some portions of BBB Passes...

*Income
Tax
Considerations*



Surcharges Are More Than Another Marginal Tax Bracket

STCG/ Ordinary Rate	Single	Joint	Trusts & Estates
10%	\$0 to \$10,275 Taxable Income	\$0 to \$20,550 Taxable Income	\$0 to \$2,750 Taxable Income
12%	\$10,275 to \$41,775	\$20,550 to \$83,550	
22%	\$41,775 to \$89,075	\$83,550 to \$178,150	
24%	\$89,075 to \$170,050	\$178,150 to \$340,100	\$2,750 to \$9,850
32%	\$170,050 to \$215,950	\$340,100 to \$431,900	
35%	\$215,950 to \$539,900	\$431,900 to \$647,850	\$9,850 to \$13,450
37%	\$539,900+	\$647,850+	\$13,450+
(+5%) 43%	\$10,000,000+ MAGI	\$10,000,000+ MAGI	\$200,000+ MAGI
(+3%) 46%	\$25,000,000+ MAGI	\$25,000,000+ MAGI	\$500,000+ MAGI

LTCG/QD Rate with NIIT	Single	Joint	Trusts & Estates
0%	\$0 to \$41,675 Taxable Income	\$0 to \$83,350 Taxable Income	\$0 to \$2,800 Taxable Income
15%	\$41,675 to \$200,000 <i>MAGI</i>	\$83,350 to \$250,000 <i>MAGI</i>	\$2,800 to \$13,700
18.8%	\$200,000 <i>MAGI</i> to \$459,750	\$250,000 <i>MAGI</i> to \$517,200	
23.8%	\$459,750+	\$517,200+	\$13,700 + <i>MAGI</i>
(+5%) 28.8%	\$10,000,000+ MAGI	\$10,000,000+ MAGI	\$200,000+ MAGI
(+3%) 31.8%	\$25,000,000+ MAGI	\$25,000,000+ MAGI	\$500,000+ MAGI



Tax Policy: Non-Grantor (Taxable) Trusts Are Evil

*Highest Bracket
@
\$500,000 of "Income"*

**Non-Grantor
Trust**

**Non-Grantor
Trust**

**Individual
Beneficiary**

**Non-Grantor
Trust**

**Individual
Beneficiary**

**Non-Grantor
Trust**

**Individual
Beneficiary**

**Individual
Beneficiary**

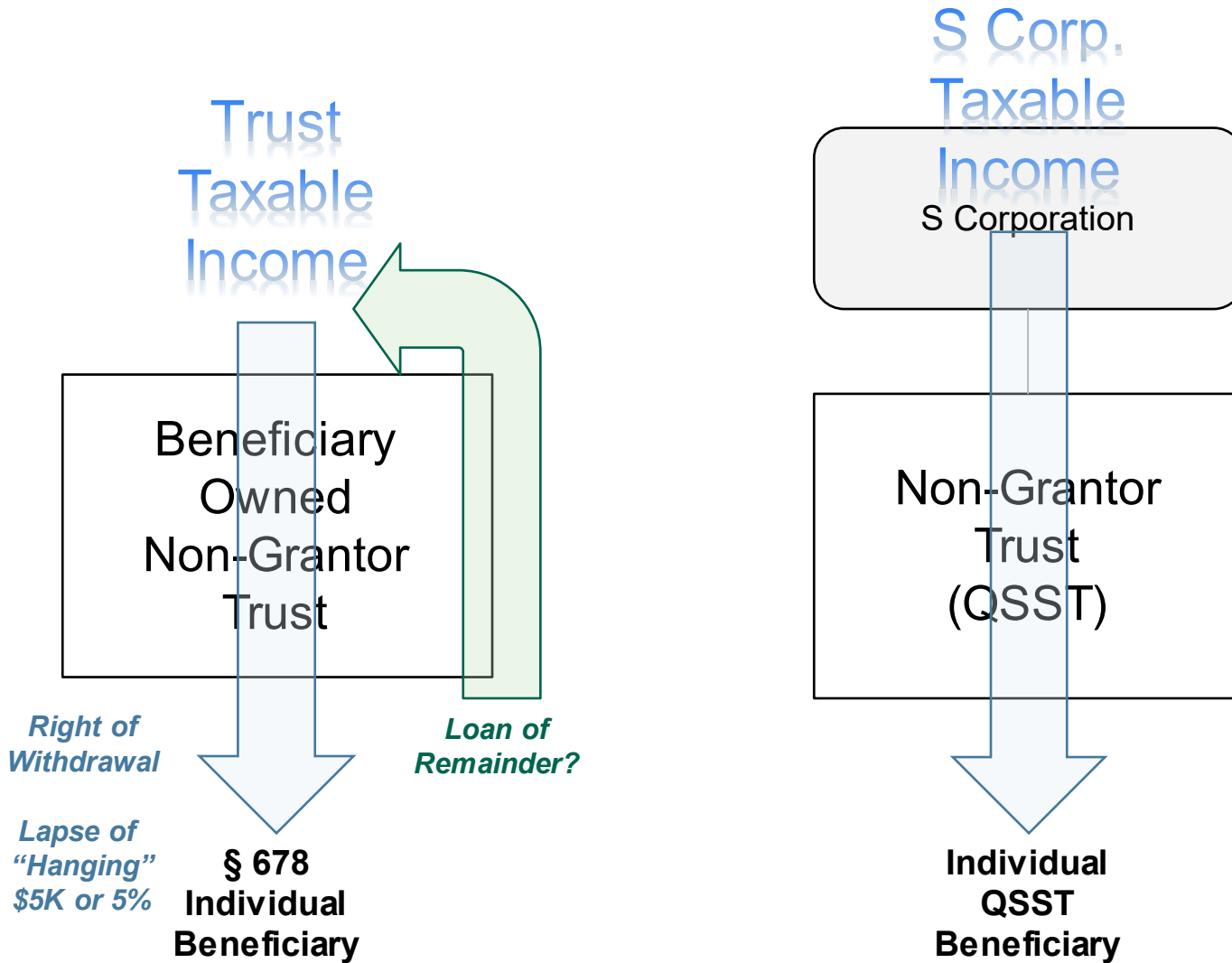
**Individual
Beneficiary**

**Individual
Beneficiary**

Highest Bracket @ \$25,000,000 Mil. of "Income" Each

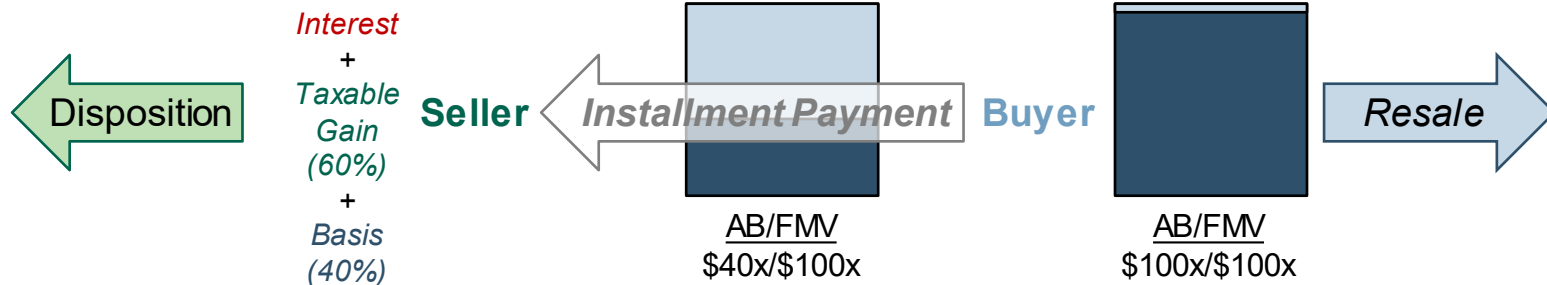


Other Options to Have Income Taxed to Individual Beneficiary





Taxable Installment Obligations



■ Death of Seller

- Installment note is IRD
- Estate distribution of note to the obligor is a taxable disposition

■ Taxable Dispositions

- Sale or exchange
- Gift, contribution to trust, and distribution to beneficiary

■ Not a Taxable Disposition

- Transfers between grantor and grantor trust
- Transfer to former spouse incident to divorce
- § 721 contributions and § 731 distributions (partnerships)
- § 351 contributions and § 361 distributions (corporations)

■ Taxation

- Gross profit percentage (profit divided by total contract price) determines gain
- Minimum interest at AFR
- Installment method by default (may elect out by due date of income tax return)
- Can have variable principal payments or interest only
- Only applies to gain, not loss

■ Installment Method Not Allowed

- Dealer Dispositions
- Inventory Sales
- Marketable Securities
- Depreciable Property Sales to Related Persons
- Portion of Gain Attributable to Recapture

■ Resales by Related Party

- Second disposition within 2 years of the first disposition
- Amount realized on second disposition treated as payment to original seller

■ Tolling of 2-Year Period

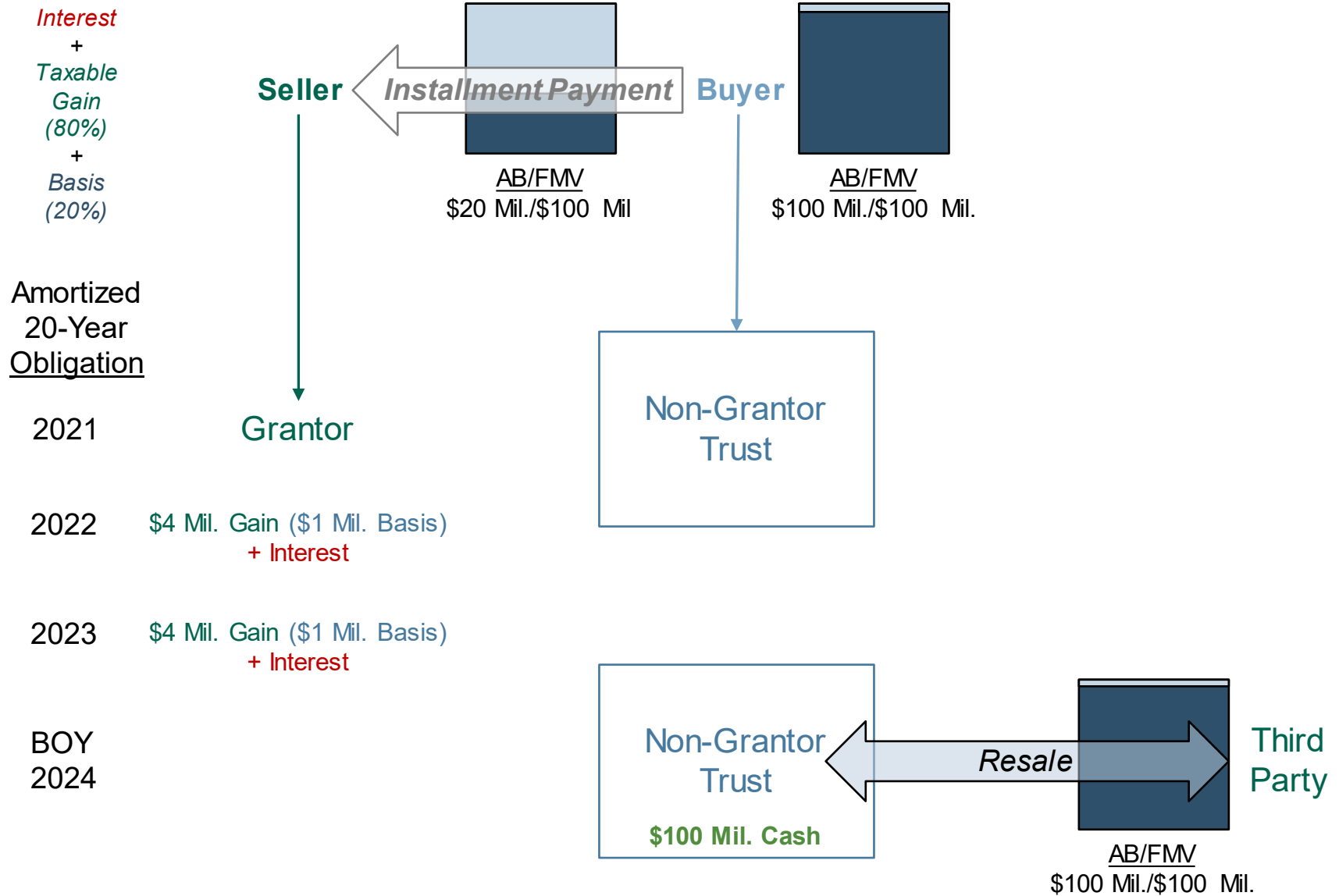
- Related party's risk of loss is substantially diminished
- Put, short, right to acquire, or other transaction

■ Second Disposition

- Sale, exchange, **gift**, or cancellation of installment obligation
- Does NOT include any transfer after earlier of death of original seller or related party



Capturing Basis and “Rushing” a Subsequent Sale





***Charitable Remainder Trusts
Today and Tomorrow***



Deferring and Stretching Out Gain Over Multiple Tax Years

TAXABLE SALE

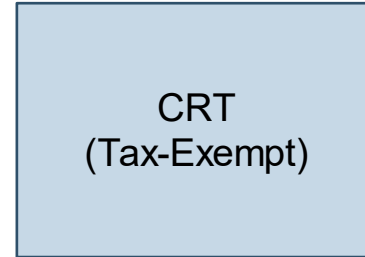


zero basis

Effective Federal Rate

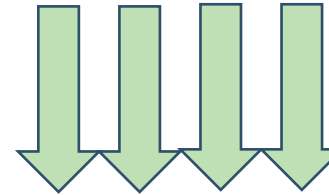
- \$1 Mil. Gain: 19.0%
- \$5 Mil. Gain: 22.8%
- \$10 Mil. Gain: 23.3%
- \$25 Mil. Gain: 26.5%
- \$50 Mil. Gain: 27.7%

Taxpayer
(or Trust)



Charity

Tax
Deduction



Taxpayer
(or Trust)

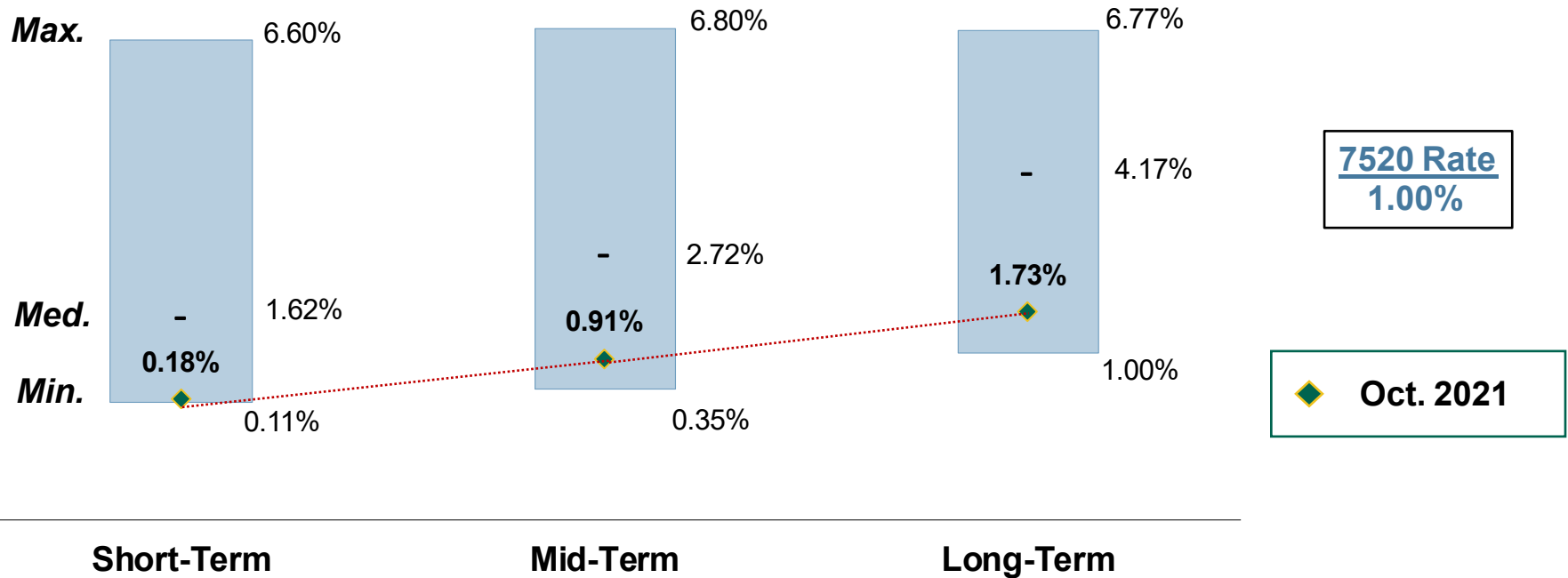
- Tier: Character of Income
- 1(a): Ordinary
 - 1(b): Qualified Dividend
 - 2(a): Short-Term Gain
 - 2(b): Long-Term Gain
 - 3: Tax-Exempt
 - 4: Basis

LTCG/QD	Joint
0%	\$0 to \$83,350 Taxable Income
15%	\$83,350 to \$250,000 <i>MAGI</i>
18.8%	\$250,000 <i>MAGI</i> to \$517,200
23.8%	\$517,200+
(+5%) 28.8%	\$10,000,000+ MAGI
(+3%) 31.8%	\$25,000,000+ MAGI



The Rates in October 2021

Applicable Federal Rates Jan. 1998 – Oct. 2021

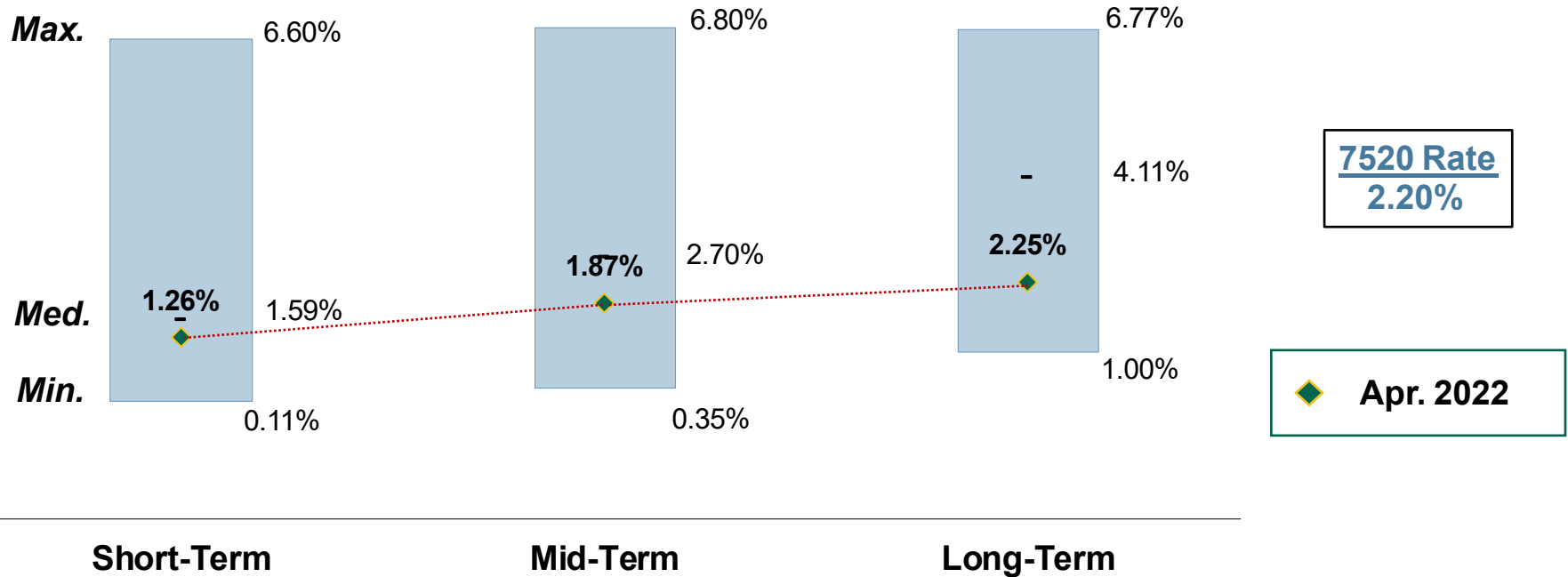


- Refinancing may require consideration.
- Consider prepaying debt and replace with new promissory note.
- Remember term of note should not be longer than life expectancy of holder.



The Rates in April 2022

Applicable Federal Rates Jan. 1998 – Apr. 2022



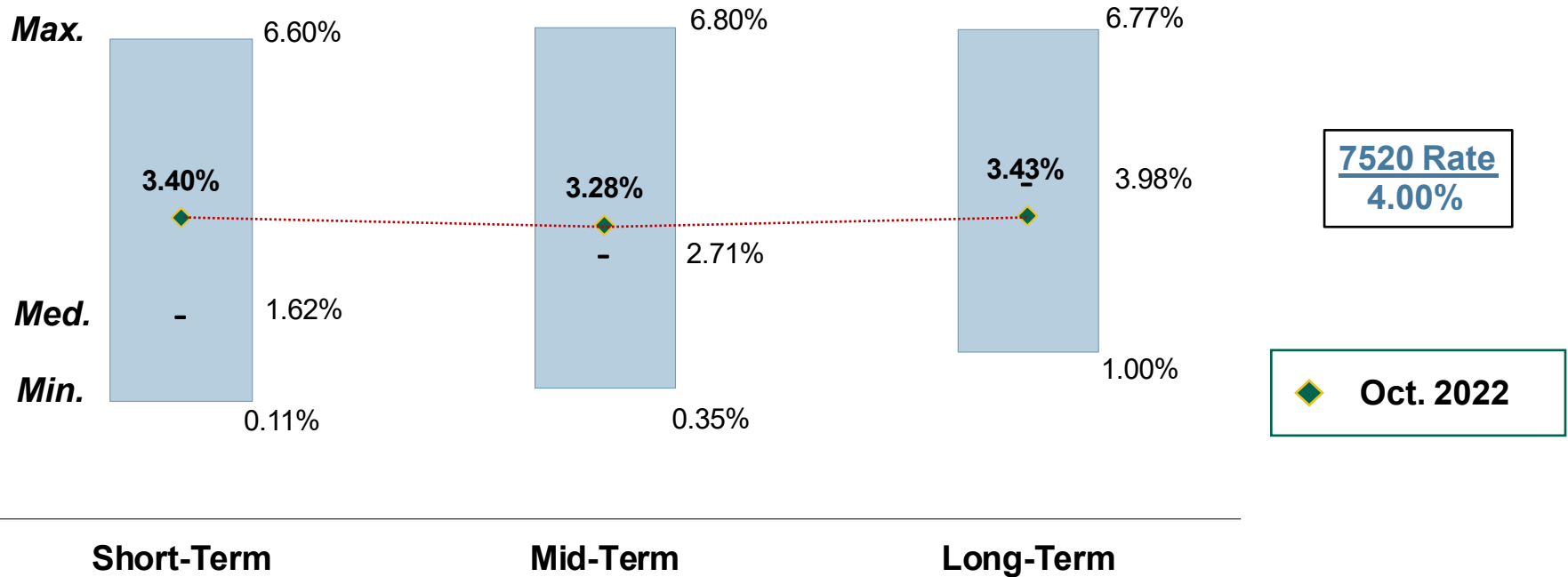
- Refinancing may require consideration.
- Consider prepaying debt and replace with new promissory note.
- Remember term of note should not be longer than life expectancy of holder.



Today AFRs Are No Longer Low, Especially Short-Term

Applicable Federal Rates

Jan. 1998 – Oct. 2022



- Refinancing may require consideration.
- Consider prepaying debt and replace with new promissory note.
- Remember term of note should not be longer than life expectancy of holder.



Today: CRUTs Up, CRATs Down

Maximum Allowable Lifetime Unitrust Percentage

Age	4.0% 7520 Rate	6.0% 7520 Rate
40	7.197%	7.336%
50	10.033%	10.226%
60	15.500%	15.798%
70	26.279%	26.785%
80	49.799%	50.000%

Maximum Allowable Lifetime Annuity Percentage

Age	4.0% 7520 Rate	6.0% 7520 Rate
40	---	6.238%
50	---	6.441%
60	5.289%	6.839%
70	6.124%	7.569%
80	7.271%	9.235%

Rev. Proc. 2016-42: Savings language to be exempt from exhaustion test.
If charity value falls below 10%, early termination as “qualified contingency” under § 664(f).



The End of Stretch IRAs...

■ SECURE Act

- Eliminates stretch IRAs for all non-spouse beneficiaries, requiring payout within 10 years

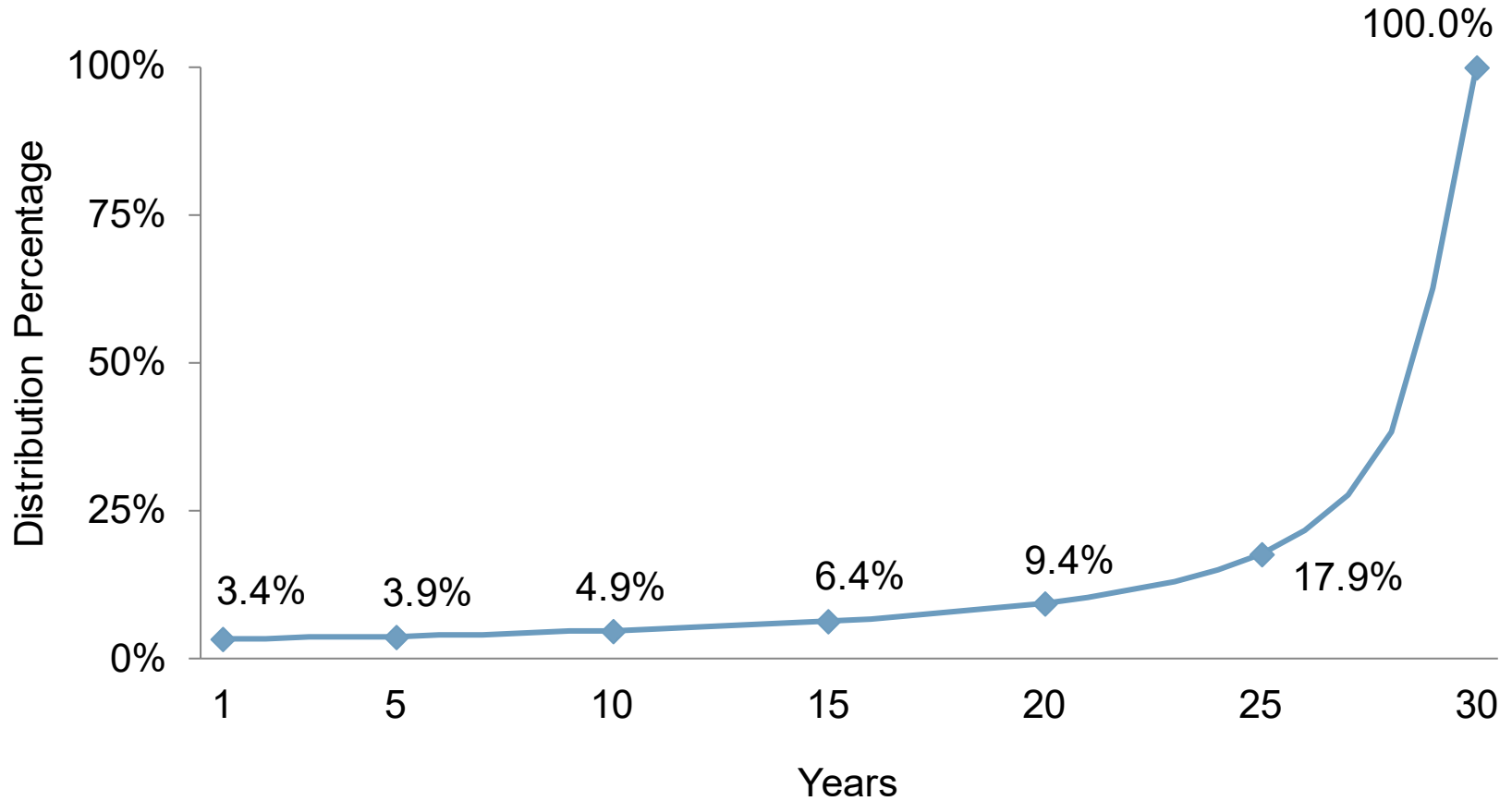
■ Planning implications for IRAs and Charity

- Repeal of stretch-out greatly increases the appeal of gifting IRAs directly to charity
- More clients should consider CRTs for the “stretch-out-like” impact



Required Minimum Distributions: Old Law

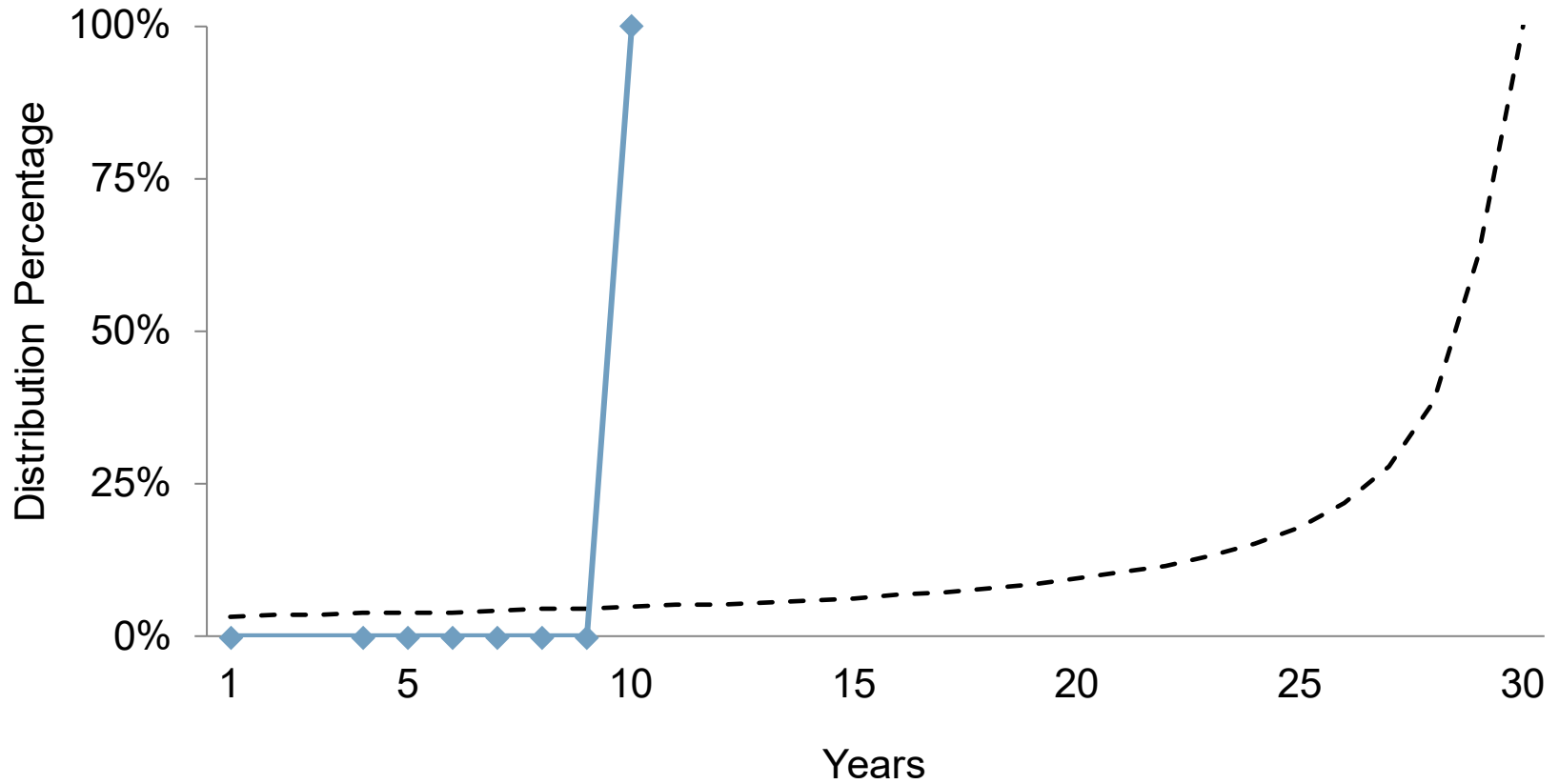
55-Year-Old Non-Spouse Beneficiary Stretch Over Life Expectancy





SECURE Act Ends Stretch IRAs

55-Year-Old Non-Spouse Beneficiary Stretch Limited to 10 Years*





IRA Case Study Assumptions

- Non-spouse beneficiary is 55 years old (\$10 million IRA)

- IRA → Beneficiary
 - Federal estate tax liability on IRA is \$4 million and is assumed to be paid from non-IRA assets
 - Beneficiary is entitled to \$4 million IRC 691(c) income tax deduction on IRA distributions*

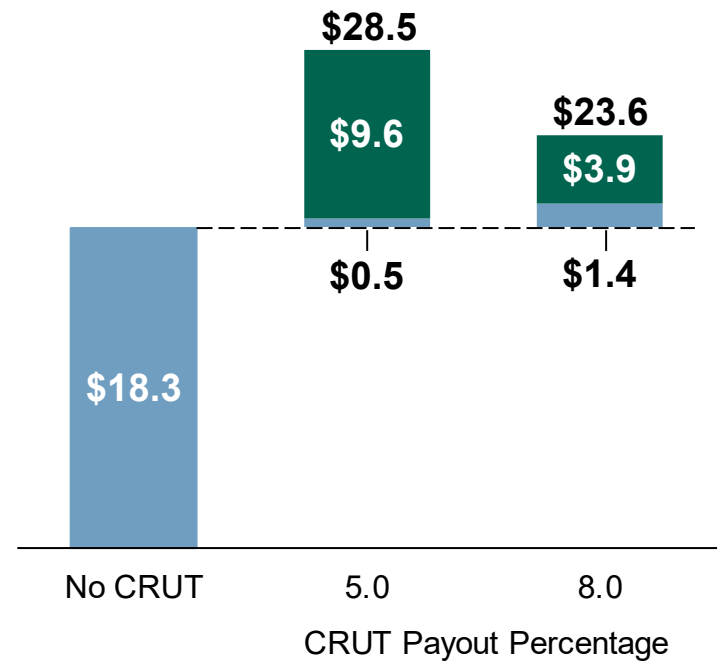
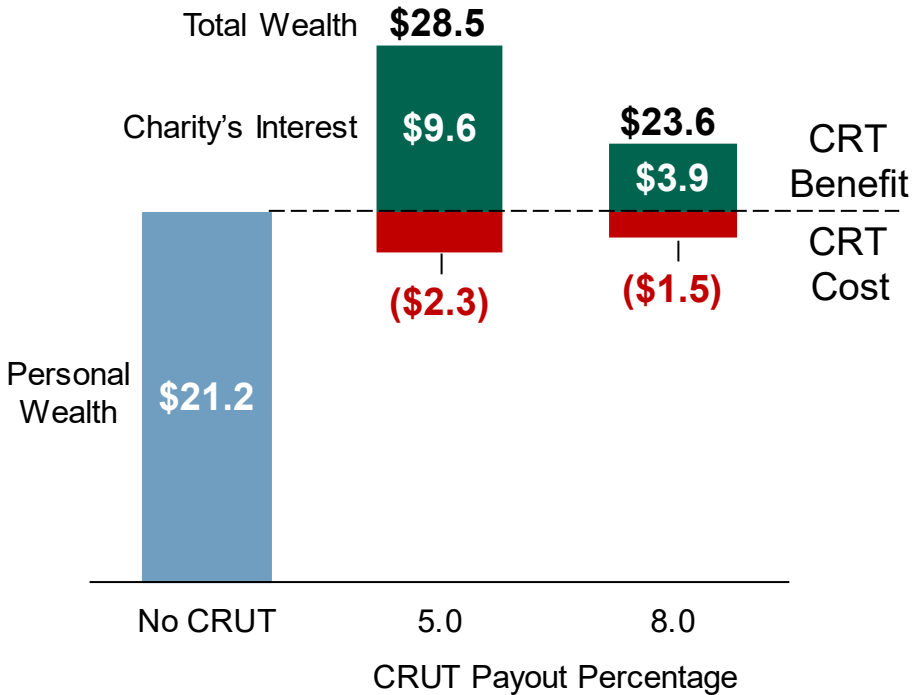
- IRA → CRUT
 - Federal estate tax liability calculated on present value of non-spouse beneficiary's life interest in CRT**
 - IRC 691(c) deduction is netted against Tier 1 accounting income from IRA distributions to the CRT
 - Estate tax savings is credited to non-spouse beneficiary's taxable account
 - 5.0% CRUT: Estate tax = \$2.7 million, Tax savings = \$1.3 million
 - 8.0% CRUT: Estate tax = \$3.3 million, Tax savings = \$0.7 million



Median Wealth—Year 30: Beneficiary IRA vs. CRUT

Stretch Over Beneficiary Life Expectancy* (US\$ Millions, Real)

Stretch Limited to 10 Years* (US\$ Millions, Real)



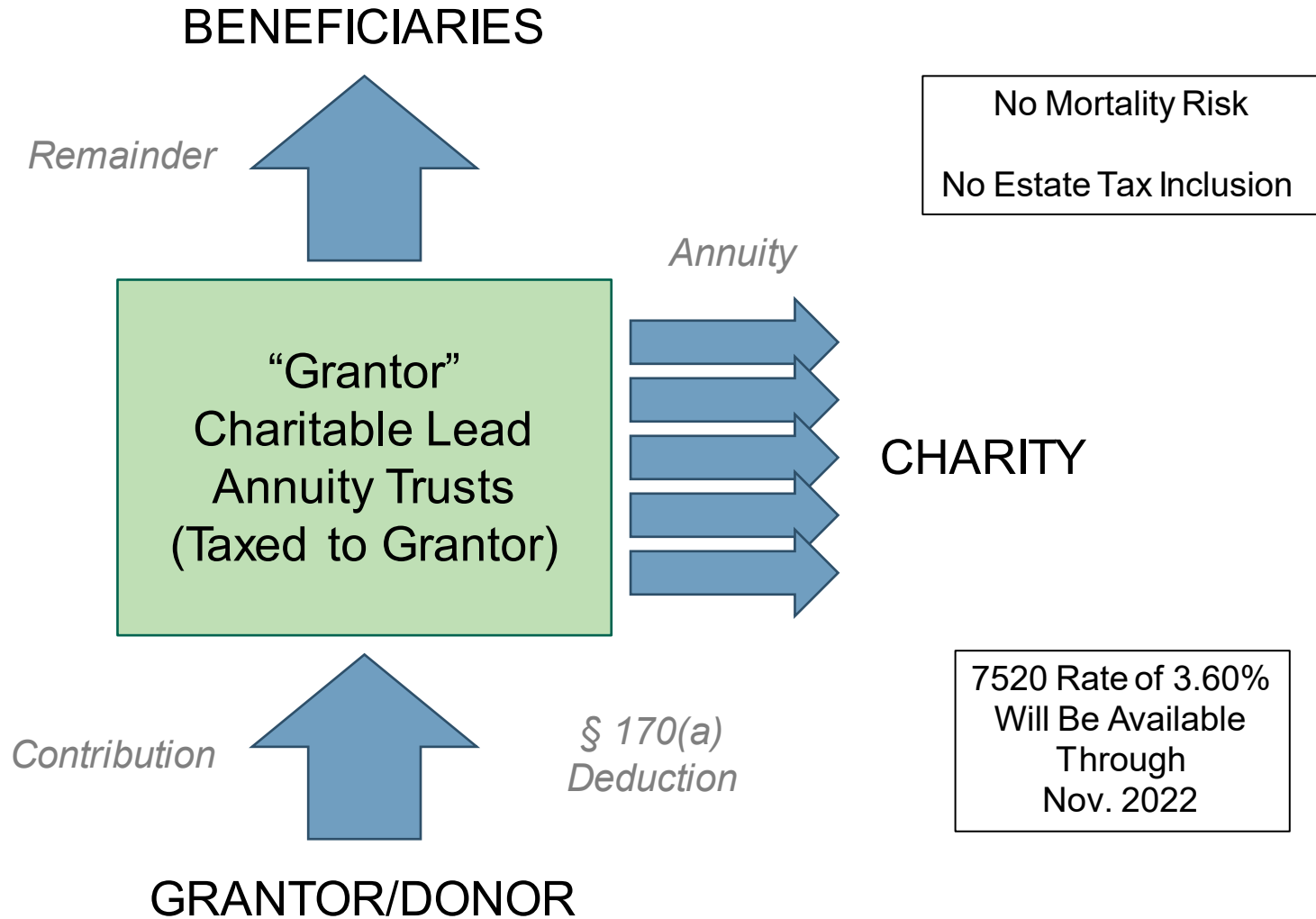
*Values displayed are based on the median outcome.



Back-Loaded Grantor CLATs



“Intentionally Defective” Grantor Charitable Lead Trusts





- IRS Forms for Charitable Lead Trusts

- Guaranteed Annuity
 - ◆ Determinable amount
 - ◆ Paid periodically
 - ◆ Not less than annually

- Payment Requirements
 - ◆ Not subject to any minimum or maximum payout
 - ◆ May provide for an annuity amount that is
 - ▶ Fixed dollar
 - ▶ Increases during the annuity period
 - ▶ Provided that the value of the annuity is ascertainable at the time the trust is funded



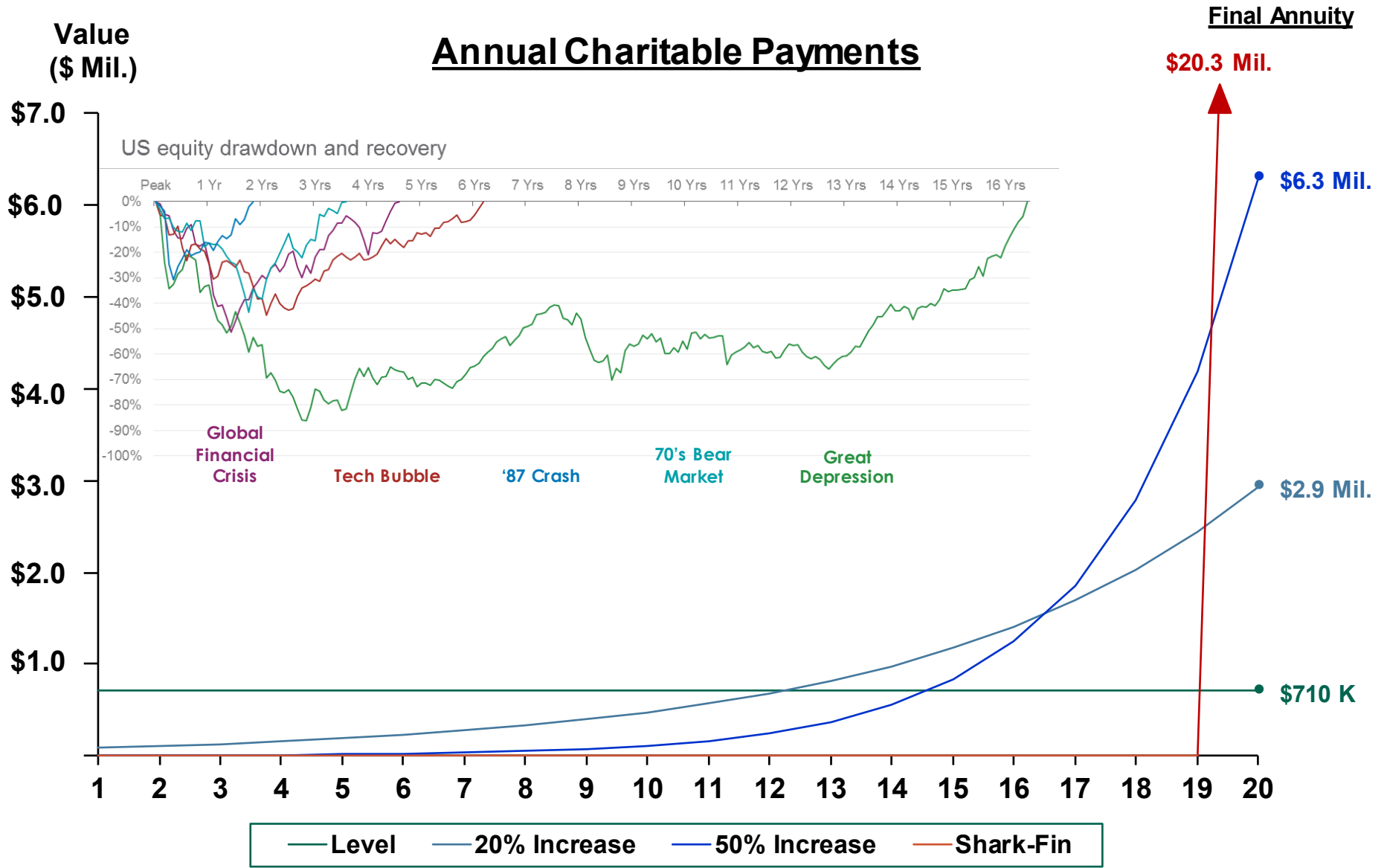
Possible Guaranteed Annuities (\$10 Mil. for 20 Yrs. @ 3.6%)

Year	Level	20% Increase	50% Increase	"Shark-Fin"
1	\$ 709,992	\$ 91,627	\$ 2,832	\$ 1,000
2	\$ 709,992	\$ 109,953	\$ 4,249	\$ 1,000
3	\$ 709,992	\$ 131,943	\$ 6,373	\$ 1,000
4	\$ 709,992	\$ 158,332	\$ 9,559	\$ 1,000
5	\$ 709,992	\$ 189,998	\$ 14,339	\$ 1,000
6	\$ 709,992	\$ 227,998	\$ 21,508	\$ 1,000
7	\$ 709,992	\$ 273,597	\$ 32,263	\$ 1,000
8	\$ 709,992	\$ 328,317	\$ 48,394	\$ 1,000
9	\$ 709,992	\$ 393,980	\$ 72,591	\$ 1,000
10	\$ 709,992	\$ 472,776	\$ 108,887	\$ 1,000
11	\$ 709,992	\$ 567,332	\$ 163,330	\$ 1,000
12	\$ 709,992	\$ 680,798	\$ 244,995	\$ 1,000
13	\$ 709,992	\$ 816,958	\$ 367,492	\$ 1,000
14	\$ 709,992	\$ 980,349	\$ 551,238	\$ 1,000
15	\$ 709,992	\$ 1,176,419	\$ 826,857	\$ 1,000
16	\$ 709,992	\$ 1,411,703	\$ 1,240,286	\$ 1,000
17	\$ 709,992	\$ 1,694,043	\$ 1,860,429	\$ 1,000
18	\$ 709,992	\$ 2,032,852	\$ 2,790,643	\$ 1,000
19	\$ 709,992	\$ 2,439,422	\$ 4,185,965	\$ 1,000
20	\$ 709,992	\$ 2,927,307	\$ 6,278,948	\$20,258,367
Total	\$14,199,847	\$ 17,105,706	\$ 18,831,178	\$20,277,367

Present Value of \$10 Mil.
(Gift or Estate Tax Deduction)
(Income Tax Deduction if Grantor CLAT)



Back-Loading: Allows for Volatility and More Wealth Transfer





Return Will Determine Value to Children at End of 20 Years

Ending Remainder Value to Children (\$10 Mil. Contribution)

Return	Level	20% Increase	50% Increase	Shark-Fin
4%	\$ 769,023	\$ 1,211,220	\$ 1,449,894	\$ 1,624,087
6%	\$ 5,953,866	\$ 9,079,159	\$ 10,686,497	\$11,777,203
8%	\$14,118,926	\$ 20,895,423	\$ 24,216,191	\$26,306,443

Aggregate Amount Paid to Charity Over Term

	Level	20% Increase	50% Increase	Shark-Fin
Charity	\$14,199,847	\$ 17,105,706	\$ 18,831,178	\$20,277,367



“Partnering” with Charity



A Powerful Planning Tool: Entity Taxed as a “Partnership”

Advantages: Flexibility

- Non-Tax Reasons (e.g., control, centralization, management, etc.)
- Potential Valuation Discounts
- Proactive Tax Basis Management
- Multiple Classes of Interests

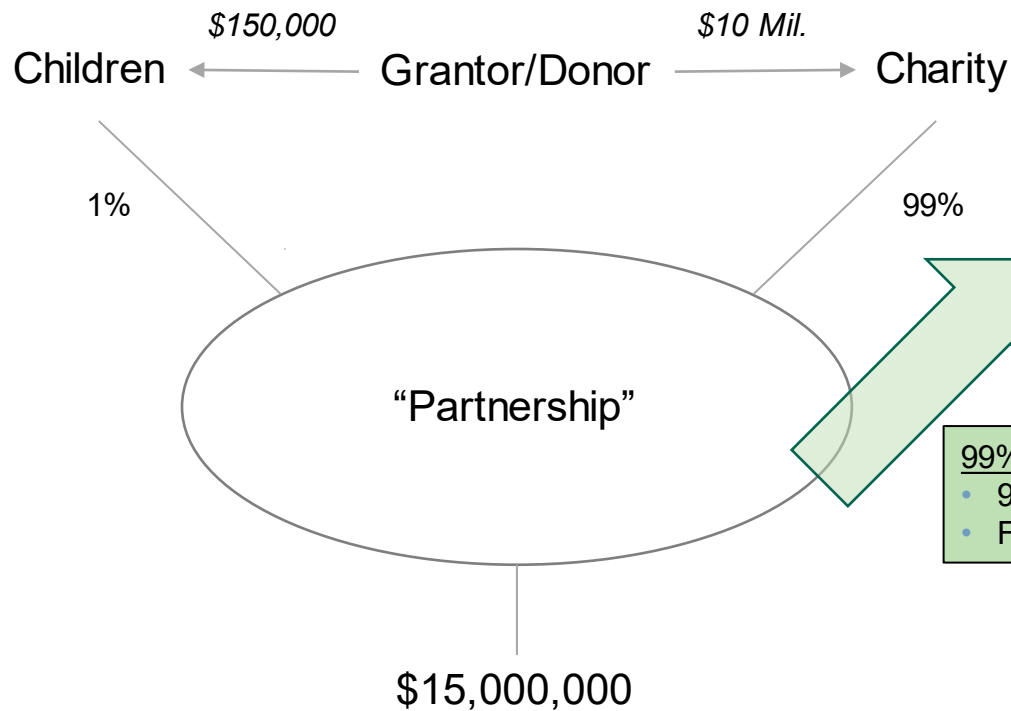
Disadvantages: Complexity

- Subchapter K
- Chapter 14

“Partnership”



Charitable FLP Redemption



Form 8282 (Donee Information Return)

- Disposition of nonmarketable asset
- Within 3 years of contribution
- Filed within 125 days

99% Limited Partnership

- 99% of Tax Items
- FMV upon redemption (\$10 Mil.)

2001 EO CPE: G (Control and Power : Issues Involving Supporting Organizations, Donor Advised Funds, and Disqualified Person Financial Institutions)

- “[T]his year’s favorite charity scam superseding the charitable split-dollar transaction”
- “Key point is control” by the donor
- Sale of appreciated asset and keeping partnership through term of 40 years
- Partnership has right to sell property to donor or family at a specified price (like a put option)
- Depending on facts, it may “cross over into the area of clear tax abuse”
- Identified issues: private inurement & benefit, § 511 (Unrelated Business Income), § 4958 (Excess Benefit Transaction)
- If private foundation, § 4941 (Self-Dealing), and § 4943 (Excess Business Holdings)

Planning Considerations

- Transfer GP interest to family trust contemporaneously or soon after contribution to charity
- Distribute net income annually
- Allow charity to sell LP interest (if can find a buyer)
- Do not grant an option to charity
- Do not sell property to donor or donor’s family
- No compensation to GP



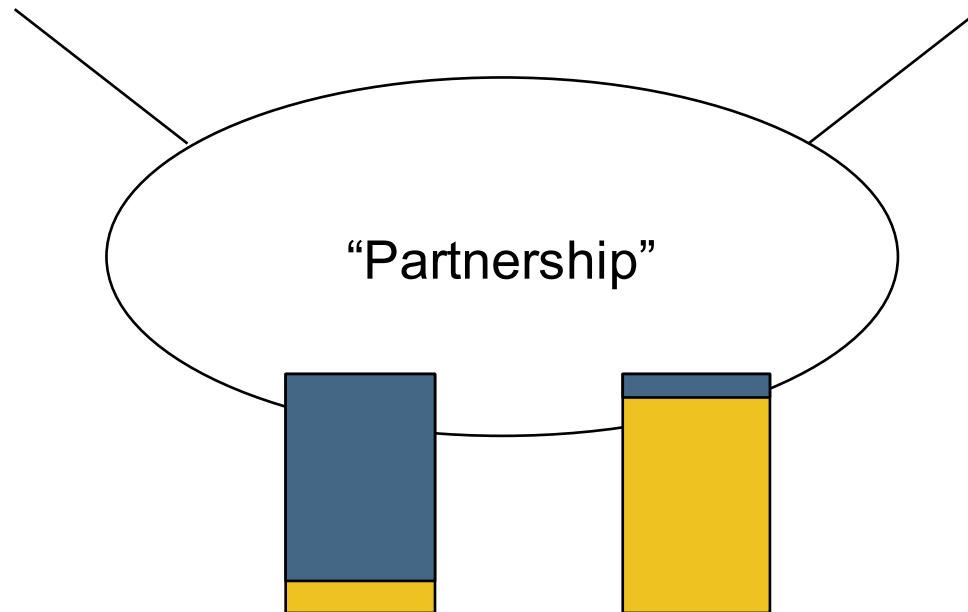
Charity and Tax Basis Management

High "Outside" Basis

Low "Outside" Basis

Taxable Partners

Charity

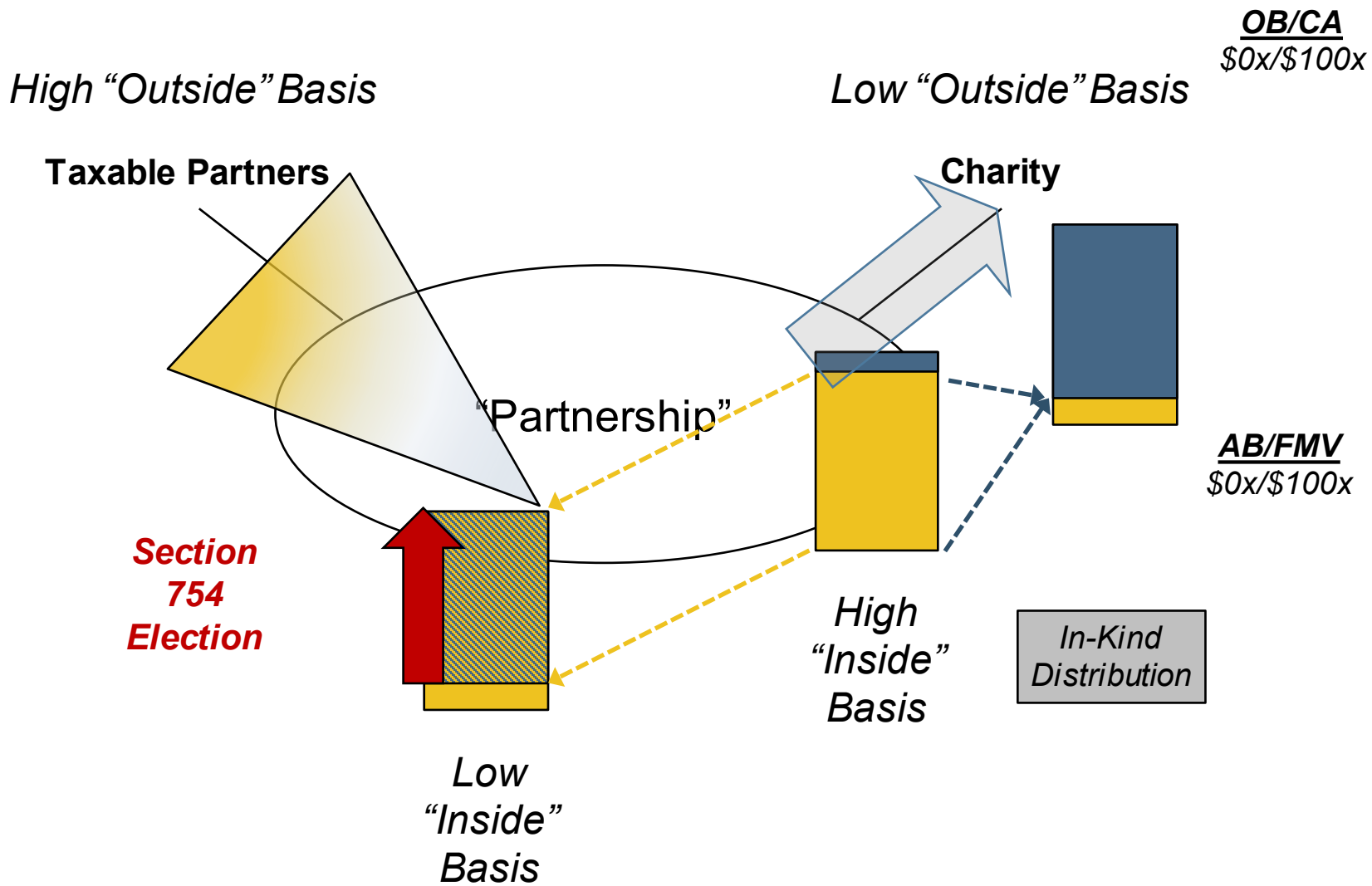


*Low
"Inside"
Basis*

*High
"Inside"
Basis*

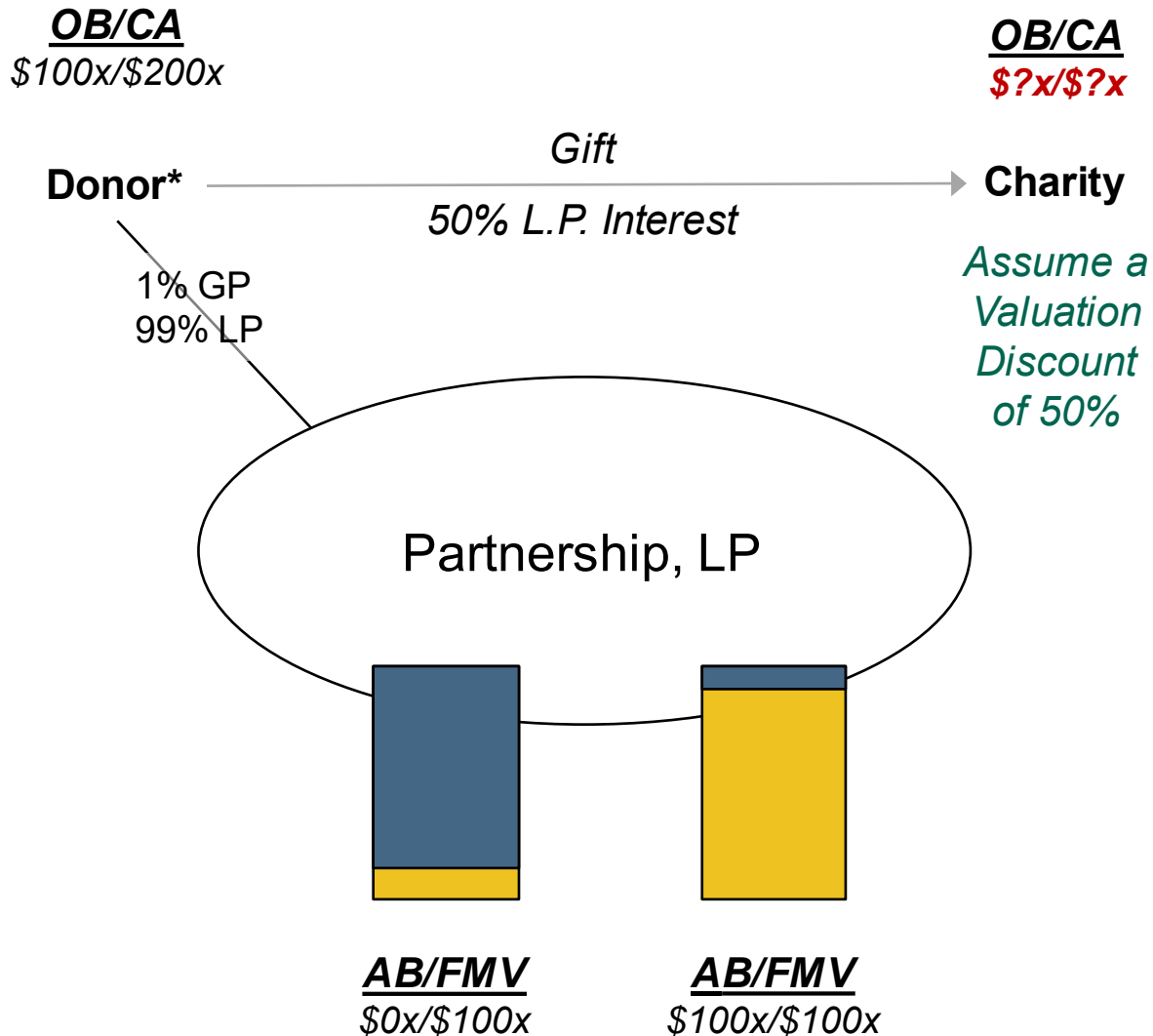


Basis "Strip" and "Shift" with Charity





Gift to Charity to Assist with Tax Basis Management



*Assumes nominal interest held by another partner. That interest is ignored for purposes of this illustration.



Calculating Capital Account & Basis of Transferred Interest

CAPITAL ACCOUNT OF TRANSFERRED INTEREST

Upon a transfer of all or a part of a partnership interest, the transferor's capital account "that is attributable to the transferred interest carries over to the transferee partner." Treas. Reg. § 1.704-1(b)(2)(iv)(I). See Treas. Reg. § 1.704-1(b)(5), Ex. 13.

$$\begin{array}{r} \text{Transferor's} \\ \text{Capital Account} \\ \$200 \end{array} \quad \times \quad \begin{array}{r} \text{Percentage} \\ \text{Transferred} \\ 50\% \end{array} \quad = \quad \begin{array}{r} \text{Transferee's} \\ \text{Capital Account} \\ \$100 \end{array}$$

ADJUSTED BASIS OF TRANSFERRED INTEREST

"[T]he basis of the transferred portion of the interest generally equals an amount which bears the same relation to the partner's basis in the partner's entire interest as the fair market value of the transferred portion of the interest bears to the fair market value of the entire interest." Rev. Rul. 84-53, 1984-1 C.B. 159.

$$\begin{array}{r} \text{Transferor's} \\ \text{Adjusted Basis} \\ \$100 \end{array} \quad \times \quad \frac{\begin{array}{r} \text{Fair Market Value (Discounted)} \\ \text{Transferred Portion} \\ \$50 \end{array}}{\begin{array}{r} \text{Fair Market Value} \\ \text{Transferor's Entire Portion} \\ \$200 \end{array}} \quad = \quad \begin{array}{r} \text{Transferee's} \\ \text{Adjusted Basis} \\ \$25 \end{array}$$



Basis "Strip" and "Shift" Example

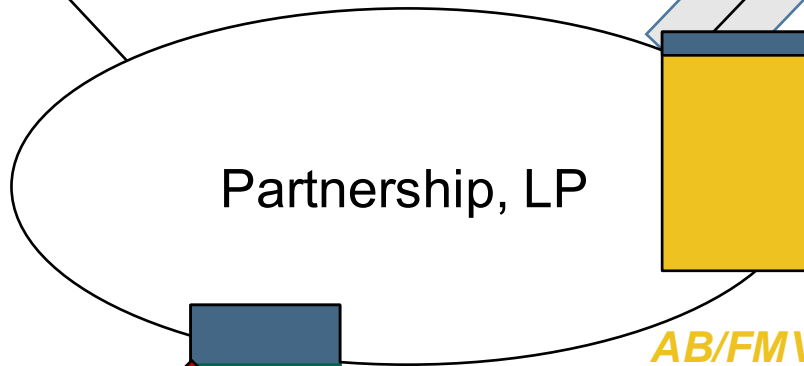
OB/CA
\$75x/\$100x

OB/CA
\$25x/\$100x

OB/CA
\$0x/\$0x

Donor

Charity



AB/FMV
\$25x/\$100x

**Section
754
Election**

AB/FMV
\$100x/\$100x

AB/FMV
\$75x/\$100x



If BBB Passes or Doesn't Pass

*Transfer
Tax
Considerations*



To Gift or Not to Gift: That's the Question...

Up to Wealthy

\$0 to ~\$12.06 Mil.

- ❑ Limit taxable gifts
- ❑ Preserve Applicable Exclusion
- ❑ Take advantage of free “step-up” in basis
- ❑ Limit valuation discounts
- ❑ Transfers of wealth in excess of the Applicable Exclusion via “zeroed-out” techniques
- ❑ Transfer high basis assets to IDGTs with “swap” power

“Middle Class” Wealthy

~\$12.06 Mil. to ~\$50.0 Mil.

- ❑ Taxable gifts in excess of the “Original” Applicable Exclusion depend on whether taxpayer can afford to make such gift
- ❑ Careful consideration of “split-gift” election (or NOT) in certain years
- ❑ Spousal Lifetime Access Trusts
- ❑ Retained cash flow techniques (i.e., preferred partnership freezes)
- ❑ Trusts that provide maximum “flexibility”

Ultra-Wealthy

Above ~\$50.0 Mil.

- ❑ Large taxable gifts to use “Original” and “Bonus” Applicable Exclusion
- ❑ Transfer to IDGTs (with “swap” power”)
- ❑ Valuation discount planning
- ❑ “Zeroed-out” techniques, leveraging taxable gifts (i.e., installment sale)
- ❑ “Free-basing” with marital deduction and estate reduction planning with surviving spouse

Consider:

Applicable Exclusion gifts of cash (or marketable securities), and
Exercise of “swap” power in the future.



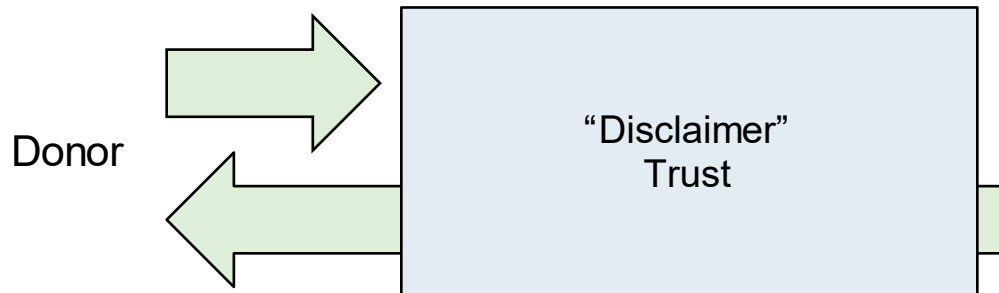
***“Undoing”
Taxable Gifts
after the Transfer***



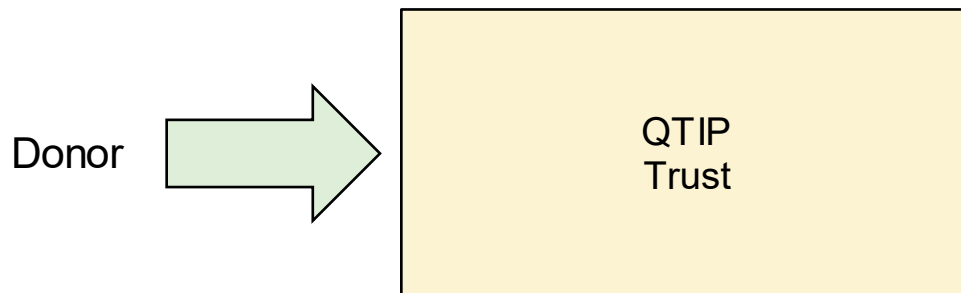
Undoing Gifts: Disclaimer Trusts & QTIP Elections

Reasons to “Undo” Taxable Gifts:

- Current Applicable Exclusion Amount becomes permanent
- Gifted asset depreciates in value
- Loss of “step-up” in basis
- NY donor dies soon after gift (gifts within 3 years of death are subject to NY estate tax but with no corresponding federal estate tax deduction): 49.6% v. 56% effective transfer tax



- *Trust provides if beneficiary disclaims interest in trust, property is returned to donor.*
- *If a qualified disclaimer (9 months), not a taxable gift*



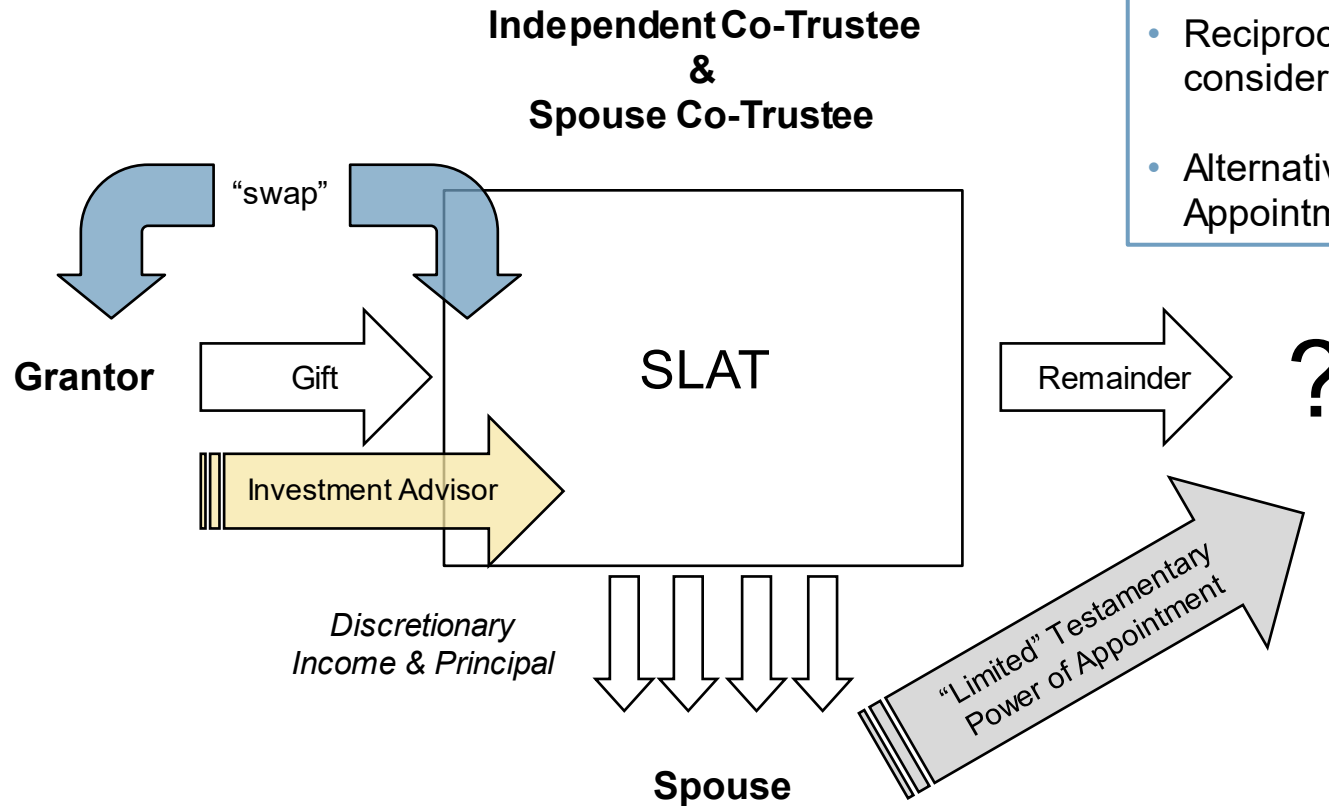
If, before due date of the donor’s gift tax return (April 15 or October 15), donor makes § 2523(f) QTIP election on gift tax return, transfer covered by the marital deduction and not a taxable gift that reduces Applicable Exclusion Amount



Spousal Lifetime Access Trusts, Grantor Trusts & Flexibility



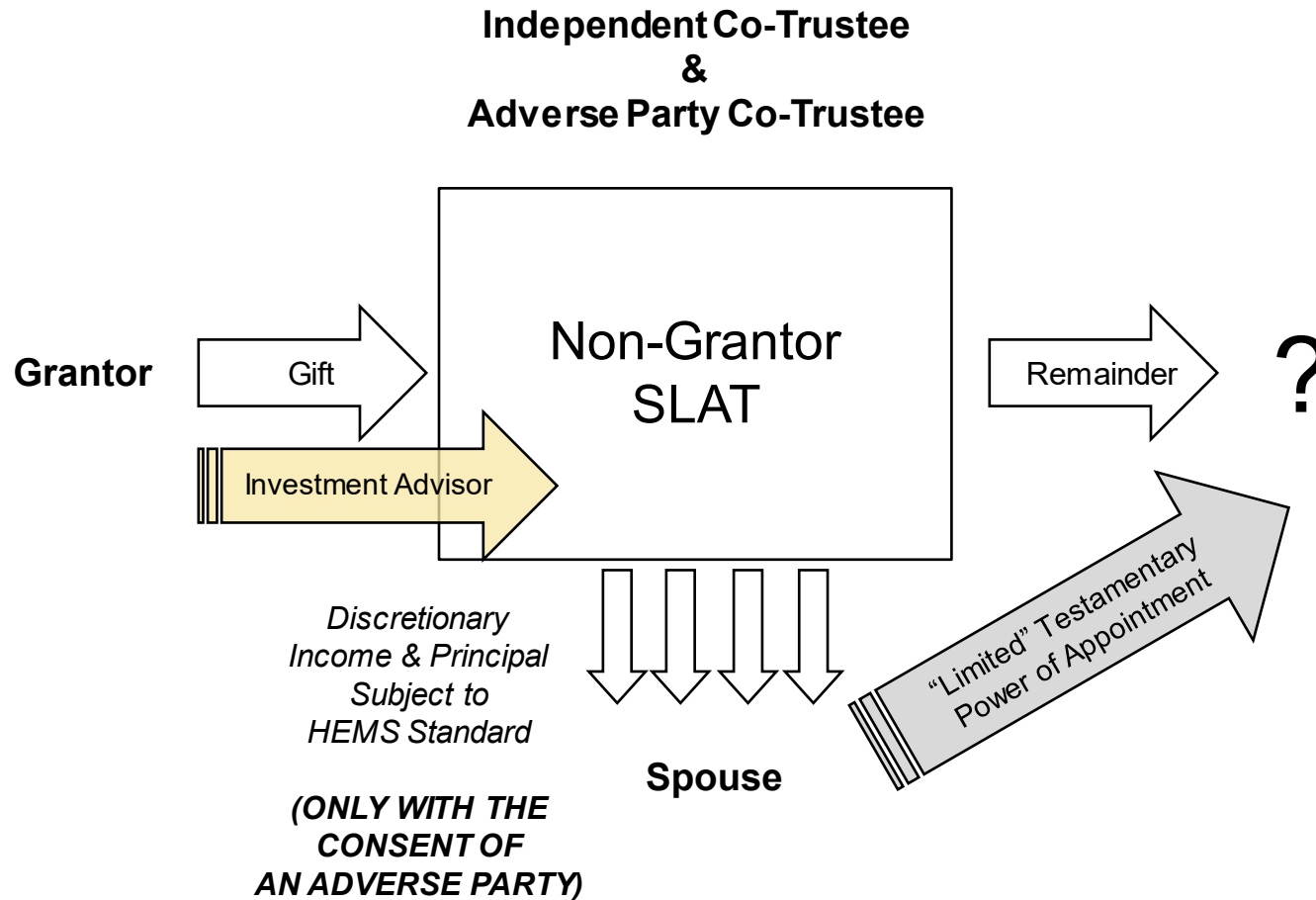
Spousal Lifetime Access Trust



- Applicable state law on donor's creditor claims critical to know
- Reciprocal trust doctrine considerations (Grace or Levy)
- Alternative: Special Power of Appointment Trust (SPAT)



Non-Grantor Spousal Lifetime Access Trust





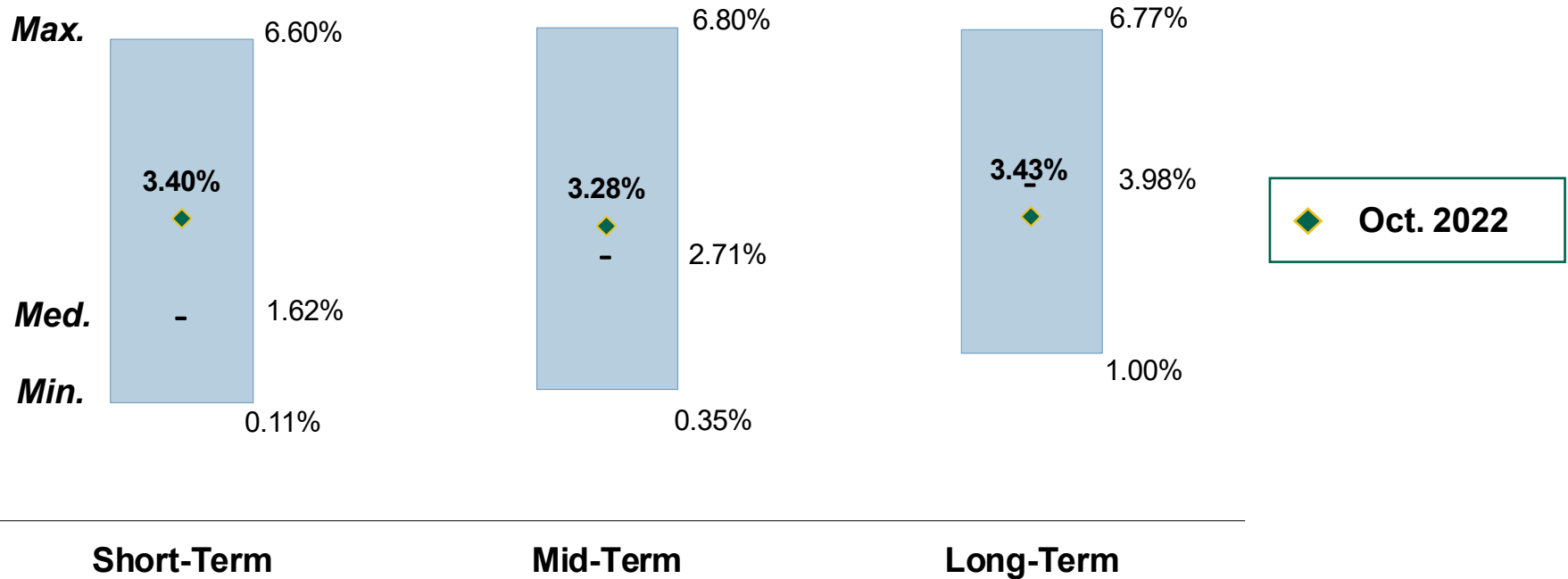
Intra-Family Loans & Sales to IDGTs



Today AFRs Are No Longer Low, Especially Short-Term

Applicable Federal Rates

Jan. 1998 – Oct. 2022



- Refinancing may require consideration.
- Consider prepaying debt and replace with new promissory note.
- Remember term of note should not be longer than life expectancy of holder.



The Valuation of Promissory/Installment Notes in the Future?

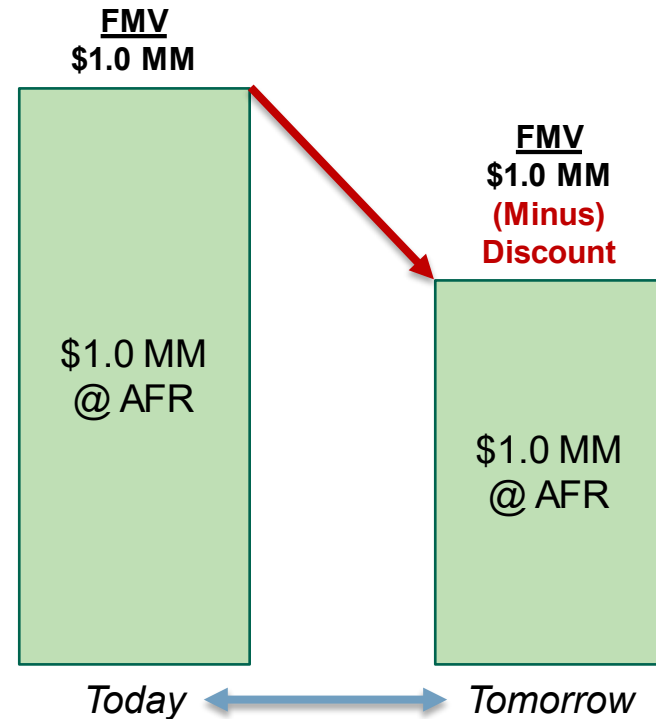
“In the case of an entity engaged in an active trade or business, at least 60 percent of whose value consists of the nonpassive assets of that trade or business, and to the extent that the liquidation proceeds are not attributable to passive assets within the meaning of section 6166(b)(9)(B), such proceeds may include such a note or other obligation if such note or other obligation is adequately secured, requires periodic payments on a non-deferred basis, is issued at market interest rates, and has a fair market value on the date of liquidation or redemption equal to the liquidation proceeds.” Prop. Treas. Reg. 25.2704-3(b)(iv).

Loans and Installment Sales Today

- ◆ Applicable federal rate (long-term, not short or mid-term);
- ◆ 10% (or less) equity;
- ◆ No prepayment penalty; and
- ◆ Adequate security not required.

Promissory Notes Will Need to Be:

- ◆ Adequately secured;
- ◆ Requires periodic payments on a non-deferred basis;
- ◆ Issued at market interest rates; and
- ◆ Has a fair market value equal to the liability.



Using Notes to Avoid Section 2036 Issues:

- 1: Sell Family-Owned Entity to IDGT for FMV in Exchange for Installment Note.
- 2: Gift the Installment Note to IDGT (Borrower).

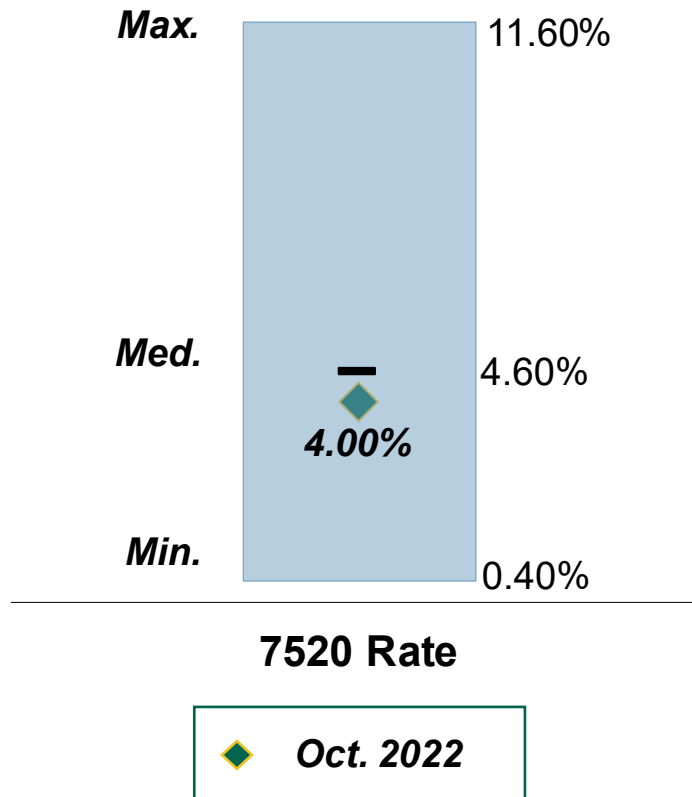


GRATs: Long or Short?



Section 7520 Rate

Section 7520 Rate (Since Inception) Mar. 1989 – Oct. 2022





100 Years? 365 Years?

Estate Tax Inclusion is LESSER of:

- FMV of GRAT assets; or
- Amount of Principal to Pay Annuity in PERPETUITY

$$= \frac{\text{Annuity Payment}}{\text{7520 Rate at Death}}$$

100 Year GRAT

Annuity	\$408,080.00
7520 Rate	4.0%
Years	100
PV of Grantor's Retained Interest	\$10,000,000
Annuity Factor	24.504999
Life Factor	0.98019996
Remainder Factor	0.01980004

7520 Rate at Death	§ 20.2036-1(c)(2) Inclusion
1.0%	\$ 40,808,000
2.0%	\$ 20,404,000
3.0%	\$ 13,602,667
4.0%	\$ 10,202,000
5.0%	\$ 8,161,600
6.0%	\$ 6,801,333
7.0%	\$ 5,829,714

GRAT Asset Value	
Years	Annual Return
	7%
5	\$ 11,678,756
10	\$ 14,033,297
15	\$ 17,335,664
20	\$ 21,967,404
25	\$ 28,463,659

365 Year GRAT

Annuity	\$400,000.24
7520 Rate	4.0%
Years	365
PV of Grantor's Retained Interest	\$10,000,000
Annuity Factor	24.99998484
Life Factor	0.99999393
Remainder Factor	6.065E-07

7520 Rate at Death	§ 20.2036-1(c)(2) Inclusion
1.0%	\$ 40,000,024
2.0%	\$ 20,000,012
3.0%	\$ 13,333,341
4.0%	\$ 10,000,006
5.0%	\$ 8,000,005
6.0%	\$ 6,666,671
7.0%	\$ 5,714,289

GRAT Asset Value	
Years	Annual Return
	7%
5	\$ 11,725,220
10	\$ 14,144,931
15	\$ 17,538,701
20	\$ 22,298,638
25	\$ 28,974,696

Private Split-Dollar Life Insurance Alternative? Good Place for Installment Notes?



What About Long-Term GRATs?

50 Year GRAT

Annuity	\$465,502.00
7520 Rate	4.0%
Years	50
PV of Grantor's Retained Interest	\$10,000,000
Annuity Factor	21.48218462
Life Factor	0.859287385
Remainder Factor	0.140712615

7520 Rate at Death	§ 20.2036-1(c)(2) Inclusion
1.0%	\$ 46,550,200
2.0%	\$ 23,275,100
3.0%	\$ 15,516,733
4.0%	\$ 11,637,550
5.0%	\$ 9,310,040
6.0%	\$ 7,758,367
7.0%	\$ 6,650,029

GRAT Asset Value	
Years	Annual Return 7%
5	\$ 11,348,537
10	\$ 13,239,929
15	\$ 15,892,705
20	\$ 19,613,361
25	\$ 24,831,773

60 Year GRAT

Annuity	\$442,018.45
7520 Rate	4.0%
Years	60
PV of Grantor's Retained Interest	\$10,000,000
Annuity Factor	22.62348997
Life Factor	0.904939599
Remainder Factor	0.095060401

7520 Rate at Death	§ 20.2036-1(c)(2) Inclusion
1.0%	\$ 44,201,845
2.0%	\$ 22,100,923
3.0%	\$ 14,733,948
4.0%	\$ 11,050,461
5.0%	\$ 8,840,369
6.0%	\$ 7,366,974
7.0%	\$ 6,314,549

GRAT Asset Value	
Years	Annual Return 7%
5	\$ 11,483,585
10	\$ 13,564,389
15	\$ 16,482,824
20	\$ 20,576,081
25	\$ 26,317,085

70 Year GRAT

Annuity	\$427,450.62
7520 Rate	4.0%
Years	70
PV of Grantor's Retained Interest	\$10,000,000
Annuity Factor	23.39451498
Life Factor	0.935780599
Remainder Factor	0.064219401

7520 Rate at Death	§ 20.2036-1(c)(2) Inclusion
1.0%	\$ 42,745,062
2.0%	\$ 21,372,531
3.0%	\$ 14,248,354
4.0%	\$ 10,686,266
5.0%	\$ 8,549,012
6.0%	\$ 7,124,177
7.0%	\$ 6,106,437

GRAT Asset Value	
Years	Annual Return 7%
5	\$ 11,567,360
10	\$ 13,765,664
15	\$ 16,848,899
20	\$ 21,173,296
25	\$ 27,238,486



Long-Term GRATs with a Bonus Exclusion Gift

\$10 Mil. Contribution - \$3.97 Mil. Retained Annuity = \$6.03 Mil. Taxable Gift

50 Year GRAT

Annuity	\$184,804.30
7520 Rate	4.0%
Years	50
PV of Grantor's Retained Interest	\$ 3,970,000
Annuity Factor	21.48218462
Life Factor	0.859287385
Remainder Factor	0.140712615

7520 Rate at Death	\$ 20.2036-1(c)(2) Inclusion
1.0%	\$ 18,480,430
2.0%	\$ 9,240,215
3.0%	\$ 6,160,143
4.0%	\$ 4,620,107
5.0%	\$ 3,696,086
6.0%	\$ 3,080,072
7.0%	\$ 2,640,061

GRAT Asset Value	
Years	Annual Return
	7%
5	\$ 12,962,756
10	\$ 17,118,175
15	\$ 22,946,364
20	\$ 31,120,702
25	\$ 42,585,633

60 Year GRAT

Annuity	\$175,481.33
7520 Rate	4.0%
Years	60
PV of Grantor's Retained Interest	\$ 3,970,000
Annuity Factor	22.62348997
Life Factor	0.904939599
Remainder Factor	0.095060401

7520 Rate at Death	\$ 20.2036-1(c)(2) Inclusion
1.0%	\$ 17,548,133
2.0%	\$ 8,774,066
3.0%	\$ 5,849,378
4.0%	\$ 4,387,033
5.0%	\$ 3,509,627
6.0%	\$ 2,924,689
7.0%	\$ 2,506,876

GRAT Asset Value	
Years	Annual Return
	7%
5	\$ 13,016,370
10	\$ 17,246,985
15	\$ 23,180,641
20	\$ 31,502,901
25	\$ 43,175,301

70 Year GRAT

Annuity	\$169,697.90
7520 Rate	4.0%
Years	70
PV of Grantor's Retained Interest	\$ 3,970,000
Annuity Factor	23.39451498
Life Factor	0.935780599
Remainder Factor	0.064219401

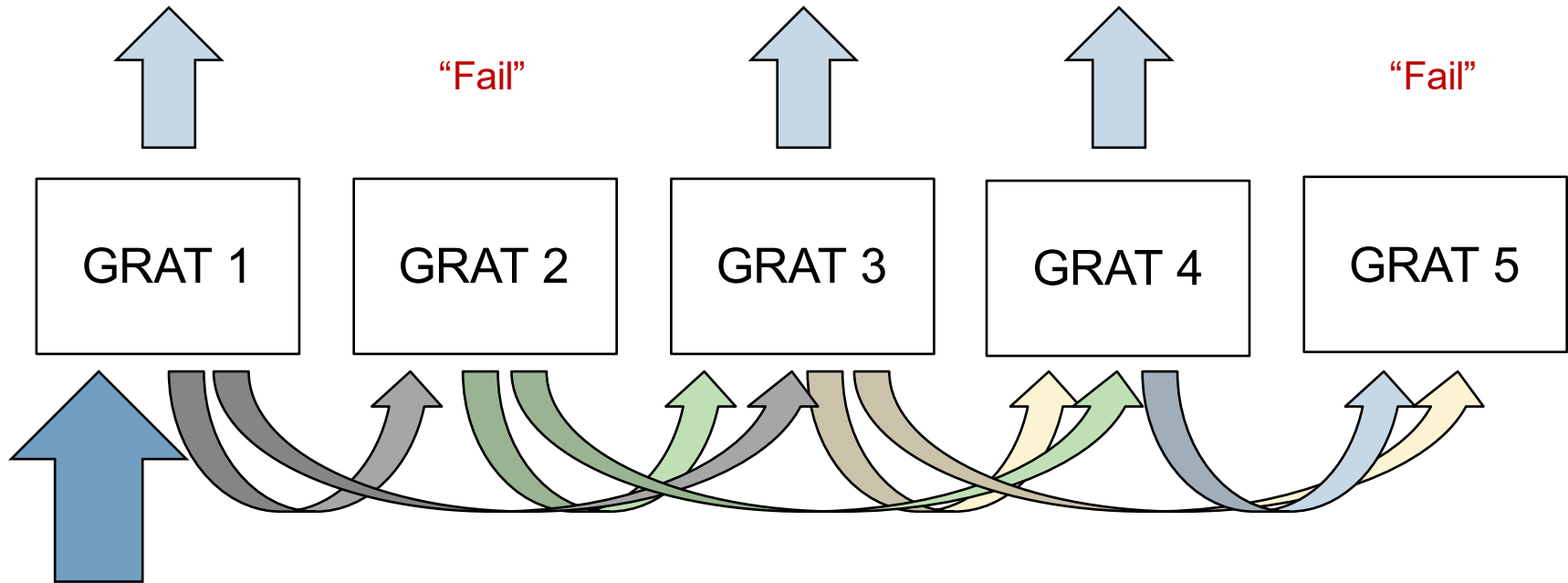
7520 Rate at Death	\$ 20.2036-1(c)(2) Inclusion
1.0%	\$ 16,969,790
2.0%	\$ 8,484,895
3.0%	\$ 5,656,597
4.0%	\$ 4,242,447
5.0%	\$ 3,393,958
6.0%	\$ 2,828,298
7.0%	\$ 2,424,256

GRAT Asset Value	
Years	Annual Return
	7%
5	\$ 13,049,629
10	\$ 17,326,891
15	\$ 23,325,973
20	\$ 31,739,996
25	\$ 43,541,098



Short-Term (2-Year) “Zeroed-Out Rolling” GRATs

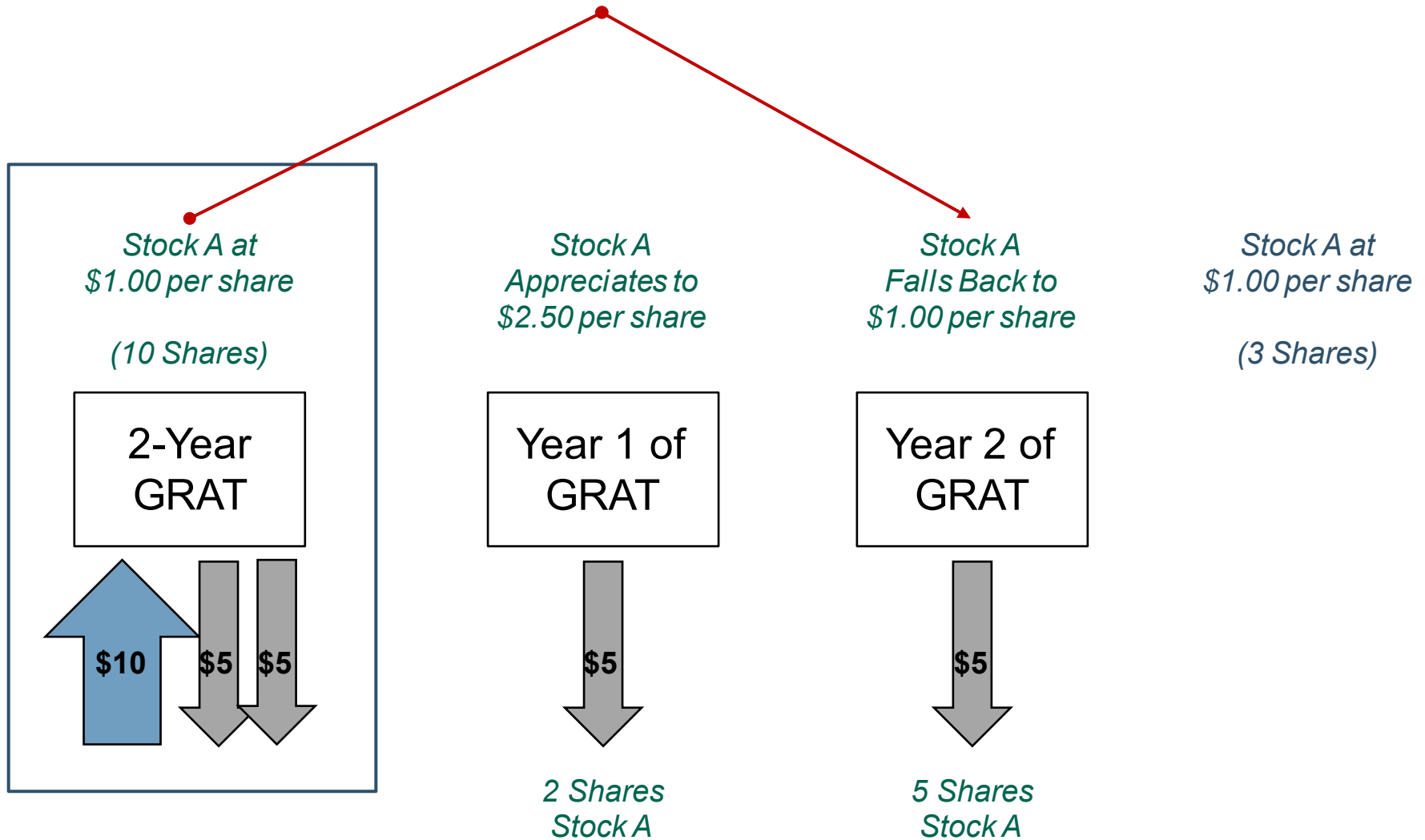
BENEFICIARIES (GRANTOR TRUST)



GRANTOR



Short-Term GRATs Are About Volatility (Not Return or 7520 Rate)

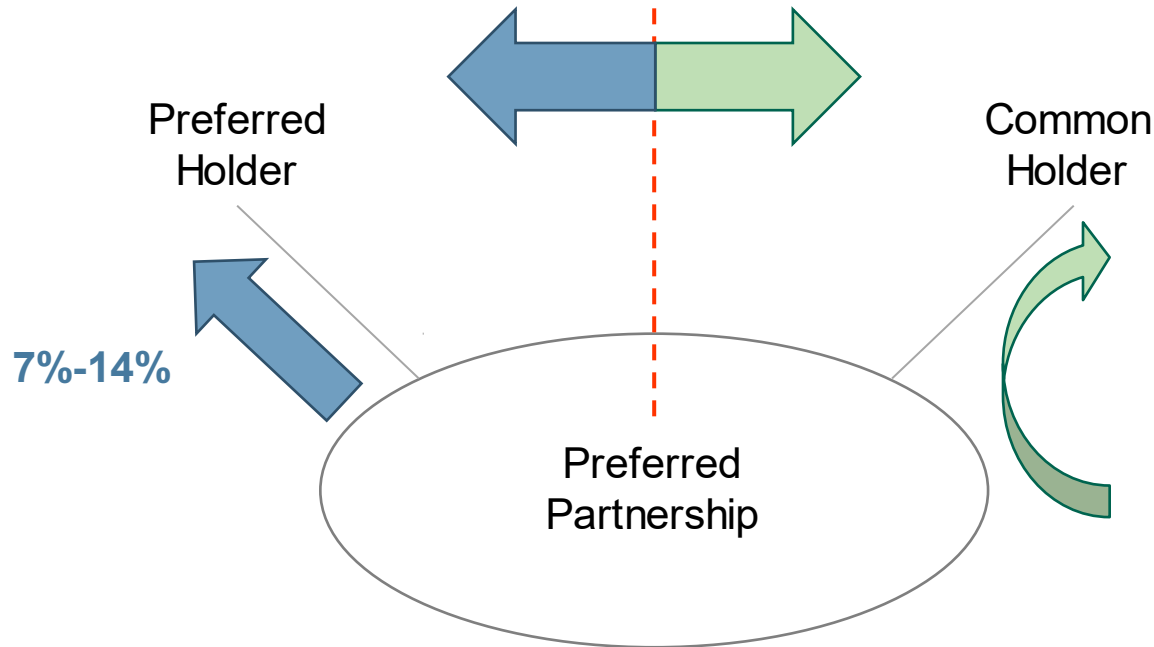




Preferred Partnership Structures: Forward, Reverse, and “Busted”



Preferred & Common: Retain or Transfer?

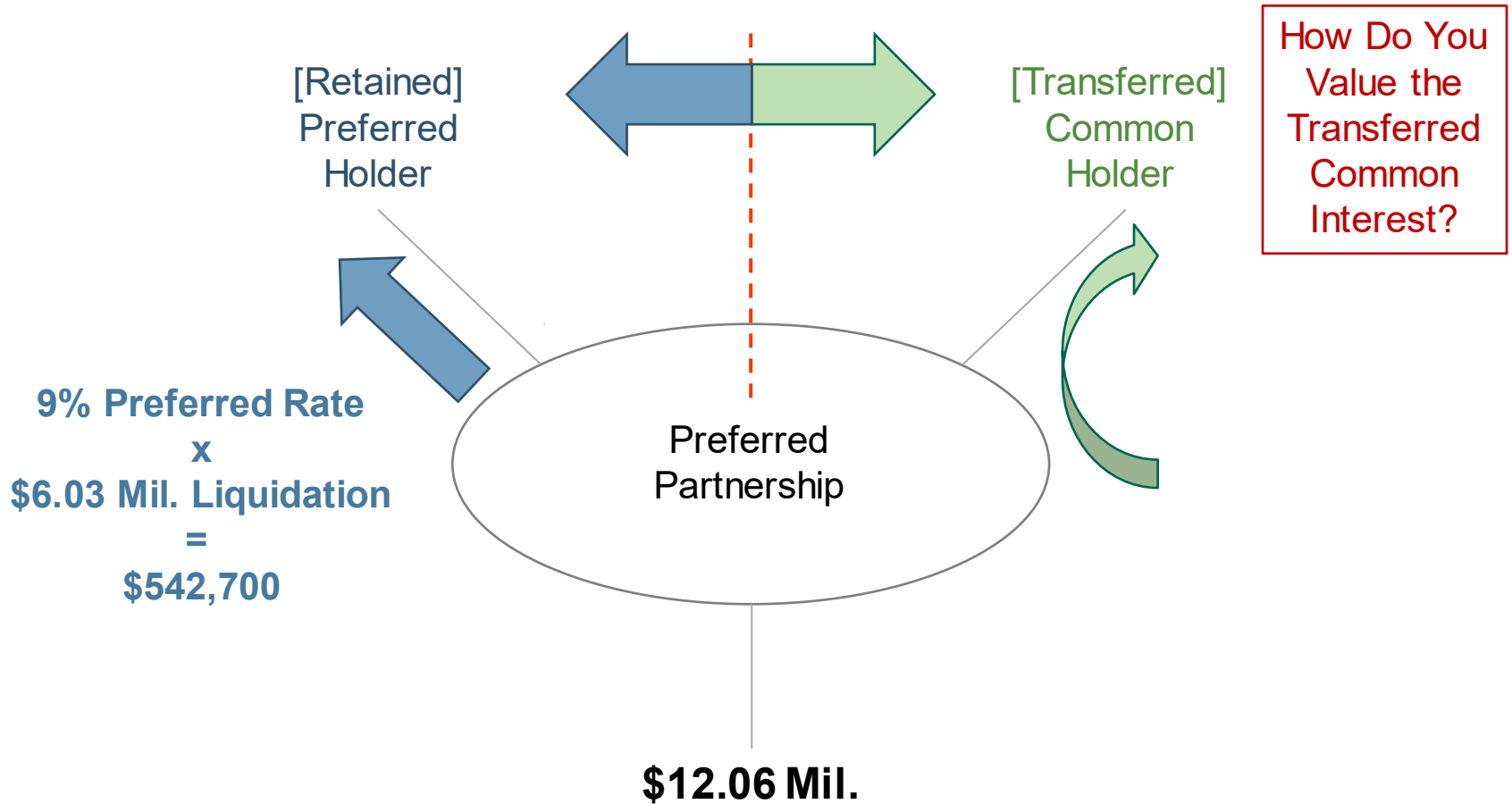


- Fixed Liquidation Value
- Annual Distribution at Fixed Rate/Amount
- Tax Items Preferentially Allocated
- Retain (Traditional), § 2701 Applies
- Transfer (Reverse), Normal Gift Tax Rules

- All Value in Excess of Preferred
- No Fixed Annual Distribution
- Residual Tax Items
- If Retain, Normal Gift Tax Rules
- If Transfer, § 2701 Applies



"Forward Freeze" Preferred Partnership Transaction





Forward Freeze: Subtraction Method (Valuing Common Interest)

- **Step 1: Determine**
 - ◆ Value of all family-held interests

- **Step 2: Subtract**
 - ◆ Value of senior equity interests

- **Step 3: Allocate**
 - ◆ Among the transferred interests

- **Step 4: Determine**
 - ◆ Value of the gift

Section 2701

Not liquidation value
No minority interest discount

Zero OR
Value of
“Qualified Payment” Interest

Minority interest discount
Lack of marketability discount
Subordination discount

Qualified Payment
Annual
Cumulative
Fixed Rate

Rev. Rul. 83-120

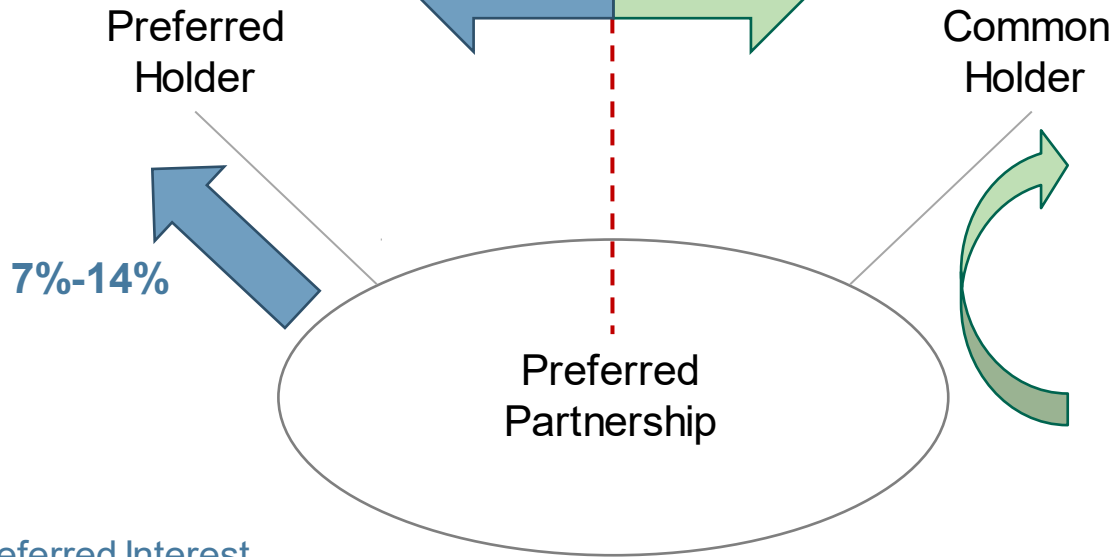
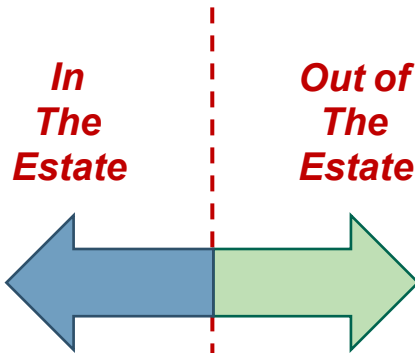
No ability to
inflate value above
liquidation



Retain Preferred/Transfer Common: Qualified or Non-Qualified

Estate Tax

Qualified Preferred Interest
Fair Market Value
(Liquidated at Death?)
(Cost-of-Living Liquidation?)



Non-Qualified Preferred Interest
Fair Market Value (Liquidated?)
less

Reg. § 25.2701-5(a)(3) Adjustment

Separate from § 2001(g)
"clawback" Regulations

Gift Tax

Common Interest
Family Interests
less
Qualified Interest
less
Discounts

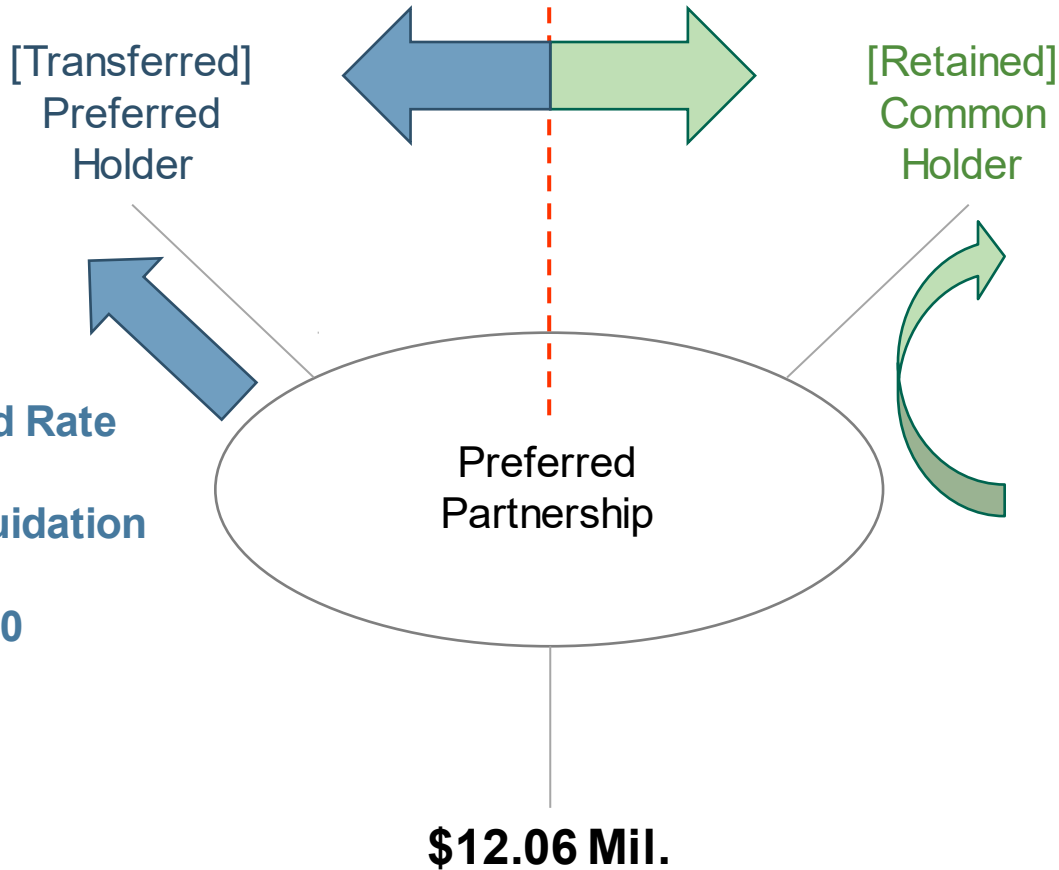
Common Interest
Family Interests
less
Zero



"Reverse Freeze" Preferred Partnership Transaction

How Do You Value the Transferred Preferred Interest?

$$\begin{aligned} &9\% \text{ Preferred Rate} \\ &\times \\ &\$6.03 \text{ Mil. Liquidation} \\ &= \\ &\$542,700 \end{aligned}$$





Reverse Freeze: Junior Equity Exception & Rev. Rul. 83-120

“Junior Equity Exception” to Section 2701

- Normal gift tax valuation rules apply
- Lack of marketability and minority interest discounts applicable

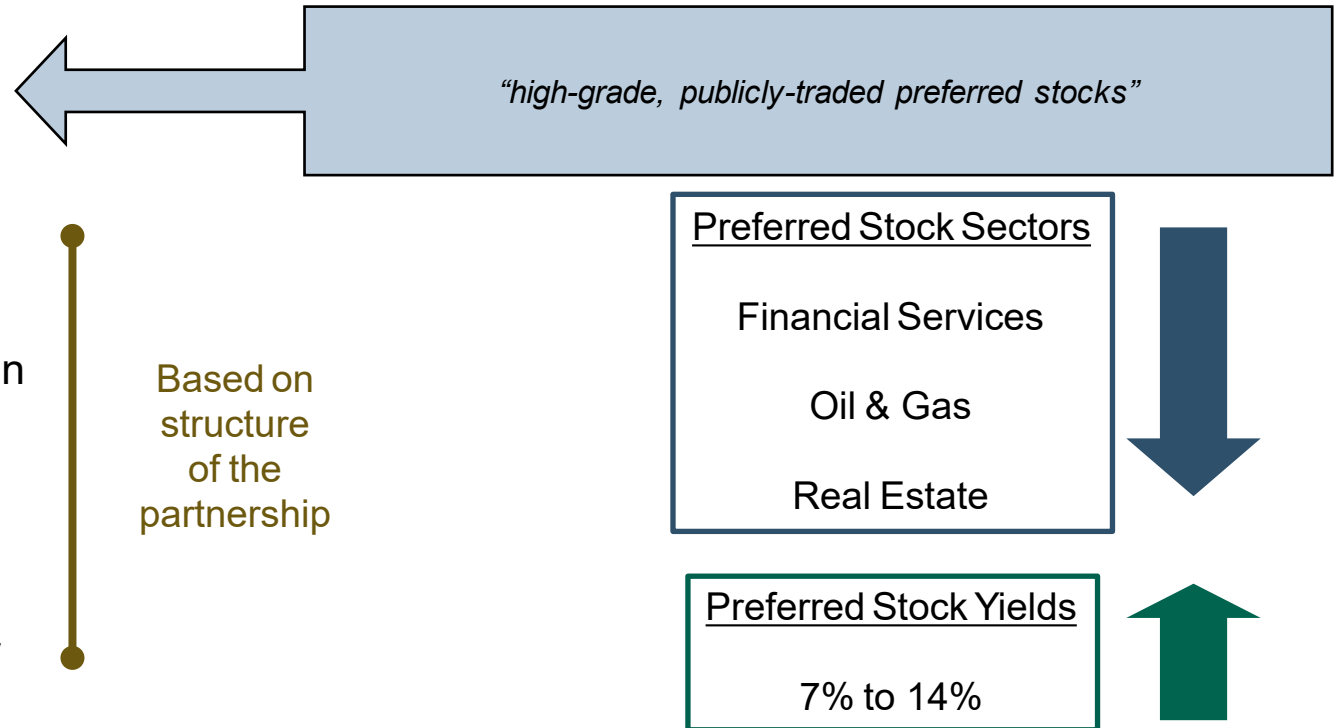
Rev. Rul. 83-120

■ Major Factors

- ◆ Yield
- ◆ Dividend Coverage
- ◆ Dissolution Protection

■ Minor Factors

- ◆ Voting Rights
- ◆ Lack of Marketability

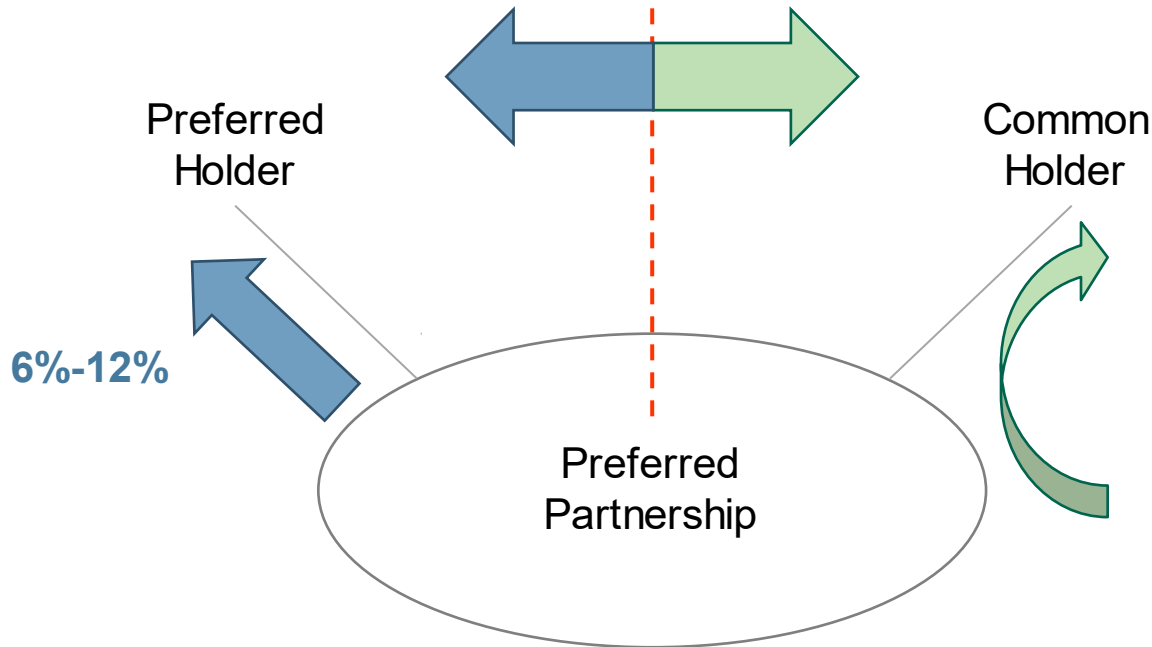




Preferred Partnerships



Preferred & Common: Retain or Transfer?

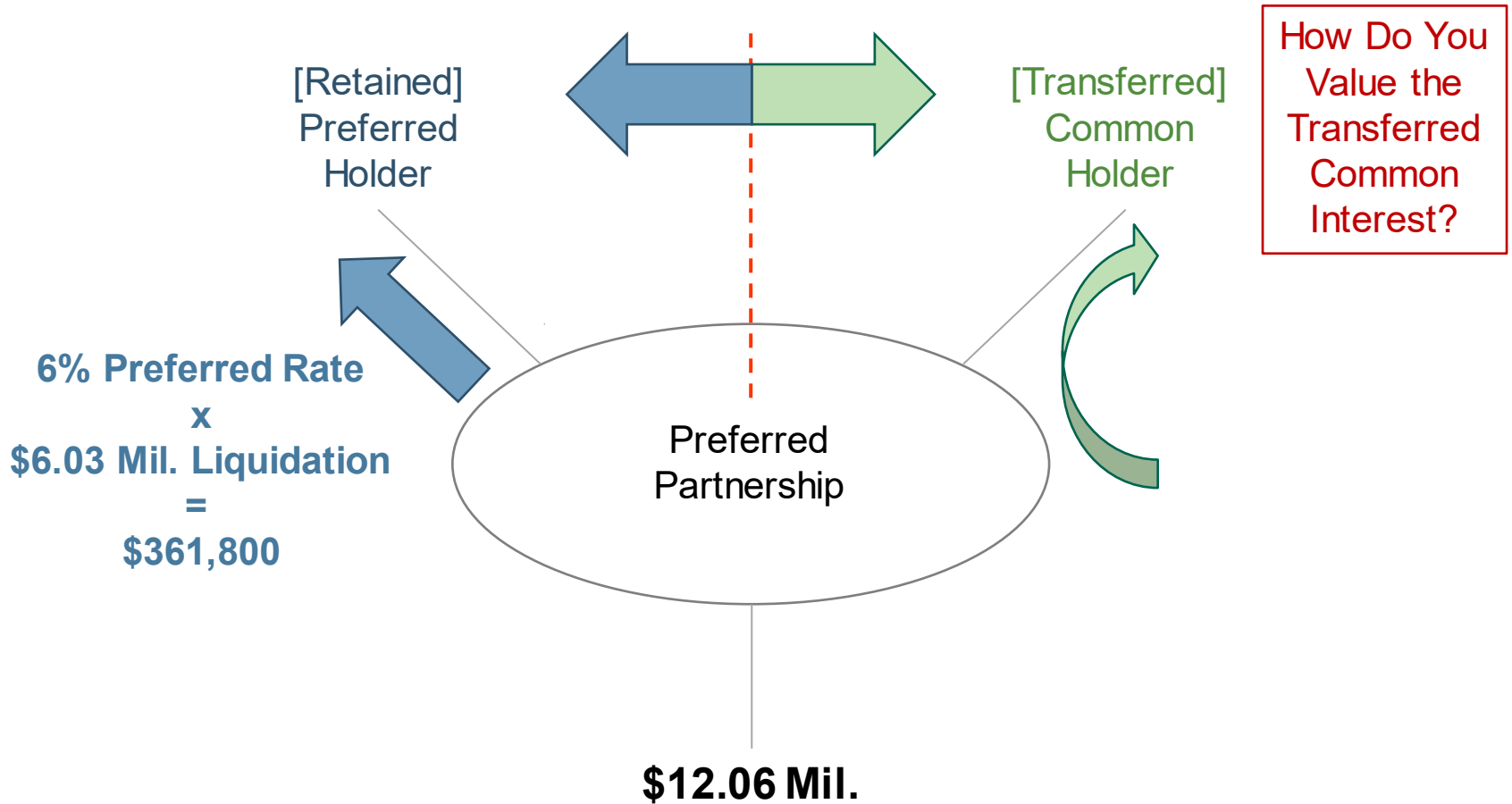


- Fixed Liquidation Value
- Annual Distribution at Fixed Rate/Amount
- Tax Items Preferentially Allocated
- Retain (Traditional), § 2701 Applies
- Transfer (Reverse), Normal Gift Tax Rules

- All Value in Excess of Preferred
- No Fixed Annual Distribution
- Residual Tax Items
- If Retain, Normal Gift Tax Rules
- If Transfer, § 2701 Applies



"Forward Freeze" Preferred Partnership Transaction





Forward Freeze: Subtraction Method (Valuing Common Interest)

- **Step 1: Determine**
 - ◆ Value of all family-held interests

- **Step 2: Subtract**
 - ◆ Value of senior equity interests

- **Step 3: Allocate**
 - ◆ Among the transferred interests

- **Step 4: Determine**
 - ◆ Value of the gift

Section 2701

Not liquidation value
No minority interest discount

Zero OR
Value of
“Qualified Payment” Interest

Minority interest discount
Lack of marketability discount
Subordination discount

Qualified Payment
Annual
Cumulative
Fixed Rate

Rev. Rul. 83-120

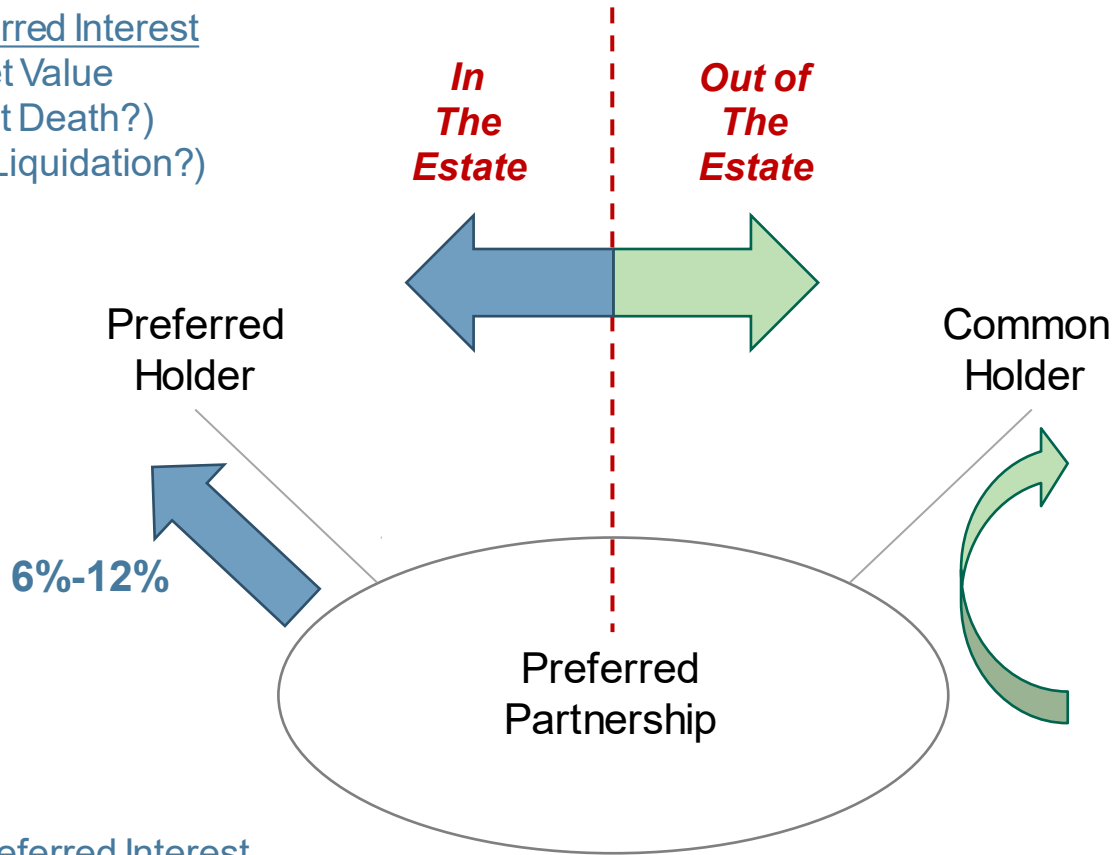
No ability to
inflate value above
liquidation



Retain Preferred/Transfer Common: Qualified or Non-Qualified

Estate Tax

Qualified Preferred Interest
 Fair Market Value
 (Liquidated at Death?)
 (Cost-of-Living Liquidation?)



Gift Tax

Common Interest
 Family Interests
 less
 Qualified Interest
 less
 Discounts

Non-Qualified Preferred Interest
 Fair Market Value (Liquidated?)
 less
 Reg. § 25.2701-5(a)(3) Adjustment

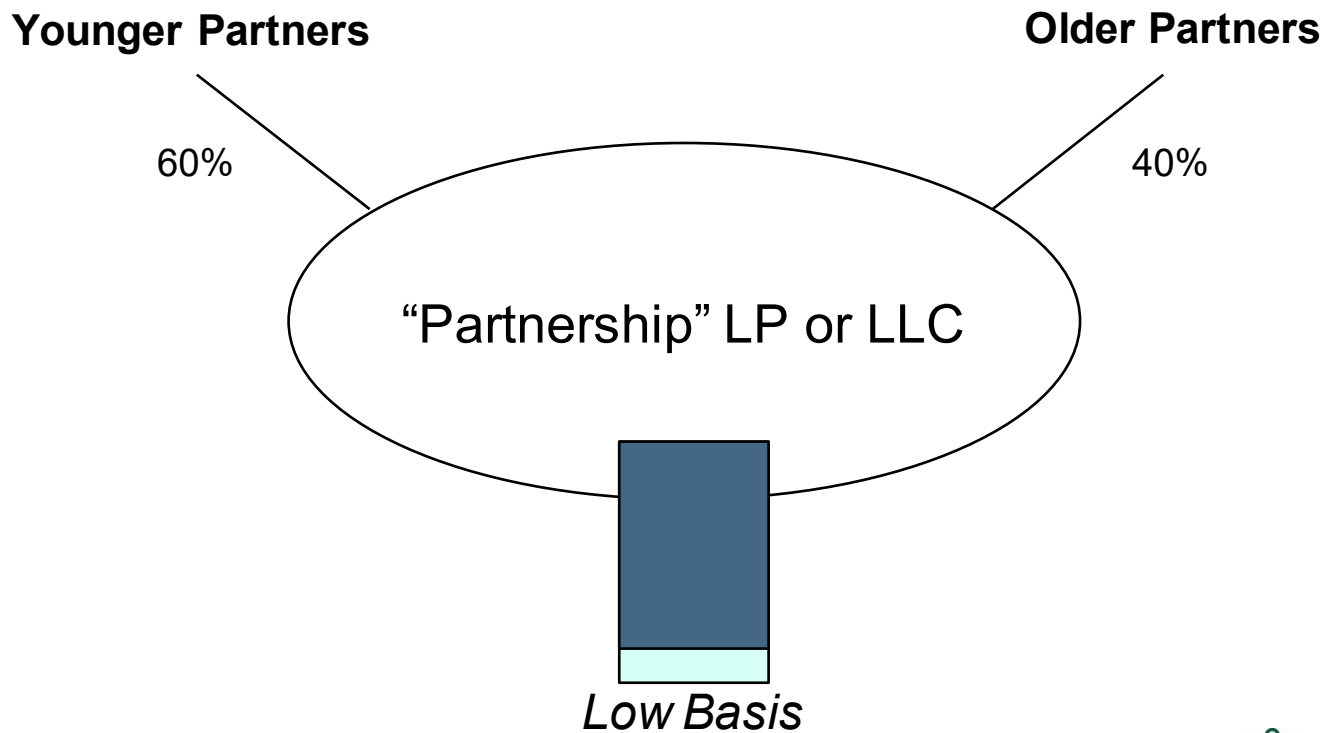
Common Interest
 Family Interests
 less
 Zero



Eliminating Valuation Discounts On Pre-Existing FLP Interests Included in the Gross Estate



Eliminating Valuation Discounts on Pre-Existing FLPs





Eliminating Valuation Discounts on Pre-Existing FLPs

Younger Partners

100%



Holding, LLC

Older Partners

100%

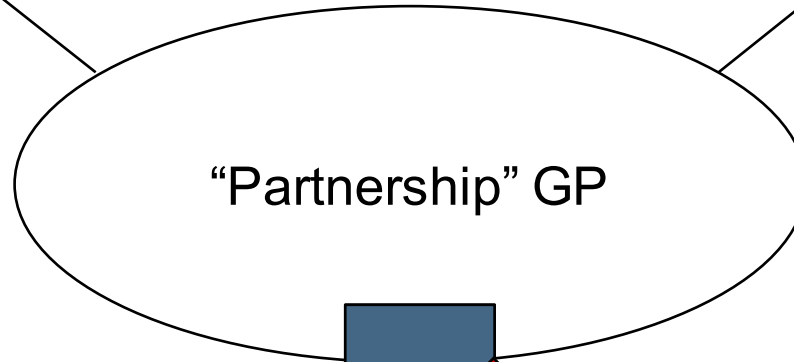


Holding, LLC



Disregarded Entities

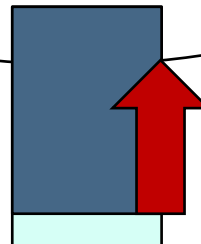
60%



"Partnership" GP

40%

*"Convert" to
General Partnership*



Low Basis

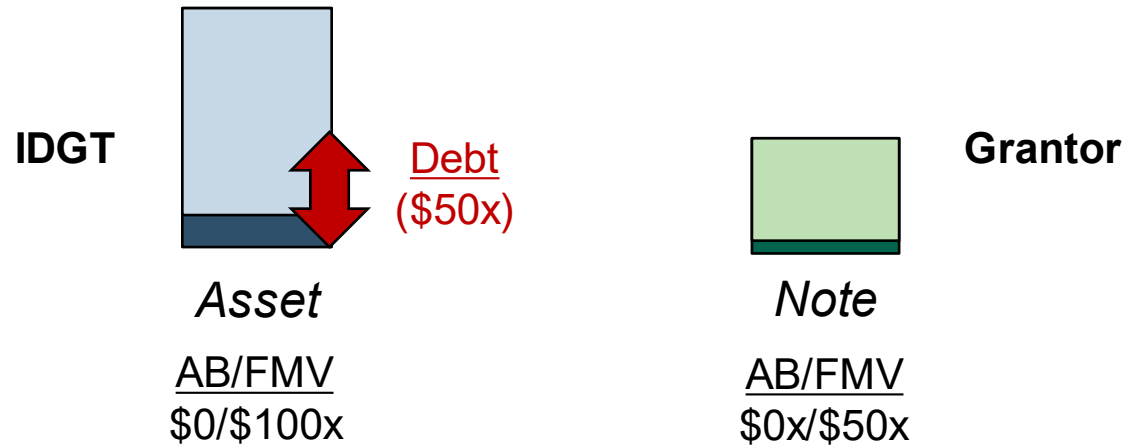
**Section
754
Election**



*Eliminating Outstanding Installment Notes,
Avoiding Gain At Death, and
Getting A “Step-Up” On The IDGT Property*



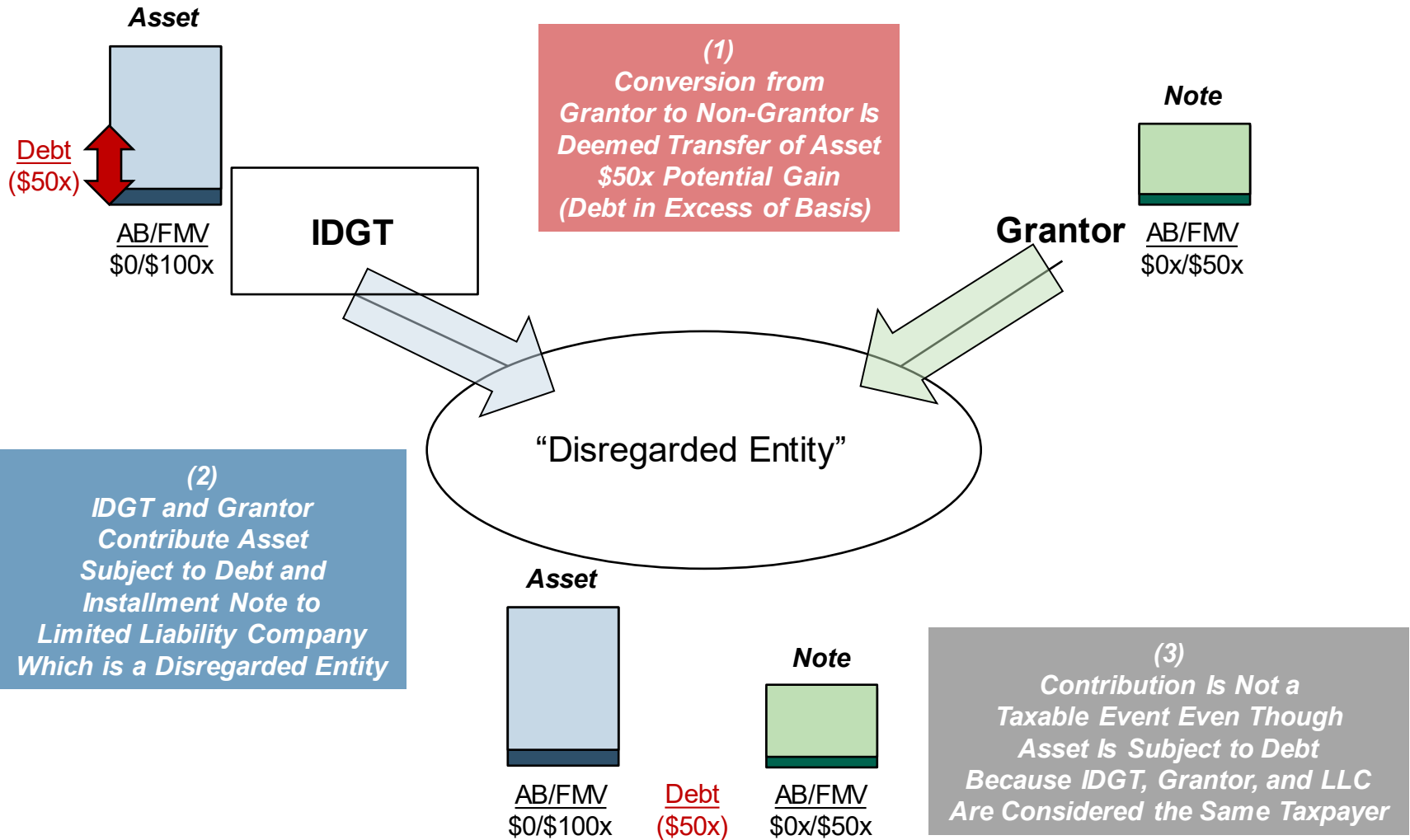
Installment Sale to IDGT and Outstanding Note



***Potential \$50x Taxable Gain
Upon Conversion of
Grantor Trust to Non-Grantor Trust***

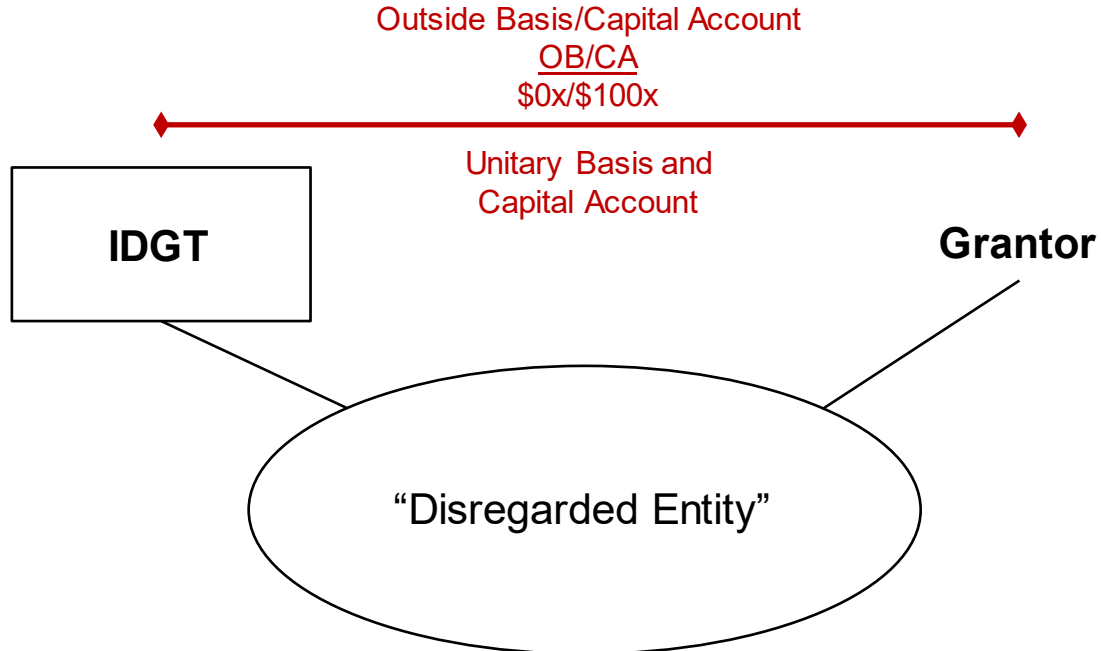


Making the Debt Disappear with a Disregarded Entity

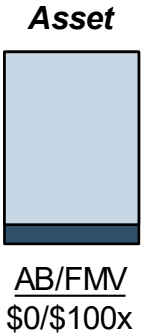




Debt “Merges” and Disappears: Non-Taxable Event

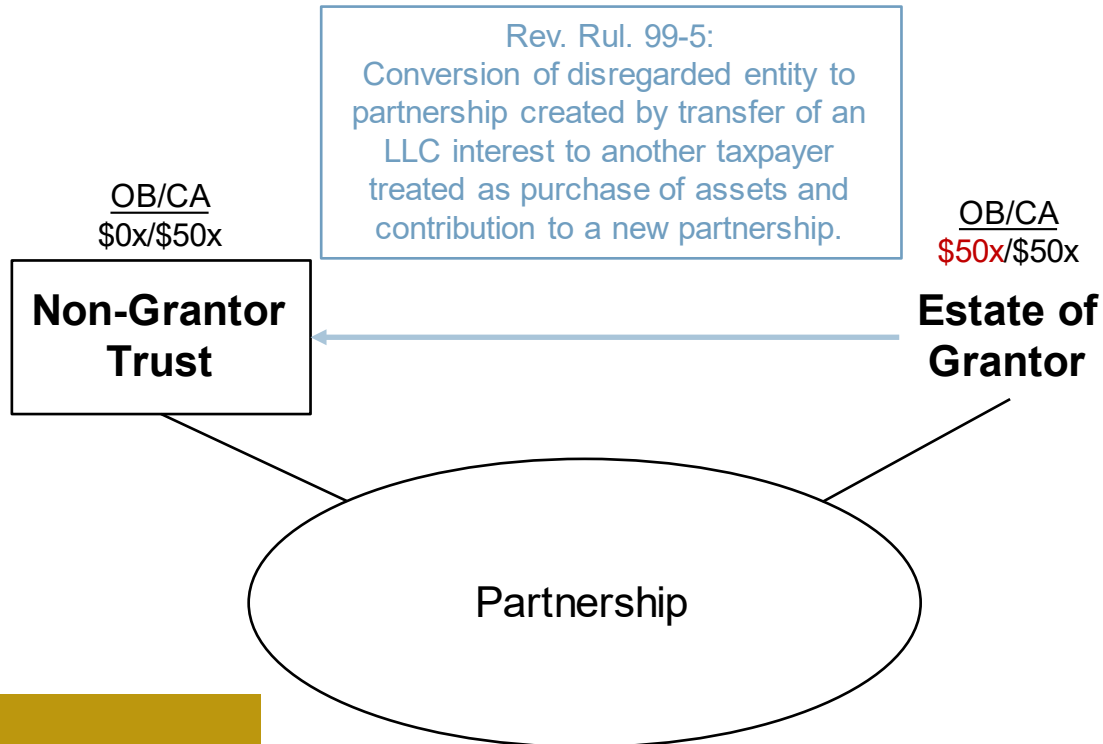


(4)
*Debt Obligation and the Note
“Merge” and the Debt is Deemed
Extinguished. No Cancellation of
Indebtedness Because IDGT, Grantor, and
LLC Are Considered the Same Taxpayer*

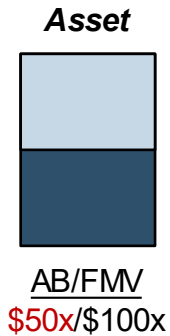




Death of Grantor: Disregarded Entity to a Partnership



(5)
Grantor's Death Converts the LLC to a Partnership for Tax Purposes. Treated as the Creation of a New Partnership: Grantor's Portion of the Asset Gets a "Step-Up" in Basis and Is Contributed to a Newly Formed Partnership.



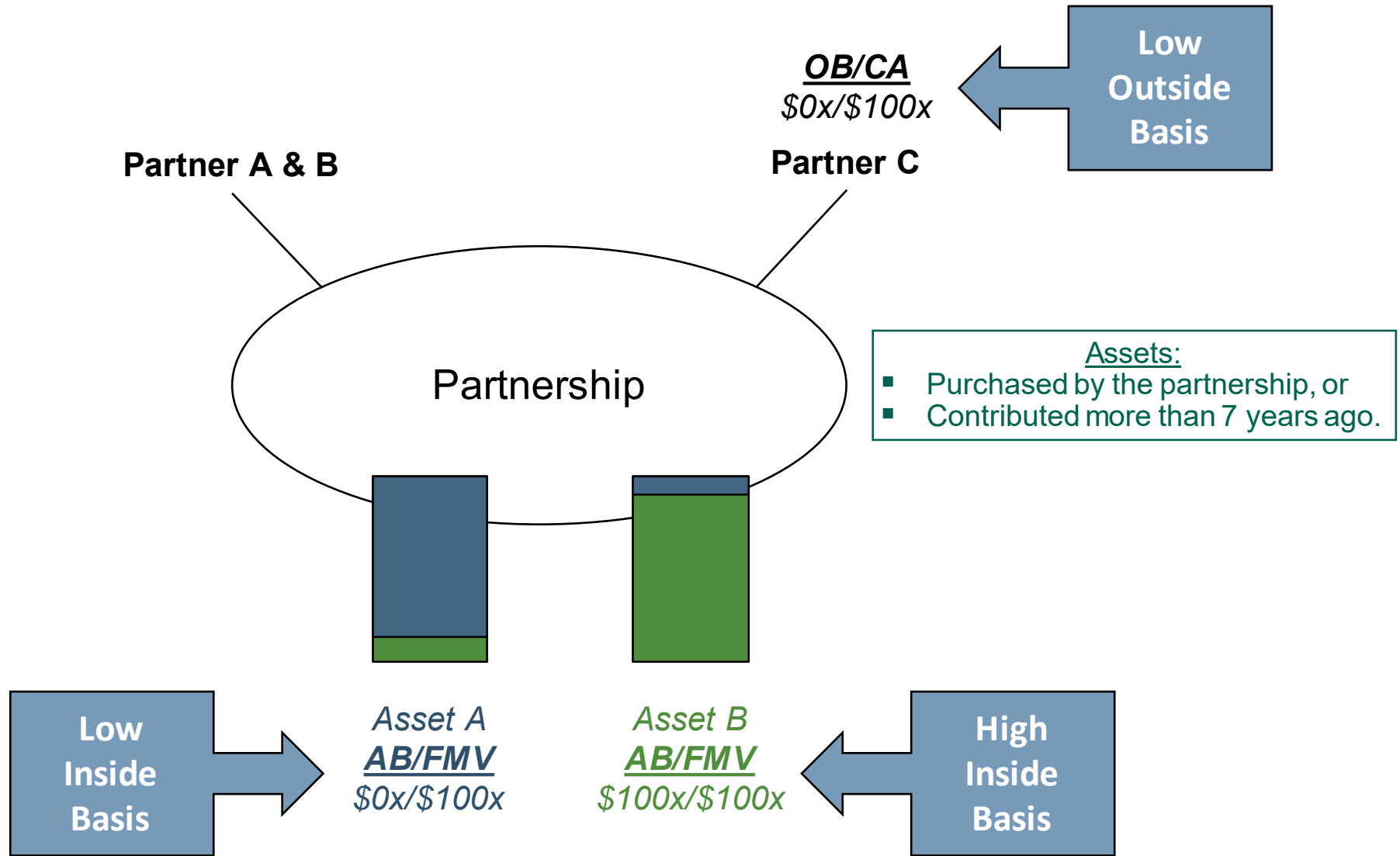
- (6)
End Results:
- a) *No Gain on the Grantor's Death;*
 - b) *Asset in IDGT Gets a Partial Basis Adjustment under § 1014; and*
 - c) *No Installment Note Included in Grantor's Estate.*



The Basics of Basis Stripping, Shifting, and Swapping

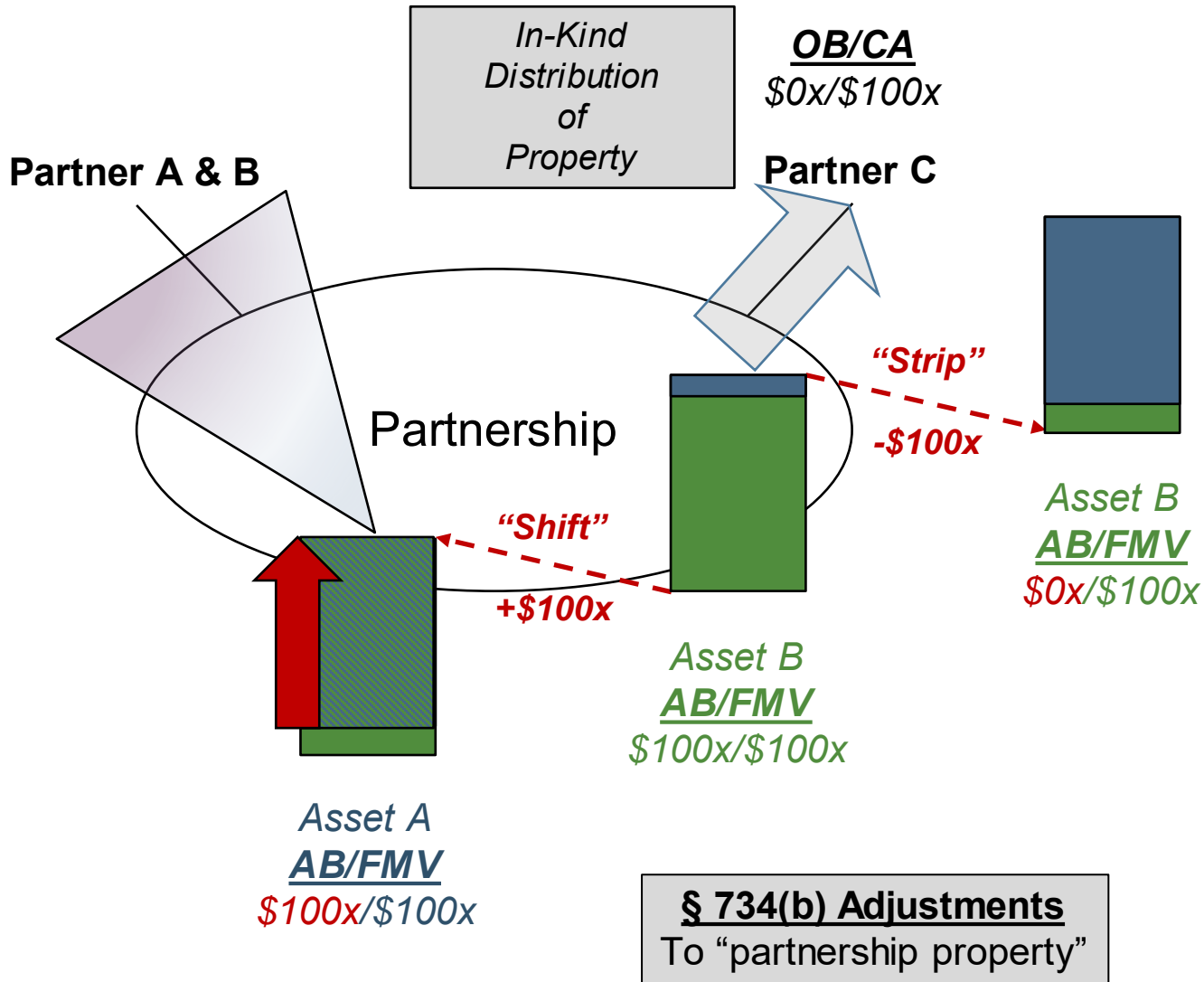


The Basic Elements





“Strip” Basis with Distribution & “Shift” with Election

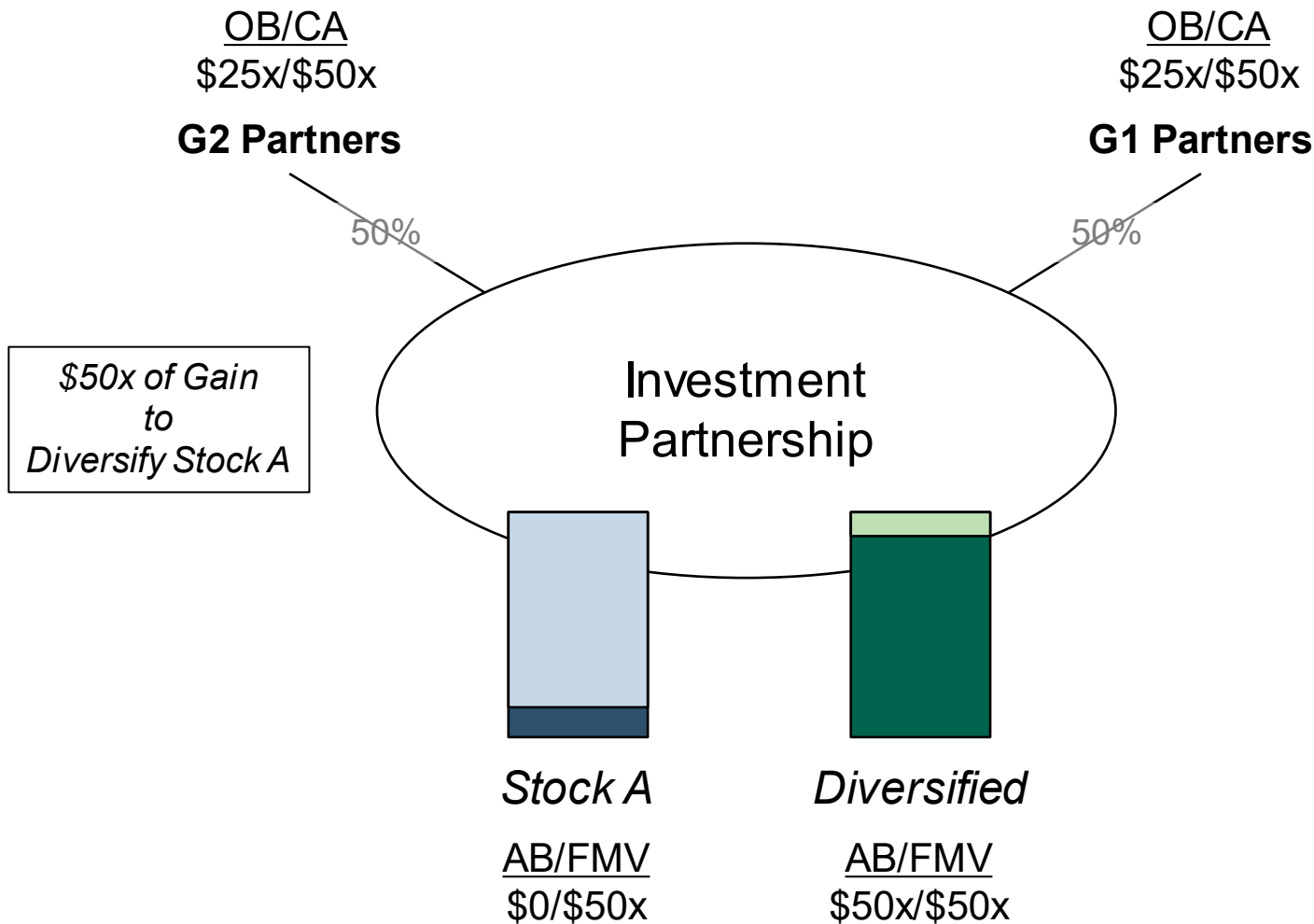




***Creating, Stripping, and
Shifting Basis
(Even with Marketable Securities)***

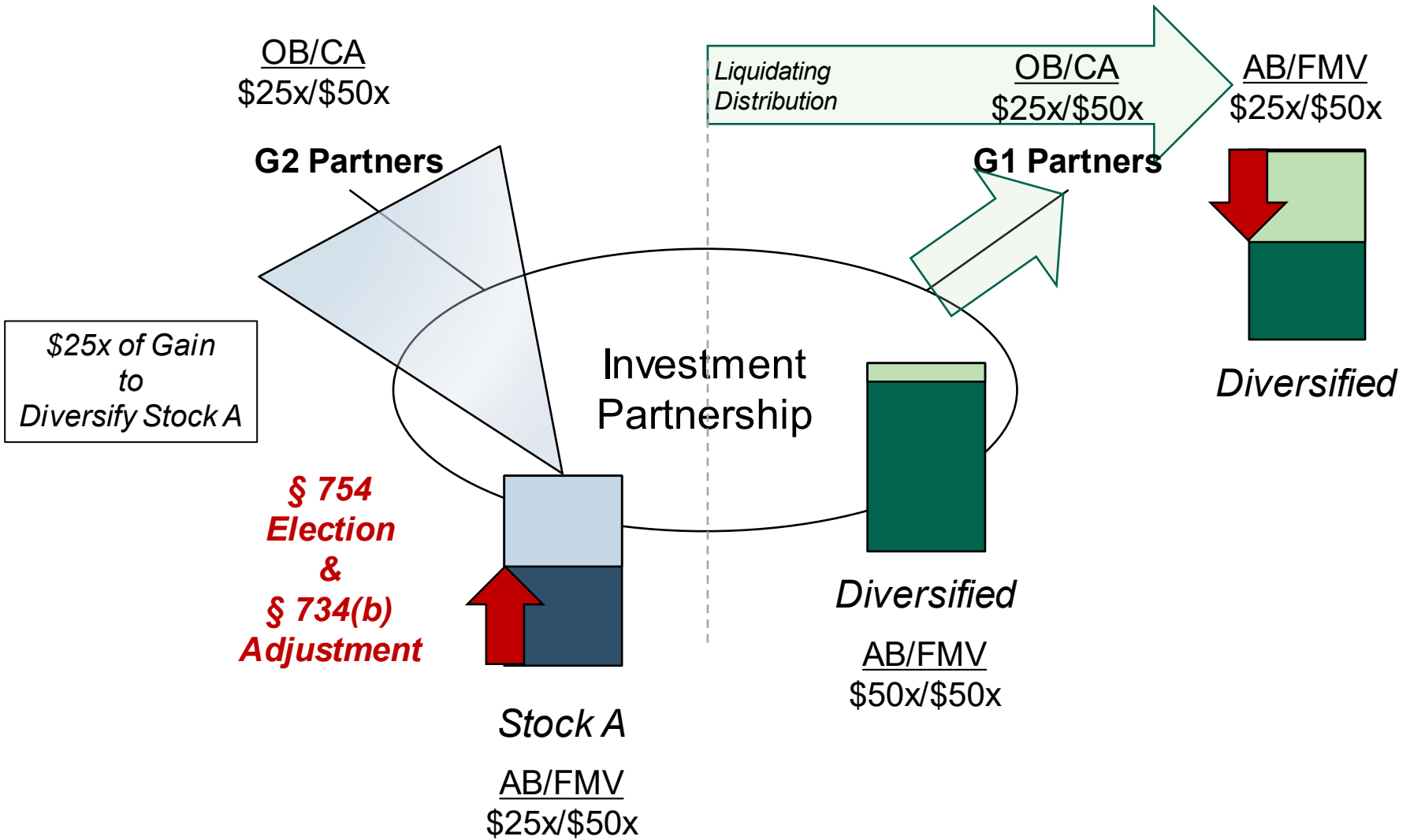


Basis Shift From Diversified to Concentrated



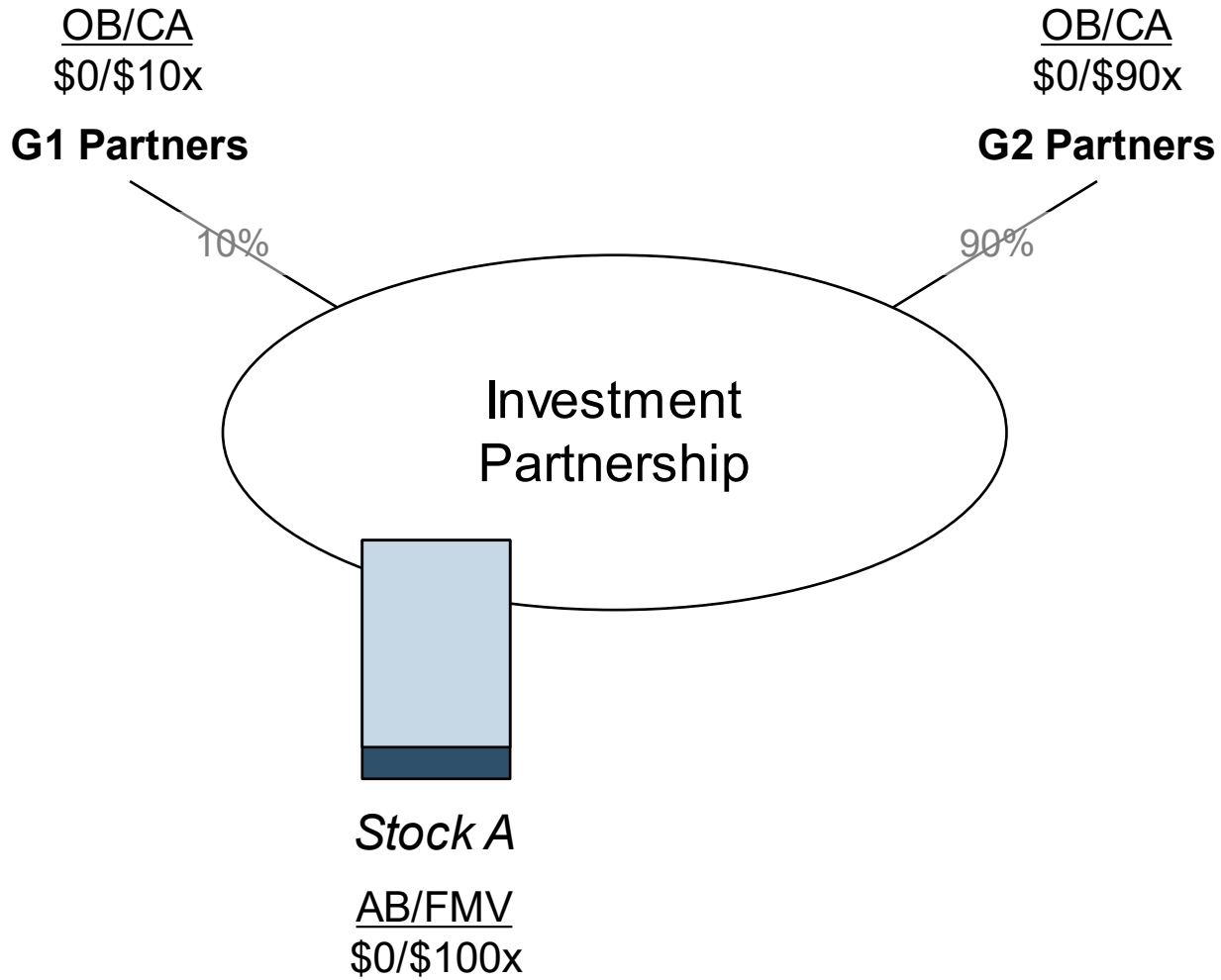


Basis Shift From Diversified to Concentrated



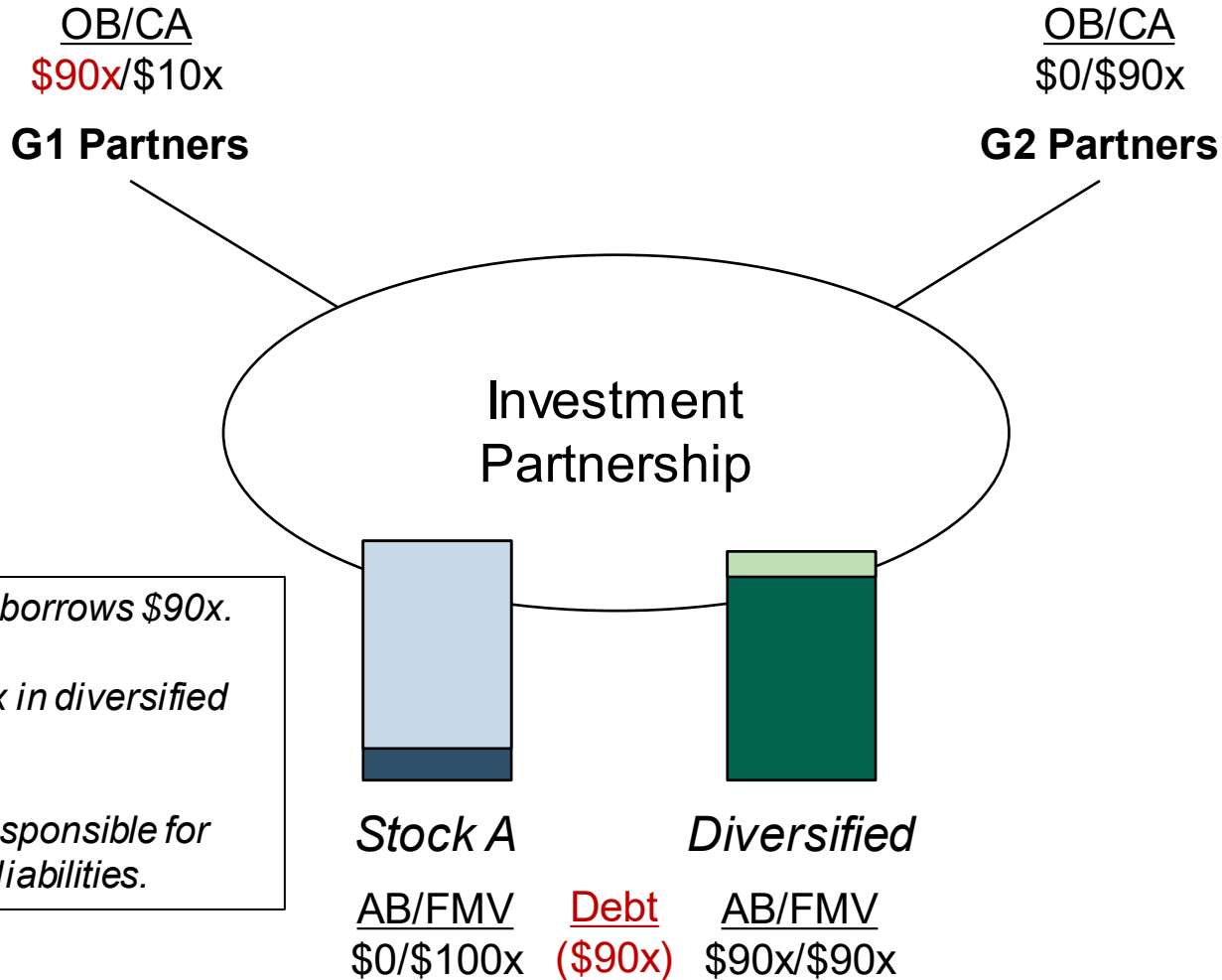


Debt to Exchange Concentrated for Diversified Position





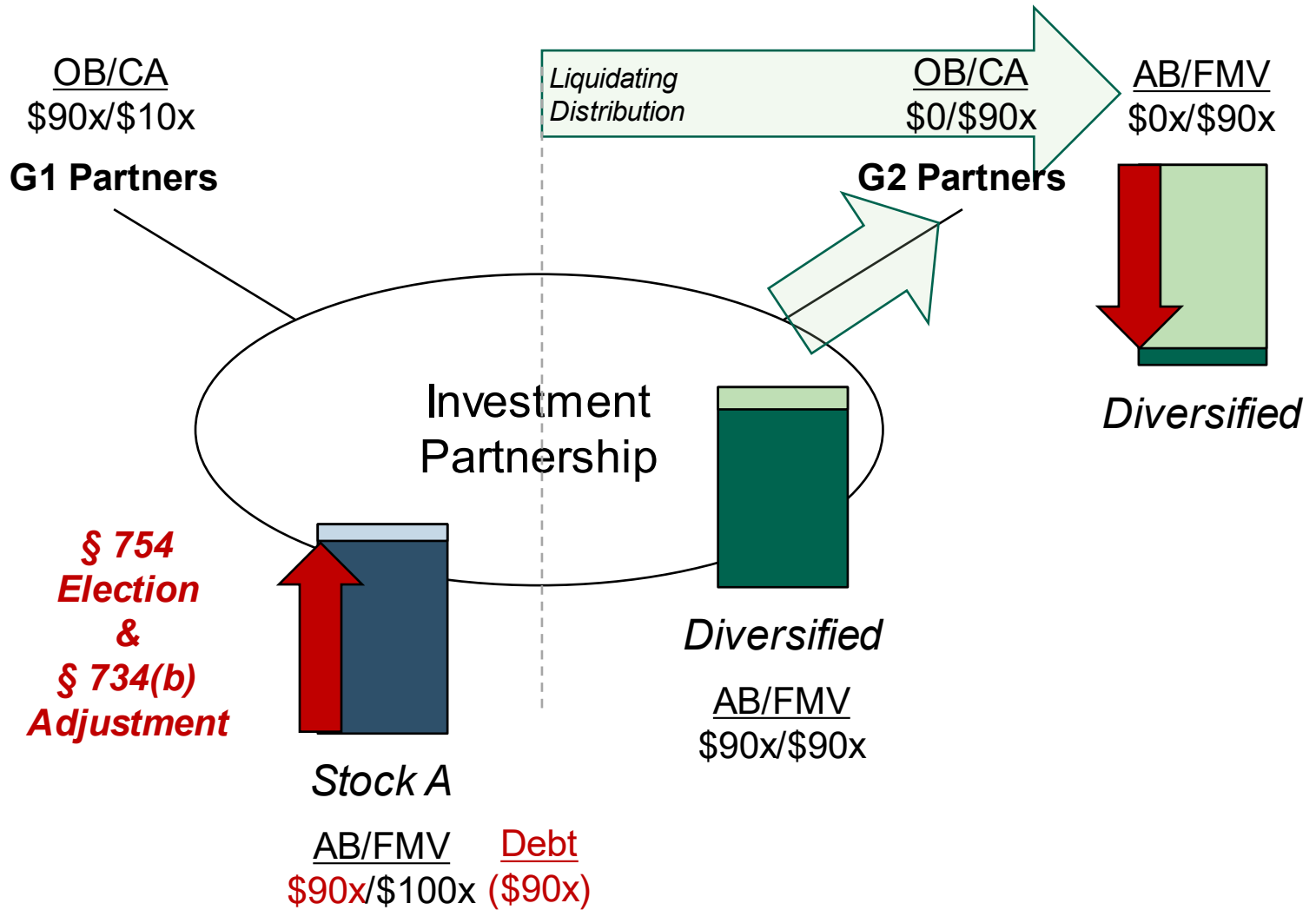
Debt to Exchange Concentrated for Diversified Position



1. Partnership borrows \$90x.
2. Invests \$90x in diversified portfolio.
3. G1 solely responsible for partnership liabilities.



Debt to Exchange Concentrated for Diversified Position

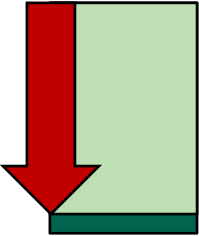




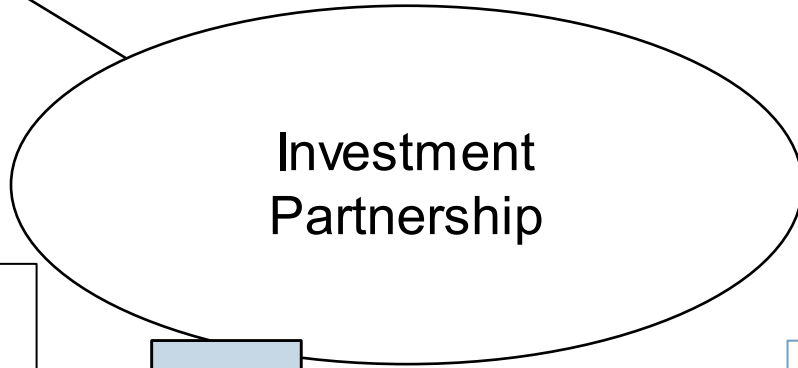
Debt to Exchange Concentrated for Diversified Position

OB/CA
~~\$9x/\$10x~~
G1 Partners

AB/FMV
\$0x/\$90x
Former G2 Partners



Diversified



Stock A
AB/FMV
~~\$9x/\$10x~~

1. Sells 90x of Stock A (\$81x of AB).
2. Recognizes \$9x of gain (+9x OB of G1=\$99x).
3. Repays \$90x to lender (-\$90x OB of G1=\$9x).

Isn't this just an exchange fund?
Can this be used with tangible personal property in lieu of a "like-kind" exchange?



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