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Lum Law Notes

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Lum, Drasco & Positan LLC

Attorneys At Law Since 1870

Real Estate and M & A Transactions – Avoiding Traps For the Unwary

The recently enacted Tax Cut and Jobs Act of 2017 (the "TCJA") amends IRC Section 864(c) by adding a new subsection (8), which in summary provides that where a nonresident alien or foreign corporation has gain or loss on the disposition of an interest in a partnership (including limited liability companies taxed as a partnership) that is engaged in a trade or business in the U.S., the gain or loss that is attributable to the partnership's U.S. trade or business is treated as effectively connected to a U.S. trade or business and thus subject to U.S. federal income tax. This provision applies to dispositions on or after November 27, 2017.

In addition, TCJA revised IRC Section 1446(f) to provide that effective January 1, 2017, a purchaser of a partnership interest (again, including a membership interest in an LLC taxed as a partnership), is generally required to withhold ten percent of the amount realized by the seller on the disposition, and remit the withheld amount to the IRS. If the purchaser does not comply with these withholding/remittance requirements, the partnership itself is required to withhold from distributions to the purchaser the amount that should have been withheld, plus interest. These rules apply to sales of both U.S. and non-U.S. partnerships that have income effectively connected to a U.S. trade or business determined under Section 864(c).

Withholding is required unless (i) the purchaser receives an affidavit from the seller stating that the seller is a U.S. citizen (including taxpayer identification number), (ii) it has been determined that there is no income effectively connected to a U.S. trade or business, (iii) the IRS agrees to a lower withholding requirement, or (iv) interests in the partnership are publically traded.

Partnership Agreements and Operating Agreements Should Be Reviewed

New rules went into effect on January 1, 2018 for the audit of partnerships and limited liability companies by the IRS which can have a significant impact on companies which have not adequately planned to address them. The rules are varied and complex but among the most important changes are that assessments and collections will take place against the entity rather than the individual partners or members and the partners or members can be bound by the actions of a partnership representative who is not answerable by law to the other partners or members and is not even required to keep them informed.

Everyone with an interest in a partnership or limited liability company is strongly advised to have their partnership agreement or operating agreement reviewed to determine whether amendments are necessary to address the issues contained in this new law.

Unwinding an Irrevocable Trust

For estates of decedents dying and gifts made after December 31, 2017 and before January 1, 2026, the TCJA doubles the base estate and gift tax exemption amount from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011 (In 2018, $11.2 million per single individual/$22.4 million per married couple). Also, effective January 1, 2018, the New Jersey estate tax is repealed.

With these sweeping estate and gift tax law changes, some clients may desire to reevaluate insurance and other trust held assets to determine if these assets should be redeployed.

A distinguishing feature of an irrevocable trust is that it is supposedly not possible to modify or terminate such a trust. Fortunately, N.J.S.A. 3B:31-27 provides that an irrevocable trust may be modified or terminated upon consent of the trustee and all beneficiaries, if the modification or termination is not inconsistent with a material purpose of the trust.

While there may be good reasons to modify or terminate an irrevocable trust due to changes in the law, it is important to remember that if an irrevocable trust is terminated, the assets distributed from the trust become subject to the claims of creditors. Also, the recent estate and gift tax law changes have been extremely favorable; however, in the future the pendulum could swing in the other direction and Congress could lower the current exemption amounts.

The decision to modify or terminate an existing irrevocable trust should be evaluated on a case-by-case basis to fully assess the implications of such a decision.

Tax Reform: Divorce Game Changer

Prior to TCJA, payor spouses enjoyed a tax deduction for payment of alimony, while receipt of alimony was taxable to the payee as income. Under the TCJA, alimony obligations created under a settlement agreement or judgment of divorce executed after December 31, 2018 or executed before that date but modified after it (if the modification expressly provides that the new amendments apply), will no longer be deductible by the payor or taxable to the payee. As such, the looming implementation date of TCJA may well provide an incentive for payor spouses currently in the midst of divorce litigation to finalize their settlement. Payee spouses, on the other hand, might be inclined to delay settlement into 2019. Following implementation of TCJA in 2019, litigants and their attorneys will be faced with the question of how to calculate support under the new tax regime, as future litigants will likely see reduced alimony offers to compensate for the loss of the deduction.

To discuss any of the above, please contact any of our Business attorneys:

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