Powers of Deduction: Tax-Saving Strategies Under the Legislation Formerly Known as the Tax Cuts and Jobs Act (PowerPoint)

Thomas J. Pauloski

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Powers of Deduction: Tax-Saving Strategies Under the Legislation Formerly Known as the Tax Cuts and Jobs Act

Thomas J. Pauloski, J.D.
National Managing Director
Wealth Planning and Analysis Group
Bernstein does not provide tax, legal, or accounting advice. In considering the information contained in this presentation, you should independently verify all conclusions before implementing any strategy on your own behalf or on behalf of your client.
## Comparative Highlights of Prior Law and “The-Legislation-Formerly Known as the Tax Cuts and Jobs Act”

ATRA, et al.

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Top marginal corporate income tax rate</strong></td>
<td>35%</td>
<td>21%</td>
</tr>
<tr>
<td><strong>Top marginal individual income tax rate</strong></td>
<td>39.6%</td>
<td>37%, but up to 20% of domestic qualified business income is deductible</td>
</tr>
<tr>
<td><strong>Surtax on net investment income</strong></td>
<td>3.8%</td>
<td>Same</td>
</tr>
<tr>
<td><strong>Nonitemizers</strong></td>
<td>Combination of standard deduction and personal exemptions</td>
<td>2x standard deduction; personal exemptions eliminated</td>
</tr>
<tr>
<td><strong>Itemized deductions</strong></td>
<td>Subject to “3% cutback”</td>
<td>“3% cutback” and most deductions repealed; state and local tax deduction limited to $10,000 per year</td>
</tr>
<tr>
<td><strong>Estate and GST taxes</strong></td>
<td>$5.49M inflation-indexed exclusion; 40% “flat” rate</td>
<td>Same, except 2x prior basic exclusion amount through 2025</td>
</tr>
<tr>
<td><strong>Step-up in income tax basis at death</strong></td>
<td>Applies to all decedent’s estates</td>
<td>Same</td>
</tr>
</tbody>
</table>

**Federal Wealth Transfer and Income Taxes: Then and Now**

- **Basic exclusion amount**
  - 2001: $675,000
  - 2018: $11.18 Mil.

- **Transfer tax rate**
  - 2001: 55%
  - 2018: 40%

- **Income tax rates**
  - **Long-Term Capital Gain/Qualified Dividend**
    - 2003: 15.0%
    - 2018: 23.8%
  - **Short-Term Capital Gain/Ordinary Income**
    - 2003: 35.0%
    - 2018: 40.8%

*The top income tax rates in 2018 include the 3.8% Medicare surtax on net investment income. The top ordinary income/short-term gain rate and qualified dividend/long-term gain rate in 2018 are 37% and 20%, respectively. Sources: Internal Revenue Service (IRS) and AB*
**Tax Domicile of the Transferor—and Transferee—Matters**

*Based on Health Care and Education Reconciliation Act of 2010, American Taxpayer Relief Act of 2012, and Tax Cuts and Jobs Act of 2017. Rates represent Bernstein’s estimate of the top marginal tax, federal and state income, capital gain, and estate tax brackets. Blended rates assume that state and local income taxes are not deductible for federal income tax purposes, notwithstanding the $10,000 deduction allowance for state and local taxes (including real property taxes) under current law, but that the 3.8% Medicare surtax on net investment income is adjusted to reflect the offset for state or local income taxes paid.

Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions.

Sources: [www.taxfoundation.org](http://www.taxfoundation.org), IRS, and AB
Some Assets Will Benefit from Step-Up; Others May Not

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Tax Characteristic*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creator-Owned Copyrights, Trademarks, Patents, and Artwork</td>
<td>Ordinary → Long-Term</td>
</tr>
<tr>
<td>Negative-Basis Commercial Real Property LPs</td>
<td>Ordinary and Long-Term</td>
</tr>
<tr>
<td>Artwork, Gold, and Other Collectibles</td>
<td>28% Long-Term</td>
</tr>
<tr>
<td>Low-Basis Stock</td>
<td>20% Long-Term</td>
</tr>
<tr>
<td>Roth IRA Assets</td>
<td>Tax-Free</td>
</tr>
<tr>
<td>High-Basis Stock</td>
<td>Minimal Gain</td>
</tr>
<tr>
<td>Bonds</td>
<td>Typically Minimal Gain</td>
</tr>
<tr>
<td>Cash</td>
<td>Basis = Face Value</td>
</tr>
<tr>
<td>Depreciated Stocks</td>
<td>Capital Loss Erased</td>
</tr>
<tr>
<td>Variable Annuities</td>
<td>Partially IRD**</td>
</tr>
<tr>
<td>Traditional IRA and Qualified Plan Assets</td>
<td>100% IRD**</td>
</tr>
</tbody>
</table>

*Tax rates cited below do not include the 3.8% Medicare surtax on net investment income.

**"IRD" means income in respect of a decedent.

Source: AB
Consider Likely Post-Transfer Appreciation, Not Just Gap Between Effective Estate and Capital-Gains Tax Rates

Is anticipated \([A_{pt} \times T_e] > [T_{cg} \times \{(V - B) + A_{pt}\}]\) ?

where:

\begin{align*}
A_{pt} &= \text{Post-transfer appreciation;} \\
T_e &= \text{Transferor’s effective \textit{estate} tax rate} \\
T_{cg} &= \text{Transferee’s effective \textit{income} tax rate} \\
V &= \text{Current asset value} \\
B &= \text{Current adjusted basis}
\end{align*}

\textit{Expected timing of transaction and transferor’s death are also key variables}

Source: AB
Consider Likely Post-Transfer Appreciation, Not Just Gap Between Effective Estate and Capital-Gains Tax Rates

Is anticipated $[A_{pt} \times T_e] > [T_{cg} \times (V - B) + A_{pt}]$ ?

where:

- $A_{pt}$ = Post-transfer appreciation;
- $T_e$ = Transferor’s effective estate tax rate;
- $T_{cg}$ = Transferee’s effective income tax rate;
- $V$ = Current asset value;
- $B$ = Current adjusted basis.

Consider potential impact of increased exclusion on effective estate tax rate.

Expected timing of transaction and transferor’s death are also key variables.

Source: AB
The Next 10 Years Are Likely to Be Challenging for Investors

As of June 30, 2018

*Represents projected pretax compound annual growth rates.

**Stocks modeled as MSCI World Index. Bonds modeled as intermediate-term diversified municipals.

Based on AllianceBernstein’s estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise or a range of future results. See Appendix for further details.

Source: AB
At Least Some International Exposure Is Advisable

<table>
<thead>
<tr>
<th>Category</th>
<th>Median 10-Year Growth Rate</th>
<th>Mean Annual Return</th>
<th>Mean Annual Income</th>
<th>One-Year Volatility</th>
<th>10-Year Annual Equivalent Volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Equivalents</td>
<td>2.4%</td>
<td>2.7%</td>
<td>2.7%</td>
<td>0.5%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Short-Term Treasuries</td>
<td>3.5%</td>
<td>3.6%</td>
<td>3.4%</td>
<td>1.1%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Short-Term Taxables</td>
<td>3.9%</td>
<td>4.1%</td>
<td>4.1%</td>
<td>1.4%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Short-Term Diversified Municipals</td>
<td>2.3%</td>
<td>2.4%</td>
<td>2.3%</td>
<td>0.9%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Int.-Term Treasuries</td>
<td>2.9%</td>
<td>3.0%</td>
<td>3.7%</td>
<td>5.1%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Int.-Term Taxables</td>
<td>3.2%</td>
<td>3.3%</td>
<td>4.6%</td>
<td>5.4%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Int.-Term Corporates</td>
<td>3.3%</td>
<td>3.5%</td>
<td>5.2%</td>
<td>6.2%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Int.-Term Diversified Municipals</td>
<td>2.7%</td>
<td>2.8%</td>
<td>2.9%</td>
<td>4.2%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Global Int.-Term Taxables (Hedged)</td>
<td>2.6%</td>
<td>2.7%</td>
<td>3.2%</td>
<td>4.4%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Int.-Term TIPS</td>
<td>3.7%</td>
<td>4.1%</td>
<td>4.1%</td>
<td>3.7%</td>
<td>7.2%</td>
</tr>
<tr>
<td>High Yield</td>
<td>4.2%</td>
<td>4.9%</td>
<td>8.8%</td>
<td>12.5%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Global Large-Cap (Unhedged)</td>
<td>7.3%</td>
<td>8.7%</td>
<td>2.7%</td>
<td>15.7%</td>
<td>14.7%</td>
</tr>
<tr>
<td><strong>US Diversified</strong></td>
<td><strong>6.4%</strong></td>
<td><strong>8.0%</strong></td>
<td><strong>2.4%</strong></td>
<td><strong>16.3%</strong></td>
<td><strong>15.3%</strong></td>
</tr>
<tr>
<td>US Value</td>
<td>6.9%</td>
<td>8.3%</td>
<td>2.8%</td>
<td>16.0%</td>
<td>15.0%</td>
</tr>
<tr>
<td>US Growth</td>
<td>6.0%</td>
<td>7.9%</td>
<td>1.9%</td>
<td>18.1%</td>
<td>16.7%</td>
</tr>
<tr>
<td>US Mid-Cap</td>
<td>6.8%</td>
<td>8.6%</td>
<td>2.0%</td>
<td>17.9%</td>
<td>16.9%</td>
</tr>
<tr>
<td>US Small/Mid-Cap</td>
<td>6.8%</td>
<td>8.7%</td>
<td>2.0%</td>
<td>18.7%</td>
<td>17.7%</td>
</tr>
<tr>
<td>US Small-Cap</td>
<td>6.7%</td>
<td>9.1%</td>
<td>1.9%</td>
<td>20.5%</td>
<td>19.6%</td>
</tr>
<tr>
<td><strong>Developed International</strong></td>
<td><strong>7.9%</strong></td>
<td><strong>9.9%</strong></td>
<td><strong>3.4%</strong></td>
<td><strong>18.1%</strong></td>
<td><strong>17.0%</strong></td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>6.0%</td>
<td>9.8%</td>
<td>3.3%</td>
<td>26.1%</td>
<td>25.6%</td>
</tr>
<tr>
<td>Global REITs</td>
<td>6.8%</td>
<td>8.4%</td>
<td>4.0%</td>
<td>16.7%</td>
<td>15.7%</td>
</tr>
<tr>
<td>Real Assets</td>
<td>6.2%</td>
<td>7.3%</td>
<td>3.2%</td>
<td>13.3%</td>
<td>14.4%</td>
</tr>
<tr>
<td>Diversified Hedge Fund</td>
<td>5.4%</td>
<td>5.7%</td>
<td>2.6%</td>
<td>10.8%</td>
<td>14.9%</td>
</tr>
<tr>
<td>Inflation</td>
<td>2.9%</td>
<td>3.2%</td>
<td>n/a</td>
<td>1.3%</td>
<td>6.2%</td>
</tr>
</tbody>
</table>

Based on 10,000 simulated trials each consisting of ten-year periods. Reflects AllianceBernstein’s estimates and the capital-market conditions of June 30, 2018. For hedge fund asset classes, “Mean Annual Income” represents income and short-term capital gains.

Data do not represent past performance and are not a promise or a range of future results.

Source: AB
For the “Lucky” Few to Whom the Estate Tax Still Applies . . .
Projected Effect of Inflation on Basic Exclusion Amount . . .

*Based on projected increases in “chained” CPI-U, rounded (except for 2018) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th (“high”), 50th (“median”), and 90th (“low”) percentile outcomes for the inflation-adjusted basic exclusion amount.
Based on Bernstein's estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.
Source: AB
**... Unless We Get This**

---

**Basic Exclusion Amount**  
Nominal (USD Millions)

---

<table>
<thead>
<tr>
<th>Year</th>
<th>Low Inflation*</th>
<th>Median Inflation*</th>
<th>High Inflation*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>$6.6</td>
<td>$11.6</td>
<td>$11.6</td>
</tr>
<tr>
<td>2022</td>
<td>$6.9</td>
<td>$12.1</td>
<td>$12.1</td>
</tr>
<tr>
<td>2024</td>
<td>$12.6</td>
<td>$12.1</td>
<td>$12.1</td>
</tr>
<tr>
<td>2026</td>
<td>$12.6</td>
<td></td>
<td>$12.6</td>
</tr>
<tr>
<td>2028</td>
<td></td>
<td></td>
<td>$12.6</td>
</tr>
</tbody>
</table>

*Based on projected increases in “chained” CPI-U, rounded (except for 2018) to the nearest $100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th (“high”), 50th (“median”), and 90th (“low”) percentile outcomes for the inflation-adjusted basic exclusion amount. Based on Bernstein’s estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.

Source: AB
Potential Strategy: Lock in Today’s Still-Low Interest Rates . . . But Retain the Option to Complete the Gift Later

Applicable Federal Rates (AFR)
100% Annual Compounding

Source: www.irs.gov
Lock in . . . For How Long? As Long as You Can*

*The long-term AFR is compelling due to current “flatness” of the yield curve, but the terms of any intrafamily debt instrument must be commercially reasonable. For example, many estate planning professionals advise against maturities that exceed the lender’s life expectancy. See, e.g., S. Akers & P. Hayes, ABA Section of Real Property, Trust and Estate Law, “Estate Planning Issues With Intra-Family Loans and Notes,” https://www.americanbar.org/content/dam/aba/publishing/rpte_ereport/2014/1_february/te_akers.authcheckdam.pdf, at 95 (Feb. 1, 2014). Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions. Source: www.irs.gov
How Installment Sale to Irrevocable ("Intentionally Defective") Grantor Trust Works

Key points:
- Over time, Grantor transfers assets to IGT
- Collectively, transfers are treated as part-gift (10%), part-sale (90%)
- In exchange for assets sold, Grantor receives promissory note; interest payable annually for note term, with principal and final interest installment due upon maturity
- Until then, Grantor pays all income taxes on behalf of IGT and its beneficiaries
- Annual growth in excess of AFR may avoid gift, estate, and GST taxes*

*Potential benefit to trust and its beneficiaries equals post-transfer growth of assets given, plus growth of assets sold in excess of interest payable. "AFR" means applicable federal rate, annual compounding, as published by the Treasury Department. The mid-term AFR applies to fixed debt having a term greater than three years, but not greater than nine years; the long-term AFR applies to longer term loans; the short-term AFR to shorter term loans.

For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

Source: AB

*Potential benefit to trust and its beneficiaries equals post-transfer growth of assets given, plus growth of assets sold in excess of interest payable. "AFR" means applicable federal rate, annual compounding, as published by the Treasury Department. The mid-term AFR applies to fixed debt having a term greater than three years, but not greater than nine years; the long-term AFR applies to longer term loans; the short-term AFR to shorter term loans.

For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

Source: AB
Rolling GRATs Generally Outperform Term GRAT or Installment Sale, But Are Subject to Legislative Risk and Interest-Rate Risk

Range of Remainder Values: Per $1 Million Contributed - Year 9
$ Thousands, Real

<table>
<thead>
<tr>
<th>Probability</th>
<th>Term GRAT*</th>
<th>Short-Term Rolling GRATs**</th>
<th>Installment Sale***</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>$1,063.3</td>
<td>$1,447.8</td>
<td>$1,397.5</td>
</tr>
<tr>
<td>10%</td>
<td>$263.8</td>
<td>$560.9</td>
<td>$408.0</td>
</tr>
<tr>
<td>50%</td>
<td>$160.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>90%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>95%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*“Term GRAT” assumes nine-year annuity term; GRAT is zeroed-out; Section 7520 is 2.6%; annuity payments increase by 20% each year.

**“Short-Term Rolling GRATs” assumes series of two-year GRATs; each GRAT is zeroed-out; initial Section 7520 rate is 2.6%; level annuity payments each year. Subsequent GRATs are funded with annuities from existing GRATs; Section 7520 rate for each subsequent GRAT is determined using Bernstein’s wealth forecasting model. For each GRAT, any assets remaining at end of annuity term are transferred to irrevocable grantor trust (IGT).

***“Installment Sale” assumes assets are sold to IGT in exchange for nine-year promissory note, bearing interest at 2.1% payable annually, with balloon payment of principal upon maturity. Creditworthiness is assumed to be provided by existing trust assets or guarantees, rather than through a gift of “seed capital.”

Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the next nine years. All portfolios invest in globally diversified equities. Data do not represent past performance and are not a promise of actual future results or a range of future results. Asset values represent estimated liquidation value net of capital gains tax assuming top federal tax rates. See Appendix, Notes on Wealth Forecasting System, for details. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

Source: AB
Is the Likely Outperformance of Rolling GRATs Worth the Loss of Flexibility?

Range of Remainder Values: Per $1 Million Contributed - Year 9
$ Thousands, Real

<table>
<thead>
<tr>
<th>Probability</th>
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</tr>
<tr>
<td>95%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Term GRAT** assumes nine-year annuity term; GRAT is zeroed-out; Section 7520 is 2.6%; annuity payments increase by 20% each year.

**“Short-Term Rolling GRATs” assumes series of two-year GRATs; each GRAT is zeroed-out; initial Section 7520 rate is 2.6%; level annuity payments each year. Subsequent GRATs are funded with annuities from existing GRATs; Section 7520 rate for each subsequent GRAT is determined using Bernstein’s wealth forecasting model. For each GRAT, any assets remaining at end of annuity term are transferred to irrevocable grantor trust (IGT).

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Source: AB Bernstein
“This was a mistake”: Restore everything to its initial state by essentially “calling” the note.

“I shoulda done a gift”: If the gift tax is repealed, forgive the note and, voila, the sale or loan instantly becomes a gift.

“This is great!”: Continue to take advantage of the leverage that the note structure provides, until the note is forgiven or paid in full.

 Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions. Source: AB
Favor Leveraged Transactions Over Applicable* Exclusion Gifts . . . For Now

<table>
<thead>
<tr>
<th>Installment Sale or Loan at AFR</th>
<th>Applicable Exclusion Gift</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scalable</td>
<td>Limited to available exclusion</td>
</tr>
<tr>
<td>“Reversible”: A sale or loan can be</td>
<td>Irreversible</td>
</tr>
<tr>
<td>■ Unwound or</td>
<td></td>
</tr>
<tr>
<td>■ Converted to a gift in whole or in part by forgiving the debt</td>
<td></td>
</tr>
<tr>
<td>■ Key driver (interest rates) are likely to rise, which may dilute</td>
<td>■ Key driver (higher applicable exclusion amount) is likely to remain</td>
</tr>
<tr>
<td>the effectiveness of the strategy if postponed</td>
<td>in effect until at least early 2021</td>
</tr>
<tr>
<td>■ “Free” step-up in basis at death is preserved</td>
<td>■ “Free” basis step-up at death is impaired</td>
</tr>
</tbody>
</table>

*The “applicable exclusion amount” means the basic exclusion amount plus any deceased spousal unused exclusion amount. See IRC § 2010(c)(2).
Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions.

Source: AB
When Might Current Use of the Exclusion Make Sense

- Forgive existing debt to clean up older client’s balance sheet
- Support existing debt by increasing seed capital of irrevocable (“intentionally defective”) grantor trust
- Equalize prior gifts among children and grandchildren
- Avoid state estate tax
- Rollout of pre-9/18/2003 “split-dollar” life insurance plan*
- Gifts to nongrantor trusts to facilitate multiple state and local tax (SALT) deductions**
- Cover imputed gift associated with private annuity under “minimum funding” regulations***

*A “material modification” to a pre-9/18/2003 split-dollar plan is treated as a new plan, which could result in a taxable gift. See Treas. Reg. § 1.7872-15(n)(2).

**See IRC § 164(b)(6).

***Failure of the regulatory exhaustion test may result in a deemed gift of a portion of assets initially transferred to a private annuity. See, e.g., Treas. Reg. § 25.7520-3(b)(2)(v) Example 5.

Bernstein is not a legal, tax, or estate advisor. Investors should consult these professionals as appropriate before making any decisions.

Source: AB
Qualified Opportunity Fund (QOF)
Special Rule for Capital Gains Invested in a “Qualified Opportunity Fund”

- Broad deferral opportunity introduced in new Code Section 1400Z-2
- If taxpayer so elects, gross income for taxable year shall not include
  - Gain from sale or exchange
  - To or with unrelated party (except 20% test, rather than “normal” 50% test)
  - To extent invested in qualified opportunity fund (QOF)
  - Within 180 days after sale or exchange
- Immediate questions
  - Do only “capital gains” qualify (as suggested by the title to Code Section 1400Z-2)? Or do any “gains” qualify (as suggested by the statutory text)?
  - How to treat portion of gain that is deferred under other provisions, e.g., installment sale rules?
  - And just what the heck is a QOF!? ≠

Sources: IRC § 1400Z-2(a) and AB
Deferral . . . With the Potential for Complete Elimination of a Portion of the Gain

- Gain on original investment is deferred until first to occur of:
  - Sale or exchange of QOF interest; or
  - December 31, 2026

- When computing previously deferred gain:
  - Investor’s basis generally is zero
  - Investor’s basis may be increased based on QOF holding period
    - If investor holds QOF interest for five years, basis is increased by 10% of deferred gain
    - If investor holds QOF interest for seven years, basis is increased by an additional 5%
  - If investor holds QOF interest for 10 years, basis of that interest equals its fair market value upon disposition—no further taxable gain

- Observation: Deferral until 2026—when most of ... sunsets—may be very valuable to some taxpayers (due to, e.g., restoration of most pre-2018 deductions)

Sources: IRC § 1400Z-2(b), (c) and AB
What Is a QOF?

- Investment vehicle
  - That is organized as corporation or partnership
  - For purpose of investing in “qualified opportunity zone property” … but not another QOF
  - And that holds at least 90% (measured twice per year) qualified opportunity zone property, which may include
    - Qualified opportunity zone stock
    - Qualified opportunity zone partnership interests, and
    - Direct ownership of qualified opportunity zone business property
  - Acquired after December 31, 2017 (i.e., apparently no preexisting funds or projects will qualify)

- To determine whether particular tangible property or business is located within “qualified opportunity zone,” as defined in Code Section 1400Z-1(a), see Notice 2018-48 and [https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx](https://www.cdfifund.gov/Pages/Opportunity-Zones.aspx)

Sources: IRC § 1400Z-2(d) and AB
What Is “Qualified Opportunity Zone Business Property”?

- **Tangible** property
  - That is used in QOF’s trade or business
  - Is acquired by purchase after December 31, 2017
  - Either
    - Use of the property commences with the QOF; or
    - QOF substantially improves the property, so that basis more than doubles within 30 months
  - And substantially all such property is used in a qualified opportunity zone

- Severe penalty applies for each month during which QOF fails to satisfy 90% test

- Other tidbits
  - “Sin businesses” (e.g., golf and country clubs; racetracks; liquor stores; massage parlors; hot tub, suntan, or gambling facilities) do not qualify
  - “Guidance” is imminent, per Notice 2018-48

Sources: IRC § 1400Z-2(d)(2)(D), (d)(3)(A)(iii), (f)(1), and AB
Comparison: $76.2 Million Traditional Investment Versus $100 Million in a QOF

$Millions, Nominal

Assumptions:
1. Long-term capital gain tax rate = 23.8%
2. QOF taxed on 12/31/2026 after 15% basis adjustment
3. Invest in QOF within 180 days after recognizing $100M gain
4. Hold QOF for at least 10 years

Comparison:
- **80/20 Liquid Portfolio**: $112.1 million
- **QOF Breakeven**: $132.3 million
- **QOF Moderate**: $159.4 million
- **QOF Good**: $199.2 million
- **QOF Great**: $285.7 million

**Annual Return**
- **5.9%** for the 80/20 Liquid Portfolio
- **3.6%** for the QOF Breakeven
- **6.0%** for the QOF Moderate
- **9.0%** for the QOF Good
- **15.0%** for the QOF Great

Tax due on initial $100M gain, reduced by 15% basis adjustment.

Data does not represent past performance, and is not a promise of actual future results or range of future results.

Source: AB
20% Deduction for Qualified Business Income (QBI)
Quick Math Quiz: You Are a Shareholder of a Company Doing Business in the US . . . Which New Tax Rate Appeals to You?

1. “C” corporation = Flat 21% rate

2. “S” corporation = Individual rates apply, up to 37%

3. “S” corporation with 20% deduction for QBI = Effective rate of up to 29.6%

Source: AB
Quick Math Quiz: You Are a Shareholder of a Company Doing Business in the US . . . Which New Tax Rate Appeals to You?

1. “C” corporation = Flat 21% rate
2. “S” corporation = Individual rates apply, up to 37%
3. “S” corporation with 20% deduction for QBI = Effective rate of up to 29.6%

Oddly, the correct answer is probably “3.” Here’s why . . .
Choice of Entity: Tracing $1 of Trade or Business Income

Highest marginal federal income-tax brackets
1. Corporate rate = 21%
2. Individual rate = 37%
3. Individual rate with full QBI deduction* = 29.6%

*Up to 20% of qualified business income (QBI) is deductible under new Section 199A of the Internal Revenue Code of 1986, as amended (IRC).
Sources: Sections 1, 11, and 199A of the Internal Revenue Code of 1986, as amended (IRC), and AB
Choice of Entity: Two Key Issues

Highest marginal federal income-tax brackets
1. Corporate rate = 21%
2. Individual rate = 37%
3. Individual rate with full QBI deduction* = 29.6%

Can the corporation retain this portion and “squeeze out” some additional return prior to distribution?

Can the shareholder qualify for the full 20% QBI deduction?

*Cup to 20% of qualified business income (QBI) is deductible under new Section 199A of the Internal Revenue Code of 1986, as amended (IRC).
Sources: IRC §§ 1, 11, and 199A, and AB
A Few Basic Requirements for the QBI Deduction

- Must be a US trade or business

- Business cannot be a “C” corporation, so the following ordinarily will qualify
  - Proprietorship
  - Partnership (including most LPs and LLCs)
  - “S” corporation

- Income received as an employee or in the form of a guaranteed payment does not qualify as QBI

- **No** QBI deduction for
  - Capital gain income
  - Most dividends
  - Interest

Source: AB
“Okay, Sounds Good . . . How Do I Qualify for the QBI Deduction?” Answer These Three Simple Questions

- “Am I poor?”
  - For this purpose, the kinder, gentler Internal Revenue Code defines “poor” as
    - An individual, trust, or estate whose taxable income is no more than $157,500 this year; or
    - A married couple whose taxable income is no more than $315,000 this year
  - If you are “poor,” congratulations! You can deduct 20% of your QBI!!*

- “Do I wear a pocket protector?”
  - Most taxpayers people in a “service” business (e.g., doctor, lawyer, consultant, or investment manager, among others) can’t get the 20% QBI deduction unless they are “poor”
  - But even if “rich,” if you are an (a) architect or (b) engineer, you qualify for the QBI deduction!

- “Do I have business partner named `Donald’?”
  - Owners of businesses that have (a) few wage-earning employees and (b) little or no depreciable property are limited in the amount of QBI they can deduct
  - But businesses that have lots of depreciable property (e.g., business-related real estate) or lots of employees may be able to steer clear of those limitations

*The QBI deduction is phased out for individuals with taxable income greater than $157,500 up to $217,500, and for couples with taxable income greater than $315,000 up to $415,000. See IRC § 199A(b)(3)(B), (e)(2).
Sources: IRC § 199A and AB
“I Want the Full QBI Deduction, But Congress Apparently Thinks I’m ‘Rich’ . . . What Else Can I Do?”

- Reduce your taxable income
  - Maximize contributions to qualified retirement plans, including
    - Individual retirement account (IRA), 401(k), or 403(b) plan *(not* Roth);
    - Profit-sharing plan; and
    - Cash balance plan
  - If itemizing deductions, increase charitable contributions
- Separate nonqualifying service business activities from qualifying businesses (e.g., spin off business real estate from one’s medical practice)
- Shift ownership (and K-1 income) among multiple taxpayers, potentially including taxable trusts

Source: AB
Tax-Efficient Investing
Future Returns Are Likely to Be Lower . . .

Median Return Projections* for Next 30 Years
vs. 30-Year Historical Compound Return‡

<table>
<thead>
<tr>
<th>% Stocks/% Bonds</th>
<th>100% Bonds</th>
<th>30/70</th>
<th>60/40</th>
<th>80/20</th>
<th>100% Stocks</th>
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<tr>
<td>Historical Compound Return‡</td>
<td>4.6%</td>
<td>6.6%</td>
<td>8.2%</td>
<td>9.2%</td>
<td>10.0%</td>
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<td></td>
<td>3.2%</td>
<td>4.9%</td>
<td>6.3%</td>
<td>7.1%</td>
<td>7.7%</td>
</tr>
</tbody>
</table>

Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the periods analyzed. **Data do not represent past performance and are not a promise of future results or a range of future results.** See Appendix, Notes on Wealth Forecasting System, for details.

*Projected pretax 30-year compound annual growth rate. Stocks (or “global equities”) are modeled as 21% US diversified, 21% US value, 21% US growth, 7% US small-/mid-cap, 22.5% developed international, and 7.5% emerging-market stocks, and bonds are modeled as intermediate-term diversified municipal bonds. Reflects Bernstein’s estimates and the capital-market conditions as of December 31, 2015.

‡Historical compound return calculated from January 1, 1986, through December 31, 2015 with equities represented as follows: 70% S&P 500 and 30% MSCI EAFE from 1986 through 1987, and 70% S&P 500, 25% MSCI EAFE, and 5% MSCI EM thereafter; bonds represented by the Lipper Short/Intermediate Municipal Bond Fund Average.

Sources: Lipper, MSCI, Standard & Poor’s, and AB
... Especially in the Next 5-10 Years

Median Return Projections* for Next 30 Years
vs. 30-Year Historical Compound Return‡

<table>
<thead>
<tr>
<th>% Stocks/% Bonds</th>
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<th>60/40</th>
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<td>4.9%</td>
<td>6.3%</td>
<td>7.1%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Next 5 years: About 2.5%</td>
<td>3.2%</td>
<td>6.6%</td>
<td>8.2%</td>
<td>9.2%</td>
<td>10.0%</td>
</tr>
</tbody>
</table>

Next 5 years: About 6.2% for US large cap stocks

Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of future results or a range of future results. See Appendix, Notes on Wealth Forecasting System, for details.

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Sources: Lipper, MSCI, Standard & Poor’s, and AB
Which of the Following Portfolios Do You Like Best . . . A Tax-Exempt Portfolio that Barely Keeps Up with Inflation?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*
Assumes:
- 2% Inflation
- 50% Ordinary Income Tax Rate
- 33% Long-Term Capital Gain Tax Rate

- Net to investor
- Income taxes
- Inflation

<table>
<thead>
<tr>
<th>Portfolio</th>
<th>Nominal, Pre-Tax</th>
<th>“Real” return</th>
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<tbody>
<tr>
<td>A</td>
<td>2%</td>
<td>0%</td>
</tr>
<tr>
<td>B</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>C</td>
<td>10%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Data do not represent past performance and are not a promise of future results or a range of future results.

*“Portfolio A” means hypothetical tax-exempt portfolio that is expected to return 2% per year over the illustrated period; “Portfolio B” means hypothetical portfolio that is expected to return 6% per year over the illustrated period with all returns characterized as qualified dividends and long-term capital gains and taxed at long-term capital gain tax rate; “Portfolio 3” means hypothetical portfolio that is expected to return 10% per year over the illustrated period with all returns characterized as ordinary income and short-term capital gains and taxed at ordinary tax rate.

Source: AB
Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*

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Source: AB
Or a High-Returning, Very Tax-Inefficient Portfolio that Loses 70% of Its Return to Inflation and Taxes?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*
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• 2% Inflation
• 50% Ordinary Income Tax Rate
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Source: AB
But What if We Could Eliminate the Income Tax . . .

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*
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Source: AB
... And Replace It with Something More Reasonable?

Hypothetical Portfolio Returns, Net of Inflation and Income Taxes*
Assumes:
• 2% Inflation
• 50% Ordinary Income Tax Rate
• 33% Long-Term Capital Gain Tax Rate

Nominal, Pre-Tax = 10%

Net to investor | Income taxes | PPLI charges | Inflation
--- | --- | --- | ---
2% | 1% | 7% | 2%
Nominal, Pre-Tax = 6%

Nominal, Pre-Tax = 2%

Portfolio A

“Real” return = 7%

If you could trade a 5% annual tax for a 1% annual fee... Would you?

Portfolio C

Portfolio B

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Source: AB
What Types of Investments Are We Talking About?

Asset Classes Best Suited to PPVA / PPVUL

- **High-returning investments**
  - Returns must be sufficient to offset contract / policy costs

- **Tax-inefficient investments**
  - Examples of such income include taxable interest, rental income, and short-term capital gains

- **Illiquid investments**
  - Often tax-inefficient in nature
  - Long time horizon

For illustrative purposes only. Data do not represent past performance and are not a promise of actual future results or a range of future results. AB is not a legal, tax, estate, or insurance advisor. Investors should consult these professionals as appropriate before making any decisions.

Source: AB
Proposed Strategy: Wrap These Investments in an Inexpensive, “Private Placement” Life Insurance Policy

Growth of $10 Million Post Liquidation, Net of Tax
$Millions

- PPVUL Death Benefit
- PPVUL Liquidation Value
- Taxable Portfolio

Years
5 10 15 20 25 30

Portfolio Values at Year 30 Post Liquidation, Net of Tax
$Millions

- Taxable Portfolio
- PPVUL Liquidation Value
- PPVUL Death Benefit

$37.5 $65.9 $140.8

*Assumes 10.0% return each year, consisting 100% of ordinary income / short-term capital gain. Income taxes computed at an effective ordinary income / short-term capital gain tax rate of 55% and an effective long-term capital gain / qualified dividend tax rate of 35%. For each year depicted, “Taxable Portfolio” is the value of the portfolio net of taxes due for income, realized capital gains and unrealized capital gains. For each year depicted, “PPVUL Liquidation Value” is net of ordinary income tax for embedded growth of PPVUL policy (cash value). “PPVUL Death Benefit” represents the death benefit (no tax). PPVUL Assumptions – Insured: Male, Age 60, Preferred; Situs: Delaware; Modified Endowment Contract (MEC); Face Amount: $25,680,000; Investment: $10,000,000; Policy Underwriting Charge: $2,000; Premium Load Components – Year 1: $227,000 Total (Federal DAC Tax: $100,000, State Premium Tax: $2,000, Distribution Charge: $125,000); Annual M&E (assessed on Total Account Value): $10,000,000 to $40,000,000 = 0.45%, $40,000,000 and above = 0.35%; Annual COI (Cost of Insurance): cost of providing death benefit. Data do not represent past performance and are not a promise of actual future results or a range of future results.

Based on AB analysis and illustration provided by insurance provider. AB is not a legal, tax, estate, or insurance advisor. Investors should consult these professionals as appropriate before making any decisions.

Sources: Lombard International and AB
Charitable Contribution Strategies
Eliminated or Curtailed Many of Our Favorite Income Tax Deductions

- **Eliminated**
  - Miscellaneous itemized deductions
  - Alimony (beginning in 2019)

- **Restricted**
  - State and local taxes: Limited to $10,000 per taxpayer, per year
  - Mortgage interest: Still deductible, but limit of $750,000 on residential debt and other restrictions

- **Still available**
  - Ordinary and necessary business expenses
  - Investment interest
  - Medical expenses above 7.5% of adjusted gross income through 2018, 10% thereafter

- **Charitable contributions**

Source: AB
Example: “Bunching” Annual Charitable Contributions*

Continue with $10,000 Annual Giving

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<tbody>
<tr>
<td>Mortgage Interest</td>
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<td>State &amp; Local Taxes</td>
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<tr>
<td>Charitable Gifts</td>
<td>$10k</td>
<td>$10k</td>
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<tr>
<td><strong>Total Deductions</strong></td>
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<table>
<thead>
<tr>
<th>Amount Above Standard Deduction</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<tbody>
<tr>
<td></td>
<td>$2k</td>
<td>$2k</td>
<td>$2k</td>
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Tax savings for annual donations:
- $740 in each of years 1 through 4
- $2,960 over four years

Double Gifts in Alternate Years

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
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<th>2020</th>
<th>2021</th>
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<td>Charitable Gifts</td>
<td>$10k</td>
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<tr>
<td><strong>Total Deductions</strong></td>
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<td><strong>$16k</strong></td>
<td><strong>$36k</strong></td>
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<table>
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<th>Amount Above Standard Deduction</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<td>$12k</td>
<td>$0</td>
<td>$12k</td>
<td>$0</td>
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</table>

Tax savings alternate-year donations:
- Tax savings of $4,440 in years 1 and 3
- $8,880 savings over four years

In this example, “bunching” saves nearly $6,000 over four years

*Effective 2018, the standard deduction was increased to $24,000 (from $12,700 in 2017) for married taxpayers filing jointly, expiring after 2025. Assumes cash gifts and 37% effective tax rate.

Bernstein is not a legal, tax or estate advisor. Investors should consult these professionals as appropriate before making any decisions.

Sources: [www.irs.gov](http://www.irs.gov) and AB
Finding the Most Tax-Efficient Source for Charitable Contribution*

$20,000 Charitable Contribution
Fully Deductible, 37% Income Tax Bracket

- **Charitable IRA Rollover**
  - Cost to taxpayer: $7,400
  - Benefit of deduction: $12,600
  - Tax never paid: $3,570

- **Cash**
  - Cost to taxpayer: $7,400
  - Benefit of deduction: $12,600
  - Tax never paid: $7,400

- **25% Basis Stock**
  - Cost to taxpayer: $7,400
  - Benefit of deduction: $9,030
  - Tax never paid: $9,030

“Charitable IRA Rollover” means tax-free IRA distribution by taxpayer age 70½ or older to public charity that is not donor-advised fund or supporting organization. See IRC § 408(d)(8). “25% Basis Stock” means contribution to public charity of long-term capital gain property having adjusted basis equal to 25% of fair market value at time of contribution. “Cost to taxpayer” means value of contributed property reduced by economic benefit of any deduction and income tax otherwise payable avoided due to contribution. “Benefit of deduction” means economic benefit of fully deductible contribution, assuming effective income tax rate of 37%. “Tax never paid” means (i) in case of Charitable IRA Rollover, 37% ordinary income tax that would have been paid on taxable distribution from IRA; and (ii) in case of 25% Basis Stock, 23.8% long-term capital gain tax that would have been paid upon sale of stock. Each case assumes taxpayer has adequate income in year of contribution to deduct contribution in full.

Source: AB
Finding the Most Tax-Efficient Source for Charitable Contribution*

$20,000 Charitable Contribution
Fully Deductible, 37% Income Tax Bracket

- Cost to taxpayer
- Benefit of deduction
- Tax never paid

Particularly compelling for non-itemizers

$20,000 Charitable Contribution
Fully Deductible, 37% Income Tax Bracket

“Charitable IRA Rollover” means tax-free IRA distribution by taxpayer age 70½ or older to public charity that is not donor-advised fund or supporting organization. See IRC § 408(d)(8).

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Source: AB
Appendix
Case Study: Real Estate Investor
Real Estate Investor Case Study Assumptions

- Real estate entrepreneur, Lando, age 67, owns 45% interest in commercial property
  - Nondiscounted value of interest = $135 million
  - Reduced by 25% valuation discount (base case) = <$33.75 million>
  - Reduced by 45% share of $150 million debt = <$67.5 million>
  - **Net value (discounted) = $33.75 million**

- 45% of annual cash flow (net of debt service) = $3.15 million (9.3% of net value)

- Lando is considering selling his interest to an irrevocable grantor trust

---

*How sensitive is the analysis to the level of valuation discount? Would a long-term sale be preferable?*

---

*At time of this analysis (May 2017), Section 7520 rate was 2.4%; mid-term applicable federal rate (AFR) was 2.04%; long-term AFR was 2.75%. “Installment sale” means annual interest-only payments at mid- or long-term AFR, as appropriate, with “balloon” principal payment at maturity. We assume that guarantees, rather than seed capital, will be used to establish creditworthiness of purchasing trust. Excess cash is invested 70% in global stocks, 30% in intermediate-term bonds; specific portfolio allocation information is available upon request. Bernstein does not provide legal or tax advice, or opine as to the appropriateness or amount of any valuation discount. Consult with competent professionals in these areas before making any decisions.*

Sources: [www.irs.gov](http://www.irs.gov), AB
Debt on Property Enhances Sensitivity to Valuation Discount . . .

Probability of Success,* Nine-Year Installment Sale

* "Success" means probability of trust remainder of at least $1. Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.
... And to Note Term

Probability of Success,* 25% Valuation Discount

- Scenario A: 18%
- Scenario B: 26%
- Scenario C: 49%
- Scenario D: 70%

Long-Term AFR (12 years)

Risk-Mitigating
Diversifying
Return-Seeking

30% 0% 70%
30% 0% 70%
30% 0% 70%
30% 0% 70%

*"Success" means probability of trust remainder of at least $1.
Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.
Paired Installment Sale-GRAT Strategy

*Alternatively, excess return from GRATs could be directly to individual beneficiaries, or to separate irrevocable grantor or nongrantor trust for their benefit. For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
Source: AB
How Grantor Remainder Annuity Trust (GRAT) Works

Key points:
- Grantor transfers assets to GRAT
- Grantor receives annuity payments from trust during annuity term
- Grantor pays taxes on trust income
- If GRAT assets grow faster than Section 7520 rate (3.2% in April 2018), excess passes to Beneficiaries at end of annuity term free of gift tax
- If desired, “Beneficiaries” may be limited to Grantor’s spouse or irrevocable trust established for his/her benefit; if properly structured, assets in that trust should avoid estate tax at Grantor’s death and at Beneficiaries’ deaths

*If present value of annuity stream retained by Grantor equals value of assets contributed to trust, grantor makes no gift for gift tax purposes; GRAT is said to be “zeroed out.”

For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

Source: AB

If Grantor fails to survive annuity term, full date-of-death value of GRAT assets may be subject to estate tax
Refinement: Short-Term Rolling GRATs

- Contribute initial assets to first of a series of two-year GRATs
- Annual payouts are contributed to new two-year GRAT each year
- Any appreciation above the Section 7520 rate in each trust passes tax-free to or for the benefit of the remainder beneficiaries*

*If present value of annuity stream retained by Grantor equals value of assets contributed to trust, grantor makes no gift for gift tax purposes; GRAT is said to be “zeroed out.” This display assumes each GRAT is zeroed-out.

For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.

Source: AB
“Paired” Strategy Enhances Probability of Success . . . Without Extending Note Maturity or Increasing Discount Percentage

Probability of Success,* Nine-Year Installment Sale at 25% Valuation Discount, plus Nine-Year “Rolling” GRAT Strategy

*“Success” means probability of trust remainder of at least $1. “GRAT” means series of two-year, zeroed-out, “rolling” GRATs funded entirely with globally diversified stocks; specific portfolio allocation information is available upon request. Percentage allocation to GRAT strategy is relative to discounted value of real estate interest sold. Strategy is initiated in May 2017, when Section 7520 rate is 2.4%; rate for subsequent GRATs is determined by Bernstein’s wealth forecasting model.
Based on Bernstein’s estimates of the range of returns for the applicable capital markets over the periods analyzed. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Appendix, Notes on Wealth Forecasting, for details.
Notes on Wealth Forecasting System

1. Purpose and Description of Wealth Forecasting System

Bernstein’s Wealth Forecasting System℠ is designed to assist investors in making long-term investment decisions regarding their allocation of investments among categories of financial assets. Our new planning tool consists of a four-step process: (1) Client Profile Input: the client’s asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long term and how different asset allocations might impact his/her long-term security; (3) The Capital Markets Engine: Our proprietary model, which uses our research and historical data to create a vast range of market returns, takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: Based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th percentiles on “box and whiskers” graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived by taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein’s estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized.

2. Rebalancing

Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship’s allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio’s value.

3. Expenses and Spending Plans (Withdrawals)

All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses that will have capital gains tax implications.
4. Modeled Asset Classes

The following assets or indexes were used in this analysis to represent the various model classes:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Modeled As...</th>
<th>Annual Turnover Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intermediate-Term Diversified Municipal Bonds</td>
<td>AA-rated diversified municipal bonds with seven-year maturity</td>
<td>30%</td>
</tr>
<tr>
<td>US Diversified</td>
<td>S&amp;P 500 Index</td>
<td>15</td>
</tr>
<tr>
<td>US Value Stocks</td>
<td>S&amp;P/Barra Value Index</td>
<td>15</td>
</tr>
<tr>
<td>US Growth Stocks</td>
<td>S&amp;P/Barra Growth Index</td>
<td>15</td>
</tr>
<tr>
<td>US Low Vol Equity</td>
<td>MSCI US Minimum Volatility Index</td>
<td>15</td>
</tr>
<tr>
<td>Developed International Stocks</td>
<td>MSCI EAFE Unhedged</td>
<td>15</td>
</tr>
<tr>
<td>Emerging Markets Stocks</td>
<td>MSCI Emerging Markets Index</td>
<td>20</td>
</tr>
<tr>
<td>High-Risk International Stocks</td>
<td>Country Fund</td>
<td>15</td>
</tr>
<tr>
<td>US SMID</td>
<td>Russell 2000</td>
<td>15</td>
</tr>
</tbody>
</table>

5. Volatility

Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital Markets Projections page at the end of these Notes.

In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.0%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein’s forecast of volatility is based on historical data and incorporates Bernstein’s judgment that the volatility of fixed income assets is different for different time periods.

6. Technical Assumptions

Bernstein’s Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein’s Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. Except as otherwise noted, these simulations are based on inputs that summarize the current condition of the capital markets as of September 30, 2016. Therefore, the first 12-month period of simulated returns represents the period from September 30, 2016, through September 30, 2017, and not necessarily the calendar year of 2016. A description of these technical assumptions is available upon request.
Notes on Wealth Forecasting System

7. Tax Implications
Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

8. Income Tax Rates
Bernstein’s Wealth Forecasting System has used various assumptions for the income tax rates of investors in the case studies that constitute this analysis. See the assumptions in each case study (including footnotes) for details. Contact Bernstein for additional information.

The Federal Income Tax Rate is Bernstein’s estimate of either the top marginal federal income tax rate or an “average” rate calculated based upon the marginal-rate schedule. The Federal Capital Gains Tax Rate is the lesser of the top marginal federal income tax rate or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The State Tax Rate generally is Bernstein’s estimate of the top marginal state income tax rate, if applicable.

The Wealth Forecasting System uses the following top marginal federal tax rates unless otherwise stated: For 2016 and beyond, the maximum federal ordinary income tax rate is 43.4% and the maximum federal capital gain and qualified dividend tax rate is 23.8%.

9. Estate Transfer and Taxation
The Wealth Forecasting System models the transfer of assets to children, more remote descendants, and charities, taking into account applicable wealth transfer taxes. If the analysis concerns a grantor and his or her spouse, the System assumes that only the first to die owns assets in his or her individual name and that no assets are owned jointly. It is further assumed that the couple’s estate plan provides that an amount equal to the largest amount that can pass free of Federal estate tax by reason of the federal unified credit against estate taxes (or, if desired, the largest amount that can pass without state death tax, if less) passes to a trust for the benefit of the surviving spouse and/or descendants of the first-to-die, or directly to one or more of those descendants. It is further assumed that the balance of the first-to-die’s individually owned assets passes outright to the surviving spouse and that such transfer qualifies for the federal estate tax marital deduction. Any state death taxes payable at the death of the first-to-die after 2010 are assumed to be paid from the assets otherwise passing to the surviving spouse. To the extent that this assumption results in an increase in state death taxes under any state’s law, this increase is ignored. In addition, it is assumed that the surviving spouse “rolls over” into an IRA in his or her own name any assets in any retirement accounts (e.g., an IRA) owned by the first to die, and that the surviving spouse withdraws each year at least the minimum required distribution (“MRD”), if any, from that IRA.

At the survivor’s death, all applicable wealth transfer taxes are paid, taking into account any deductions to which the survivor’s estate may be entitled for gifts to charity and/or (after 2010) the payment of state death taxes. The balance of the survivor’s individually-owned assets passes to descendants and/or charities and/or trusts for their benefit. The survivor’s retirement accounts (if any) pass to descendants and/or charities. To the extent that a retirement account passes to more than one individual beneficiary, it is assumed that separate accounts are established for each beneficiary and that each takes at least the MRD each year from the account. In all cases, it is assumed that all expenses are paid from an individual’s taxable accounts rather than his or her retirement accounts to the maximum extent possible.
Notes on Wealth Forecasting System (cont.)

10. Capital Markets Projections (Flexible Planning Case)

<table>
<thead>
<tr>
<th></th>
<th>Median 9-Year Growth Rate</th>
<th>Mean Annual Return</th>
<th>Mean Annual Income</th>
<th>One-Year Volatility</th>
<th>9-Year Annual Equivalent Volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Diversified</td>
<td>5.7%</td>
<td>7.2</td>
<td>2.3</td>
<td>16.4</td>
<td>15.2</td>
</tr>
<tr>
<td>US Value</td>
<td>6.1</td>
<td>7.5</td>
<td>2.8</td>
<td>16.0</td>
<td>14.9</td>
</tr>
<tr>
<td>US Growth</td>
<td>5.3</td>
<td>7.1</td>
<td>1.8</td>
<td>18.1</td>
<td>16.7</td>
</tr>
<tr>
<td>US SMID</td>
<td>6.0</td>
<td>8.0</td>
<td>1.9</td>
<td>18.7</td>
<td>17.6</td>
</tr>
<tr>
<td>US Low Vol Equity</td>
<td>6.0</td>
<td>7.0</td>
<td>3.6</td>
<td>14.3</td>
<td>13.7</td>
</tr>
<tr>
<td>Developed International</td>
<td>7.0</td>
<td>8.9</td>
<td>3.3</td>
<td>18.1</td>
<td>16.9</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>5.4</td>
<td>9.1</td>
<td>3.0</td>
<td>26.1</td>
<td>25.6</td>
</tr>
<tr>
<td>High-Risk International</td>
<td>7.1</td>
<td>9.9</td>
<td>2.1</td>
<td>22.1</td>
<td>21.0</td>
</tr>
<tr>
<td>Inflation</td>
<td>2.0</td>
<td>2.3</td>
<td>—</td>
<td>1.1</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Data do not represent any past performance and are not a guarantee of any future specific risk levels or returns, or any specific range of risk levels or returns.
Based on 10,000 simulated trials each consisting of 9-year periods; contact Bernstein for additional information.
Reflects Bernstein’s estimates and the capital market conditions as of September 30, 2016.
11. Capital Markets Projections (Real Estate Investor Case)

<table>
<thead>
<tr>
<th></th>
<th>Median 10-Year Growth Rate</th>
<th>Mean Annual Return</th>
<th>Mean Annual Income</th>
<th>One-Year Volatility</th>
<th>10-Year Annual Equivalent Volatility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal Cash</td>
<td>1.4%</td>
<td>1.6%</td>
<td>1.6%</td>
<td>0.3%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Cash Equivalents</td>
<td>1.6</td>
<td>1.9</td>
<td>1.9</td>
<td>0.3</td>
<td>4.2</td>
</tr>
<tr>
<td>Intermediate-Term Municipals</td>
<td>2.6</td>
<td>2.7</td>
<td>2.8</td>
<td>3.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Diversified Hedge Fund Portfolio</td>
<td>4.7</td>
<td>5.0</td>
<td>2.0</td>
<td>11.0</td>
<td>15.1</td>
</tr>
<tr>
<td>US Diversified</td>
<td>6.0</td>
<td>7.5</td>
<td>2.3</td>
<td>16.4</td>
<td>15.3</td>
</tr>
<tr>
<td>US Value</td>
<td>6.4</td>
<td>7.8</td>
<td>2.8</td>
<td>16.0</td>
<td>15.0</td>
</tr>
<tr>
<td>US Growth</td>
<td>5.7</td>
<td>7.6</td>
<td>1.9</td>
<td>18.2</td>
<td>16.7</td>
</tr>
<tr>
<td>US SMID</td>
<td>6.4</td>
<td>8.3</td>
<td>1.9</td>
<td>18.7</td>
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</tr>
<tr>
<td>US Low Vol Equity</td>
<td>6.3</td>
<td>7.4</td>
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<td>22.1</td>
<td>21.0</td>
</tr>
<tr>
<td>Inflation</td>
<td>2.3</td>
<td>2.6</td>
<td>—</td>
<td>1.2</td>
<td>5.7</td>
</tr>
</tbody>
</table>

*Data do not represent any past performance and are not a guarantee of any future specific risk levels or returns, or any specific range of risk levels or returns.*

*Based on 10,000 simulated trials each consisting of 10-year periods; contact Bernstein for additional information.*

*Reflects Bernstein’s estimates and the capital market conditions as of December 31, 2016.*