GUTTER CHAVES JOSEPHER RUBIN FORMAN FLEISHER MILLER P.A.

TAX, BUSINESS, & ESTATE AND TRUST LITIGATION UPDATE

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CONTENTS

Obscure Provision of New Tax Act Complicates Testamentary Tax Planning for Nonresidents with U.S. Beneficiaries

The Stealthy Tax Increase in the New Tax Act

Review/Summary of International Provisions of the new Tax Act

The Internal Revenue Code Jumps the Shark with the Tax Cuts and Jobs Act of 2017

Florida Homestead Protections Against Forced Sale Under Threat of Dilution

IRS On The Hunt for Bitcoin Gains

Florida Case Law Update - Trust, Estate & Guardianship Litigation

Did You Know?

Firm Announcements

ABOUT OUR FIRM

We are a boutique law firm that seeks to protect and enhance the individual, family and business wealth of our clients in the following principal practice areas: Planning to Minimize Taxes (U.S. & International) - Probate & Trust Litigation - Estate Planning, Charitable, Marital & Succession Planning - Business Structuring & Transactions - Trusts & Estates Administration - Tax Controversies - Creditor Protection.

Obscure Provision of New Tax Act Complicates Testamentary Tax Planning for Nonresidents with U.S. Beneficiaries

By Charles (Chuck) Rubin

Nonresidents with a significant portfolio of U.S. stocks typically use a non-U.S. corporation to hold their portfolio. This is because U.S. stocks are generally subject to U.S. estate taxes at the death of their owner, and absent treaty relief a nonresident owner can only exempt $60,000 in assets from U.S. estate taxes. Since stock of a non-U.S. corporation is not a U.S. situs asset for estate tax purposes, assets held in the corporation, such as U.S. stocks, avoid U.S. estate taxation.

If the nonresident owner has U.S. individual heirs who will succeed to the stocks, the transfer of the shares of stock of the foreign corporation at death can create unpleasant tax consequences for the new U.S. shareholders. If they will own a majority of the shares, in most circumstances the foreign corporation will become a controlled foreign corporation (CFC) for U.S. income tax purposes. This will result in the 10% or more U.S. shareholders becoming taxable on the investment income of the company, including capital gains, on a flow-through basis and at ordinary income rates by reason of such income being characterized as foreign personal holding company income (FPHCI). The U.S. shareholders will also suffer some level of double taxation as to U.S. withholding taxes imposed on the foreign corporation (e.g., on its U.S. source income and dividends), and on any non-U.S. withholding and other taxes - no full U.S. tax credit arises and the individual shareholders only receive in effect a deduction for such taxes. Municipal bond interest also becomes taxable to the U.S. shareholders under the CFC rules.

MORE ABOUT OUR FIRM

The firm and its attorneys have been recognized in numerous peer rating guides, such as U.S. News & World Report law firm rankings, Best Lawyers, Martindale-Hubbell, Chambers, Who's Who in American Law, Florida Trend's Legal Elite, Superlawyers, and South Florida Legal Guide Top

Until now, these problems were easily resolved by liquidating the foreign corporation within 30 days of the death of the foreign stockholder. If the U.S. shareholders received a stepped-up basis in their shares (which is usually the case, subject to some questions when there is an intervening trust), the liquidation generally would have no adverse U.S. income tax consequences to them. This is because the foreign corporation would not become a CFC if the U.S. shareholders did not own it for 30 days. This could be accomplished either by an actual liquidation within the first 30 days after the death of the stockholder, or a check-the-box election (if the company was eligible) with an effective date within that period. Since a check-the-box election can be retroactive up to 75 days, this effectively provided a 105 day window to take care of things.

The problem today is that the new Act repeals the 30 day window, thus resulting in CFC status immediately as of death of the stockholder. Thus, a liquidation or check-the-box election effective within the first 30 days

is taxed as a CFC liquidation, which is not nearly as painless as a non-CFC liquidation. Note that making a check-the-box election with an effective date PRIOR to death of the shareholder may resolve the liquidation problem, but will likely void the estate tax insulation of the foreign corporate ownership of the securities.

What's the problem with liquidating the CFC? Under Code §336, the CFC is treated as having sold its assets on liquidation for their value. If the stocks are appreciated in value, and assuming this results in overall net gain, that gain is treated as FPHCI which flows through to the U.S. shareholders and is taxable to them as ordinary income. The U.S. shareholders do get a basis step-up under Code §961 for this income, and they also likely received a basis step-up at death of the stockholder - this will typically result in a capital loss to the U.S. shareholders equal to the FPHCI they realized on the liquidation. Since the capital loss cannot offset the ordinary income treatment of the FPHCI (beyond $3,000), the loss is of not much help as to the FPHCI, resulting in the burdensome taxation of the passed-through ordinary income.

Thus, the removal of the 30 day exempt period in the new Act makes things difficult for nonresidents with U.S. heirs and their planners who sought to avoid the negative CFC implications of the foreign holding company structure.

The problem is not insurmountable - there are ways to deal with it.

One way is via churning. This involves regular and periodic sale and repurchase of the appreciated stock by the foreign corporation during the lifetime of the nonresident stockholder. Such sales and repurchases will increase the income tax basis of the stocks on a regular basis. In most circumstances any gain from such sales is not subject to U.S. income tax absent the involvement of real property holding companies. It does require some diligence to keep current on the churning, however. Further, if the U.S. stock is not publicly traded, then the sale and repurchase can be more difficult. The step transaction doctrine and attempts by the IRS to disregard the churning are always an issue. Note that this is not a "new" technique - many practitioners in the past have been leery of their clients taking immediate action upon death of the stockholder within the 30 day/105 day windows discussed above, so churning was recommended to avoid the need for such immediate action.

An alternative method to deal with the issue would be to domesticate the foreign corporation post-death, make a Subchapter S election to avoid double tax on the appreciation, and wait out the 5 year built-in gains period. This is a possible approach, but clients may be uncomfortable with having to hold the stock for the five year period.

Another approach involves having the foreign holding company owned in turn by two foreign corporation holding companies, with the nonresident owner being the shareholder of those companies. A check-the-box election is made after death, retroactive to prior to death, for the foreign subsidiary holding the U.S. stock. On the deemed predeath liquidation, a deemed sale occurs of the U.S. stock, but since it occurred prior to death there is no CFC or FPHCI flowing through to U.S. shareholders - but a basis step-up still occurs by

reason of the liquidation. The two intermediate holding companies then liquidate after death - while they are CFC's, there is no gain on the U.S. stocks they received from the liquidating subsidiary and thus no FPHCI (except perhaps on appreciation occurring after the deemed liquidation date of the subsidiary foreign corporation). This still requires diligent action near the time of death, and issues of tax relevancy of the check-the-box election may apply.

Of course, there are alternate methods of planning for the U.S. securities, such as the use of an irrevocable trust to own the U.S. stocks, dual partnership structures, and tiered foreign corporate structures that can do a post-death check-the-box election retroactive to predeath to enter into a dual partnership structure.

Non-U.S. situs appreciated assets held through a foreign corporation can result in similar problems for the U.S. heirs. However, if those are segregated into their own foreign corporation, a pre-death effective check-the-box election can be conducted to eliminate the taxable gain. This can be done for the non-U.S. situs assets since they will not be subject to U.S. estate taxes even if deemed owned by the nonresident shareholder directly at the time of death.

These problems and resolutions may also apply to other U.S. situs assets other than stock of U.S. corporations. However, U.S. real property interests (including stock of U.S. real property holding companies) are more problematic given that capital gains from disposition are nonetheless subject to U.S. income tax under Code §897.

THE STEALTHY TAX INCREASE IN THE NEW TAX ACT

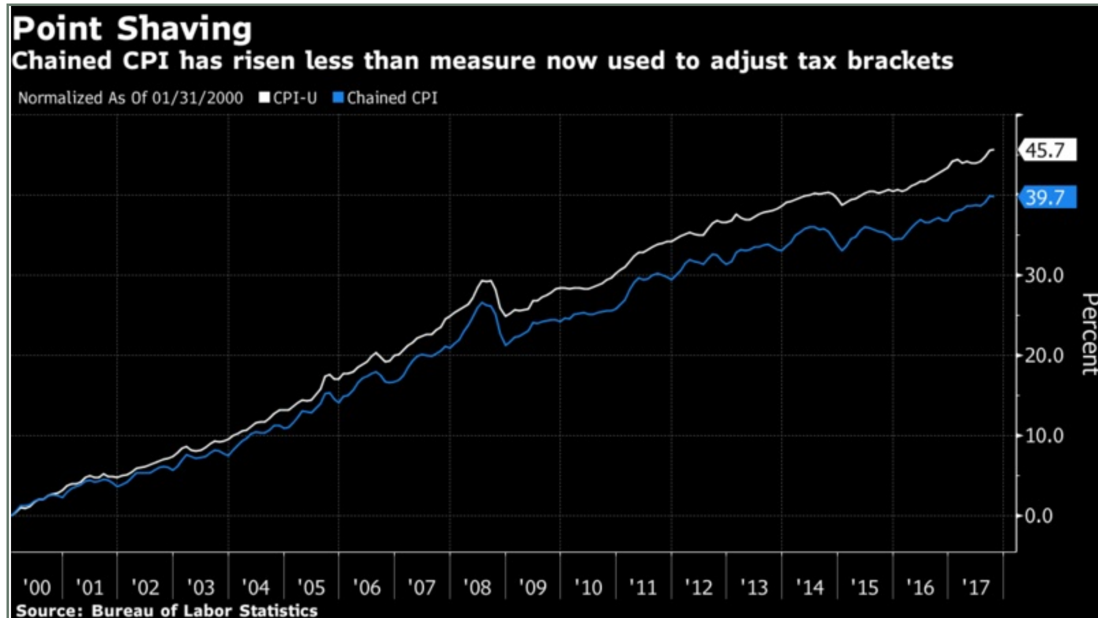
By Charles (Chuck) Rubin

Ever since the Reagan Administrative, tax brackets have been indexed for inflation. This avoids bracket creep when taxpayers move into a higher tax bracket because inflation pushes up their income. The thinking is that inflation increases are not real increases in earnings, so the rate tables should be indexed to avoid tax increases arising solely from inflation. This seems like less of an issue today with relatively tame inflation rates, but remember that inflation went into the teens in some years in the1970's making bracket creep a big issue.

The new Act changes rate indexing and other Code indexing from the former Consumer Price Index (CPI) to a new creation known as "chained CPI." Chained CPI is an adjustment to CPI that reduces the inflation rate by attempting to factor in human behavior that when prices rise, some consumers will look for less expensive substitute products, so that the overall inflation is lower than it would first appear when measured by actual spending.

So was chained CPI brought in due to a desire by Congress to more accurately measure inflation? Doubtful. By reducing the inflation rate for tax purposes to what may be less than the actual rate, bracket creep will now increase faster for taxpayers. This will increase taxes, and is thus a hidden revenue raiser. The

differences between the two rates are not that significant, but will add up over time. See this table for how the cumulative spread increases over time:



I have seen estimates that the effective tax increase next year will be $800 million, and is estimated to be $31.5 billion by 2027. Bracket creep tends to burden lower income taxpayers more than higher income taxpayers, because the brackets are smaller and thus will trigger more increases on the low end - further, for taxpayers already at the highest rate there is no higher bracket to creep into.

The wealthy will still be impacted as the unified credit exemption from transfer taxes is now coming under chained CPI adjustments. This means slower increases in such exemptions and thus more potential transfer taxes.

It is interesting that chained CPI was brought in by the Republicans and in a tax cut bill. I assume it was included to help the budget numbers work.

Note that Pres. Obama tried to bring chained CPI to social security increases during his administration which would have the effect of reducing social security payouts, but was beat down by Democrats. Don't be surprised if we see that before Congress again in the near future.

REVIEW/SUMMARY OF INTERNATIONAL PROVISIONS OF THE NEW TAX ACT

By Charles (Chuck) Rubin

Our firm has prepared a summary and review of these new provisions. You can download it from here.

THE INTERNAL REVENUE CODE JUMPS THE SHARK WITH THE TAX CUTS AND JOBS ACT OF 2017

By Charles (Chuck) Rubin

Meaning of "jump the shark" - "It's reached its peak, it'll never be the same again, and from now on it's all downhill." [Source] Or if you prefer another popular culture reference, the Code has entered the Twilight Zone.

Case in point, new Code Section 199A which provides a 20% deduction for qualified business income earned through pass-thru entities. This one new Code Section:

a. is over 22 pages long (using the pages from the bill report and print;

b. employs approximately 20 defined terms;

c. includes 26 cross-references within Section 199A;

d. includes 25 cross-references to other Code provisions;

e. includes numerous "lesser than" or "greater than" computations, some of which are nested within each other;

f. includes computations that require subtraction, addition, and multiplication;

g. includes exemption amounts, and then includes complex formulas to phase-out out those amounts at higher levels; and

h. imports an international tax concept (effectively connected income) into a provision applicable to all domestic pass-through entities.

Forgive me if some of these counts are off a bit - I was getting nauseous going through the provision so could only go through it once in counting.

I'm sure our Congressmen and women understand the gist of the deduction, but I sincerely doubt that most of them have read the language of this provision. I further doubt whether ANY of them can fully comprehend the operation of the statute from the text of the statute alone.

There are plenty of complex provisions in the Internal Revenue Code, but this one statute is really up there. Yes, I can figure it out, but I have been practicing tax law for over 35 years, and it took me quite a while to parse out and comprehend this statute. This is serious business when a law is written as to be incomprehensible to 99%+ of the population. Some aspects of this are:

1. The Rule of Law is degraded, if not obliterated. How can one be subject to the Rule of Law when the law itself is incomprehensible to most everyone?

2. How can a taxpayer be penalized for violating this law when it is incomprehensible? Is there de facto reasonable cause relief for violation?

3. Similarly, how is a typical federal District Court judge going to understand this statute in a tax dispute with the IRS?

4. How much wasted time, effort, and cost will be expended at the taxpayer and professional advisor/accountant level in regard to complying with and planning in regard to this provision?

I pity the poor programmers at Turbotax and other tax preparation software companies that will have to convert this into computer code.

If you think I am exaggerating, you can download the statutory language here and read it for yourself.

Was there really no way to provide this deduction in a much simpler, shorter, and straight-forward manner? While there are some provisions of the new law that aim to simplify the Code, at least for smaller taxpayers and businesses, provisions like this swamp that simplification effort and continue the beastly size and complexity of the Internal Revenue Code.

Florida Homestead Protections Against Forced Sale Under Threat of Dilution

By Charles (Chuck) Rubin

Once every 20 years, Florida convenes a Constitution Revision Commission (CRC) to review and make recommended changes to the Florida Constitution. Proposed changes are then put to Florida voters for approval or disapproval. A CRC is presently convened and at work in making such a review.

The CRC process is fairly advanced regarding a change to Article X, Section 4. Proposal 17 would add the following language relating to the exemption of homestead property from creditor claims:

> (d) Notwithstanding subsection (a), a homestead is not exempt from creditor claims if an owner:
>
> (1) Obtained the homestead using the proceeds from a fraudulent or dishonest act; or
> (2) Caused the creditor's damages or losses by an intentional criminal or fraudulent act.
>
> The legislature may enact implementing legislation consistent with the purposes of subsection (d), and such legislation may include, but is not limited to, limitations periods and protections for an innocent spouse or dependents.

There are a number of problems with this (especially the broad scope of losing the exemption for funds from a mere "dishonest act," whatever that means) but on December 4, an amendment was approved in committee to change the proposal to read:

> Notwithstanding subsection (a), a homestead is not exempt from the claim of a creditor if the creditor:
>
> (1) Establishes in an action against the owner of the homestead that the creditor's funds were fraudulently used by the owner to acquire or improve the homestead; or
>
> (2) Obtains a judgment against the owner of the homestead for damages caused by an intentional tort or intentional criminal or fraudulent act by the owner of the homestead, so long as the homestead was not the primary residence for the owner's spouse or minor child when the tort or act occurred or at the time of the judgment in the action.

Subsection (1) appears to me to be a fraudulent conveyance exception to creditor protection. That is, if funds are transferred into a homestead (whether such funds were fairly and legally owned, or obtained in a fraudulent or other improper manner) in defeat of a creditor's claims, then the protection would not apply. This is not presently allowed under the Havoco decision of the Florida Supreme Court, and thus would void that holding. The policy of protecting the homestead of a debtor and his or her family members so as to avoid them being kicked to the curb and/or becoming public charges of the state would be diluted, in favor of creditors. Beyond this change in policy, the use of the term "fraudulently" also raises an interpretative question. While fraudulent conveyance law employs the term "fraud" in its title, it does not require common law fraud to occur before it applies. By using the term "fraudulently," is this provision requiring common law fraud, thus imposing a higher standard than prevailing fraudulent conveyance law, or merely intending to co-opt the less rigorous requirements of fraudulent conveyance law?

Subsection (2) provides a new exception to protection if the creditor was injured by an intentional tort, or intentional criminal or fraudulent act - essentially a "bad acts" exception. This is a substantial loss of protection from what is under current law. It does provide an exception if the owner's spouse or minor child is living on the homestead at the time of the bad act or judgment, which is a good thing but has the unfortunate consequences of providing a windfall to bad actors and their families if they have a cohabitating spouse or minor child.

You can monitor the activities of the CRC here.

IRS On The Hunt for Bitcoin Gains

By Charles (Chuck) Rubin

While bitcoin seems like money, for federal income tax purposes, it is not. Like any asset, when it is sold or used to purchase goods or services, gain results if the value of the bitcoin is greater than the taxpayer's basis in it (generally, what the taxpayer paid to acquire it).

The IRS suspects that either intentionally or unintentionally, many taxpayers are not reporting their bitcoin gains. To help find such taxpayers, it issued a John Doe summons against Coinbase, a leading bitcoin firm, for extensive information on its users. Coinbase objected, but a federal court has now ordered it to comply. The IRS did not get access to all the information that Coinbase has on its customers, such as account opening records, copies of passports or driver's licenses, all wallet addresses, and all public keys for all accounts/wallets/vaults. Nonetheless, Coinbase has been ordered to turn over the following information for each customer, (1) the taxpayer ID number, (2) name, (3) date of birth, (4) address, (5) account activity including transaction logs or other records identifying the date, amount, and type of transaction (purchase/sale/exchange), the post transaction balance, and the names of counterparties to the transaction.

Tax return preparers should be asking their clients about bitcoin transactions, and taxpayers should know that the IRS is actively seeking information on persons that buy or sell bitcoin.

U.S. v. Coinbase, Inc., Case No. 17-cv-01431-JSC (U.S.D.C. Northern District of California)

Florida Case Law Update - Trust, Estate & Guardianship Litigation

By Jenna Rubin

Stuart v. Ryan, --- So.3d --- (Fla. 4th DCA 2017)

This decision is a nice review of the availability of exceptions to Florida homestead creditor protection. Despite the fact that the discussion about exceptions to homestead being dicta, because the property in

question was determined to not be homestead property, the decision provides a summary of the status of the law in this area.

The Florida Constitution lists only three exceptions to our homestead creditor protection: (1) government entities with a tax lien or assessment on the property; (2) banks or other lenders with a mortgage on the property which originated from the purchase of the property; and (3) creditors with liens on the property which originated from work or repair performed on the property. The Court acknowledged that the Florida Supreme Court had recently recognized a fourth exception for alimony creditors, and that other Florida courts had found other exceptions for specific factually distinct situations. It concluded that the exceptions should be limited to those found in the Florida Constitution and those recognized by the Florida Supreme Court.

In this case however, whether or not an exception existed did not matter, because the Court held that the property in question was not homestead property. It found that a person who "intends" to make Florida her permanent residence cannot claim the benefits of the homestead exemption if their principal residence is in fact elsewhere.

Flanzer v. Kaplan, --- So.3d --- (Fla. 2d DCA 2017)

The Court here considered when a party must bring an action to challenge the validity of a trust purportedly procured by undue influence. While the Florida Trust Code prescribes when a challenge to the validity of a trust may be started (when it becomes irrevocable or upon the settlor's death), the Trust Code does not specify a limitations period for challenging the trust. As a result, we must look to the general rules for limitations contained in Chapter 95.

In this situation, the daughter of the settlors of an irrevocable trust tried to challenge that irrevocable trust as the product of undue influence. The trustees of the trust argued that her challenge was time barred because more than four years had passed since the trust had been created. The daughter argued that the delayed discovery doctrine should apply, because undue influence is considered a "species of fraud." The delayed discovery doctrine provides that where an action is founded on fraud, the statute of limitations does not run until the time the facts giving rise to the cause of action were discovered or should have been discovered with the exercise of due diligence.

The Court held that even though undue influence and fraud are separate causes of action, because the delayed discovery doctrine applies to causes of action founded upon fraud, the doctrine should apply to claims of undue influence.

In re Guardianship of Bloom, 227 So.3d 165 (Fla. 2d DCA 2017)

While this decision involved a lengthy description of prior litigation among the various competing parties in this guardianship, and ultimately trust and estate dispute, the takeaway of the decision is simple. The Court noted an ambiguity in F.S. 736.1005 regarding when notice must be given of an application for attorney's fees, and held that, "an applicant for attorney's fees under section 736.1005 must serve an application for attorney's fees to the parties identified in the statute contemporaneously with the filing of the application with the court" (emphasis added).

Sarfaty v. M.S., --- So. 3d --- (Fla. 3d DCA 2017)

In this guardianship decision, the Court considered how strictly to interpret F.S. 744.331 and FPR 5.550, dealing with the required procedures following the filing of a petition to determine incapacity. It held in situations like this one, where the procedural deficiencies were a result of actions of the parties and occurred with everyone's knowledge, such deficiencies are not enough to result in a dismissal of the petition without leave to amend.

The alleged deficiencies were twofold. First, counsel for the AIP argued that the petition should be dismissed because of the alleged failure of court-appointed counsel to read the petition and form notice to the AIP. Second, counsel argued that the petition should be dismissed because the examining committee members did not file their reports within the fifteen day period required by F.S. 744.331(3)(e). The trial court dismissed the petition and ruled orally that an amendment to the petition would not be allowed.

The Court reversed, finding that while counsel's arguments may constitute legal defenses to the petition, they failed to establish the legal insufficiency of the petition. Appellants argued that substantial compliance with the statute and rule were insufficient based on the holdings of In re Fey, 624 So.2d 770 (Fla. 4th DCA 1993) and Borden v. Guardianship of Borden-Moore, 8181 So.2d 604 (Fla. 5th DCA 2002). The Court held that even though In re Fey states that "compliance with section 744.331 and rule 5.550 is mandatory," the non-compliance here caused no fundamental error- there was no evidence presented that the court-appointed counsel did not actually read the petition to the AIP, the AIP substituted in independent counsel fairly quickly, private counsel and other family members were present for the examining committee meetings and the matter was continued by agreement of all parties.

DID YOU KNOW?

Babies are born without knee caps. They don't appear until the child reaches 2-6 years of age.

FIRM ANNOUNCEMENTS

The firm is happy to announce that Jenna Rubin has been admitted as a member of the firm. Jenna focuses her practice on probate, trust and guardianship litigation and administration, as well as estate and tax planning. She is a graduate of Northwestern University and of Harvard Law School.

Recent awards and accolades:

- Charles (Chuck) Rubin was awarded the Marquis Who's Who Albert Nelson Marquis Lifetime Achievement Award.
- Corporate USA Today named Charles (Chuck) Rubin as its 2018 Estate Planning Lawyer of the Year - USA.
- Worldwide Financial Advisor named the firm as Estate Planning Law Firm of the Year - USA as part of its Golden Advisor Awards 2017.

DAILY TAX AND BUSINESS UPDATES AVAILABLE. View prior articles, updates that we didn't have room for in this newsletter, or read the above postings when they are first published, by visiting http://www.rubinontax.blogspot.com and http://www.rubinonprobatelit.blogspot.com. To read this issue, or past issues, online, visit http://www.floridatax.com/httpdocs/Resources.html (and scroll to the bottom of the page).

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Feel free to forward this newsletter on to anyone who you think may be interested.

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