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# CARES Act: Tax changes affecting individuals - Part 1

By Eva Stark, JD, LL.M.

(Part 1 of a 2-part series)



The Coronavirus Aid, Relief and Economic Security (CARES) Act was signed into law on March 27th, 2020. While there has been much focus—even frenzy—around the benefits conferred on businesses by the more than \$2 trillion economic relief package, there has been less discussion about provisions that may benefit individuals, which mainly involve changes to tax-advantaged health accounts, charitable deductions, a refundable tax credit, suspension of required minimum distributions and easier access to retirement plans through distributions or loans. Part I of this article discusses all of the

above except the provisions involving enhanced access to retirement accounts, which will be the focus of Part 2.

## Expanded Use of Tax-Advantaged Health Accounts

Individuals may be able to use tax-advantaged health accounts—such as HSA's or FSA's—for certain over-the-counter medications. Tax-advantaged health accounts may additionally be used to purchase certain feminine products. Under previous law, such accounts could only be used for over-the-counter medications with a doctor's

prescription. This deterred many taxpayers from fully utilizing their accounts, as obtaining a prescription could be time-consuming and costly.

## Bigger Charitable Deductions

### NEW ABOVE-THE-LINE DEDUCTION.

Beginning in the 2020 tax year, taxpayers who do not itemize deductions may be eligible to take an above-the-line deduction for up to \$300 in eligible cash contributions to qualifying charities. Qualifying charities generally do not include certain private foundations, supporting organizations and donor-advised funds.



## HIGHER AGI PERCENTAGE

**LIMITATION.** The AGI percentage limitation for cash contributions by individuals to qualifying charities has been suspended for the 2020 tax year. Under previous law, the deduction an individual could receive for a qualifying charitable cash contribution was limited to 60% of the taxpayer's Adjusted Gross Income or AGI. Contributions to certain private foundations, supporting organizations and donor-advised funds are generally ineligible for this increased limit.

## Refundable Tax Credits

Individuals with adjusted gross income under \$75,000 (\$150,000 for married filing jointly) may be eligible for a \$1,200 (\$2,400 for married filing jointly) tax credit, plus \$500 for each dependent under age 17. Above this level, the credit is phased out by \$5 for each \$100 of additional income. The credit is completely phased out for those with income in excess of \$99,000 (\$198,000 for married filing jointly).

While the credit is technically for tax year 2020, individuals' level of income for 2020 is yet to be seen. As a result, the advanced rebates were based on income for tax years 2019 or 2018 at the time of issuance. Individuals who received a rebate because their income was below threshold levels in 2018 or 2019, but whose 2020 income will exceed such levels, will not be required to repay their rebates. Individuals who did not receive a rebate because their 2019 or 2018 income was too high, but whose income will be below these thresholds in 2020, may be eligible for the rebate upon filing of their 2020 tax return.

## Suspension of 2020 Required Minimum Distributions

Qualified plan participants and IRA owners will not be required to take required minimum distributions for 2020. Individuals need not be adversely affected by Covid-19 to take advantage of this benefit. The

RMD suspension also applies to beneficiaries who have inherited accounts. Qualified plan participants or IRA owners who have already taken an RMD and would like to "undo" the distribution might consider a 60-day rollover of the distribution, if requirements for such a rollover would otherwise be met. Beneficiaries of inherited IRAs or plans cannot roll over distributions. If the 60-day rollover window has passed, individuals might also take advantage of the extended deadline for rollover distributions set out in Notice 2020-23. The notice extended the deadline for rollovers that had to be completed between April 1, 2020 and July 14, 2020 to July 15. Those affected by Covid-19, might also explore treating the distribution as a "Coronavirus-Related Distribution" and repaying it within three years.

See the upcoming Part 2 of this article for more details on Coronavirus-Related Distributions and Coronavirus-Related Loans.



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As a result of the Tax Cuts and Jobs Act of 2017 (TCJA) the estate, gift and generation skipping transfer (GST) tax exemption amounts increased to approximately \$11.18 million per person (approximately \$22.36 million for a married couple). For assets transfers in excess of the applicable exemption amount and otherwise subject to such taxes, the highest applicable federal tax rate remains at 40 percent. While the exemption amounts are indexed for inflation, current law provides for an automatic sunset of these increased exemption amounts after 2025. As a result, the exemption amounts available in 2026 and beyond could be reduced to a level provided under prior law (\$5.49 million/single and \$10.98 million/couple in 2017, indexed for inflation) absent further action by Congress. In addition, under different rates, rules and exemption amounts (if any), there may be state and local estate, inheritance or gift taxes that apply in your circumstances. Please consult your own tax or legal advisor for advice pertaining to your specific situation. This material includes a discussion of one or more tax related topics. This tax related discussion was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purposes of avoiding any IRS penalties that may be imposed upon the taxpayer. The Nautilus Group® is a service of New York Life Insurance Company. Nautilus, New York Life Insurance Company, its employees or agents are not in the business of providing tax, legal or accounting advice. Individuals should consult with their own tax, legal or accounting advisors before implementing any planning strategies. SMRU 1858987 Exp. 6/9/2022

## Estate Planning

# Decanting: Quelling qualms about irrevocability.

By Kristen E. Simmons, Esq.

Advisors often hear the same excuses from clients for not completing an estate plan or implementing life insurance. Sometimes, the client may have already implemented an irrevocable trust and felt that it no longer met their family's needs. This may be a deterrent from using that irrevocable trust or a new trust to acquire life insurance that would provide a significant impact for the client's family. If the client is young, he or she may have concern about changing family circumstances or the fear of missing out on the next great planning opportunity, and the irrevocable nature of various planning techniques may be the roadblock. Decanting is a useful tool to quiet these common client concerns.

## What is Decanting?

The term "decant" is defined by Merriam Webster as "to pour out, transfer or unload as if by pouring." In the world of estate planning, decanting is a tool used to modify an irrevocable trust to remove unfavorable provisions, or to make adjustments based on changed circumstances. When an irrevocable trust is decanted, the trustee generally exercises its distribution power over the trust to distribute property from an existing trust to a different trust (whether already existing or newly established) with one or more of the same beneficiaries. Currently twenty-nine states have enacted statutes that permit the decanting of an irrevocable trust. Furthermore, many of the states that have not yet adopted their own decanting statutes are considering



the adoption of the Uniform Decanting Act.

Decanting is derived from the Trustee's authority and/or discretion to make distributions of income and/or principal to the beneficiaries of an irrevocable trust. At its core, the theory behind decanting is that if the Trustee has discretion to make a distribution outright to a beneficiary, the Trustee should be able to exercise that discretion to make a distribution to a beneficiary with further strings or conditions (such as in further trust). Each state that has adopted a decanting statute has slightly different requirements in order for an irrevocable trust to be decanted. Under the laws of each state that permits decanting, the common thread is that decanting cannot be used to add a beneficiary that was not a beneficiary of the original trust.

## Top 3 Reasons to Decant a Trust

There are several common reasons to decant a trust. Some of these are minor and include changing the situs to alleviate state income tax considerations. The following are what I consider the top three reasons to decant a trust.

**1. "EXTEND" THE TERM OF THE TRUST.** Many trusts distribute outright to the trust beneficiaries at staggered ages, such as one-third at age 25, half the balance at age 30, and the balance at age 35. The idea behind this outright distribution is to delay the distribution of the assets until a beneficiary's presumed maturity. However, trusts can provide a significant level of creditor, divorce and estate tax savings to the beneficiary if implemented properly.

With trusts that distribute outright at staggered ages, if a beneficiary is being sued or going through a divorce at the time of an outright distribution, the assets may become exposed to claims. Holding assets in a continuing, discretionary trust provides optimal creditor protection. Further, if a beneficiary has developed a problem (for example, drug or alcohol dependency or need for qualification for state benefits), outright distributions can be harmful. Therefore, one of the most common reasons we find to decant a trust is to allow the assets to be held for the beneficiary in continuing trust (rather than distributing outright).

**IMPORTANT NOTE:** Decanting cannot generally be used to extend the perpetuity period of an existing trust. Doing so may trigger the "Delaware Tax Trap" and therefore have immediate transfer tax consequences.

## 2. CHANGING A SUPPORT TRUST INTO A DISCRETIONARY TRUST.

In certain states, exception creditors can pierce through a support trust – one that distributes to the beneficiaries for their health, education, maintenance and support - and attach the interest of a beneficiary, even if the trust includes a spendthrift clause. A discretionary trust is one in which distributions may be made in the sole and absolute discretion of the trustee, not subject to any specific standard for distribution. A discretionary trust offers a greater level of creditor and divorce protection to the beneficiaries (assuming the use of a proper distribution trustee that is not a beneficiary of the trust), and, with the exception of Florida, the remaining 49 states in the United States recognize the protections offered by a properly drafted discretionary trust. In certain jurisdictions, such as California,



state income tax may be applied to a support trust if a beneficiary resides in the state. Because of the added level of creditor protection with a discretionary trust (and potentially state income tax savings), another common reason to decant is to convert a support trust into a discretionary trust. When decanting a support trust into a discretionary trust, situs selection is critical, as only six states expressly permit decanting a support trust into a discretionary trust.

**3. ADDING POWERS OF APPOINTMENT.** Before decanting, a change in family circumstances or lack of control over an irrevocable trust may have resulted in a full distribution of the trust to the primary beneficiary (thereby negating the transfer tax and creditor protection benefits of the trust). With decanting, instead of distributing the trust to the primary beneficiary, the Trustee may distribute the assets into a trust that gives the primary beneficiary a

power of appointment. This power of appointment may be limited so as not to cause inclusion in the beneficiary's estate, but may be broad enough to allow the primary beneficiary to direct the ultimate distribution upon the beneficiary's death (for example, the power of appointment could be exercised by the beneficiary in favor of a person who was not a beneficiary of the original trust).

Although a properly drafted trust can provide divorce and creditor protection to the beneficiaries, if the trust is drafted to be outside the beneficiary's estate for estate tax purposes, then the assets in the trust do not benefit from a step-up in basis, even if the beneficiary does not have a taxable estate. Decanting can be used to transfer assets into a trust that provides a formula general power of appointment. This would purposely include assets in the beneficiary's estate in order to reset the basis of the trust assets (up to the estate tax exemption available in the beneficiary's estate).



## Decanting Checklist

Seeing the benefits that can be achieved through decanting, advisors must determine whether an existing trust can be decanted and, if so, whether any changes to the situs of the trust must be made in order to achieve the ultimate goal.

- **Does the trust agreement prohibit decanting?**

Many older trust agreements do not include a specific prohibition on decanting, since it is a relatively new development in estate planning. However, as clients are implementing estate plans now, we often have clients that have very specific wishes related to their assets and beneficiaries, and do actually want to “rule from the grave.” In those client circumstances, it is important to discuss decanting with the clients to determine whether a prohibition should be included in the new trust agreement.

- **Does the trustee have sufficient distribution discretion?**

In order for the Trustee to exercise the decanting power, the Trustee must have the discretion to make distributions of income and/or principal. In certain trusts, poor drafting may prevent the exercise of the decanting power. For example, many old life insurance trusts do not allow any distributions of income or principal until the death of the settlor/insured. In these trusts, decanting would not be an option while the settlor is alive, and other alternatives would need to be used to potentially move the life insurance policy from the trust.

- **Does the state law of the current situs of the trust allow decanting? Can the situs of the trust be changed? Is the state’s decanting law broad enough to achieve the desired changes?**

A common hurdle to decanting a trust is the trust provision

regarding the governing law, situs and/or principal place of administration. If the jurisdiction applicable to the subject trust is one that has not yet adopted a decanting law (or one in which the desired result of decanting cannot be achieved), then the first step is to look to the terms of the trust instrument to see if a change of situs or place of administration is permissible. If it is not permissible under the terms of the trust document, then the advisor must look to the state law of the applicable jurisdiction to see whether it has a decanting law that would allow the change of situs to the desired jurisdiction (resulting in potentially multiple decantings to get to the ultimate resulting trust) or whether the state has adopted some form of the Uniform Trust Code, which allows for either a non-judicial settlement agreement (to modify the trust to allow for a change of situs) or provides a specific statute permitting the change of the principal place of administration of the trust.

## Conclusion

In sum, even if a client has a clean slate and has not previously done any estate planning, decanting can be a helpful tool to quell common fears that would impede implementation of the estate plan. For more information on situs selection for decanting, see Steve Oshins’ Decanting State Rankings chart, available on our website at [www.oshins.com](http://www.oshins.com).



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# Building a business: Entity selection and forms of organization

By David R. Toups, JD, MBA, CFA®, CFP®, CTFA

**F**or business owners, the type of entity selected, or not selected, will have far reaching implications for the owners and the business. Serious consideration should be given to this important decision because later modifications or changes may trigger tax or liability issues or even transfer problems for successors, heirs, or loved ones. This article reviews the forms of business organization for entities and non-entities that are commonly encountered doing business in the United States.

**SOLE PROPRIETORSHIP.** When businesses start small, often the expense and administrative burden of creating an entity separate and apart from the owner is not worth the effort. The income generated by the sole proprietorship is reported on the owner's personal income tax return and is taxed at the owner's personal income tax rate. If the business remains small and the owner's assets remain modest, a sole proprietorship, which is the default non-entity mode of operating a business, may suffice until the business's or owner's assets grow. Once the owner's assets grow past the state's judgment exemption amounts—which is an amount of property set by statute that a judgment debtor may retain in the event of a substantial adverse judgment or bankruptcy—the business owner at this point is no longer "judgment proof." The more property the business owner has, the more he or she becomes an attractive target for predatory litigation and stands to lose as a result of an adverse life or business event. Since no distinction is made between



the business and the owner, a sole proprietorship provides no liability protection to the business owner. The owner's personal assets are subject to both personal and business liabilities. A similar scenario exists, but further compounds the liability issues, if the business owner has another person working with him or her as a partner.

**GENERAL PARTNERSHIPS.** General partnerships are a type of default entity formed by two or more people operating a business together. The income produced by the general partnership is reported on each partner's individual income tax return according to his or her share. In this type of arrangement, each partner is considered a general partner of the business, each has agency for the other, and the personal assets of each are available to cover liabilities generated by the business. Each general partner also has agency for the business, which means each can

bind the business to contracts and potential liabilities. Each partner's personal assets are subject to the business's liabilities. Therefore, in the event one partner exercises poor judgment, the other partner may have to pay for it with his or her own personal assets. Such a proposition often leads the owners to seek improved liability protection once the business grows from its infancy.

Before discussing entities that limit an owner's liability to his or her investment in the firm, a brief discussion is in order regarding taxation. An entity may exist under state law and be recognized as being separate and apart from its owners to other businesses, vendors, customers, and the state and local governments; however, the federal government may treat the entity differently for tax purposes than its form suggests. Federal taxation may vary based upon options selected by the business or by the number

of people who own it. This is most clearly shown by limited liability companies.

### **LIMITED LIABILITY COMPANIES.**

A limited liability company (LLC) is a type of entity permitted in some states, which is most characteristically known for its simplicity of administration. LLCs do not require the administration maintenance which is typically associated with C corporations. Since C corporations provide a more formal structure for complex companies, the administrative burdens required to address the needs of a large shareholder base do not exist for an LLC. An LLC may opt to be taxed as a C corporation, an S corporation, or as a partnership. An LLC with only one owner is referred to as a single-member LLC, and the federal government disregards the entity for taxation purposes and treats it as a sole proprietorship. Since an LLC has light administration requirements and enjoys flexibility in choosing a taxation structure, this has become a mainstay entity form for small to medium sized businesses. Prior to states adopting the LLC form as a type of entity authorized by their statutes, business owners often formed C corporations to obtain liability protection for their personal assets.

**C CORPORATIONS.** C corporations, as discussed, provide the framework and flexibility necessary to accommodate large publicly traded firms with enormous shareholder bases and the associated administration burdens that would accompany such numbers. C corporations are subject to their own tax rates under the federal tax laws. Under these laws, when viewed from a shareholder's perspective, the revenue generated by the corporation is taxed twice—once at the corporate level and once again

at the shareholder's personal level when the corporation pays that shareholder's portion in the form of a dividend. At one point in time, C corporations were one of the only forms available for business owners to utilize. The double taxation paired with the inability for the corporation to pass-through losses that normally occur in the initial years of a fledgling business made liability protection an expensive proposition for those early business owners choosing this entity form. These hurdles to small to medium sized businesses prompted the subchapter S election.

**S CORPORATIONS.** The term S corporation is really a misnomer. No state grants charters or organization letters for an S corporation. An S corporation is actually a C corporation (or an LLC) that has filed a subchapter "S" election with the IRS. By filing such an election, the organization agrees to certain restrictions as to ownership and governance in exchange for being taxed as a pass-through entity or taxed at the personal income tax rates of its owners. The owners of the S corporation report their respective portion or share of the company's income or the losses on their personal income tax returns. C corporations with an S election were a common structure form prior to states adopting the use of LLCs as an alternate entity form.

**LIMITED PARTNERSHIPS.** The unpleasant consequence of being held responsible for a fellow general partner's errors or omissions, as discussed above, gave rise to the adoption of limited partnership forms. A limited partner's liability risk in the organization is limited to his, her, or its investment in the partnership. A limited partnership requires at least one general partner to manage the partnership and remain subject to personal liability for the partnership's liabilities; however, another entity providing liability protection may serve as a general partner and mitigate the risks associated with this requirement.

Partnerships also enjoy great flexibility in allocating income and losses to its partners. Partnerships are pass-through entities having the assets or losses reported and accounted for on each of its partners' personal income tax returns according to their allocated share.

Although liability protection is an essential component to selecting a business organization's form, taxation and structure considerations may make one form a better fit over another for differing business and economic realities. Consultation with advisors familiar with your state's business environment is always a smart first step in the planning process.



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