

## **Mary Vandenack's Notes from the NYU Advanced Trusts and Estates Conference, Steve Leimberg's Estate Planning Email Newsletter - Archive Message #2897 - 02-Aug-21**

The **NYU Advanced Trusts & Estates Conference** was held virtually July 28, 2021. **Mary E. Vandenack** attended the NYU Advanced Trusts & Estates Conference, virtually, and agreed to share her notes.

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### **NOTES:**

#### **CHAIR:**

Brad J. Richter

#### **OUT WITH THE OLD, IN WITH THE NEW, USING TRUST DECANTING TO ADAPT TO CHANGED CIRCUMSTANCES**

**Presenter:** Wendy Wolff Herbert, Esq., Fox Rothschild, LLP, Princeton, NJ

Decanting is an ability to provide flexibility to our clients to make changes to our documents.

#### **Why Decant?**

An irrevocable trust is supposed to be irrevocable so why do we want to make changes? The fact is that it is impossible to anticipate all the legal and life changes that will occur ahead of time. There may be a

need to change the trustee, trustee powers, consider tax impacts due to tax law changes, address drafting errors, and family changes that were unanticipated.

There are three methods to change an irrevocable trust. The first is judicial modification, which is likely the safest but least favorable in terms of accomplishing the process. Non-judicial modifications are another way to make changes to irrevocable trusts. There are challenges such as capacity of beneficiaries. What statutes allow concerning non-judicial modification may be limited.

### What is Decanting?

Decanting allows the trustee to make changes to an irrevocable trust without beneficiary consent or judicial approval. Decanting is the trustee's exercise of a discretionary power to distribute the trust assets to another trust. Authority can come from the trust instrument. Authority can also come from common law and likely exists in all states. A state may have passed an explicit statute authorizing decanting.

The first recognition of decanting was Phipps v. Palm Beach Trust Company, 142 Fla. 782. The Florida Supreme Court held that a trustee who has a discretionary power to distribute property to a beneficiary outright may also distribute the property to the beneficiary in further trust. The goal was to allow the primary beneficiary to have a testamentary power of appointment in favor of his spouse.

All states that have considered the issue of the power to decant have determined that the trustee has such power.

In Weidenmayer v. Johnson, 106 N.J. Super. 161 (App. Div. 1969). John Seward Johnson created a trust for his son, John Seward Johnson, Jr. The trustees exercised their discretion to distribute Seward's interest to him and he contributed the distribution to another trust. Such trust provided for Johnson for life and for some of his children. Two children from a prior marriage were excluded. There was some doubt as to whether those children were his. The children that were cut out as a result of the distribution to a second trust sued. The court held the trustees had not abused their discretion. The court noted that the two children who were cut out were not damaged because distribution or exercise of power of appointment could have prevented them from inheriting anyway. The court noted that the settlor's peace of mind was a reasonable basis for the exercise of the trustee's discretion.

Hodges v. Johnson, 170 N.H. 470 (2017). New Hampshire has a decanting statute allowing a trustee to decant from one irrevocable trust to another. A trust had been created by Settlor. Over the years, family rifts evolved related to the involvement of some family members in the family business. The Settlor requested the trustees to decant the trusts in a manner that would result in a change of the beneficiaries. The trustees did so and the result was to eliminate four of six beneficiaries and various contingent beneficiaries. The New Hampshire Supreme Court upheld a lower court ruling that the decanting was improper and void because the trustee violated his fiduciary duty. The Court stated that the trustee had failed to treat the beneficiaries equitably given the intent and purposes of the trust. There is a difference between a power to distribute and a power of appointment in this context.

In the Wiedemeyer case, the court said that X was clearly the primary beneficiary and he had a testamentary of appointment. In the Hodges case, the trust was for the spouse and children and there was no direction to favor one beneficiary.

- Where trustee has broad discretion to distribute property, trustee can likely decant.
- Exercise of power must be in good faith.

- Trustee must act consistently with terms of the trust.
- Know who the primary beneficiary is.
- What were the intentions of the settlor in setting up the trust?
- Equitably consider the interests of beneficiaries.

In at least thirty states, there is statutory authority to decant. New York was the first state to enact a decanting statute. Statutes vary in significant aspects.

A trustee with an unlimited power to invade principal has the right to decant to a trust that cuts out beneficiaries that were named in the first trust. A modification of unlimited discretion with health, education, maintenance and support does not result in limiting the discretion to distribute for decanting purposes.

Statutes often require that notice of decanting must be given. To the extent that notice is required, the person being notified does not necessarily have any ability to do anything about it.

#### Tax Issues Related to Decanting.

Decanting does not generally result in a recognition event if the trustee has the power to distribute the assets; however a decanting of assets from one trust to another may result in a taxable recognition event if beneficiaries possess interests in the new trust that are materially different and the transfer requires beneficiary approval.

Carrying out of DNI from one trust to the other may result in income tax issues and should be considered prior to decanting. A shift of income from one trust to another could be a positive.

Generally, there is no gift arising from decanting even when the decanting favors one beneficiary over another. There is a different result if the trustee is also a beneficiary. There can be a gift if there is a transfer of an interest from the trustee/beneficiary to another beneficiary.

Decanting may be favored over judicial modification to avoid gift tax issues that may arise from a requirement of beneficiary consent.

Decanting may have tax issues where the trust from which assets are being distributed has an ascertainable distribution standard. When trustee is beneficiary, the best approach may be to use a special trustee to effectuate decanting.

When decanting from a grandfathered GST trust, there are some safe harbors. See Reg. 1.26-2601-1.

Decanting deals with trusts that are already in place and how we can take advantage of decanting statutes to support flexibility when needed. Consider building flexibility into the trust documents.

#### **ESTATE PLANNING UNDER THE NEW BIDEN ADMINISTRATION**

**Presenters:** George D. Karibjanian, Esq., Franklin Karibjanian & Law, Boca Raton, FL & Washington D.C.

Reconciliation simply requires a majority vote but tax changes have to sunset. Otherwise, a vote of 60 is required.

#### What Happens if Estate Exemption Falls?

Even if there is no change now, TCJA expires 12/31/2025 and exemption returns to 2011 levels. Treasury regulations provide that there will be no clawback for the drop in exemption amount after 2025.

20.2010-1(c). These regulations do not contemplate an exemption prior to the sunset of the TCJA.

Retroactivity is constitutional and can occur. Whether it can occur is different from whether it is fair. A way to combat retroactivity is to use a defined value clause. The IRS could raise Procter as a challenge to validity. It is more difficult to use a formula for hard assets than for closely held business interests.

### Gifts in 2021

Outright gifting is the easiest thing to do. Disadvantage is that recipient has full use of gifted funds and donor loses complete control. Outright gifting does not necessarily maximize the use of all the donor's available exemptions, such as GST.

Gifts in trust allow donor to retain some control over gifted funds. Donor may benefit multiple generations. Settlor can use both gift tax exemption and GST exemption. Trust has some asset protection. Primary disadvantage is that donor has still lost use of 11.7m of assets.

Asset protection should be considered in all trusts.

Settlor might create an inter vivos QTIP trust. This is trust settlor creates for spouse, providing spouse mandatory income and discretionary principal. Trust is intended to qualify for gift tax marital deduction. If exemption amount is reduced, the QTIP election does not have to be made and exemption is used. If exemption amount is not reduced, then QTIP election can be made and no exemption will have been used.

Inter-vivos QTIP trust can result in a "back end" trust interest for donor spouse. Treas. Reg. 25-2523(f)-1(f) – A back end interest does not create gross estate inclusion under 2036 and 2038. Issue could still be under 2041. Several states have enacted statutes that negate potential 2041 argument by stating that creator of trust with Back End interest is the spouse and not the settlor. Be aware that if the settlor resides in a jurisdiction that has adopted the Uniform Voidable Transactions Act, creating a trust in another jurisdiction could be deemed to be voidable per se.

Consider a completed gift DAPT. A DAPT is often created as an incomplete transfer so there is no transfer tax assessed upon creation. Remainder interest is not a completed gift because settlor retains a special testamentary power of appointment. The income interest is not a completed gift because the settlor either retains a veto power over distributions or a special lifetime power of appointment. The only time transfer taxes are due prior to death is if distributions are made to anyone other than settlor. As a completed gift, the DAPT can provide the settlor with the use of exclusion amount while retaining the ability to receive distributions. The IRS determined in PLR 200944002 that an Alaska DAPT where there was no retention by the settlor of any special powers or the veto power, which meant that the settlor departed with dominion and control upon the transfer, resulted in a completed gift. UVTA affects DAPT planning.

An alternate is the Hybrid DAPT. In a hybrid DAPT, the trust is created as a standard third party irrevocable gifting trust where the settlor is not a potential beneficiary; however, a Trust Protector has the power to add the settlor as a permissible beneficiary. The presumption is that the settlor would only be added if the settlor needs the funds. Because the Trust Protector is an independent party, the settlor's addition as a beneficiary is completely out of the settlor's control. Thus, the trust is a completed gift trust.

When drafting a SLAT, absolutely consider the reciprocal trust doctrine. Reciprocal trusts are those created at the same time with substantially identical terms. If trusts are reciprocal, IRS may disregard the gift and negate the use of exemption amount.

Although GRATs are typically zeroed out, they should be considered as hedge strategies. Consider laddered GRATs. GRATS may be eliminated or require longer terms under future legislation.

Beware of divorce. As a result of 2017 Tax Act §682 was repealed, which results in a grantor trust remaining a grantor trust upon divorce. This result can be prevented in a SLAT with a death on divorce clause but cannot be resolved in an inter vivos QTIP.

A beneficiary defective inheritor's trust ("BDIT") is a trust that is deemed to be owned by a beneficiary for income tax purposes because it grants the beneficiary powers over the entire corpus, yet is not considered to be owned by them for estate/gift/asset protection purposes after lapse. BDIT's are primarily used as a substitute for sales to IDGTs. Some commentators state that BDITS are mostly useless unless leveraged.

A beneficiary deemed owner trust ("BDOT") refers to a trust that is deemed to be owned by a beneficiary for income tax purposes because it grants a beneficiary powers over income, but is not considered to be owned by them for estate/gift/asset protection purposes, because it does not grant a power over corpus. As a result, a BDOT has many uses besides being a substitute for an installment sale to an IGT.

### **HIGHLIGHTS OF SECURE ACT – Developments in Retirement Planning**

**Presenter:** Brad J. Richter, Esq., Fried, Frank, Harris, Shriver & Jacobson LLP

A significant amount of assets exist in the form of retirement assets. Such assets exist in many different forms of investments. IRAs hold the most retirement assets. That is followed by defined contribution plans. There are also assets in private sector defined benefit plans, government defined benefits and annuity reserves.

There are multiple sources of controlling laws: Internal Revenue Code, ERISA, DOL, PBGC, creditors rights issues. The multiple sources of these laws makes it difficult to simplify the rules in this area.

SECURE ACT was passed as part of budget bill December 20, 2019. Act is known as "Setting Every Community Up for Retirement Enhancement". A companion act was passed in the Senate called the Retirement Enhancement and Savings Act. Changes were in two areas: plan level and individual level.

Changes at plan level include escalated automatic enrollment cap and credit for the same; increased flexibility for safe harbor plans and to the employer offering annuity/life income options including portability; credit increase to small employers establishing SEP, SIMPLE-IRA, or other plan; 529 expansion to Registered Apprenticeship Programs and Educational Loan Repayments, Pooled Employer Plan; and allowing long term part time workers to participate in 401k.

Changes at individual level included repeal of age limit for contributions. There must still be earned income to make IRA, ROTH IRA or spousal IRA contributions. Back-Door ROTH IRA conversions are permitted. The age at which required minimum distributions increased to age 72. There are penalty free withdrawals for birth/adoption. Graduate non-tuition fellowship and stipends are treated as compensation for IRA purposes. Such amounts were previously not treated as compensation. Kiddie tax was re-established beginning in 2020 but election could be made to apply to 2018 and 2019.

The ability to use a stretch IRA was eliminated by repeal of the life expectancy for a majority of beneficiaries. Life expectancy has been replaced with a ten year distribution period. There are limited exceptions for "Eligible Designated Beneficiaries". Eligible Designated Beneficiaries (for whom life expectancy can be used) include spouse, minor child of participant/owner, disabled/chronically ill beneficiaries and beneficiaries not more than ten years younger. SECURE Act impacts see-through trusts.

IRAs are income in respect of decedent. The amounts are includible in decedent estate and taxable for income tax purposes to recipient upon withdrawal. In estate plan drafting, give attention to estate tax apportionment clause.

There are basically two types of qualified plans: defined contribution plan and defined benefit plan. Defined contribution plans have become most common. Defined benefit plans may be seen with educational, governmental, or old large corporate plans.

Types of IRAs include basic (traditional), SEP (simplified employee pension), SIMPLE (savings incentive match plan for employees), spousal IRA, rollover IRA, inherited IRA, Roth IRA.

The general rule of income taxation is one of ordinary income upon receipt. If there is no constructive receipt, there is no current taxation without actual receipt. Taxation results upon assignment in satisfaction of pecuniary amount. Exceptions to income taxation include rollovers, return of basis, life insurance, Roth IRA distributions. Assignment of a retirement account in satisfaction of a pecuniary amount results in taxation. Plan failure of qualification can result taxation of income and disallowance of deductions. Prohibited transactions may result in taxation.

There are exceptions regarding taxation related to rollover, return of basis, special averaging, life insurance, employer securities, and Roth IRA distributions. There is a 60-day limit on rollovers.

Retirement assets are also included in estate of decedent. Close attention should be paid to estate tax apportionment. Retirement assets are income in respect of a decedent. There is no step up in basis. There is a 691(c) deduction.

A lump distribution is a distribution of the entire amount of a qualified account. There used to be 5 and 10 year averaging that is now gone; however, there is some relief for clients 85 and older.

When employer offers a plan and employer securities are held in plan, there are some additional deferral that can result from net unrealized depreciation. This must be considered when contemplating a rollover.

Historically, a key driver was deferral. In some cases, tax considerations should not be the driver. For example, if there is a concern about the ability of a beneficiary to manage finances, beneficiary protection may prevail over tax consequences. Trusts can still be used to separate control from a beneficiary even though tax benefits are not as significant.

Deferral remains important. Consider when and how much.

Required beginning date for required minimum distributions was changed to April 1 following the year participant turns 72. That is the date that distributions must commence.

Distribution must be made by December 31 of each distribution calendar year. If first distribution is delayed to required beginning date, a second distribution must be made that year prior to December 31. More than the required distribution can always be distributed.

After the SECURE Act, three sets of rules govern. The most favored status is the spouse. The next most favored beneficiary is an eligible designated beneficiary (non-spouse). The next most favored status is designated beneficiary. The least favored status is no designated beneficiary (estate, charity, non-see through trust).

Lifetime distribution rules are unchanged. If an account owner dies after required beginning date, the life expectancy distribution scheme for beneficiaries other than eligible designated beneficiaries applies. Modified life expectancy rules apply to eligible designated beneficiaries.

If an account owner dies before required beginning date, the distribution rules depend on whether there is a designated beneficiary. If spouse is sole designated beneficiary, spouse can use spouse's single life expectancy or rollover; however the ten year rule applies to the successor beneficiary.

If beneficiary is not spouse but is an eligible designated beneficiary, the life expectancy of eligible designated beneficiary can be used but ten year rule applies to successor beneficiary. If designated beneficiary is not an eligible designated beneficiary, ten-year rule applies. If there is not a designated beneficiary, five-year rule applies.

If an account owner dies after required beginning date, the rules depend on whether there is a designated beneficiary. If spouse is sole designated beneficiary, spouse can use the longer of spouse's single life expectancy or participant's life expectancy (rollover is still usually the best approach). If beneficiary is not spouse but is an eligible designated beneficiary, the life expectancy of beneficiary can be used but ten-year rule applies to successor beneficiary. If beneficiary is not an eligible designated beneficiary, then ten-year rule applies. If there is not a designated beneficiary, distributions continue over life expectancy of account owner.

IRS Publication 590-B has clarified that ten year rule means that beneficiary has ten years to fully distribute account. Distributions may, but are not required, to be taken during that period. There is still some confusion on when 10 year period ends.

Check plans to determine whether designated beneficiary is specified. Plan beneficiary designation will control over will.

Trusts can be designated beneficiaries if rules are followed. Look-through status can be obtained with a trust that is valid under state law, is irrevocable or will become so on account owner's death, beneficiary information is filed with custodian and all beneficiaries are identifiable. All beneficiaries count, including successive and contingent beneficiaries.

The first trust option is the conduit trust. Such a trust is merely a conduit for plan distributions. All benefits are payable immediately to the beneficiary. Trustee is directed to withdraw RMD annually and distribute to beneficiary. Remainder beneficiaries are disregarded for purposes of determining conduit beneficiary.

Accumulation trusts do not distribute all of RMD each year to beneficiary. Trust will have a remainder after income passing to primary beneficiary. This trust is easiest to use for multiple/difficult contingencies. SECURE Act language seems to authorize accumulation trusts. Post-SECURE, pot trusts for DB's are okay but age differential is no longer a concern.

To get EDB status post SECURE, use conduit trust. Accumulation trusts should generally be used in those situations where non-tax concerns control.

Post SECURE planning is highly fact specific. Planning ideas include using a CRT, life insurance, Roth conversions, and family bracket management.

### **INCOME TAX DEFERRAL FOR TAXPAYERS WHO ANTICIPATE SELLING APPRECIATED ASSETS WHILE LIVING**

**Presenter:** Jerome M. Hesch, Director Notre Dame Virtual Tax & Estate Planning Institute

Ideas are intended to cover income tax deferral techniques that will become more important if carryover basis at death is enacted.

#### Installment Sale to a Non-Grantor Trust

Individuals in their late 80s and 90s, and individuals in poor health should consider taxable gifts that exceed their exemption and pay the gift taxes. If the donor survives the three years after making the gift, the gift tax paid reduces the amount exposed at death.

Consider creation of a complex trust that is a non-grantor trust. Use an installment sale of an asset to complex trust for both estate planning and income tax deferral for the gain realized upon eventual sale of an appreciated asset for cash.

Example: Senior owns a family business with value of \$30,000,000. Senior's basis in asset is \$4,000,000. Senior's exit strategy is to sell business for cash at retirement. Spouse and children are not involved in family business.

Consider using a non-grantor trust created by someone other than Senior, such as Senior's mom. If someone else creates trust for Senior, Senior can have a special power of appointment and can be a beneficiary without estate tax exposure. After a valuation discount, the business is worth \$20,000,000. Senior gifts half the business to his spouse. Senior and his spouse each sell \$5,000,000 interests to the complex trust for installment notes that are interest only with principal due in 23 years. 453A is avoided as long as there is a two year period before further sale. In the next calendar year, Senior and his spouse each sell another \$5,000,000 interest for installment notes. The complex trust's cost for business is \$20,000,000 as it acquired the business by purchase. If trust later sells the business for \$42,000,000, the complex trust realizes a capital gain of \$22,000,000. Because Senior and spouse have not had any installment gain, they are not paying income taxes (although the notes will be IRD at time of death).

This structure allows Senior, Senior's spouse, and children to be beneficiaries of the trust. Income can be distributed based on tax brackets to reduce overall income tax cost of asset in trust.

#### Encumbered Real Estate Owned by a Partnership

Senior owns real estate with an adjusted basis of \$25,000, a value of \$100,000 and is subject to a \$60,000 mortgage. At the time of the sale for \$100,000, Senior received only a \$40,000 installment note, annual interest on the outstanding principal, with four \$10,000 principal payments and interest to be made every 12 months. The buyer assumes the existing mortgage. The \$35,000 excess of the \$60,000 mortgage over the \$25,000 basis is deemed to be a payment of cash at the time of the sale ("phantom gain").

Selling price is \$100,000, consisting of the \$40,000 note and the \$60,000 mortgage taken over by the buyer. With a \$25,000 basis, the realized gain is \$75,000. The installment method allows the seller to defer the reporting of the gain in the installment note. In arriving at the contract price, the selling price

is reduced by the amount of the mortgage, but only up to the seller's \$25,000 basis in the property. Therefore, the gross profit ratio is 100%. The \$35,000 amount by which the mortgage exceeds the basis is

treated as a fictional cash payment at the time of the sale. Accordingly, S is treated as having received \$35,000 at the date of the sale. With a \$60,000 liability and only a \$25,000 basis, only \$25,000 of the mortgage can be treated as a tax-free return of basis.

Defer reporting phantom gain using an installment sale to a related party.

Senior tax capital account is a negative \$5,000,000 (\$4,000,000 – \$9,000,000). Senior's outside basis is \$4,000,000. If the partnership sells the real estate subject to the mortgage, it receives only \$6,000,000 of cash, but reports an \$11,000,000 gain. Phantom gain is \$5,000,000 (mortgage in excess of basis).

Senior contributes a capital asset with a basis and value of \$5,000,000 to the partnership. Senior's outside basis is now \$9,000,000. Senior's book and tax capital accounts are increased by the contribution of an asset with a value and basis of \$5,000,000. Tax capital account is now zero (\$9,000,000 tax basis -\$9,000,000 liability).

Consider 453(g), section 1239 and section 453(k)(2) with respect to this transaction.

Senior then sells entire partnership interest to a non-grantor trust for \$11m note realizing an \$11m gain. Trust's cost basis for partnership interest \$20m. The \$9m of liabilities do not exceed the \$9m basis for Senior's partnership interest. The \$9m of liabilities is treated as a non taxable return of basis. This results in a shift of the real gain and phantom gain.

If the partnership sells real estate two years later for \$15m, subject to the \$9m liability. If basis for real estate is still \$4m, the partnership's gain is \$11m. The partnership nets \$6m of cash. Trust's outside basis is increased by \$11m share of gain. Trust's outside basis is reduced by \$9m. Upon termination of partnership, \$6m cash is distributed and the capital asset with basis and value of \$5m is distributed as liquidating distribution. Trust's outside basis of \$22m is reduced by \$6m of cash. Then trust receives capital asset with inside basis of \$5m but as a liquidating distribution, the trust's remaining outside basis is substituted as its basis for capital asset. Trust must sell capital asset in same year as liquidating distribution received.

An alternative is to terminate the partnership before the real estate is sold.

It is possible to borrow basis from another asset to increase the basis of the encumbered real estate.

Senior has two assets, marketable securities, both valued at \$30,000,000. Stock A has a basis of zero and recently purchased Stock B has a basis of \$30,000,000. Senior desires to sell Stock A in the future and hold on to

Stock B as a long-term investment. Can Senior shift the \$30,000,000 basis in Stock B to Stock A so that a sale of Stock A for \$30,000,000 cash will not result in any realized gain? The basis shifted from Stock B to Stock A creates potential gain for Stock B.

Review the basis rules under § 732 for property distributed by a partnership to a partner. When a partnership distributes an asset to a partner, the partner's basis in the distributed asset is that same as the partnership's basis. The partnership's basis carries over to the partner for both appreciated assets and assets that have declined in value. The built-in gain or built-in loss stays with the distributed asset.

A, a 20% partner, has a \$14,000 basis in her partnership interest ("outside basis"). A's 20% interest is valued at \$20,000. -Partnership distributes to A, an asset with a **basis to the partnership of \$6,000** ("inside basis") and a value of \$10,000 (the *value reduces A's book capital account*).

-No gain is realized by A or by the partnership.

-A's basis in the distributed asset is \$6,000.

-A's basis in his partnership interest is reduced by \$6,000 to \$8,000 and A's capital account is reduced by \$10,000.

-With a carryover basis, all other income tax attributes for the distributed asset are carried over to A.

Exception: Basis in distributed asset cannot exceed a partner's outside basis:

- B's outside basis is \$4,000. B's partnership interest is worth \$20,000 (**the built-in gain is \$16,000**). B receives a *liquidating* distribution of an asset with an inside basis of \$7,000 and a value of \$20,000 (**the built-in gain is \$13,000**).

- If B were permitted a \$7,000 carryover basis, B would have only \$13,000 of built-in gain in the distributed asset and \$3,000 of potential gain will disappear.

- To preserve **the \$16,000 of built-in gain**, B's basis in the distributed asset is limited to \$4,000.

If a partner's interest is terminated, the partner's outside basis is substituted as the basis for the distributed asset.

- The extra \$3,000 of inside basis cannot be used by B.

- Does the \$3,000 of basis disappear?
- **Apply the Section 754 election**
- The partnership can increase the inside basis for its remaining appreciated assets by the \$3,000 of basis that B could not use. See Section 734(b).

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

Mary Vandenack

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