



Attorneys for Family Held Enterprises
2018 Annual Meeting – Thursday, April 19, 2018
Wigwam Resort, Litchfield Park (Phoenix), Arizona

2018 Tax Update for Family Enterprises

Panelists:

Clarence G. Kehoe, CPA
Partner and Leader,
Anchin's Tax Department
(Anchin, Block & Anchin LLP)
212.840.3456
clarence.kehoe@anchin.com

Michael D. Whitty, Partner
Handler Thayer LLP
191 N. Wacker Dr., 23rd Floor
Chicago, IL 60606
312.960.2098
mwhitty@handlerthayer.com





Clarence G. Kehoe, CPA

Partner and Leader

Anchin's Tax Department (Anchin, Block & Anchin LLP)

clarence.kehoe@anchin.com

212.840.3456

- Leader of Anchin's Tax Department, Co-Leader of the Firm's Compensation & Benefits Services Group as well as a member of the Private Client Group and Executive Committee.
- Clients include employers and plan sponsors, closely held businesses, high net worth individuals, buyers and sellers of businesses, and individual executives.
- Quoted in *Forbes*, *USA Today*, *Fox Business*, *The New York Law Journal*, *The Wall Street Journal*, *Smart Money Magazine*, *Pension Plan Administrator*, *HR Magazine*, *Lawyers Weekly USA*, *New York Newsday*, and *TheStreet.com*. Has spoken at the National AICPA Conference on Employee Benefits and has appeared on national radio and television discussing tax planning.
- Member of the American Institute of Certified Public Accountants (AICPA), the New York State Society of Certified Public Accountants (NYSSCPA), and the New Jersey State Society of Certified Public Accountants (NJSSCPA).



Mike Whitty concentrates his practice in estate planning, taxation, and estate and trust administration. Mr. Whitty represents business owners, principals of venture capital and private equity funds, key executives, investors and other high-net-worth individuals in planning for the preservation and transfer of their wealth. Specifically, he advises individuals and fiduciaries in the design and drafting of estate plans, wills, trusts, lifetime gifts, premarital agreements and other estate planning documents.

Mr. Whitty has extensive experience with various types of trusts, family limited partnerships, corporate recapitalizations, shareholders' and redemption agreements, private annuities, installment sales, intra-trust sales and other transactions, self-canceling installment notes and net gifts. He also reviews and manages estate and gift tax returns, including complex reporting and valuation issues.

Mr. Whitty consults with executors, administrators, guardians and trustees in probate and trust administration. He supervises the drafting of estate administration documents and the filing of pleadings, motions and accountings with probate courts. He also advises clients in connection with litigation involving disputes between trustees and beneficiaries and in contested trust and tax matters, and he has served as an expert witness in such cases.

Mr. Whitty is a Fellow of the American College of Trust and Estate Counsel, a Fellow of the Family Firm Institute (holding certificates in Family Wealth Advising and Family Business Advising), a member of Attorneys for Family-Held Enterprises and a member of the Chicago Estate Planning Council. He was an active member in the American Bar Association through August of 2013, in which he served on the Section Council and as Chair of the Wealth Planning and Nontax Issues Group of the Probate and Trust Division in the Section of Real Property, Probate and Trust Law.

Mr. Whitty served for three years as an adjunct professor at the Northwestern University School of Law, teaching a course titled "Federal Estate and Gift Taxation and Estate Planning." He is a Certified Financial Planning practitioner (CFP™) and a member of the Financial Planning Association of Illinois. Mr. Whitty has been named to Illinois Super Lawyers and Illinois Leading Lawyers. He also received an "AV Preeminent" Peer Rating in Martindale-Hubbell.

Mr. Whitty is a frequent speaker on estate and financial planning topics, appeared on the PBS program Nightly Business Report and on WGN Chicago, and has been quoted in the Wall Street Journal. Mr. Whitty earned a BBA (1983) and J.D. (1988) from the University of Texas at Austin.

INTRODUCTION AND DISCUSSION OVERVIEW

Our main focus is on the changes resulting from the
Tax Cuts & Jobs Act of 2017 (“TCJA2017”).

Introduction and Discussion Overview

- **Short Summary of Rate and Bracket Changes and Deduction Changes for Individuals and Enterprises**
- **Planning Considerations for Enterprises and Enterprise Owners**
- **Planning Considerations for Long-Term Ownership, including Estate, Gift, and GST Tax Changes**
- **Recap of Most Important Changes to Planning Considerations and Changing Paradigms**

TCJA2017: RATE AND BRACKET CHANGES FOR INDIVIDUALS AND ENTERPRISES

Individual Income Tax Rate Changes

- **Chart 1**
 - Lower Rates
 - Brackets kick in at lower levels
- **Chart 2**
 - Married, No Children, Standard Deduction
- Individual AMT is retained, but changes substantially, with thresholds increased
- All changes sunset after 2025 *except* alimony, corporate tax rate, 3-yr holding period for carried interest
 - **Note:** The materials are all available for download, so don't worry about not being able to read the "fine print" on-screen.

Ordinary Income Tax Brackets for 2018
Pre-reform Law vs. 2017 Tax Reform Act

Chart 1
Single;
Married Filing
Jointly

(Single)				(Married Filing Joint)			
Pre-reform		Tax Reform Act		Pre-reform		Tax Reform Act	
Taxable Income	Tax Rate	Taxable Income	Tax Rate	Taxable Income	Tax Rate	Taxable Income	Tax Rate
		Over \$500,000	37%			Over \$600,000	37%
				Over \$480,050	39.6%		
Over \$426,700	39.6%						
\$424,950	35%			\$424,950	35%		
						\$400,000	35%
						\$315,000	32%
				\$237,950	33%		
\$195,450	33%	\$200,000	35%				
		\$157,500	32%			\$165,000	24%
				156,150	28%		
\$93,700	28%						
		\$82,500	24%	\$77,400	25%	\$77,400	22%
\$38,700	25%	\$38,700	22%				
				\$19,050	15%	\$19,050	12%
\$9,525	15%	\$9,525	12%				
\$1	10%	\$1	10%	\$1	10%	\$1	10%

Chart 2

Examples across three ranges of ordinary income of married taxpayers, filing jointly, with no children or other dependents, and the standard deduction only (no itemized deductions):

	\$100,000 Income		\$200,000 Income		\$500,000 Income	
	2017	2018	2017	2018	2017	2018
AGI	100,000	100,000	200,000	200,000	500,000	500,000
Standard Deduction	12,700	24,000	12,700	24,000	12,700	24,000
Personal Exemption	8,100	0	8,100	0	8,100	0
Taxable Income	79,200	76,000	179,200	176,000	487,300	476,000
Tax	11,284	8,739	37,061	30,819	140,452	120,229
Tax Savings		2,545		6,242		20,223
Effective Tax Rate	14%	11%	21%	18%	29%	25%

Changes (Mostly Limitations) to Key Deductions

- **Personal Exemptions** (now gone)
- **Standard Deduction** (now larger)
- **Deductions for Adjusted Gross Income**
 - **Alimony** (no longer deductible/includible under §682 after 2018)
 - **Moving Expenses** (no longer deductible)
- **Net Operating Losses:** The NOL deduction will be:
 - limited to 80% of all taxable income (before consideration of the NOL)
 - Carried forward only (no more carrybacks)
 - Indefinite carryforward (no time limit)

Changes (Mostly Limitations) to Key Deductions

- **Deductions from Adjusted Gross Income – Itemized Deductions**
 - **PEASE Limitation** - removed
 - **Medical Expenses** - floor reduced from 10% to 7.5% of AGI for 2017-18 only; otherwise unchanged
 - **State and Local Taxes** - limited to \$10,000, individual or MFJ; \$5k MFS)
 - **Mortgage Interest Deduction** - cap lowered, HELOCs no longer deductible
 - **Investment Interest Expense** - unchanged
 - **Charitable Contributions** – deduction ceiling for cash gifts to public charities raised to \$60% of AGI from 50%; otherwise unchanged
 - **Miscellaneous Itemized Deductions Subject to the 2% Floor** - many not deductible at all anymore, especially investment advisory
 - **Casualty Losses** - generally non-deductible, exception for federally declared disaster areas

Other Changes

- **“Kiddie Tax”** *replaced* by rule that a child’s net unearned income will be taxed at the rates and brackets applicable to trusts.
 - If the rates and brackets applicable to trusts will apply anyway, the non-tax benefits of using a trust to hold the children’s investments become more valuable.
 - Under certain circumstances, especially for those not concerned with estate taxes, the paradigm may shift from grantor trust treatment as the default to complex-trust treatment using multiple trusts to run through lower brackets (a common pattern before 1993).
 - One grantor trust tax advantage persists; best to let the donor generation pay the tax out of those assets that would otherwise be subject to gift or estate taxes in the future.

Chart 3: "C Corp" Tax Schedule, 2017
Taxable Income and Resulting Tax

Over	But Not Over	Resulting Tax is
\$0	\$50,000	15%
\$50,000	\$75,000	\$7,500 + 25%
\$75,000	\$100,000	\$13,750 + 34%
\$100,000	\$335,000	\$22,250 + 39%
\$335,000	\$10,000,000	\$113,900 + 34%
\$10,000,000	\$15,000,000	\$3,400,000 + 35%
\$15,000,000	\$18,000,000	\$5,150,000 + 38%
\$18,333,333	∞	35%

- **New for 2018+**

- 21% flat tax for C Corporations, *across the board*
 - Yes, very low income C Corporations may see a tax *increase*

- **Also New for 2018 and Beyond**

- Corporate AMT *repealed*
- Territorial system replaces worldwide system
- C Corporations with average annual gross receipts under \$25MM can all use the cash method of accounting
- Section 1031 tax-free exchanges now limited to real estate
- Section 951A, adding “global intangible low-tax income” (GILTI) as an income inclusion item for CFC owners
- Three-year holding period for carried interest

- **Not New, But of Continued Value**

- C Corporations with less than \$50MM gross assets continue to qualify for the 100% exclusion on qualified sales under Section 1202

What is IRC §199A?

Deduction for **Qualified Business Income** From a **Passthrough Entity**

- **Passthrough Entity:** Applicable to Partnerships, S-corporations, and sole proprietors
- 20% deduction on **Qualified Business Income** (“QBI”)
 - QBI has to be effectively connected to / generated within the United States
 - Qualified REIT dividends, Cooperative dividends and PTP income *all eligible*
- Deduction limited to *lesser* of:
 - 20% of QBI, or
 - Allocable Wages
- Deduction based on Activity, not Entity
- Trusts and Estates are eligible for the deduction

IRC §199A :

Deduction for Qualified Business Income From a Passthrough Entity

Defining the Available Deduction - The lesser of:

- Combined Qualified Business Income (CQBI), or
- For each trade/business, the **lesser** of:
 - 20% of **QBI**, or
 - **Allocable Wages**, being the **greater** of:
 - 50% of W-2 Wages, or
 - 25% of W-2 Wages + 2.5% of Qualified Property
- Sweet spot of ~28% for salary vs. passthrough distributions

Exception to Wage Limitation

- **Exception** for wage limitation if the taxable income of the taxpayer does not exceed the **threshold amount**.
- The **threshold amount** is:
 - \$157,500 for a single taxpayer or
 - \$315,000 for a MFJ taxpayer.
- Taxpayers ***under*** the threshold amount:
 - are entitled to 20% of the deduction, and
 - are not subject to the limitations.
- Phase-out Brackets:
 - Single: \$157,500 - \$207,500
 - MFJ: \$315,000 - \$415,000

Specified Service Trade or Businesses

The §199A Deduction is further limited for a “**Specified Trade or Business**”, which means:

- any trade or business involving the performance of services in the fields of health, *law*, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or
- any trade or business where the principal asset of such trade or business is the *reputation or skill* of 1 or more of its employees or owners, performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

Specified Service Trade or Businesses

- **General Rule:** these services are *not* eligible for the 20% deduction
- **Full Exception:** if the taxpayer's income is *less than* \$157,500 for single taxpayers (\$315,000 for MFJ)
- **Limited Phase-Out Exception:** The deduction is available but is **phased out** over certain AGI ranges:
 - \$157,500 - \$207,500 for singles,
 - \$315,000 - \$415,000 for married filing jointly
- What does this actually mean? **Expect rulings to clarify:**
 - “any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners”

PLANNING CONSIDERATIONS FOR ENTERPRISES AND ENTERPRISE OWNERS

Choice of Entity in 2018 and Beyond

Convert to C Corp?

- Is it as simple as 37% versus 21%?
- Eligible for 20% deduction?
- Why did you opt for passthrough treatment to start?
- Tax Consequences of Converting
- Are your hands tied once you convert?
- The old AET on C Corporations
- One clear cut example of when C Conversion makes sense

Choice of Entity in 2018 and Beyond

Other Choice-of-Entity Considerations:

- Advantages S corporations used to have versus partnerships in certain situations, remain
- ESBTs are no longer disqualified if NRAs are permissible beneficiaries
- ESBTs with charitable distributions can take charitable deduction under §170 rather than §642(c), providing more flexibility

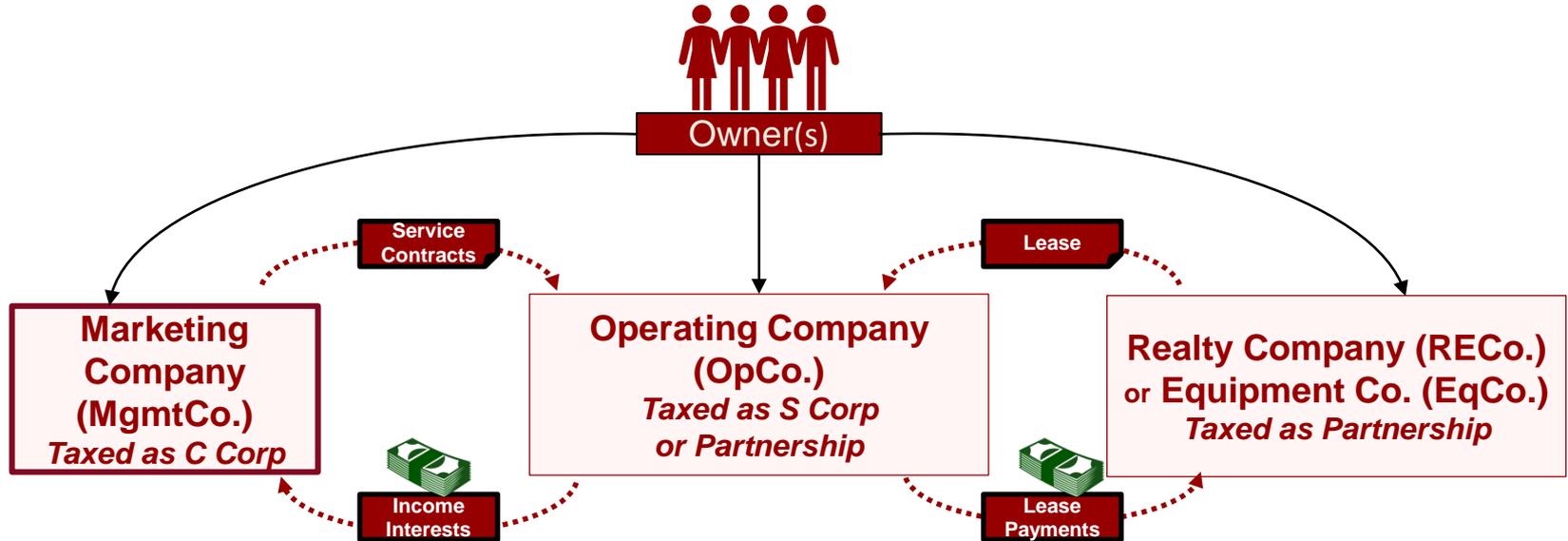
Choice of Entity in 2018 and Beyond

Instead of *converting* the operating company to a C Corp, what about *adding* one to the structure?

- Could ***provide services*** and ***absorb costs*** that would otherwise be of limited or no deductibility to the enterprise or its owners (*ex. marketing, investment, advisory*), in exchange for an ***income interest*** that carves income off the top instead of taking a deduction off the bottom.
- Non-deductible expenses offset by income taxed at 21%, rather than higher rates for the passthrough entity owners.
- See the recent *Lender* case for an illustration of how a well-structured, well-documented, and well-implemented family office structure can capture many expenses for a family and its enterprise, and fully deduct them.

Choice of Entity (Entities?) in 2018 and Beyond

Trifurcated Structure With Horizontal Divestiture



Some functions may be best run through an C corp.:

- Marketing, including entertainment, gifts, dues
- Services only deductible under §162 but not §212
- Expenses not deductible under either §162 or §212

Some operations may be best run through an S corp.:

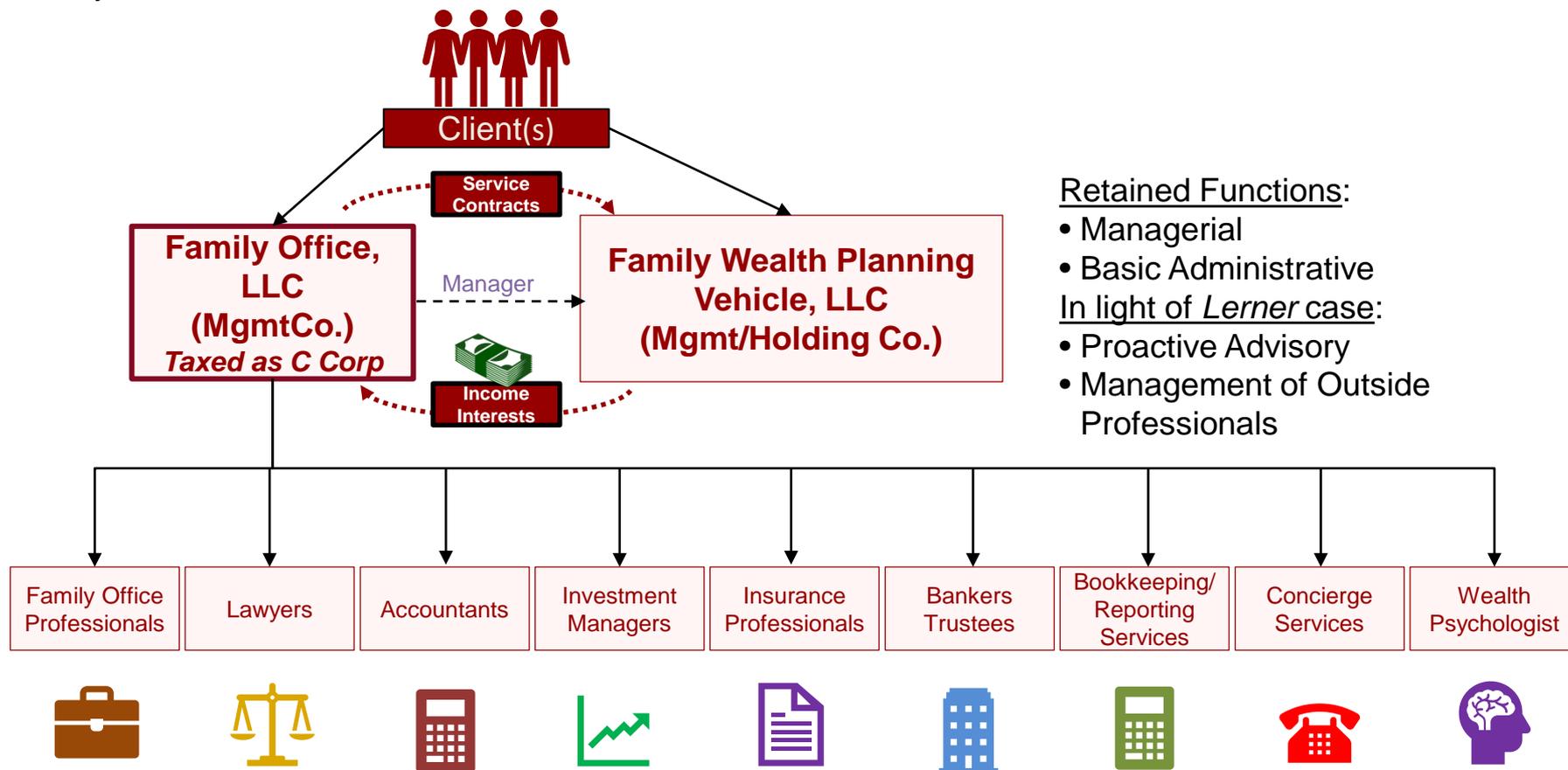
- Primary payroll for operations
- Operating income eligible for §199A Passthrough Deduction

Some assets may be best owned in a partnership, or an LLC taxed as a partnership:

- **Depreciable Assets** (property, plant, equipment)
- Assets that may be **distributed in-kind** after appreciation
- Deal structures using **special allocations**

Virtual Family Office Structure

VFO structures leverage outsourced advisors and providers, typical with early stage families before they move to a full SFO structure:

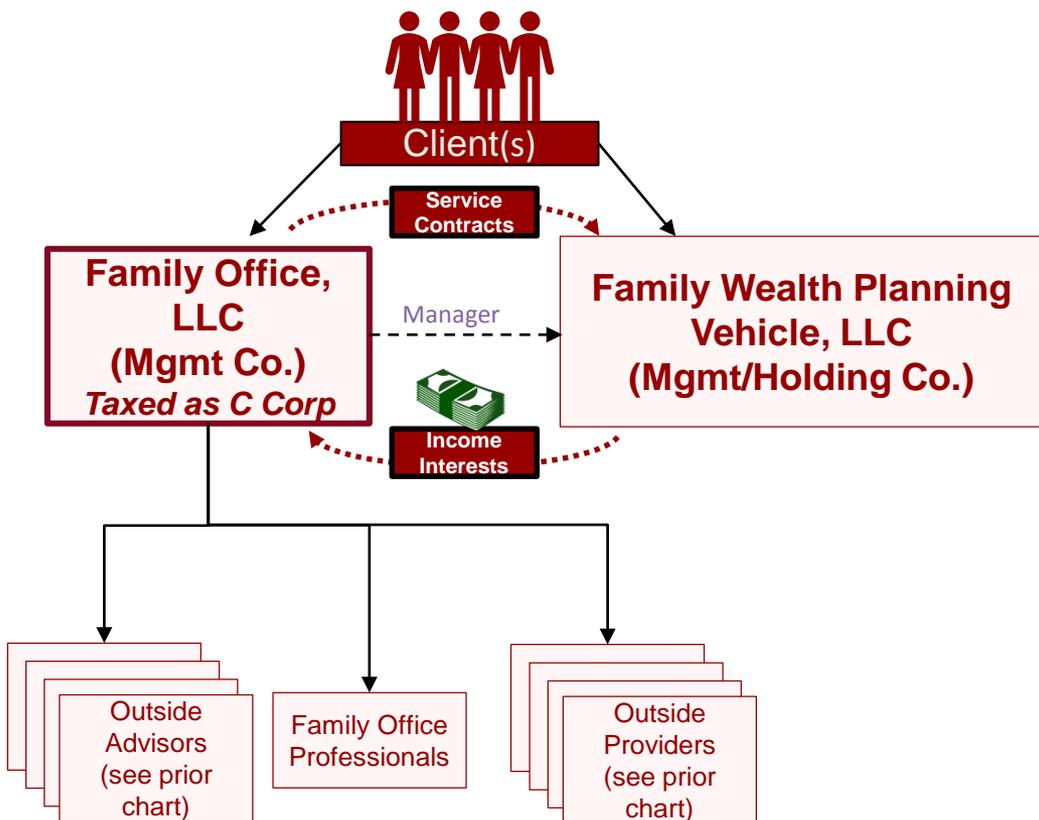


Retained Functions:

- Managerial
 - Basic Administrative
- In light of Lerner case:
- Proactive Advisory
 - Management of Outside Professionals

Virtual Family Office Structure After TCJA2017

After TCJA2017 further reduced or eliminated deductibility of many expenses under IRC §212, without reducing the deductibility of trade or business expenses under IRC §162, the VFO is enhanced.



Expenses Mgmt Co. May Still Deduct under §162:

- Investment Advisory
- Collection of Income
- Tax Preparation

Expenses Mgmt Co. Can't Deduct Either, But May Absorb At *Lower Tax Cost*:

- Marketing, including gifts, travel, and entertainment expenses subject to §274 limitations (which can apply to both §162 and §212 deductibility)
- For those expenses the C Corp. Mgmt. Co. can't deduct either, payment by the Mgmt. Co. is offset by income taxed at 21% rather than the typically higher rates for the passthrough entities.

PLANNING CONSIDERATIONS FOR LONG-TERM OWNERSHIP, INCLUDING ESTATE, GIFT, AND GST TAX CHANGES

Estate, Gift, and GST Taxes, 2018-2025

- The **TCJA2017** left the **structure** and **rates** of the estate, gift, and generation-skipping transfer taxes unchanged, but roughly doubled the **exemptions** (subject to sunset after 2025):

Chart 4: Transfer Tax Exemption Increases

Exemption Type	2017, Old Law	2018, Old Law	2018, New Law*
Gift Tax Lifetime Cumulative Exemption	\$5,490,000	\$5,600,000	\$11,180,000
Estate Tax Exemption, to extent not used for Gift Tax	\$5,490,000	\$5,600,000	\$11,180,000
GST Tax Exemption	\$5,490,000	\$5,600,000	\$11,180,000

* Exemptions did not exactly double due to changed formula for inflation adjustments

Changes to Estate Planning Considerations

For a large share of the “**middle market**” or the “merely” **high net worth**:

- Complex **transfer tax planning** now takes a back seat to **income tax planning**.
 - *Remember that there is **no portability** for state estate tax exemption or GST exemption.*
- Capture the **step-up in basis** whenever that can be accomplished without increasing transfer taxes by more.
 - Consider **unwinding** structures (FLPs, life insurance trusts, credit shelter trusts) that are no longer needed.
 - Consider amending or decanting trusts to allow for the grant of **general powers of appointment** over a credit shelter trust, or even an irrevocable trust, that would **capture basis step-up** on the death of the surviving spouse or primary beneficiary..

Changes to Estate Planning Considerations

For a large share of the “**middle market**” or the “merely” **high net worth**:

- Some transactions may have newfound popularity:
 - “Upstream” transfers to older generations with full exemptions
 - Forgiving prior loans to descendants or their trusts
 - **Spousal Lifetime Access Trusts (SLATS)** to lock in the larger exemptions while retaining access:
 - Irrevocable trust for descendants, but with spouse as permitted beneficiary (or perhaps even the *primary* beneficiary)
 - While spouse is a beneficiary, remains a grantor trust (although other grantor trust provisions will usually be included)
 - Avoid the **Reciprocal Trust Doctrine**: If wealthier spouse creates trust for other spouse and descendants, other spouse can also create a trust, but wealthier spouse’s beneficial interest should be much more restricted or non-existent

Changes to Estate Planning Considerations

For a large share of the “**middle market**” or the “merely” **high net worth**:

- Consider a default estate plan paradigm with:
 - a Single-fund QTIP as main fund where the surviving spouse is the sole beneficiary (and does not have a lifetime power of appointment), but
 - allowing the surviving spouse (by disclaimer) or the executor (by Clayton provision) to make the call as to whether and how much to set aside in a fund where the descendants are beneficiaries
- Prediction: Such clients’ “complexity tolerances”:
 - will go down for transfer tax planning
 - should stay the same or increase for income tax planning.

Changes to Estate Planning Considerations

For the “**very high net worth**” and “**ultra high net worth**” clients, planning techniques remain largely unchanged, but are **amplified** by the new **increased exemptions**:

- All else being equal, avoiding paying estate tax at **40%** of the **entire post-transfer appreciation** is worth giving up a capital gains tax of **15% or 20%** on **only** that appreciation that might otherwise qualify for basis step-up.
- Clients who can afford to do so should use their enhanced gift tax and GST Tax exemptions.
 - To address the risk of “clawback” (estate tax imposed, after the sunset of the increased exemption, on taxable gifts made while the exemption was temporarily higher), consider a **net gift agreement** that would give the estate a right of recovery against the transferee.
 - Re-evaluate estate plans’ tax apportionment clauses.

MOST IMPORTANT CHANGES TO PLANNING CONSIDERATIONS AND CHANGING PARADIGMS

Changing Paradigms

- Not necessarily “choice of entity,” but a choice for **entities**
- Simplification of estate and succession plans, with greater emphasis on income tax savings.

CONCLUSION, BIBLIOGRAPHY, AND DISCLAIMERS



**HANDLER THAYER
FAMILY OFFICE FORUM**
University Club of Chicago
June 27, 2018

SAVE THE DATE!

More information on our June 27 conference coming soon.
[Click here for our tentative Agenda.](#)

Handler Thayer, LLP is hosting a program to educate families offices about how to manage and operate their family offices. Last year Handler Thayer welcomed over 200 participants including single family offices, multi-family offices, advisers, and business owners. We look forward to another informative conference this year.

For more information about Handler Thayer and the services they provide, please visit their site.
www.HandlerThayer.com

**For Established Family Offices
and Family Offices In Formation:
By Invitation Only**

**See Mike Whitty for details, or go
to <http://www.htfof.net/agenda> .**

**When an invitation is extended, the
login code for registration will be
offered.**

DISCLAIMERS

These seminar materials are intended to provide the seminar participants with general guidance. The materials do not constitute, and should not be treated as, legal advice regarding the use of any particular estate planning technique or the tax consequences associated with any such technique.

Anchin, Block & Anchin LLP provides tax and accounting device only to its clients, does not provide legal advice, and does not assume responsibility for any individual's reliance on the written information disseminated during the seminar.

Handler Thayer LLP provides legal advice only to its clients, and has provided its portion of these materials only for general guidance and does not assume responsibility for any individual's reliance on the written information disseminated during this seminar.

Each seminar participant should independently verify all statements made in the materials before applying them to a particular fact situation, and should independently determine both the tax and nontax consequences of using any particular estate planning technique before recommending that technique to a client or implementing it on a client's or his or her own behalf.

The authors welcome your questions or comments about these seminar materials. In addition, kindly inform the authors if you become aware of any errors or omissions within these materials.