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Gunster Private Wealth Services
Year End Update at a Glance

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In This Year End Review

- Election Brings a Variety of Significant Potential Tax Changes
- 2017 Estate, Gift and GST Tax Exemptions and Exclusions
- Regulations Could Effect Valuation Discounts
- New Guidance on Leaving New York for Tax Purposes
- Digital Assets Act
- Tax Free Gifts to Pulse Victims
- IRS Trying to Counter Scam Artists
- Unforeseen Circumstances Guidance for Home Sale
- LLC Owners Must Be Careful with S Corp Elections
- Review Your Plan and Monitor Changes

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Election Brings Potential Tax Changes

For the first time since 2006, a Republican President will be in office with a Republican-controlled House of Representatives and Senate. The results of the 2016 elections will very likely have a significant impact on the tax environment faced by wealthy individuals, families and closely held businesses.

The tax proposals of President-elect Trump and Congressional Republicans involve lowering tax rates across the board while broadening the tax base by limiting or eliminating certain tax preferences, deductions and credits. Although it is far too early to predict how Tax Reform proposals will evolve as they work their way through Congress or even whether Tax Reform will be enacted, Congressional Republicans and President-elect Trump have both indicated that Tax Reform is an important priority for them early next year. Even though the specifics of what will be included in any final Tax Reform legislation will be worked out over the coming months, we can look to the outlines of Tax Reform offered by Donald Trump and House Speaker Paul Ryan during the campaign as where Congressional tax writers will begin.

Proposed Individual Income Tax Reforms

- Reduce the number of income tax brackets from 7 (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) to 3 (12%, 25%, and 33%).
- Increase the Standard Deduction and either eliminate or reduce some current itemized deductions. The proposals also consolidate the Personal Exemption into the Standard Deduction effectively eliminating the Personal Exemption for taxpayers who continue to itemize.
- Consolidate and simplify existing tax benefits for higher education and the child tax credit and tax benefits for dependent care costs.
- Eliminate the Alternative Minimum Tax.
- Leave in place the current 20% maximum rate for capital gains and qualified dividends. Speaker Ryan's proposal has a 50% exclusion for those items of investment income so those would ultimately be subject to tax at half of a taxpayer's otherwise applicable tax rate.
- Eliminate Obamacare imposed tax increases including the 3.8% "Medicare" tax on net investment income and the additional 0.9% "Medicare" tax on high-income individuals.
- Apply ordinary income tax rates to the carried interest of hedge fund managers.

Proposed Corporate Tax Reforms

- Reduce the current 35% corporate tax rate to a rate between 15% and 25%.
- Potential changes to deductibility of interest expense and depreciation of long-term assets.
- Change from a worldwide system of tax to a territorial system that would tax US companies only on income from US business.

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- Allow or require repatriation of cash held by US companies offshore at a lower tax rate.

Additionally, both President-elect Trump and Speaker Ryan's proposals include repeal of the estate and generation skipping transfer tax. There has even been the suggestion that the gift tax could be effected but changes to the gift tax are complicated by how it could effect current income tax revenue.

Since many details will still need to be decided through the political process, we cannot state with any degree of confidence what will come of Tax Reform in 2017. However, given the results of the 2016 elections, it is likely that tax rates will not be any higher in 2017 than they were in 2016.

Exemptions and Exclusions Increase for 2017

Lifetime gifts are particularly beneficial from an estate tax planning perspective, as all post-gift appreciation accrues outside of the donor's transfer tax base. When making lifetime gifts, it is important to consider the tax exemptions and exclusions that are currently available. Under current law, the lifetime gift (and estate) tax exclusion amount and the Generation Skipping Transfer tax exemption amount is $5,450,000 for 2016 and these exclusions and exemptions will increase in 2017 to $5,490,000.

The "annual exclusion" gift amount for 2016 is $14,000 and this $14,000 amount will remain unchanged in 2017. This means that you may give any one or more persons up to $14,000 (each) during the year (by December 31st) without incurring gift tax. A married couple, however, can effectively double this amount ($28,000) either by: (i) writing a check from a joint account; (ii) writing separate checks from separate accounts; or (iii) consenting to a "gift-split" on a Federal Gift Tax Return. In connection with a "gift-split," one spouse may write the check(s) (up to $28,000 in the aggregate per donee) but both spouses will be treated as having made the gift equally for federal gift tax purposes. The annual exclusion cannot be carried into a succeeding year and 2016 donees must cash any checks given to them on or before December 31, 2016.

Although an unlimited marital deduction is generally allowed for gifts to spouses, the marital deduction is not allowed for gifts made to spouses who are not U.S. citizens. However, the annual exclusion for gifts to non-citizen spouses is $148,000 in 2016 (increasing to $149,000 in 2017) for gifts to non-citizen spouses that would otherwise qualify for the gift tax marital deduction.

Of course, these exemptions and exclusions are subject to the potential tax reforms described in the first entry of this Update.

IRS Proposes Regulations Effecting Valuation Discounts

You have almost certainly never heard of Section 2704 of the Internal Revenue Code or the new Proposed Regulations applicable to Section 2704 but they are very important in the context of wealth transfer planning and they also serve as a backdrop for a sign of the modern political times.

The federal estate, gift and/or generation skipping transfer tax that applies to the transfer of assets is based upon the "fair market value" of such transferred assets. When determining the value of assets such as closely held business interests, it is appropriate to apply discounts for lack of marketability and potentially lack of control. The basis for these discounts is very straightforward. For example, a purchaser of 25% of a closely held limited liability company that owns $1,000,000 of commercial real estate would not pay $250,000 because such purchaser has a limited resale market and no control over distributions.

For the last 20 years, the IRS has consistently challenged valuation discounts and employed other litigation strategies to combat the leveraged gifting employed with closely-

held business interests. The IRS's efforts, however, have met with a mixed level of success in the courts. In the face of these judicial losses and a seemingly disinterested Congress, the IRS invoked its legislatively granted regulatory power to propose and potentially enact what most believe will be rules that effectively eliminate or at least greatly reduce valuation discounts in the context of family businesses by disregarding the restrictions placed on the transfer of equity interests which support lack of marketability or a lack of control discounts.

Many laws passed by Congress over the last few decades have been what could be considered partial or incomplete laws. Perhaps it is because the issues facing our nation are simply too complex for elected representatives of the people or perhaps members of Congress must spend too much of their time conducting election campaigns, but Congress seems to cede a good bit of its legislative authority to the relevant Department of the executive branch to fill in the blanks. The result is that an extraordinary number of our nation's laws, important laws that affect our lives, are created by the executive branch not the legislative branch and the Proposed Regulations for Section 2704 are a prime example.

The Proposed Regulations will not take effect until 30 days after being finalized. The IRS has received numerous critical comments on the Proposed Regulations, however, creating some uncertainty around when they will become final and whether changes will be made. Due to the potential significant tax consequences of these Proposed Regulations, if you have a family business and have been thinking about transferring some of its equity to a younger generation it would be prudent to consider making the transfer soon, even though there is uncertainty around when the Proposed Regulations may become final or even if they will become final.

New York Seeking Tax from "Former" Residents

People have been taking steps to change their tax residency from northern states to Florida for just about as long as Florida has had air conditioning and mosquito control districts. New York, however, understandably tries to take steps to capture tax from its departing residents whenever it can justify doing so. In July of 2016, the New York Tax Appeals Tribunal issued a ruling that a taxpayer was liable for significant New York State tax because he did not change his domicile from New York to Florida for purposes of New York law as he had claimed despite having extensive connections to Florida.

Even though the taxpayer maintained a Key Biscayne apartment and Florida driver's license, had substantial business ties to Florida, and resided in Florida more days than in New York during the year in question, the Appeals Tribunal was persuaded that the taxpayer was a New York resident because he continued to own and frequently used his New York apartment; received mail and bills at his New York address; maintained substantial business ties to New York; operated both his New York and Florida businesses from a New York office; was present in New York for at least 171 days in the year in question; and his spouse (separated) and descendants were New York residents.

While this taxpayer did have a number of strings connecting him to New York, this case serves as a reminder that simply spending more time during the year in Florida than in your former state does not mean that your former state will not seek or be able to collect tax from you. Further planning and steps may be required for you to clearly establish Florida tax residency.

Florida Enacts Law Governing Access to Digital Assets

After a good deal of debate and undoubtedly no shortage of bargaining with powerful online service providers, Florida finally enacted law covering access to digital assets by others – the Florida Fiduciary Access to Digital Assets Act. This Act allows an individual to grant access to his or her "Digital Assets" upon death or incapacity. Digital Assets are electronic records in which someone has a personal interest or right and include digital

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photographs, files stored in the cloud, electronic bank statements, social media or social network accounts, and, importantly, electronic communications and records such as emails.

You can now add provisions to your Last Will and Testament, Revocable Trust Agreement and Durable Power of Attorney permitting your fiduciaries to access, handle, distribute, delete, dispose of and otherwise exercise control over your Digital Assets. This authority may specifically authorize your fiduciaries to have the right to receive and access the "catalog" (information that identifies each person with which a user has had an electronic communication, the time and date of the communication, and the electronic address of the person), and/or the "content" (information concerning the substance or meaning of the communication which has been sent or received by a user) of electronic communications with respect to any Digital Assets.

If your estate plan does not include language authorizing access to Digital Assets, your fiduciaries will not have any such access unless you make use of an "online tool" offered by certain service providers to grant such access. In keeping with federal privacy laws, the Act prevents service providers that store electronic communications from releasing such communications to fiduciaries unless the user has affirmatively consented to the disclosure.

IRS Confirms Pulse Victim Payments Are Not Income

The IRS Commissioner has stated in a letter to Representative, and recent Senatorial candidate, Patrick Murphy that payments made to victims of the horrific mass shooting at the Pulse nightclub in Orlando, Florida do not represent taxable income to those victims regardless of who is the donor. Payments that individuals receive from a charitable organization or individual as a result of a disaster or emergency hardship are considered to be gifts (subject to the gift tax rules for individuals) and are excluded from the gross income of the recipients.

IRS Takes Some Basic Steps to Combat Scam Artists

Due to the epidemic of identity theft and phone scams, the IRS has directed its employees to move away from making initial contact with a taxpayer via phone calls. The IRS's preferred procedure will now be to first send letters via mail to initiate contact. Although scam artists will still have all of the old pre-digital age tricks, please know that the IRS does not send e-mails to collect tax and going forward you should be very skeptical if someone calls you unexpectedly claiming to be from the IRS.

Additionally, the IRS recently announced that it will begin a program of notifying individuals whose social security numbers have been used in employment-related identity theft uncovered by the IRS.

IRS Rules that the Arrival of Second Child Qualifies As an Unforeseen Circumstance

The Internal Revenue Code provides that taxpayers may exclude up to $250,000 ($500,000 for married taxpayers filing a joint return) of gain on the sale of a home if the property was owned by them for at least 2 of the past 5 years and also was used by them for 2 of the past 5 years. The Internal Revenue Code also provides that taxpayers may exclude some of the gain if the sale is caused "by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances" even if the taxpayers do not meet the standard requirements.

Upon a request from a married couple with a newly born second child, the IRS ruled this year that the couple could receive a reduced exclusion of a gain from the sale of their principal residence based on an "unforeseen circumstance." The facts and circumstances established that the couple had to sell their condominium in order to purchase a home that

would have enough room to house their growing family.

Make Sure Your LLC Taxed as a Subchapter S corporation Avoids Partnership Provisions in its Operating Agreement

Many of our clients make use of limited liability companies ("LLCs") to hold assets and conduct businesses. LLCs are so popular because they are relatively easy to use, provide limited liability protection and offer flexibility in the manner in which they are taxed. For example, an LLC owned by two individuals may be taxed as a partnership or a Subchapter S corporation for federal income tax purposes. This type of flexibility, however, offers a trap for the unwary and a recent IRS ruling highlights this trap.

Most commercially purchased, computer generated or even attorney prepared operating agreements for LLCs contain a variety of provisions that are specifically geared toward partnership taxation, including rights in liquidation governed by complex partnership tax rules.

The problem according to the IRS is that such a set of liquidation rights allows for the possibility that the LLC may not make distributions to the owners in percentages equal to their respective ownership interests. The mere possibility of such a distribution is enough to cause the LLC to be treated as if it has multiple classes of equity – a disqualifying factor for Subchapter S corporations. Many operating businesses, however, prefer Subchapter S corporation taxation.

The IRS ruled that the LLC's operating agreement included provisions relating to partnership style distributions that caused it to be treated as if it had more than one class of equity at the time of its S corporation election. As a result, the LLC's S corporation election was ineffective. Although the IRS further ruled that the ineffective election was inadvertent and allowed the owners to seek retroactive reinstatement, the LLC was potentially facing treatment as a traditional corporation with entity level tax liability for all of the previous years or the owners were facing greater employment taxes on previous distributions.

It is essential that the owners and professionals responsible for an LLC's tax compliance make sure that the terms of the operating agreement match the LLC's tax election. If proper care is not taken, the tax flexibility offered by LLCs can get the owners of the LLC tied up in a knot – a knot that will require the IRS's forgiveness to untangle. If you have an LLC taxed as a Subchapter S corporation, we strongly recommend that you have your operating agreement reviewed for compliance.

Estate Plan Review and Monitoring Changes in the Law

We recommend that you review your estate plan periodically to ensure it is updated taking into account your current family situation, your current asset structure, your dispositive wishes, the tax provisions currently in effect, and your trustee selections. As new legislation unfolds, it will be critically important to address these changes with your advisors and determine how they will impact you and your family. You should also check to make sure that your assets are properly titled so that your estate plan operates as intended.

The ability to pass your remaining estate tax exemption on to your surviving spouse at your death (otherwise known as "portability") has been an excellent recent modification to the law and reduces the urgency of estate tax planning for many couples. If you are married, and have combined assets approaching or, in excess of, $10,980,000, or one of you has assets in excess of $5,490,000, care should still be taken to ensure that both you and your spouse will fully utilize your available federal estate tax credits, which may require the gift

Mission and Goals

Gunster's dedication to the preservation of wealth and the protection of personal and business assets is at the core of the firm's Private Wealth Services practice.

Our mission is to understand our clients' goals over the long-term, and to design creative solutions for business/personal planning and complex estate and trust litigation.

Gunster's commitment to serving clients' legal needs has remained steadfast for almost a century. It drives our attorneys to strive to go beyond traditional service models and work to redefine the value a law firm seeks to deliver.

The ability to protect wealth and pass it from generation to generation has become an increasingly intricate and multilayered process. The successful implementation of estate, trust and business plans often requires attorneys who have mastered a variety of disciplines.

Gunster endeavors to provide clients with the know-how required to succeed and the depth of experience needed to implement every aspect of a client's transaction.

Gunster's probate, trust and fiduciary litigation attorneys seek to be leaders in their field. Gunster attorneys represent beneficiaries and fiduciaries on a wide range of matters touching all aspects of estate, trust and fiduciary litigation, and complex and disputed administration.

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tax-free transfer of ownership of some assets between spouses (assuming the donee spouse is a U.S. citizen). This is because there is no "portability" for the generation skipping transfer tax exemption and assets, up to your remaining estate tax exemption, left in trust for your surviving spouse can appreciate in value during your surviving spouse's life well in excess of your remaining estate tax exemption and still remain free of estate tax upon the second death.

Another item to consider is your beneficiary designations. Too often designations of life insurance, annuities and retirement plans conflict with an individual's written estate plan.

We hope the information in this letter is helpful to you in your year-end planning. If you have any questions, we would be happy to assist you. Best wishes for a healthy and joyous holiday and New Year.

In this Year-End Letter, we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your advisors rely solely on the contents of this Year-End Letter for legal advice, nor should you reach any decisions with respect to your personal tax or estate planning without further discussion and consultation with your advisors.

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