Sherman Atlas Sylvester & Stamelman

TAX AND TRUSTS & ESTATES UPDATE

Reflections on 2021

We, along with all other tax and trusts & estates professionals, are pleased that 2021 is behind us. We are looking forward in the year ahead to another productive year of thoughtful planning and trust and estate administration. It is an understatement to describe 2021 as a roller coaster ride, with the great uncertainty it presented as to possible legislative changes to income, gift and estate taxes -- changes that would have significantly impacted our clients. In the gift, estate, and generation-skipping area, not only would certain 2021 legislative proposals have reduced by one-half the available lifetime gift, estate and generation-skipping exemptions, but many of the well-established planning vehicles that we have been using for years were jeopardized. These included grantor trust planning, spousal lifetime access trusts ("SLATs"), grantor retained annuity trusts ("GRATs"), qualified personal residence trusts ("QPRTs"), and even the use of irrevocable life insurance trusts to hold family insurance outside of clients' taxable estates. Fortunately, those changes are not currently being proposed, allowing us now to breathe a sigh of relief.

A few reflections on this past year:

- With heightened focus on potential tax law changes in 2021, we had an opportunity to have very meaningful conversations with clients about their finances, family dynamics and gift, estate and generation-skipping tax situations, as well as philanthropic planning opportunities, that would potentially make sense for each particular situation. In many cases, these conversations led to significant planning that should provide substantial benefits to these families over many years.

- Confronted with the possibility of planning tools and opportunities being legislated away, clients gained a renewed understanding that the planning available today may be gone tomorrow, whether under current law (as the Federal transfer tax exemptions are now scheduled to revert to pre-2018 levels on January 1, 2026) or through new legislation that is introduced. Hopefully, this will lead to continued discussions and thoughtful planning in 2022 and beyond.

- In addition to leading to significant planning this past year, these conversations emphasized the need to keep future planning flexible, where possible, and not be driven exclusively by tax-law changes that may or may not take place.

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210 Park Avenue
2nd Floor
Florham Park, NJ
07932
(973) 302-9700

1185 Avenue of the Americas, 3rd Floor
New York, NY 10036
(212) 763-6464

- Client advisors, including lawyers, accountants, investment and insurance advisors, had different views on planning in light of legislative uncertainty. But best results were achieved when advisor teams worked together with clients to decide how to navigate each individual situation.

We are looking forward to another very positive and productive, and hopefully more tranquil, year of working together with our clients and friends.

2022 Inflation Adjustments for Tax Items

With the new year comes certain inflation adjustments for several tax-related items. Below we have listed some of the more significant changes that took effect January 1, 2022.

Estate and Gift Adjustments

Unified Credit Against Estate, Gift, and Generation-Skipping Transfer (GST) Taxes: The basic exclusion amount is now $12,060,000 (up from $11,700,000) for a single person and $24,120,000 for a married couple (up from $23,400,000).

New York's exemption from the estate tax has increased to $6,110,000 (up from $5,930,000).

New Jersey continues to have no estate tax for residents who passed away after December 31, 2017, but the New Jersey inheritance tax remains in place.

Annual Exclusion for Gifts: The first $16,000 (up from $15,000) to any person, other than gifts of future interests in property, are not included in the total amount of taxable gifts made during the year by a single person.

Annual Exclusion for Gifts to a Non-Citizen Spouse: The first $164,000 (up from $159,000) of gifts to a spouse who is not a citizen of the United States, other than gifts of future interests in property, are not included in the total amount of taxable gifts made during the year.

The $100,000 threshold for reporting gifts or bequests from a nonresident alien or foreign estate did not increase in 2022; accordingly, gifts in excess of $100,000 during the year 2022 from a nonresident alien or foreign estate must be reported.

Personal Income Tax Adjustments

Application of the Highest Tax Rate. The tax rate of 37% affects single filers whose income exceeds $539,900 (up from $523,600) and $647,850 for married joint filers (up from $628,300).

Standard Deduction. The 2022 standard deduction rises to $12,950 for single filers and $25,900 for married couples filing jointly (up from $12,550 and $25,100, respectively).

Exemption Amounts for Alternative Minimum Tax. For 2022, the alternative minimum tax exemption amount is $75,900 for single filers (up from $73,600) and $118,100 for joint filers (up from $114,600).

Retirement Savings Adjustments

Retirement Plan Contribution Limits. The 2022 contribution limit for 401(k), 403(b), and 457 plans is increased to $20,500 in 2022 (up from $19,500 in 2021), with the additional catch-up contribution limit for these plans for taxpayers who are age 50 or older remaining at $6,500. The maximum contribution to IRAs remains at $6,000, with the additional catch-up contribution limit for taxpayers who are age 50 or older remaining at $1,000.

Deduction for Traditional IRA Contributions. The deduction for a traditional IRA for single people and heads of household covered by a workplace retirement plan will phase out at adjusted gross income between $68,000 to $78,000 (up from $66,000 to $76,000). For married couples filing jointly, the income phase-out will be between $109,000 to $129,000 when the IRA contributor is covered by a workplace retirement plan (up from between $105,000 to $125,000), and between $204,000 to $214,000 (up from between $198,000 to $208,000) when the IRA contributor is not covered at work but is married to someone who is.

Maximum Roth IRA Contributions. For Roth IRAs, the income phase-out range is between $204,000 to $214,000 for married couples filing jointly (up from $198,000 to $208,000). For singles and heads of household, the income phase-out range is $129,000 to $144,000 (up from $125,000 to $140,000).

Trustees Beware:
Trust-Owned Life Insurance Needs A Regular Review to Avoid Trustee Liability

The irrevocable life insurance trust has historically been one of the most popular estate planning techniques, used as a relatively simple way to prevent death benefits from being subject to federal or state estate taxes. Often, the trustee is a trusted family member who may not even be aware of the fact that he or she has fiduciary duties to the beneficiaries of the trust. Some insurance trustees have even been known to forget that they are serving as a trustee entirely. Regardless, all trustees are duty-bound under state law to review and manage all trust assets prudently for the benefit of the beneficiaries. That means, among other things, keeping a vigilant eye on the integrity and fiscal soundness of the life insurance policies owned by the trust.

Here are some rather disturbing statistics about life insurance policies in general:

--69% have not been reviewed in the past five years
--20% of these unreviewed policies are likely to lapse in the next three to seven years
--40% of all “non-guaranteed” trust-owned life insurance policies will lapse during the insured’s lifetime

It is, therefore, imperative that any trustee of a trust owning life insurance have the policies in the trust reviewed on a regular basis by a qualified insurance professional or by a service that specializes in policy reviews. Any costs associated with these policy reviews would be an appropriate trust expense.

In practice, we have unfortunately witnessed carrier insolvency, policies that have lapsed without the knowledge of the trustee and lawsuits against trustees when insurance proceeds were less than what the beneficiaries had expected. Since the problem policies at issue might have very large face values, the magnitude of the trustee’s personal liability exposure may be quite significant.

While a review as frequently as annually is probably not necessary, a trustee should certainly review trust-owned policies every few years. That review should include the following: (1) reviewing the policy itself, including obtaining an updated "in-force illustration" from the carrier to see if the premiums are adequate to sustain the policy; (2) reviewing the insured's health or other factors that might impact the pricing of possible replacement insurance in a favorable way (e.g., the insured stops smoking); (3) reviewing the policy to confirm that it is still competitively priced compared to other products available in the marketplace; (4) reviewing the financial strength of the company that issued the policy; and (5) memorializing the results of the review in the trustee's records.

The good news is that this review process can sometimes produce an opportunity for a substantial increase in trust death benefits or reduced premium payments for the same trust death benefit. Further, it may give the trustee confirmation that the policy value outweighs the expenses and remains a prudent investment. Perhaps more importantly, it provides a trustee with the peace of mind that he or she is actively managing the life insurance policies for the benefit of the trust beneficiaries. And, finally, the fact that the trustee has regularly reviewed the trust-owned policies may provide a defense against liability in the event that some unforeseen problem arises with a policy.

The bad news is that, if the trustee has not been doing regular policy reviews, he or she is inviting liability if anything goes awry with an insurance policy owned by the trust.

Finally, we would urge all trustees to regularly consult with their professionals to help ensure that they are executing their fiduciary duties to the fullest extent.

IRS Issues Instructions on S-Corporation's Tax Reporting Related to PPP Loan Forgiveness

On December 22, 2021, the IRS released draft instructions for Form 1120-S (U.S. Income Tax Return for an S-Corporation) ("Draft 2021 Instructions"). The Draft 2021 Instructions were released for information purposes, pending the release of finalized instructions.

The Draft 2021 Instructions resolve uncertainty regarding the proper reporting of S-Corporation expenses relating to tax-exempt income resulting from the forgiveness of a PPP loan. The 2020 instructions to Form 1120-S ("2020 Instructions") had not expressly addressed PPP loan forgiveness. They had generally provided that tax-exempt income should be omitted from the calculation of an S-Corporation's accumulated adjustments account ("AAA"), while the AAA should be reduced by all deductible expenses. However, the 2020 Instructions also provided that the other adjustments account ("OAA") should be adjusted for expenses related to tax-exempt income. Since, unlike expenses relating to tax-exempt PPP loan forgiveness income, most expenses relating to tax-exempt income are generally non-deductible, many tax preparers, and most tax software, addressed this inconsistency by including tax-exempt PPP loan forgiveness income in the OAA and including the related expenses in the AAA.

The Draft 2021 Instructions now clarify that both tax-free income from PPP loan forgiveness and the expenses giving rise to such forgiveness should be included in an S-Corporation's OAA.

This distinction is of particular importance to S-Corporations which have earnings and profits ("E&P") from prior years' status as C-Corporations. Under the general S-Corporation sourcing rules, distributions are sourced first from the AAA, then from previously taxed income, then E&P, and finally the OAA. If tax-free PPP loan forgiveness income is included in

OAA, while the related expenses are included in AAA, the amount available for distribution from the AAA would be understated. For former C-Corporations, this mismatch could cause distributions to be sourced prematurely from E&P, resulting in such distributions taxed as dividends rather than reducing the shareholders tax basis in their S-Corporation stock. However, as provided in the Draft 2021 Instructions, if both the tax-free PPP forgiveness income and related expenses are included in the OAA, then there would be additional AAA from which to make distributions before E&P is reached.

Shareholders of S-Corporation should review their prior year S-Corporation returns and consult with their return preparers to confirm whether they have reported in accordance with the Draft 2021 Instructions and whether any amendments to prior returns are necessary.

New Associates Jamie Herrera and Henry Marley Join Sherman Atlas Sylvester & Stamelman Tax and Trust & Estates Practice Group

Jaime Herrera focuses her practice on advising high net worth individuals and families on all aspects of estate planning, charitable giving, and business succession matters in order to help clients achieve their personal, philanthropic, and business objectives in the most tax-efficient manner. In addition, Jaime also represents beneficiaries and fiduciaries with respect to estate administration, dispute resolution and guardianship and conservatorship issues. Jaime received her law degree, cum laude, from Rutgers School of Law, in 2013. She received her undergraduate degree from Barnard College, and her LL.M in Taxation / Certificate in Estate Planning from Villanova University.

Henry ("Hank") Marley is a 2020 graduate of Cornell Law School, where he was General Editor of the Cornell Journal of Law and Public Policy. At Cornell, Hank also participated in the Securities and Exchange Commission Student Honors program. Hank received his Baccalaureate Degree, cum laude, from Fordham University. Hank is focusing his practice on tax and estate planning, and estate administration.

Attorney Contact Information

Sandra Brown Sherman
Partner
973.302.9716
ssherman@shermanatlas.com

Andrew J. Stamelman
Partner
973.302.9714
astamelman@shermanatlas.com

Jane L. Brody
Partner
973.302.9953
jbrody@shermanatlas.com

James A. Mohoney
Counsel
973.302.9702
jmohoney@shermanatlas.com

Allison S. Clayton
Counsel
973.302.9506
aclayton@shermanatlas.com

Michele A. Fiorentino
Associate
973.302.9959
mfiorentino@shermanatlas.com

Jaime Herrera
Associate
973.302.9687
jherrera@shermanatlas.com

Henry M. Marley
Associate
973.302.9691
hmarley@shermanatlas.com

Fiduciary Specialists & Paralegal Contact Information

Monika Hilliard
Fiduciary Accountant
973.302.9701
mhilliard@shermanatlas.com

Marci Racaniello
Fiduciary Accountant
973.302.9699
mracaniello@shermanatlas.com

Betty Kleiman
Paralegal
973.302.9705
bkleiman@shermanatlas.com

Beatrice Kwok
Paralegal
973.302.9704
bkwok@shermanatlas.com

Beth Corroon
Paralegal
973.302.9509
bcorroon@shermanatlas.com

Cindy Scibilia
Paralegal
973.302.9958
cscibilia@shermanatlas.com

Katrina A. Gieniec
Paralegal
973.302.9668
kgieniec@shermanatlas.com