Adaptable Planning Advice for 2012 and Beyond

Louisiana Estate Planning Council
March 8, 2012
Charles Douglas

Who said?

"It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change."

-*L*eon C. Megginson (1963)
Professor of Management and Marketing at Louisiana State

<u>**Disclaimer Trust**</u>

Elements of a Qualified Disclaimer are:

1. The disclaimer must be irrevocable and unqualified;
2. Made in writing;
3. Delivered to the transferor within nine months;
4. No acceptance of the interest or property being disclaimed;
5. Interest disclaimed must pass to either the decedent's spouse or to a person other than the disclaimant.

<u>Planning Pointer</u>**:**

- ➢ Surviving spouse may not even make a disclaimer;
- ➢ Surviving spouse cannot retain a limited power over assets in disclaimed trust;
- ➢ No step-up in basis for assets in disclaimed trust.

One-Lung & Clayton Marital Trusts

One-Lung Marital Trust ("OLMT")

- Entire estate left to a marital trust ; executor makes a partial QTIP election;
- Two identical trusts: one qualifying for the marital deduction and the other not;
- Surviving spouse must be the sole beneficiary to the exclusion of the children.

Clayton Contingent Marital Trust (“CCMT")

- Entire estate left to a marital trust; executor makes a partial QTIP election;
- Surviving Spouse’s income interest in QTIP is contingent on QTIP election;
- Two trusts: one qualifying for the marital deduction and the other a bypass trust;
- Terms and beneficiaries of bypass trust can be different from the QTIP trust.

***Planning Pointer*:**

- OLMT and CCMT are alternatives “reduce-to zero” marital deduction formula;
- In both the OLMT and CCMT the QTIP election does not need to be made until 15 months (9 months plus a 6 month automatic extension) after the decedent's death.

Favorable Wealth Transfer Factors thru 2012

• A $5.12 million unified estate, gift, and generation skipping tax exemption and a 35% combined estate, gift and GST tax rate;

• The lowest federal interest rates, lowest gift tax rates & highest exemptions in modern times;

• Relatively low asset values, particularly with respect to real estate and closely held businesses; and

• Still, little in the way of restrictions regarding the use of GRATs and/or valuation discounts on family controlled enterprises.

Spousal Lifetime Access Trusts

- Husband in stable marriage funds SLAT with his separate property for amounts up to his $5.12 million dollar transfer exemption fbo his wife and descendants;

- During wife's lifetime, the trustee (wife alone or as a co-trustee) can distribute income and principal to herself under an ascertainable standard;

- Husband has indirect access to the trust's income and principal through his wife;

- Upon wife's demise the assets can pass estate tax free to the children and/or grandchildren (assuming husband's GST exemption was properly allocated to trust contributions).

***Planning Pointers*:**

- Wife might create an ILIT for the benefit of her husband in case wife dies first;
- Do not use gift splitting in a SLAT;
- Should husband and wife both create SLATs avoid the Reciprocal Trust Doctrine.

Beneficiary Taxed Grantor Trust (BTGT)

• Typically, a trusted third party (ie. parent) in a self-settled trust jurisdiction that has extended or revoked its perpetuities laws contributes a nominal amount of money, for example $5,000 to an irrevocable dynasty trust;

• Client has the ability to withdraw that amount using a Crummey withdrawal power which the client allows to lapse;

• By using a Crummey withdrawal power the client becomes the “owner” of the trust for income tax purposes, but not for estate tax purposes.

***Planning Pointer*:**

➢ Since the trust is a grantor trust with respect to the client, the client can sell appreciated assets like a closely held business to the BTGT (just like to an IDGT) in exchange for a promissory note without any capital gains tax consequences;

➢ Because the trust was not created by the client, transfers to the trust are not subject to the normal statute of limitations on fraudulent transfers.

No Transfer Tax Planning Clarity Past 2012

•Vote to keep the current 35% transfer tax structure with an indexing $5.12 exemption (estate, gift and generation skipping transfer (GST) tax);

• Eliminate the "death tax" altogether which currently brings in only a trickle of tax revenue in exchange for an income tax revenue raiser on the rich;

• Keep step-up in basis; or elect 8939 carryover; or tax capital gains at death;

• Let Portability lapse; or keep it; or re-instate it;

• Do nothing and allow the estate tax law to return to 2001 beginning in 2013, with a 55% transfer tax rate and a $1 million estate tax exemption;

• Adopt the President's proposed plan to return to 2009's $3.5 million estate and $1 million gift & GST tax exemptions at a 55% transfer tax rate; or

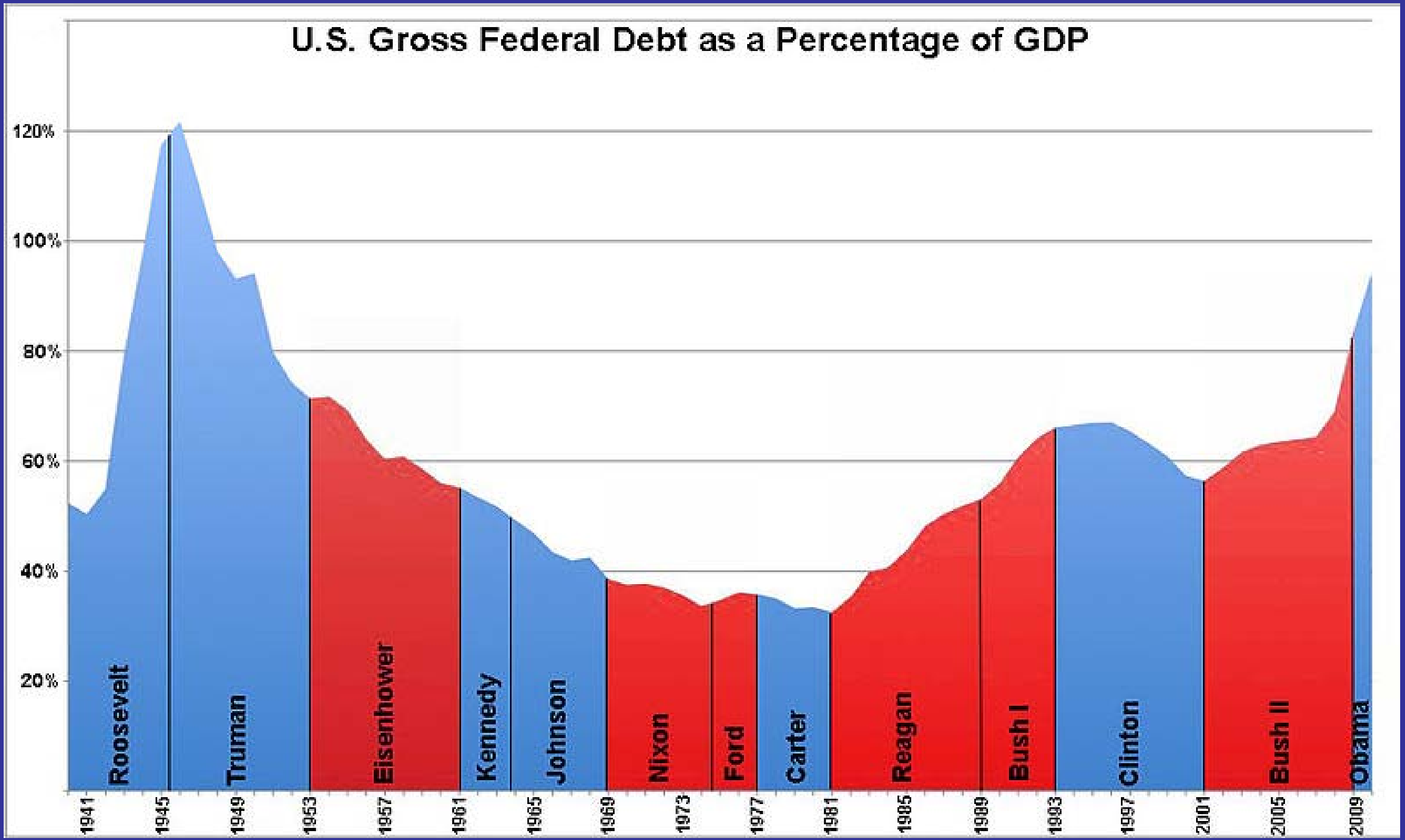
• Craft up some other short term political surprise altogether.

Client-Centric Planning Challenges

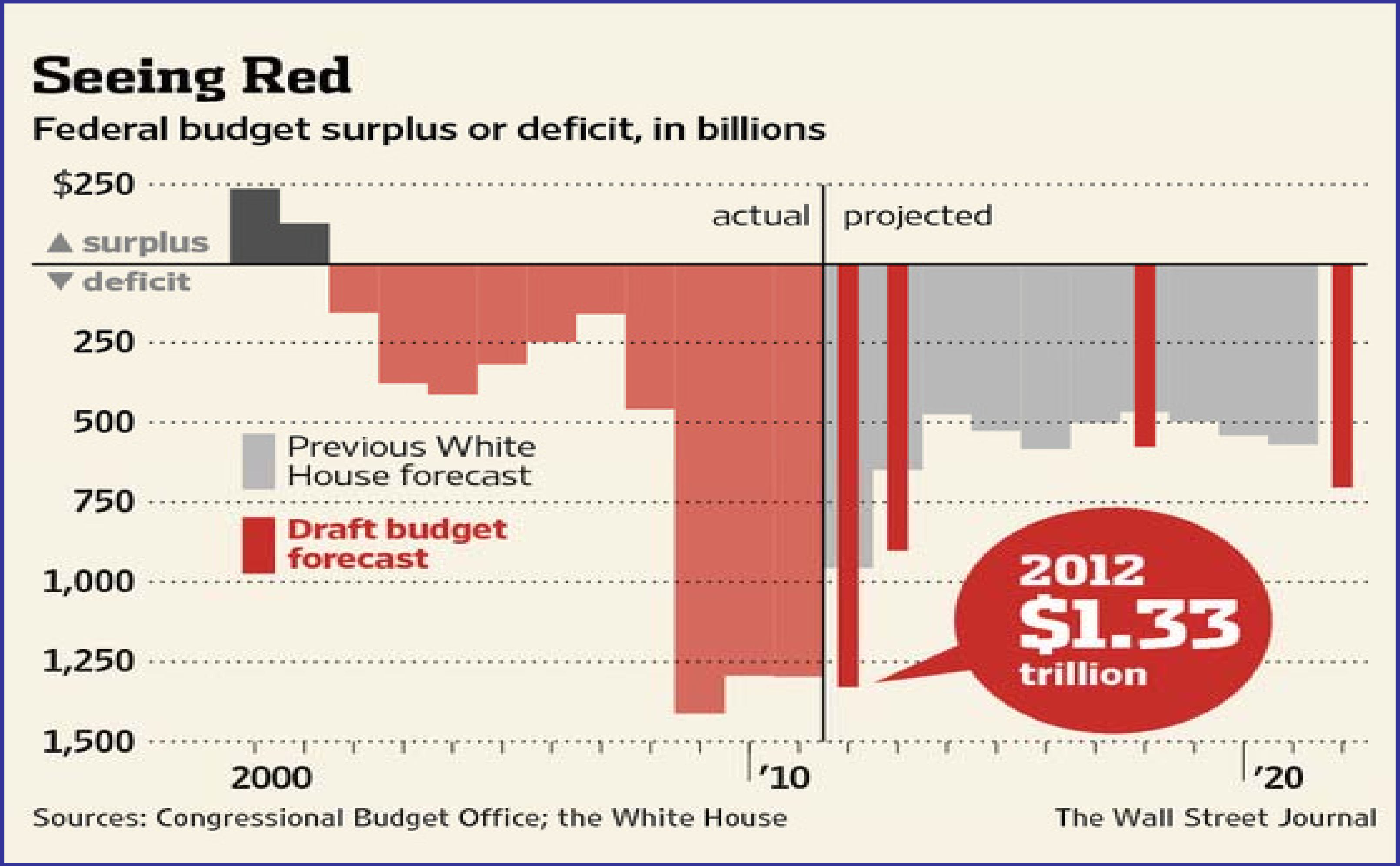
- Clients are living longer;
- Health care costs are skyrocketing;
- Family circumstances are in flux;
- Market volatility abounds with recurrent “Black Swan” events;
- Baby Boomers under-saved for the demands of retirement;
- A deficit-riddled America to negatively impact Planning Tax Policy.

Nothing "Normal" About The "New Normal"

Total Debt as a % of GDP



$5 trillion in the last 4 years!



If the U.S. Were a Corporation

1. More than $60 trillion in unfunded liabilities.

2. A negative net worth in excess of $40 trillion.

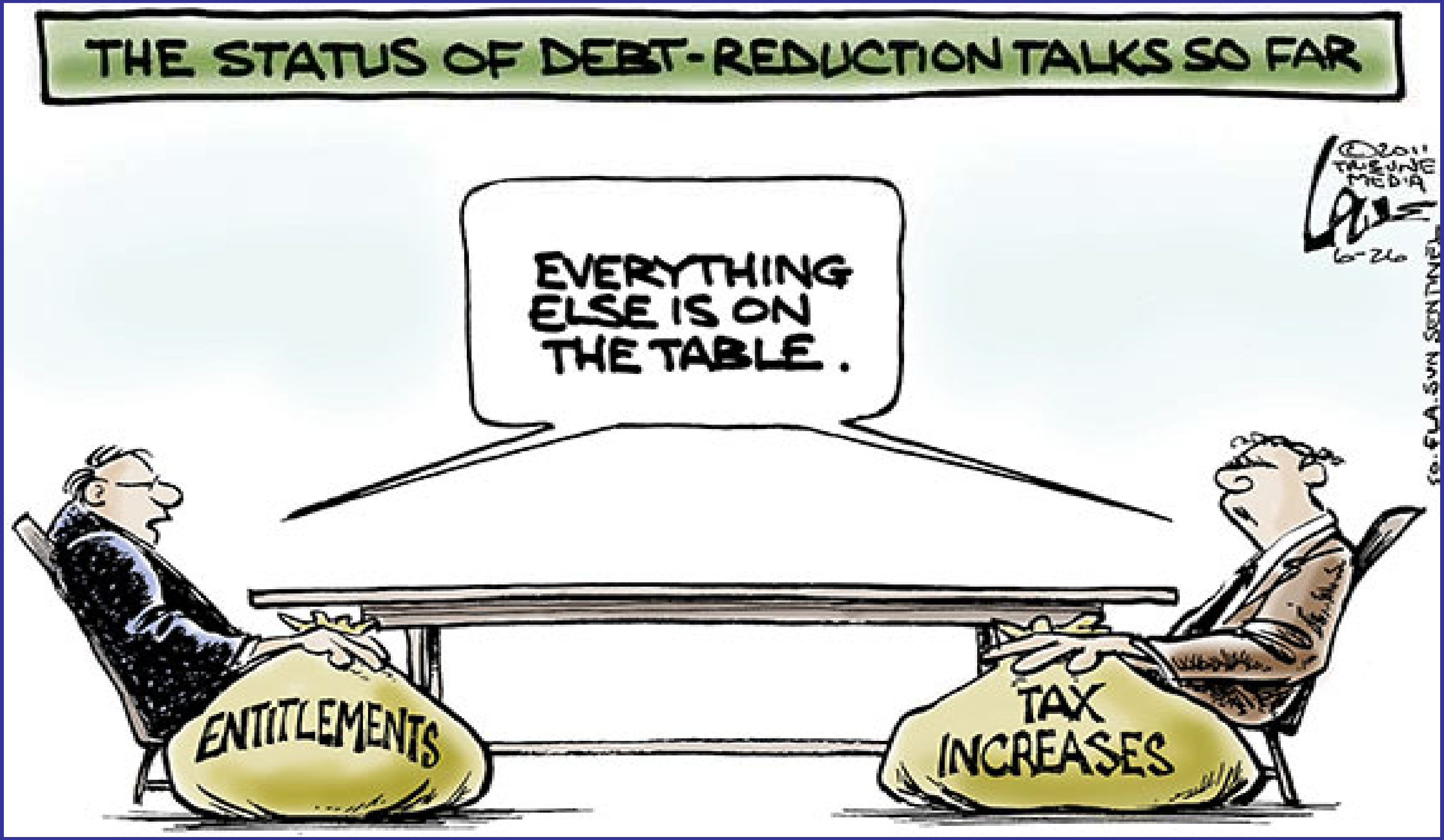
3. Government budgets only record long-term liabilities such as entitlements when they are paid, whereas corporations are required to have net present value of the liabilities as they occur.

--*USA Inc./* February, 2011

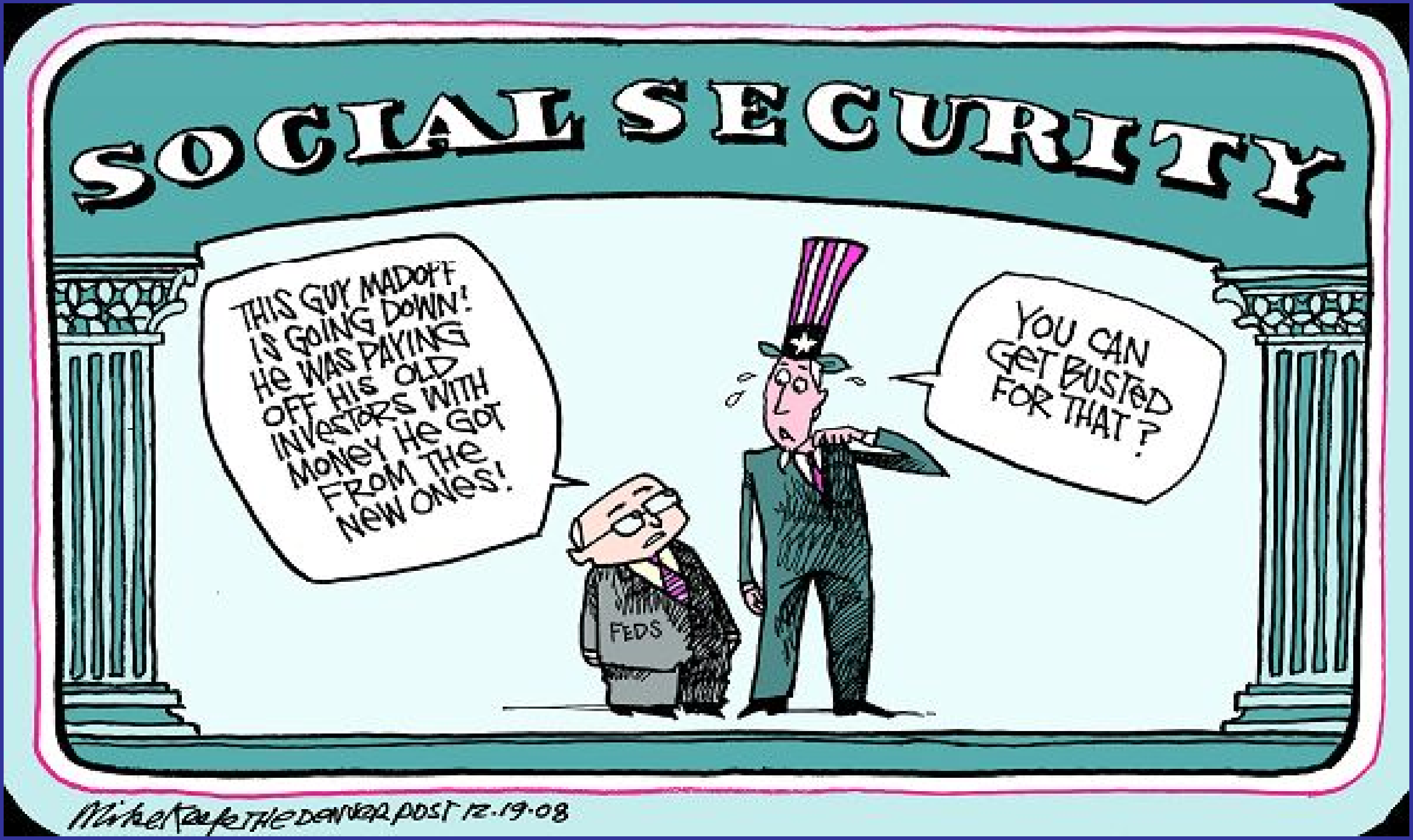
Kicking the Can or a Toxic Snowball?

Super Committee's Super Bust

Status of Debt-Reduction Talks



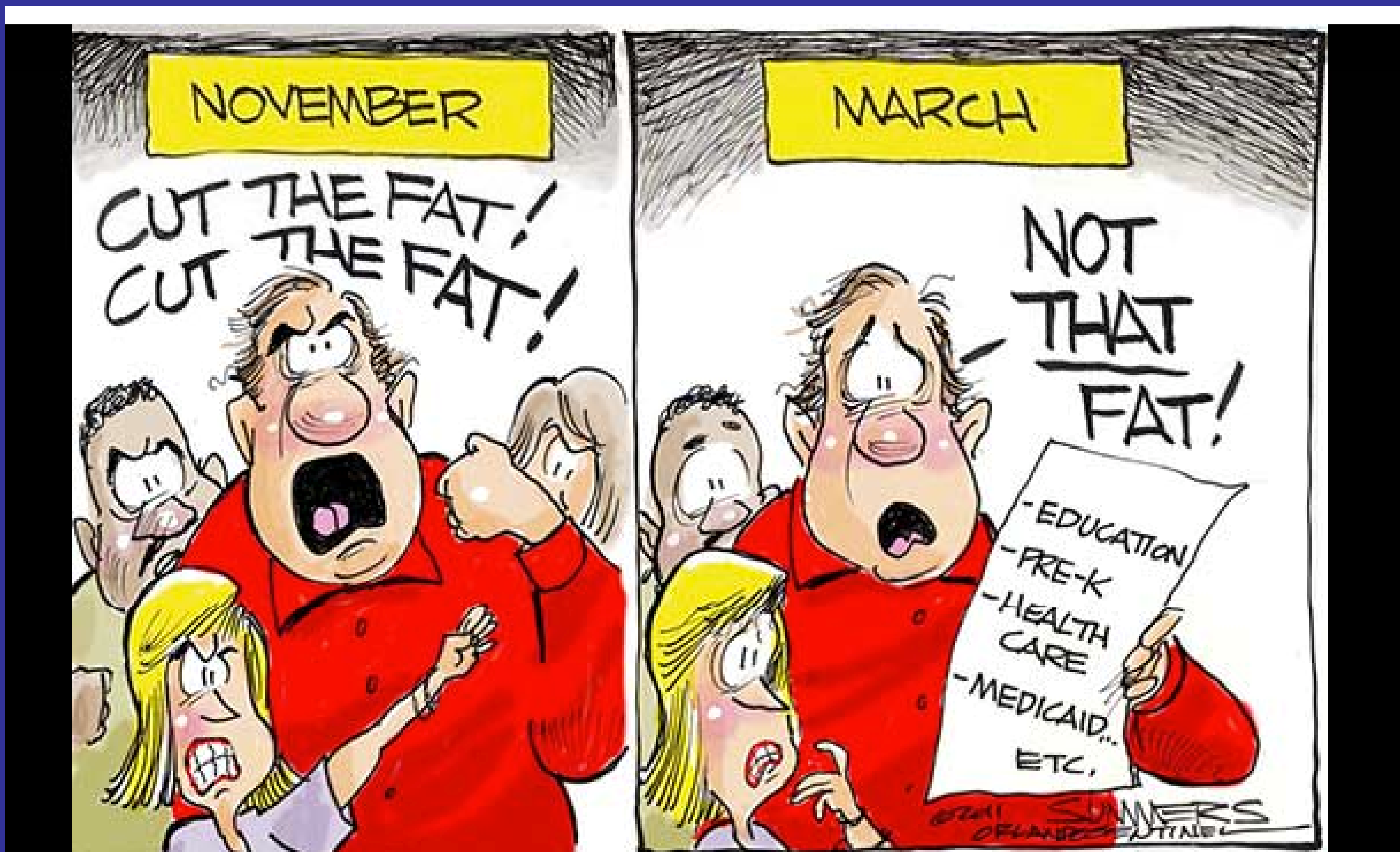
Social Security a Ponzi-Scheme?



Medicare & Runaway HealthCare Costs

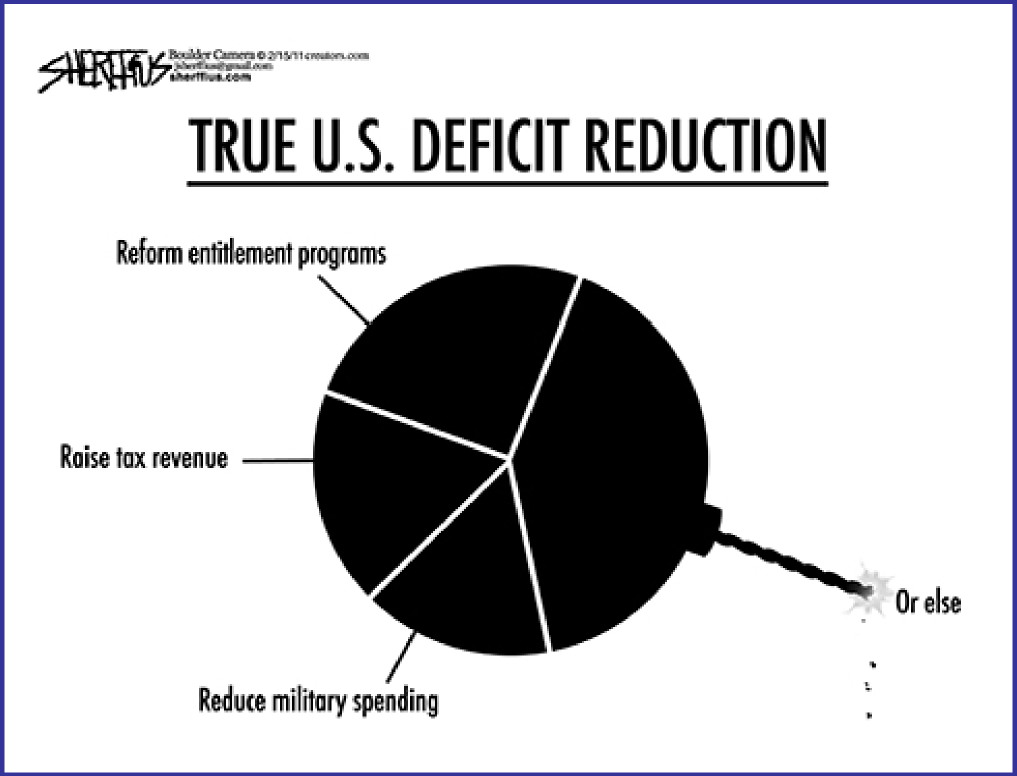
Beware of the 4 (Headless) Horsemen

Cut the FAT…. Just Not Yet



Dana Summers–Tribune Media Services

The Debt Time-Bomb is Ticking



"The U.S. is less than <u>3 years</u> away from becoming Greece."

--David Walker/July, 2011
Former Comptroller General for the USA

“Austerity” Will Come to America

Adaptable Trust Protector Powers

- Power to remove and/or to replace a trustee;
- Power to amend the trust re: administrative and dispositive provisions;
- Power to veto or direct trust distributions;
- Power to add or remove beneficiaries;
- Power to change situs and the governing law of the trust;
- Power to veto or direct investment decisions;
- Power to consent to exercise power of appointment;
- Power to terminate the Trust;
- Are the Powers Exercisable in a Fiduciary or Non-Fiduciary Capacity?

Directed Trust

Defined Value Clauses

- Limits the quantity of assets gifted or sold until a final IRS determination of value can be made;

- Any excess value over the final determination amount typically passes gift tax free to a qualified charity;

- Helpful with promissory note sale to a intentionally defective grantor trust (IDGT) due to the large $5 million gift tax exemption;

- Helpful with expressing the transferred assets as a dollar value rather than a percentage interest or number of units combined with a grantor retained annuity trust (GRAT).

Powers of Appointment

- **Special Powers of Appointment** Grant broad special powers of appointment exercisable by the primary beneficiary during lifetime and at death to essentially rewrite the trust among children, grandchildren, charities and friends.

- **Power to Decant** Allows the trustee to pay over the trust corpus from the existing trust (situs change) to a new trust created in one of the existing fifteen states that has a decanting statute for the existing trust beneficiary (ies) in order to cure current trust issues and inadequacies or to simply modernize the trust.

Possible Adverse Tax Consequences of Decanting

IRS Notice 2011-101 (some of the 13 factors below):

- A beneficiary's right to or interest in trust principal or income is changed;
- Trust principal and/or income may be used to benefit new (additional) beneficiaries;
- A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed;
- The transfer takes place from a grantor trust to one which is not a grantor trust;
- Obtaining and not obtaining a beneficiary consent;
- A change in the identity of a donor or transferor for gift tax (GST) tax purposes;
- Future power to make any such changes is created.

Key Adaptable Trustee & Distribution Provisions

•Allow a responsible primary beneficiary to act as sole trustee to make permissible discretionary distributions to themselves and to others pursuant to an ascertainable standard.

• Provide for an independent trustee (perhaps springing) in order to make discretionary distributions to the primary beneficiary above an ascertainable standard and to hold tax-sensitive administrative powers.

• Prohibit the trustee from making distributions that discharge a legal obligation of support that may result in adverse gift and estate tax consequences for the trustee.

20 Adaptable Trustee & Distribution Provisions

1. Specify the grantor’s intent, particular preference, or trust purpose;
2. Offer guidance regarding the exercise of distribution discretion;
3. Provide color for distributions re: weddings, home, car, or starting a business;
4. Consider naming a trustee that has the time and the fiduciary skill-set;
5. Provide direction on whether or not to consider beneficiary resources;
6. Designate priority among trust beneficiaries;
7. Insert tie-breaker language where co-trustees are named;
8. Allow the trustee to terminate an uneconomical trust;
9. Permit the trustee to resign and establish a process for naming a successor;
10. Allow the trustee to hold “S” stock and preserve the “S” election;

Adaptable Trustee & Distribution Provisions Cont.

11. Give the trustee broad discretion regarding investment powers;
12. Trust Protector or Special Trustee where a closely held business involved;
13. Trust Protector or Special Trustee where possible addiction to drugs or alcohol;
14. Avoid frozen fee language for trustee services;
15. Indemnify and direct trustee to retain concentrated or closely held position;
16. Provide the trustee the power to 1035 exchange or sell an insurance policy;
17. Allow the trustee to change trust situs and governing law,
18. Permit the trustee to invoke tax savings clauses,
19. Allow the trustee to merge or divide the trust;
20. Grant General Power of Appointment GST tax--overall transfer tax reduction.