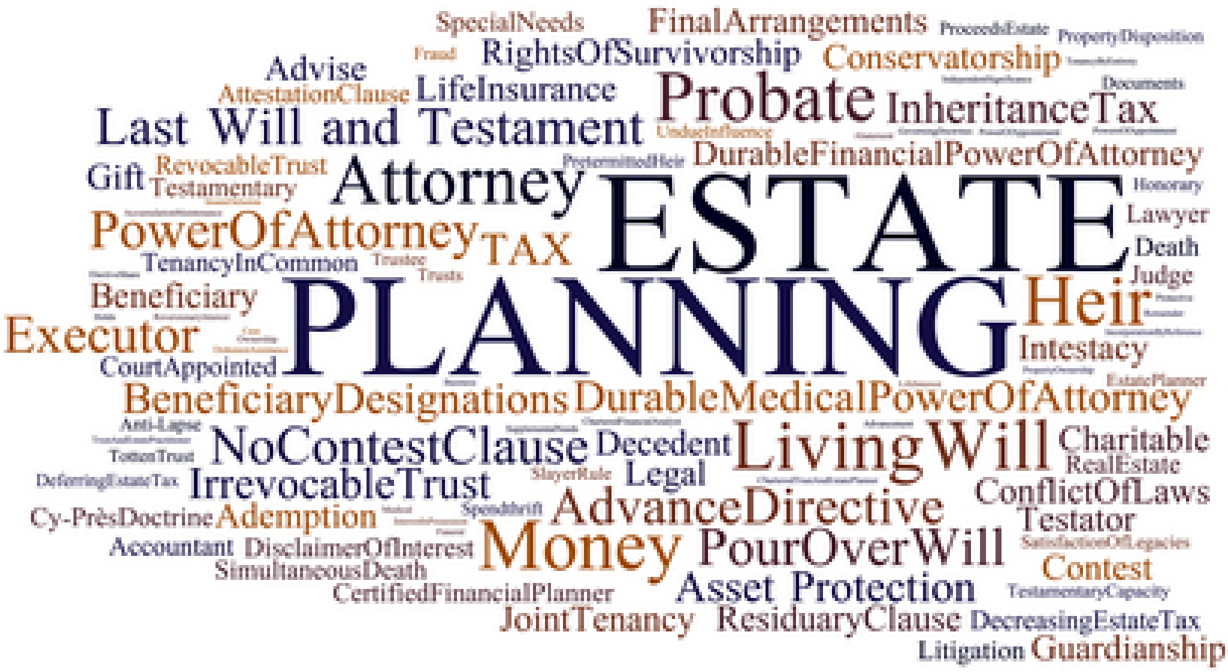

There is no doubt that estate tax planners were giddy when the estate tax exemption was raised to $11.18 million. However, as part of TCJA, there are income tax implications to certain types of estate planning, that may help your clients.

A non-grantor trust is an irrevocable trust. An irrevocable trust's main purpose is to remove assets from a taxable estate, and provide legal protection for those assets. For an irrevocable trust to work, the assets must be contributed, or sold to the trust, leaving the grantor (for lack of a better word) with no rights to the assets. Irrevocable trusts are taxable entities. Furthermore, if an monies are distributed to the beneficiaries, they receive a K-1 Form that has to be reported on their personal tax return.

For closely held businesses, they usually form pass-thru entities (PTE), such as

incorporate their sole proprietorships and partnerships. However, shortly after these concerns were raised, Congress enacted Section 199A.

Under Sec. 199A, a non-corporate taxpayer, meaning an individual, a trust, or an estate, who owns an interest in a PTE that is engaged in a qualified trade or business ("QTB"), may claim a deduction for a taxable year equal to 20% of their qualified business income ("QBI") for the taxable year.

This general rule, however, is subject to a limitation that, if triggered, may reduce the amount of the 199A deduction that may be claimed by the non-corporate taxpayer (the "limitation").

What triggers the limitation? The amount of the taxpayer's taxable income from all sources – not just the taxpayer's share of the QTB's taxable income. Moreover, if the taxpayer files a joint return with their spouse, the spouse's taxable income is also taken into account.

Specifically, once the taxpayer's taxable income exceeds a specified threshold amount, the limitation becomes applicable, though not fully; rather, it is phased in. In the case of a single individual, the limitation starts to apply at taxable income of $157,500 (the so-called "threshold amount"). The limitation is fully phased in when taxable income exceeds $207,500.

This $157,500 threshold amount also applies to non-grantor trusts and to estates.

These thresholds are applied at the level of each non-corporate owner of the business – not at the level of the entity that actually conducts the business. Thus, some owners of a QTB who have higher taxable incomes may be subject to the limitations, while others with lower taxable incomes may not.

In considering the application of this limitation, the IRS recognized that there are

qualified property with a relatively low unadjusted basis, the sole proprietor may want to retain ownership of the depreciable property and lease it (rather than contribute it) to the business entity, so as to preserve their original unadjusted cost basis and avoid a lower unadjusted cost basis in the hands of the entity (based on the owner's adjusted basis for the property) to which it would otherwise have been contributed, and to afford their successors in the business and to the property an opportunity to increase their unadjusted basis in the property, assuming it has appreciated – basically, real estate – after the owner's death.

An irrevocable trust is generally treated as a form of pass-through entity to the extent it distributes (or is required to distribute) its distributable net income (DNI), which is basically, taxable income with certain adjustments to its beneficiaries, for which the trust claims a corresponding distribution deduction. In that case, the income tax liability for the income that is treated as having been distributed by the trust shifts to the beneficiaries to whom the distribution was made.

To the extent the trust retains its DNI – i.e., does not make (and is not required to make) a distribution to its beneficiaries – the trust itself is subject to income tax.

In the case of an irrevocable trust, at least in the first instance, the 199A deduction is applied at the trust level. Because the trust is generally treated as an individual for purposes of the income tax, the threshold amount for purposes of triggering the application of the limitation is set at $157,500 (with a $50,000 phase-in range).

However, if the trust has made distributions during the tax year that carry out DNI to its beneficiaries, the trust's share of the QBI, W-2 Wages, and Unadjusted Basis of the QTB in which it owns an interest are allocated between the trust and each beneficiary-distributee.

This allocation is based on the relative proportion of the DNI of the trust that is

determining its own 199A deduction, and the beneficiaries use their own taxable incomes.

Based on the foregoing, a trustee may decide to make a distribution in a particular tax year if the trust beneficiaries to whom the distribution is made are in a better position to enjoy the 199A deduction than are the trust and the other beneficiaries.

This is the main reason estate planning requires tax planning from a qualified tax attorney, CPA, or enrolled agent.