FEATURE:
ESTATE PLANNING & TAXATION

By **Elizabeth Garlovsky**

Everything Old is New Again

Drafting tips under the Tax Cuts and Jobs Act

In the wake of the Tax Cuts and Jobs Act of 2017 (the Act),[1] which became effective on Jan. 1, 2018, we find ourselves faced with arguably the most significant changes to the U.S. Tax Code since 1986. As a result, we're flooded with information as to how to respond and how best to advise our clients going forward. Memories of the Economic Growth and Tax Relief Reconciliation Act from 2001, and of the American Taxpayer Relief Act from 2013 (not to mention the 2010 Tax Act that reinstated the estate tax and introduced for the first time a $5 million basic exclusion amount[2] and portability[3]), come rushing back as well.

Over the past 17 years, several dramatic changes in the transfer tax laws have repeatedly led to urgent action needed to ensure that our clients' estate plans would still accomplish their goals. We quickly learned in 2001, as we faced rising exemption amounts and a potential repeal, that to provide the most security for our clients, we had to modify our estate-planning forms and approach drafting in ways that disrupted decades of reliance on the old regime. We rewrote our formula clauses and found ways to make our documents more flexible and, therefore, compliant with the new laws as well as to make sure that we covered as many bases as possible in times of uncertainty. While the Act once again causes disruption, there's no need to panic. We've been here. We've done this. We've survived and come out better than before, armed with a toolbox that isn't yet obsolete.

The Act is creating a lot of buzz and maybe even a lot of headaches. However, it's also a gift in disguise to us as drafters of estate-planning documents. The gift comes in the form of an opportunity. While arguably forced on us, we have an opportunity to counteract complacency by forcing ourselves to review our forms and reach out to our clients. While we're taking the time to update our forms to respond to the Act, we can also take the opportunity to modernize our clients' documents by including digital asset planning and dispute resolution clauses to help reduce exposure to litigation.

Here are some drafting tips and techniques to address the Act, as well as other recent developments in areas such as digital asset planning and planning to address litigation, which become more relevant every day.

Planning in General

The Act presents us with an opportunity to give options to our clients both with respect to lifetime gifting as well as testamentary planning. It includes a huge increase in the exemption amount, along with some radical changes to the income tax laws. While some clients will benefit from taking advantage of the increased exemption through making large gifts, many clients will remain reluctant to gift because their estates are even less likely to be subject to estate tax at death. We must be able to put clients in a position, through our advice and our drafting, to take advantage of the opportunity to reduce income tax liability as transfer tax liability issues dissipate.

So, now what? Where do we start?

Flexibility is Key

First and foremost, we must continue to remember that flexibility is key. Our documents must be able to withstand these changes without much effort. As estate-planning attorneys, we're painfully aware that it's not efficient to reinvent the wheel every time we draft a new estate plan. Our clients undoubtedly agree. They want to believe that they're hiring an expert who can

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prepare documents from forms using a certain amount of boilerplate language, which in turn saves them time and money. From our clients' perspective, we should be able to update our documents with a few keystrokes in no time. While we may never be able to make clients understand that careful drafting requires us, every time, to assess how the form fits the individual client and involves customization, we must remain vigilant and not succumb to a fill-in-the-blank style of drafting. Our responsibility to analyze how the provisions of our documents affect different clients is especially important considering the Act. The good news is, because of what we've learned from the historical changes to the transfer tax laws, we shouldn't have to overhaul our forms to address this new wave of changes. Those of us who have been diligent about changing the way we draft all along should be able to update our forms without too much effort. As a review, however, here are some suggestions for key sections of existing forms to reassess:

1. Review formula clauses and provisions of A-B trusts to ensure the amounts being allocated to the trusts, per the formula, still match the client's goals. With the increase in the exemption (again), a spouse could inadvertently be completely disinherited under a traditional plan.

2. Review powers of appointment (POA) everywhere in the document. As income tax planning has become more relevant, there may be a benefit to including general POAs (for purposes of achieving basis step-up) when limited POAs previously made sense. To that end, we should also review the objects of such powers. Many traditional documents allow spouses of descendants and charities as permissible appointees. Analyze whether this remains appropriate or, in some cases, should be added.

3. Review whether a multiple trust plan (A-B) still makes sense. With the increased exemption, it's possible that for married clients, a single fund marital trust that can qualify for either full or partial qualified terminable interest property (QTIP) treatment (perhaps to address state estate taxes)[4] will work just fine (not to mention that it often makes life easier for the clients). With a single fund marital trust, a *Clayton* QTIP trust[5] can also be used, which allows the portion of the trust over which no QTIP election is made to be distributable under more flexible terms and to beneficiaries other than the spouse (like a traditional "B" or credit shelter trust). A disclaimer approach can also be employed, which would allow the amounts of an outright bequest to a spouse, which the spouse disclaims, to automatically fund a trust that would qualify for QTIP treatment.

Portability can be equated with simplicity so long as we're diligent in advising clients of the advantages and disadvantages of relying on it in lieu of traditional trust planning.

4. Add trust protectors. Many of us have been incorporating trust protectors into our documents for the better part of the last decade in response to the ever-changing laws. Trust protectors can be an incredibly useful tool to address unanticipated changes not contemplated when the document is initially prepared and executed. Trust protectors needn't be active participants in the trust; rather, you can include a mechanism in the document for the appointment of a trust protector as needed. Here's sample language for designation of a trust protector:

> **Designation of Trust Protector.** I may designate the initial trust protector for any separate trust created hereunder. Upon my inability to manage my own affairs or upon my death, the then acting

successor trustee may designate the initial trust protector. Any such designation shall be made by written instrument signed by the party making such designation and accepted by the designated trust protector. A copy of this written instrument shall be delivered to the current income beneficiary of such trust, the trustee and the party being designated as trust protector, with the original instrument stored with the trust records. The trust protector alone shall be able to exercise the powers conferred under this Article, and shall have no other rights, powers, authorities or duties under this Agreement…

Helping clients navigate options to help reduce income taxes overall as part of their planning will separate the everyday estate planner from the true advisor.

5. Lock in portability. Portability planning (discussed in more detail below) is more relevant now than ever. It's a good idea to make sure that a trustee is authorized to make the election (notwithstanding the expense involved). This is especially important in blended families. The surviving spouse is the only person who can make the election and the only person with an interest in the value of the election.[6] Some sample language to consider:

Special Provisions for DSUE. To the extent no executor is appointed, the trustee is authorized (unless directed otherwise in writing by my spouse) to calculate the amount of my deceased spousal unused exclusion amount under Section 2010(c)(4) of the Internal Revenue Code of 1986, as amended and as in effect from time to time (the "Code"), and elect to have such amount taken into account on my estate tax return under Section 2010(c)(5) of the Code. The trustee is authorized to pay any expenses or costs associated with making such election. The trustee shall notify my spouse that such election was made, and shall provide evidence of such election, including the total deceased spousal unused exclusion amount for which the election was made. In the event an executor is appointed but the executor fails to make such election, I authorize the trustee to make such election independent of the executor (subject to my spouse's written direction to the contrary).

Increased Exemption

Second, we want to find ways to help our clients address and take advantage of the increase in exemption. Don't worry; this isn't hard. Consider:

1. Portability planning. The Act preserved portability (for federal estate tax purposes only). We haven't yet let our guard down with portability. Portability was essentially designed to benefit those individuals who never made it to their attorney (or maybe, if not more likely, didn't want to pay the fees for a plan) by allowing a surviving spouse a credit on his subsequent death for the unused exemption of the predeceased spouse. Portability can be equated with simplicity so long as we're diligent in advising clients of the advantages and disadvantages of relying on it in lieu of traditional trust planning. Some of the obvious advantages include the ability to forego trust planning, the ability to achieve maximum basis step-up at both spouses' death (because no assets will fund a family trust) and the ability to consider planning around state estate taxes. Some of the disadvantages include the fact that the generation-skipping transfer tax exemption isn't portable, and many states don't allow a taxpayer to port the unused state exemption of his spouse, which can be problematic especially in situations in which one spouse has more assets than the other and/or in blended families.

2. Lifetime gifts. There are many different trust vehicles to choose from that will allow clients to remove assets from their taxable estates during this pre-2025 window. The maximum basic exclusion was doubled from $5 million to $10 million, indexed for inflation.[7] Taken together with the increased annual exclusion amount increase (now $15,000/donee[8]), gifting has

become even more powerful. If outright cash gifts are unattractive to the donor, or perhaps not appropriate for the donee, there are several different types of trusts that require minimal administration, which make them attractive to many clients. To name a few:

a. Irrevocable gift trusts for descendants
b. Lifetime QTIP trusts
c. Lifetime credit shelter trusts
d. Spousal limited access trusts
e. Irrevocable life insurance trusts

If the goal is to use the exemption amount for both spouses, then before we consider any of the trust options, it's important to take a fresh look at the reciprocal trust doctrine.[9] In many cases, other than the goal of reducing the taxable estate, the goals for each trust established by each grantor/spouse are inherently different at the outset. However, we can't forget to illustrate the differences through our drafting. We can't be slaves to our templates. It's a good idea to establish these trusts in different years with a decent time lapse in between them. Distribution standards can (and often should) vary, especially given the outside assets of the beneficiary. Similarly, one spouse may be better off with a corporate trustee or co-trustee versus simply naming each spouse as the other's trustee. There may be children from prior marriages to consider, or children with special needs, and as such, we should analyze POAs carefully.

Income Tax Planning

We must take into consideration that clients may be better off planning to reduce their heirs' and legatees' exposure to income taxes by drafting around achieving maximum step-up in basis. Also, helping clients navigate options to help reduce income taxes overall as part of their planning will separate the everyday estate planner from the true advisor. The following

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non-exhaustive list of options are available:

1. General POAs. One technique that we can use with little to no effect on the client during lifetime is to allow an independent third party to grant a beneficiary (typically the surviving spouse) a general POA to force estate inclusion. If there are concerns that the spouse won't use the POA in a desirable way, the power can be made exercisable only in favor of creditors. We must exercise caution with this technique and implement it only when the facts demonstrate that in fact creditors aren't a significant threat.

2. Turning off grantor trust status. The benefits of the grantor being treated as the owner of a trust for income tax purposes may be diluted under the Act, especially when estate taxes are no longer an issue.

Some practitioners avoid arbitration clauses because they can frustrate the intent of the grantor of the trust and/or bind remainder beneficiaries unfairly.

3. Gifts to Internal Revenue Code Section 529 plans. With the expansion of permissible uses of assets in a Section 529 plan (which may vary by state), encourage clients to explore increased gifting to a Section 529 plan. Many states offer a state income tax deduction for contributions to specific plans, and the assets within the plan grow income tax-free.[10]

4. Charitable planning. For charitably inclined clients who also like simplicity and who'll continue to itemize deductions on their income tax returns, the Act provides that charitable contributions of cash to qualified charities are deductible up to 60 percent of an individual taxpayer's adjusted gross income.

Technology/Digital Assets

Separate from what's happened or will happen to the Tax Code as we know it (or as we knew it), as technology continues to rule the day, we must continue to make the disposition of our clients' digital lives a priority. Technology continues to advance with lightning speed both with respect to how we handle digital assets and how we use technology to be more efficient. One recent case decided late last year by the Supreme Court of Massachusetts shows a welcome moving of the needle in the direction of easier access to a decedent's digital assets.

In *Ajemian v. Yahoo, Inc.*,[11] following the death of John G. Ajemian, his brother and sister were appointed as co-administrators of his estate. They sought access to an email account owned by John (and his brother). Yahoo denied the access based on the Stored Communications Act (SCA).[12] Yahoo asserted that its Terms of Service governing the email account granted it discretion to deny the request. The siblings sued Yahoo, and ultimately, the court decided that the SCA doesn't prohibit Yahoo from voluntarily disclosing the contents of the account when the personal representatives of the estate authorize such disclosure. **Lesson:** Address digital assets in the documents you prepare for clients. While there's still no guarantee that a personal representative will be successful in subsequent challenges, especially in other jurisdictions, this case lays the foundation that courts may be able to intervene and help survivors of loved ones obtain crucial information that lives only on the Internet.

Two other recent cases illustrated the application of and tested New York's recently enacted digital assets statute. Both *Estate of Serrano*[13] and *Estate of White*[14] involved attempts by personal representatives to gain access to a decedent's Google account under New York's digital assets statute.[15] Under this statute, a personal representative is provided with a clear mechanism to request a "catalogue" of a decedent's electronic communications. This includes a list of emails exchanged, contacts and calendar entries (but not content, which would be the actual text in emails exchanged). The court found that Google was bound to provide the catalogue access on the requirements of the statute being met. New York's law also provides for a personal representative to gain access to content, but only with a specific grant of access by the decedent or a court order. We should be including comprehensive provisions in our documents, as opposed to merely relying on state law, to maximize the fiduciary's access to digital property.

Here's a sample provision for dealing with digital assets:

TRUSTEE POWERS.

Digital Property. The trustee shall be authorized to access, handle, distribute and dispose of digital devices, digital assets and digital accounts ("Digital Property") that may comprise any portion of the trust estate. As used herein, "digital devices" shall include, but not be limited to computers, tablets, storage devices and cellular phones; "digital assets" shall include digital content (and not only catalogues of content), including without limitation, electronic mail, calendar entries and contacts, electronically stored documents, images, video or other files, regardless of the ownership of the physical device upon which the digital asset is stored; and "digital accounts" shall include but not be limited to electronic mail accounts, websites, blogs, social network and media accounts (such as Facebook, Twitter, LinkedIn, Instagram, Dropbox, Evernote and the like) financial management accounts, online store accounts (such as Amazon, PayPal, Google Wallet, iTunes and the like) and other online accounts, and all associated logins, passwords, security codes and security questions.

Dispute Resolution

With the increased exemption amount, many clients will lose interest or motivation to engage in complicated tax planning. However, as we face what will likely be the largest intergenerational transfer of wealth in our country, making sure estate-planning documents are in order has never been more important. Experts predict that over the next 30 to 40 years, more than $30 trillion in assets (financial and non-financial) will change hands.[16] As a result, fiduciary litigation, which has seen a significant uptick in the last 10 to 15 years, is becoming a trend that's not likely to change anytime soon. Many beneficiaries or potential recipients of this wealth view their inheritances as a substitute for hard work or retirement planning.

Fiduciary litigation cases are usually complex as emotions run high. Much like divorce attorneys, we often face the dilemma in these cases as to whether protracted litigation is the right path, especially when the litigants don't have access to funds to finance the litigation or the emotional wherewithal to go through the experience. We can take the approach of our counterparts who prepare agreements to document divorces and commercial transactions and include alternative dispute resolution clauses in our trust documents. There are two basic types of alternative dispute resolution that are easy to incorporate into a trust agreement (but should be done with careful consideration only): (1) mediation, and (2) binding arbitration.

Mediation involves the engagement of a third, neutral party to assist parties in conflict with the negotiation of a settlement of a dispute. The process of mediation can begin before any party files a pleading in court and can be required in the document. The goal of mediation is to deter disputing parties from taking their case to court by encouraging a reasonable settlement. The document (that is, the trust agreement) can direct the disputing parties to engage in mediation as a first line of defense. The document can also specify how the mediator will be selected and how mediation fees will be handled. Regarding fees, they can be paid by the trust or by the disputing parties. For example, a trust agreement might provide the following language:

> We can use this time of uncertainty to provide security for those who may be vulnerable to issues more universal than estate taxes.

Mediation of Disputes. Upon my incapacity or death, if any dispute arises between or among one or more trustees, beneficiaries, trust protectors or any other fiduciary ("disputing parties") with respect to the administration of the trust or any trust created hereunder, the disputing parties shall make a good faith effort to settle any such dispute through mediation administered by a certified mediator. The cost of mediation shall be [borne equally by the disputing parties] OR [paid for by the trust]. The disputing parties shall make reasonable efforts to agree on the mediator to employ for the mediation. Said mediator shall have at least

> ten (10) years' experience in trust law of the state that governs the situs of the trust. If the disputing parties cannot reach a settlement within sixty (60) days of the commencement of mediation, I direct the disputing parties to submit to arbitration as provided herein.

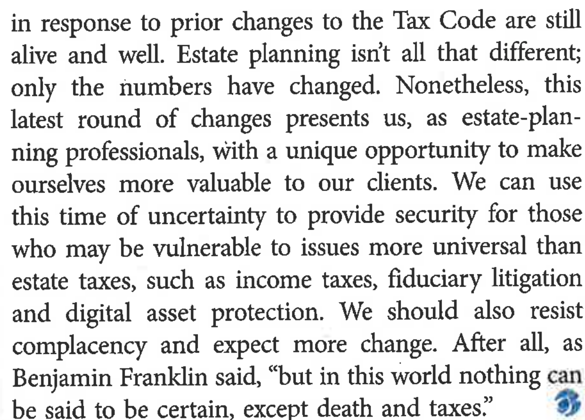
Arbitration is the process of engaging a third, neutral party to resolve the dispute and make a decision that will be binding on the disputing parties. The disputing parties will enter into a written agreement in which they'll agree to be bound by the arbitrator's decision. Some practitioners avoid arbitration clauses because they can frustrate the intent of the grantor of the trust and/or bind remainder beneficiaries unfairly.[17]

Before we contemplate how to incorporate mediation and/or arbitration clauses into our trust agreements or other testamentary documents, we mustn't forget about the powerful, more familiar tool known as the "no contest" clause, which can cut a potential disputing party off at the pass. Sometimes referred to as "in terrorem clauses," these provisions serve to disinherit any party to a trust or estate who challenges the document in any way. The enforceability of in terrorem clauses varies by state.

A sample no contest clause might read as follows:

> **No Contest Clause**. I have taken great care to designate, through the provisions of this trust, how I desire the property in the trust to be distributed and the trust to be administered after my death. I do not want the trustee or the beneficiaries to be involved in time-consuming and costly litigation concerning the function of the trust and distribution of the assets. Therefore, if an heir, beneficiary, or a representative thereof, or anyone claiming to have a beneficial interest in the trust should legally challenge the trust, its provisions or distribution of the assets, then all gifts or distributions intended for said challenging individual shall lapse and be of no effect for the challenging individual or his or her heirs. Such challenging individual and his or her heirs shall be treated as having predeceased me for all purposes hereunder.

Unique Opportunity



Many of the changes we've made to the way we practice in response to prior changes to the Tax Code are still alive and well. Estate planning isn't all that different; only the numbers have changed. Nonetheless, this latest round of changes presents us, as estate-planning professionals, with a unique opportunity to make ourselves more valuable to our clients. We can use this time of uncertainty to provide security for those who may be vulnerable to issues more universal than estate taxes, such as income taxes, fiduciary litigation and digital asset protection. We should also resist complacency and expect more change. After all, as Benjamin Franklin said, "but in this world nothing can be said to be certain, except death and taxes."

Endnotes

1. Also known as Public Law No. 115-97.
2. Internal Revenue Code Section 2010(c)(3).
3. IRC Section 2010(c)(4).
4. IRC Section 2056(b)(7).
5. *Estate of Clayton v. Commissioner*, 976 F.2d 1486 (5th Cir. 1992).
6. *In re Estate of Vose*, 390 P.3d 238 (Okla. 2017).
7. The basic exclusion amount provided for in IRC Section 2010(c)(3) will be indexed for inflation using the new "chained CPI approach" under the Tax Cuts and Job Act. Pursuant to Revenue Procedure 2018-18, issued March 5, 2018, the basic exclusion amount for 2018 was set at $11.18 million per individual.
8. IRC Section 2503(b).
9. The reciprocal trust doctrine is judicially created and provides that if two trusts contain certain characteristics which render them virtually identical, the trusts can be "unwound" and includible in the estates of the grantors. *See United States v. Grace*, 395 U.S. 316 (1969).
10. IRC Section 529(a).
11. SJC-12237 (Mass. Oct 16, 2017).
12. 18 U.S. C. Sections 2701, et seq.
13. *Estate of Serrano*, 54 N.Y.S.3d 564 (2017).
14. *Estate of White*, 2017 NYLJ Lexis 2780.
15. New York adopted the Revised Uniform Fiduciary Access to Digital Assets Act of 2015 and added it as Article 13-A of the Estates, Powers and Trusts Law.
16. Accenture, "The 'Greater' Wealth Transfer: Capitalizing on the Intergenerational Shift in Wealth" (2015), *www.accenture.com/us-en/-/media/Accenture/Conversion-Assets/DotCom/Documents/Global/PDF/Industries_5/Accenture-CM-AWAMS-Wealth-Transfer-Final-June2012-Web-Version.pdf.*
17. For a more thorough discussion on the use of arbitration in trust and estate matters, including sample language, *see* Bridget A. Logstrom, "Arbitration in Estate and Trust Disputes: Friend or Foe?" 30 *ACTEC Law Journal* 266 (2005) and Bridget A. Logstrom, Bruce M. Stone and Robert W. Goldman, "Resolving Disputes with Ease and Grace," 31 *ACTEC Law Journal* 235 (2005).