

## **Advanced Portability Strategies in Estate Planning: Navigating Asset Composition, Decoupling, GST Exemption Issues and More**

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TUESDAY, JUNE 10, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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# ***Advanced Portability Strategies in Estate Planning: Navigating Asset Composition, Decoupling, GST Exemption Issues and More***

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***Strafford Publications' Advanced Portability Webinar***

***June 10, 2014***

# Implement These Changes NOW

## *Consider Restructuring Existing Plans to Enable the Possibility of Using Portability*

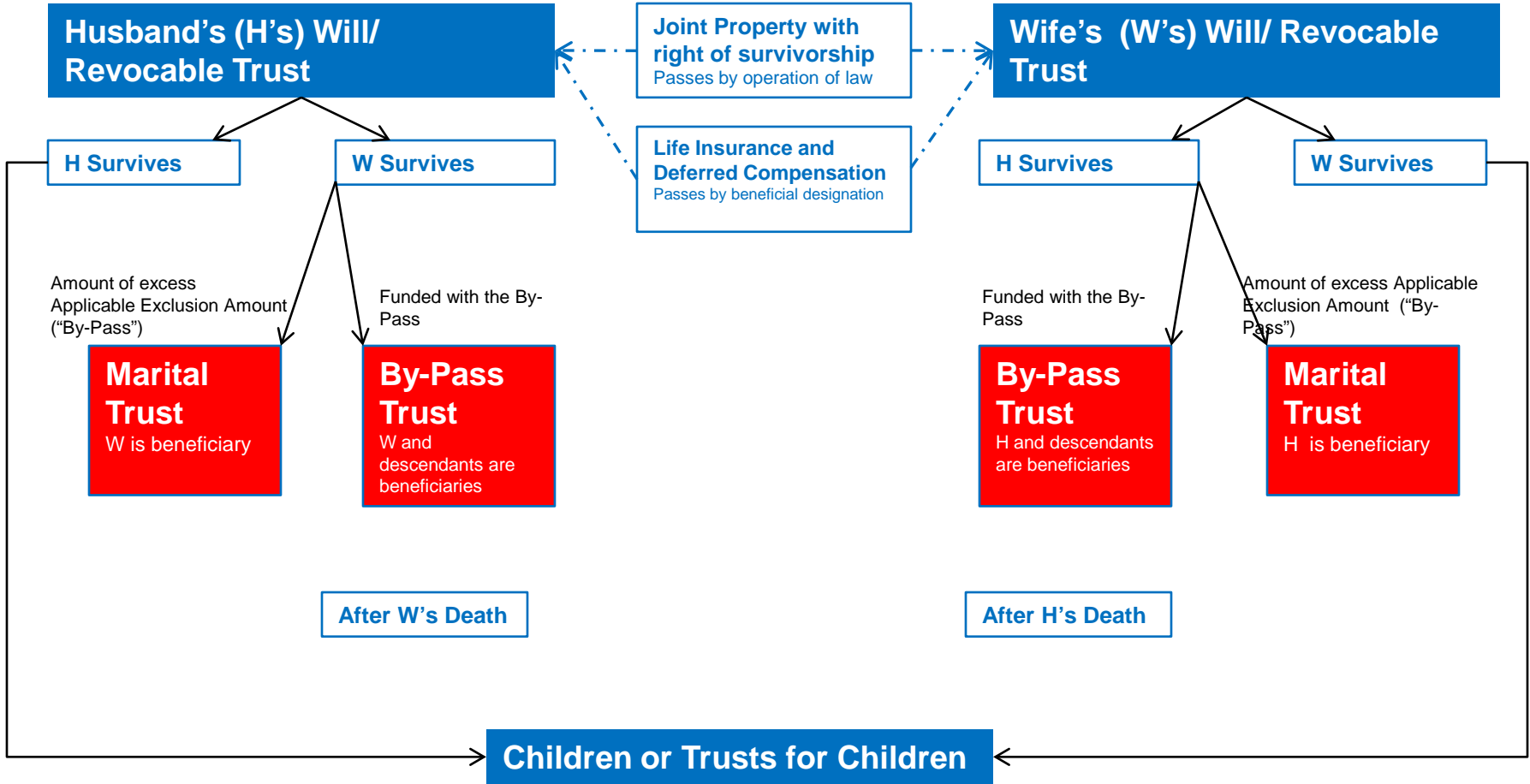
- *Perhaps still achieving the non-federal estate tax benefits of a by-pass trust.*

# Projected Aggregate Applicable Exclusion Amounts

This chart projects the aggregate applicable exclusion amounts (AEA) that will be available to a married couple, considering annual inflation adjustments to the basic exclusion amount (BEA). The axis across the table is the year of the first spouse's death – to that point in time the BEA component of both spouses' AEAs are being indexed, and thereafter going down the axis on the left side of the table to the year of the surviving spouse's death, only the BEA of the surviving spouse's AEA is being indexed. This may assist in determining whether it is reasonable to assume the couple will have an estate tax liability.

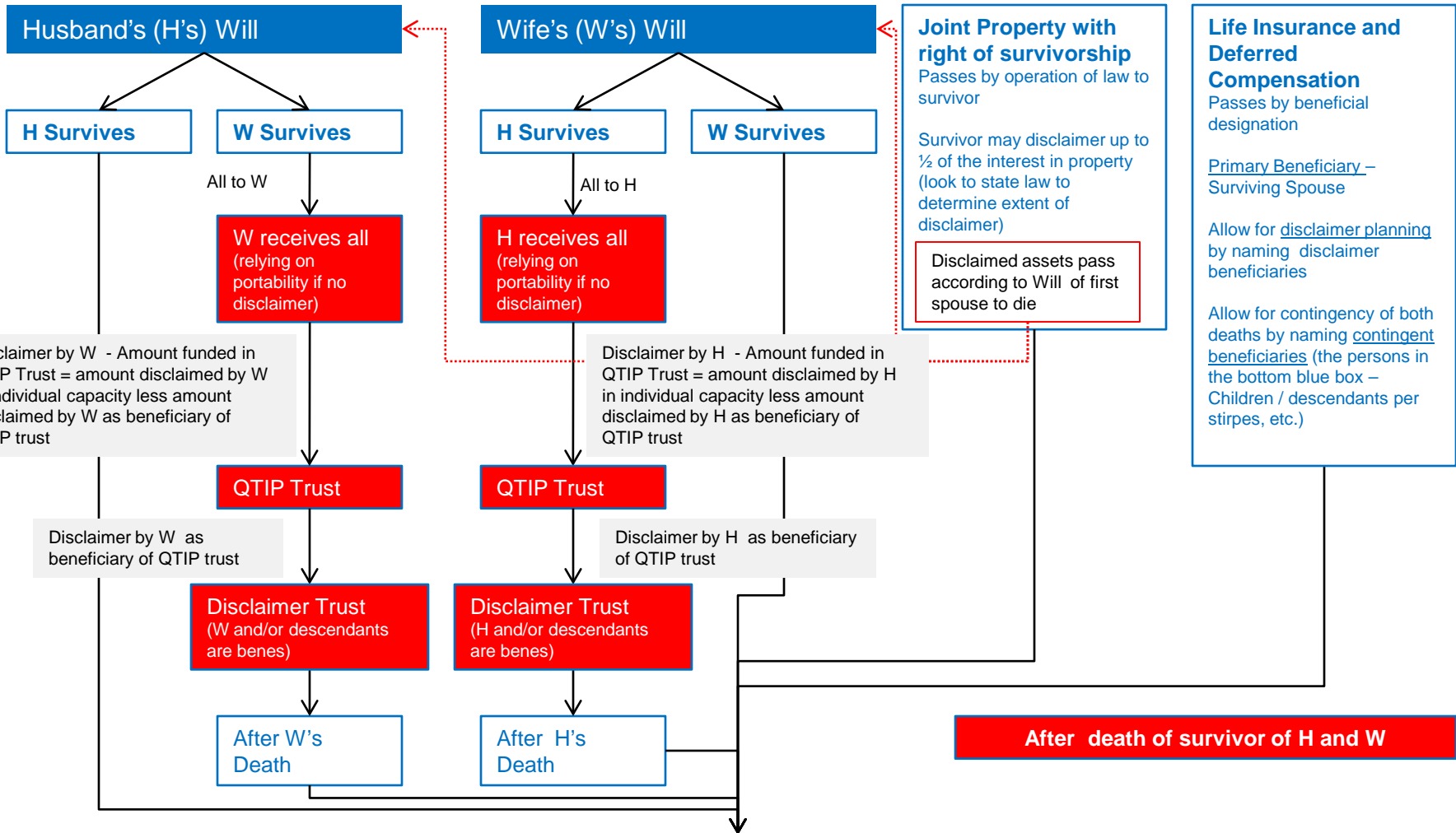
Starting Basic Exclusion Amount		\$ 5,340,000	Inflation Adjustment		2.45%															
		Year of Deceased Spouse's Death																		
		2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	
Year of Surviving Spouse's Death	2014	10,680,000																		
	2015	10,850,000	11,020,000																	
	2016	10,980,000	11,150,000	11,280,000																
	2017	11,120,000	11,290,000	11,420,000	11,560,000															
	2018	11,260,000	11,430,000	11,560,000	11,700,000	11,840,000														
	2019	11,410,000	11,580,000	11,710,000	11,850,000	11,990,000	12,140,000													
	2020	11,560,000	11,730,000	11,860,000	12,000,000	12,140,000	12,290,000	12,440,000												
	2021	11,710,000	11,880,000	12,010,000	12,150,000	12,290,000	12,440,000	12,590,000	12,740,000											
	2022	11,870,000	12,040,000	12,170,000	12,310,000	12,450,000	12,600,000	12,750,000	12,900,000	13,060,000										
	2023	12,030,000	12,200,000	12,330,000	12,470,000	12,610,000	12,760,000	12,910,000	13,060,000	13,220,000	13,380,000									
	2024	12,190,000	12,360,000	12,490,000	12,630,000	12,770,000	12,920,000	13,070,000	13,220,000	13,380,000	13,540,000	13,700,000								
	2025	12,360,000	12,530,000	12,660,000	12,800,000	12,940,000	13,090,000	13,240,000	13,390,000	13,550,000	13,710,000	13,870,000	14,040,000							
	2026	12,530,000	12,700,000	12,830,000	12,970,000	13,110,000	13,260,000	13,410,000	13,560,000	13,720,000	13,880,000	14,040,000	14,210,000	14,380,000						
	2027	12,700,000	12,870,000	13,000,000	13,140,000	13,280,000	13,430,000	13,580,000	13,730,000	13,890,000	14,050,000	14,210,000	14,380,000	14,550,000	14,720,000					
	2028	12,890,000	13,060,000	13,190,000	13,330,000	13,470,000	13,620,000	13,770,000	13,920,000	14,080,000	14,240,000	14,400,000	14,570,000	14,740,000	14,910,000	15,100,000				
	2029	13,070,000	13,240,000	13,370,000	13,510,000	13,650,000	13,800,000	13,950,000	14,100,000	14,260,000	14,420,000	14,580,000	14,750,000	14,920,000	15,090,000	15,280,000	15,460,000			
	2030	13,260,000	13,430,000	13,560,000	13,700,000	13,840,000	13,990,000	14,140,000	14,290,000	14,450,000	14,610,000	14,770,000	14,940,000	15,110,000	15,280,000	15,470,000	15,650,000	15,840,000	16,030,000	16,220,000
	2031	13,450,000	13,620,000	13,750,000	13,890,000	14,030,000	14,180,000	14,330,000	14,480,000	14,640,000	14,800,000	14,960,000	15,130,000	15,300,000	15,470,000	15,660,000	15,840,000	16,030,000	16,230,000	16,420,000
	2032	13,650,000	13,820,000	13,950,000	14,090,000	14,230,000	14,380,000	14,530,000	14,680,000	14,840,000	15,000,000	15,160,000	15,330,000	15,500,000	15,670,000	15,860,000	16,040,000	16,230,000	16,420,000	16,610,000
	2033	13,860,000	14,030,000	14,160,000	14,300,000	14,440,000	14,590,000	14,740,000	14,890,000	15,050,000	15,210,000	15,370,000	15,540,000	15,710,000	15,880,000	16,070,000	16,250,000	16,440,000	16,630,000	16,820,000
	2034	14,060,000	14,230,000	14,360,000	14,500,000	14,640,000	14,790,000	14,940,000	15,090,000	15,250,000	15,410,000	15,570,000	15,740,000	15,910,000	16,080,000	16,270,000	16,450,000	16,640,000	16,830,000	17,020,000
2035	14,280,000	14,450,000	14,580,000	14,720,000	14,860,000	15,010,000	15,160,000	15,310,000	15,470,000	15,630,000	15,790,000	15,960,000	16,130,000	16,300,000	16,490,000	16,670,000	16,860,000	17,050,000	17,240,000	
2036	14,500,000	14,670,000	14,800,000	14,940,000	15,080,000	15,230,000	15,380,000	15,530,000	15,690,000	15,850,000	16,010,000	16,180,000	16,350,000	16,520,000	16,710,000	16,890,000	17,080,000	17,270,000	17,460,000	
2037	14,720,000	14,890,000	15,020,000	15,160,000	15,300,000	15,450,000	15,600,000	15,750,000	15,910,000	16,070,000	16,230,000	16,400,000	16,570,000	16,740,000	16,930,000	17,110,000	17,300,000	17,490,000	17,680,000	
2038	14,950,000	15,120,000	15,250,000	15,390,000	15,530,000	15,680,000	15,830,000	15,980,000	16,140,000	16,300,000	16,460,000	16,630,000	16,800,000	16,970,000	17,160,000	17,340,000	17,530,000	17,720,000	17,910,000	
2039	15,190,000	15,360,000	15,490,000	15,630,000	15,770,000	15,920,000	16,070,000	16,220,000	16,380,000	16,540,000	16,700,000	16,870,000	17,040,000	17,210,000	17,400,000	17,580,000	17,770,000	17,960,000	18,150,000	
2040	15,430,000	15,600,000	15,730,000	15,870,000	16,010,000	16,160,000	16,310,000	16,460,000	16,620,000	16,780,000	16,940,000	17,110,000	17,280,000	17,450,000	17,640,000	17,820,000	18,010,000	18,200,000	18,390,000	
2041	15,680,000	15,850,000	15,980,000	16,120,000	16,260,000	16,410,000	16,560,000	16,710,000	16,870,000	17,030,000	17,190,000	17,360,000	17,530,000	17,700,000	17,890,000	18,070,000	18,260,000	18,450,000	18,640,000	

# Traditional By-Pass Trust Plan





# Waterfall Disclaimer Portability Plan



**Joint Property with right of survivorship**  
 Passes by operation of law to survivor

Survivor may disclaim up to 1/2 of the interest in property (look to state law to determine extent of disclaimer)

Disclaimed assets pass according to Will of first spouse to die

**Life Insurance and Deferred Compensation**  
 Passes by beneficial designation

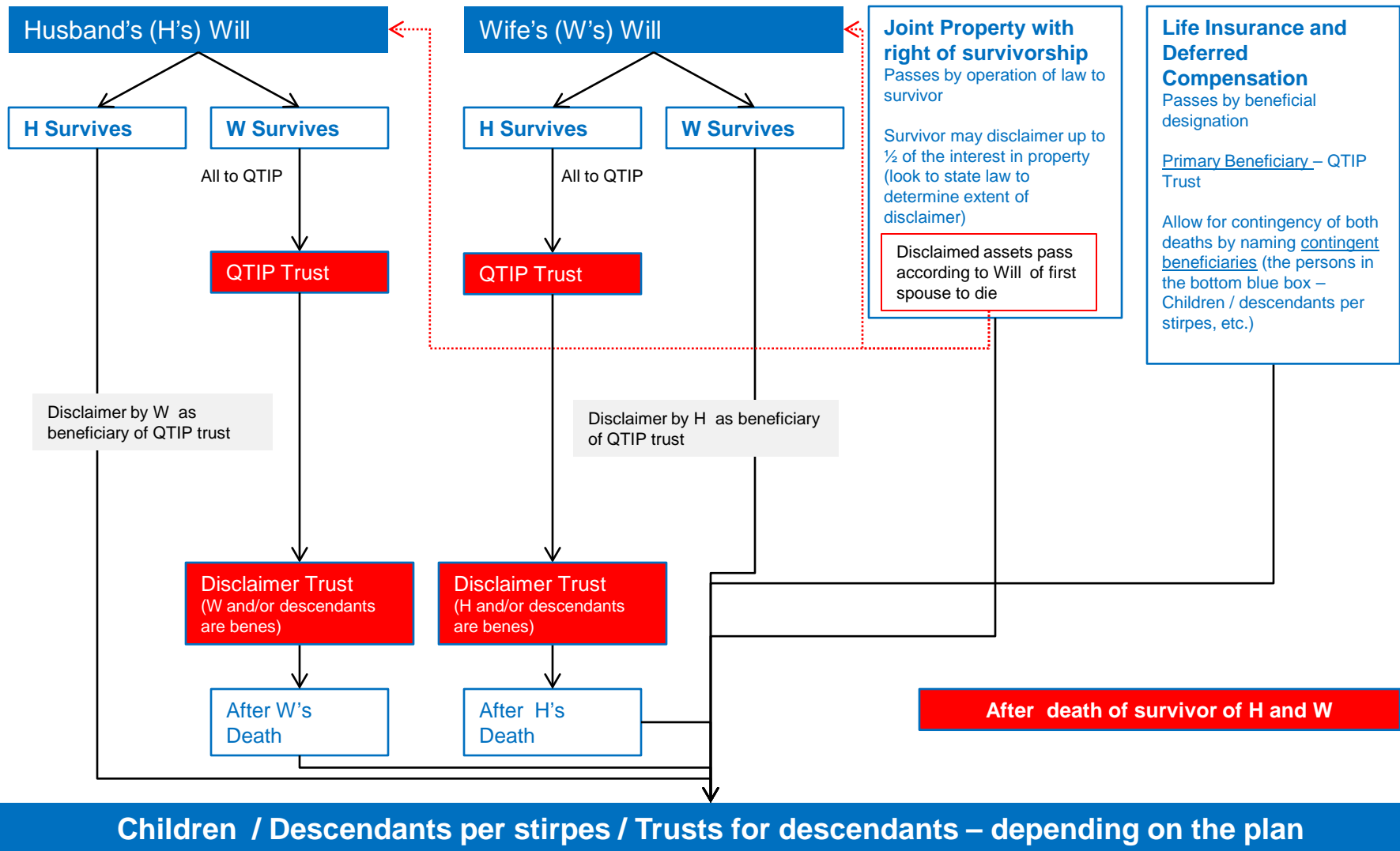
Primary Beneficiary – Surviving Spouse

Allow for disclaimer planning by naming disclaimer beneficiaries

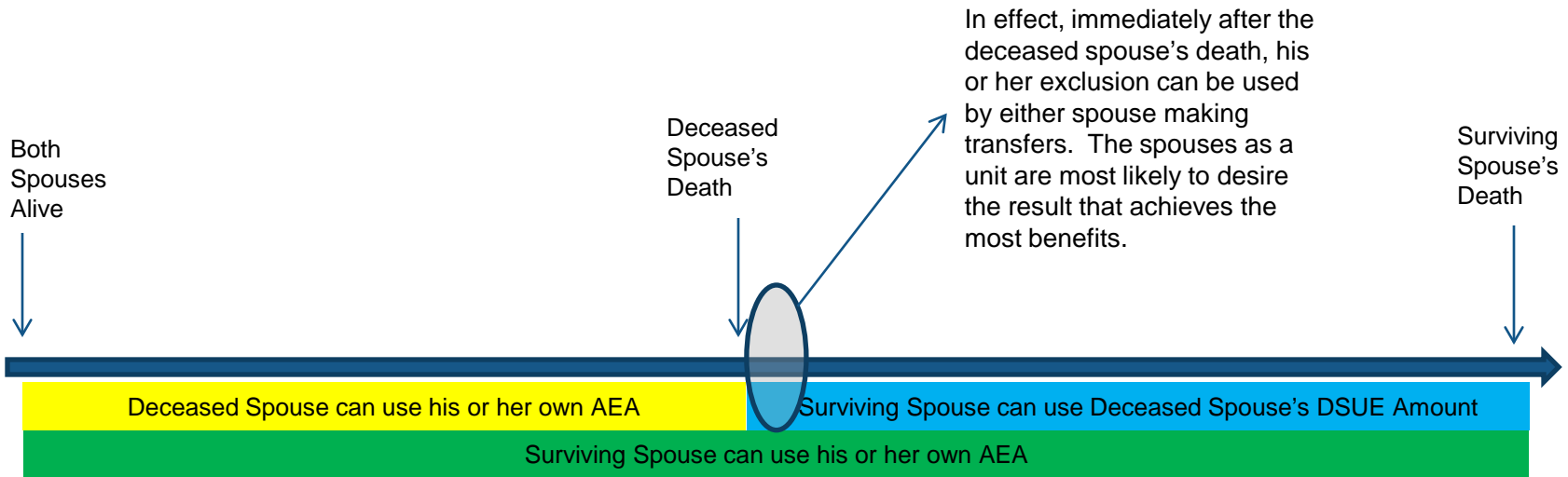
Allow for contingency of both deaths by naming contingent beneficiaries (the persons in the bottom blue box – Children / descendants per stirpes, etc.)

**Children / Descendants per stirpes / Trusts for descendants – depending on the plan**

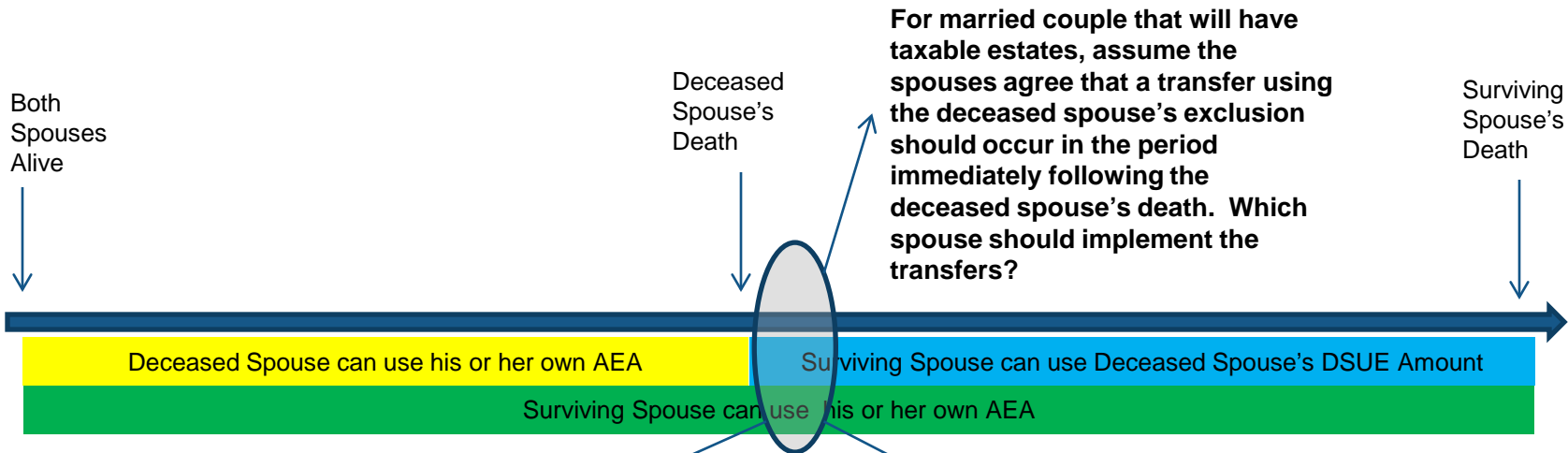
# QTIP Trust Portability Plan



# Chart #1 Marital Unit Timeline for AEA Use



## Chart #2 Marital Unit Timeline for AEA Use



### Deceased spouse controls the implementation of transfers using the deceased spouse's AEA through bypass trust if and to the extent that:

The clients are concerned that:

- The surviving spouse could divert deceased spouse's share of the marital unit's assets to someone other than the natural beneficiaries of the marital unit;
- The surviving spouse needs creditor protection or may be subject to undue influence; or
- The surviving spouse needs assistance with asset management; and

the couple is concerned that the surviving spouse might divert the tax benefits of the deceased spouse's exclusion amount to someone other than natural beneficiaries of the marital unit.

### Surviving spouse controls the implementation of all other transfers using both spouses' AEA.

The Basic Waterfall Disclaimer Portability Plan is changed to the QTIP Trust Portability Plan if the clients are concerned that:

- The surviving spouse could divert deceased spouse's share of the marital unit's assets to someone other than the natural beneficiaries of the marital unit;
- The surviving spouse needs creditor protection or may be subject to undue influence; or
- The surviving spouse needs assistance with asset management.

# Portability and Second Marriages and Blended Families

## Example: Husband & Wife, 2<sup>nd</sup> marriage, separate families

- Each has \$3 million of assets
- Desire to benefit the surviving spouse through a trust and upon surviving spouse's death pass the assets to separate families
- No step-up with By-Pass Trust Plan
- No protection on diversion of tax benefit with the QTIP Portability Plan

# Portability and Second Marriages and Blended Families

## Example: Husband & Wife, 2<sup>nd</sup> marriage, separate families

- Prenupt requires Husband to leave \$3 million of assets in a QTIP trust for Wife
- Husband is concerned about diversion of tax benefit with the QTIP election

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## 706 Filing Requirement

- **Rev. Ruling 2014-18 allows for late filing. (No later than Dec. 31, 2014).**
- **Extends the Service's review time of the 706**

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# Planning for Decoupled States

- **Depart**
- **Divest**
- **Recouple**



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# Portability Creates Distinct Classes of Married Taxpayers

- Under \$5 million
- \$5 million to \$10 million
- \$10 million +

# Planning for the Classes

- Under \$5 M and no control: Disclaim or marital deduction trust
- Under \$5 M and control concerns: Consider an exemption trust
- \$5 M - \$10 M: Hybrid portability with state QTIP
- \$10 M +: Traditional planning

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# Allocation of Assets

- IRD and declining assets
- Assets with high growth likely to be retained

# Trust Income Tax Matters

## Burdens of Trusts-2014:

- 39.6 percent rate on income \$12,150+.  
Single person reaches 39.6% at \$406,750, couples at \$457,600.
- Tax on \$12,150 equals \$3,140.50 (25.8%).  
Individual pays \$1,368.75 (11.3%), married \$1,250 (10%).
- 5 percent surtax on qualified dividends and capital gains \$12,150+. Individuals and couples on over \$400,000.
- No new income tax basis unless included in gross estate.
- 3.8 percent surtax on income \$12,150+.  
Single at \$200,000, couples at \$250,000.

# Trust Income Tax Matters – Part 2

## Potential Remedies

- + **Outright distribution or withdrawal rights.**
- + **Multiple trusts-avoid the surtaxes.**
- + **Tax manage investments**  
Distribute or minimize ordinary income and recognition of gain.  
Focus on fixed income and distribution.
- + **Allocate gains to income.**  
Possibly cap distributable gains.
- + **Supercharged Credit Shelter Trust (SCST)**  
(21 Probate & Prop 52 July/August 2007)
- + **Irrevocable Grantor Inter Vivos Exclusion Trust (IGIVE Trust)**  
(BNA Tax Management Estates, Gifts & Trusts Journal March/April 2012)
- + **Minimum Income Tax Trust (MIT Trust)**  
(Trusts & Estates May 2014)

# By-Pass Trust Techniques to Attain Basis Adjustments are Not as Efficient as Portability

## Example: Married Couple

- FL Home (tenancy by the entirety) = \$5 million
- Joint & Survivor Annuity payments = \$0 value upon survivor's death
- Home doubles in value between spouses' deaths

\*For simplicity assume the basic exclusion amount is always \$5 million.

# Example Continued:

## ➤ Upon Husband's death:

- Wife disclaims one-half survivorship interest
- \$2.5 million funds Disclaimer By-Pass Trust
- \$2.5 million DSUE

## ➤ Upon Wife's death:

- Home valued at \$10 million
  - AEA = \$7.5 million
  - Basis Adjustment cannot fully wipe out capital gain
- With full portability, the Wife's AEA would be \$10 million – i.e., no estate or income tax

# By-Pass Trust Techniques to Attain Basis Adjustments

- Independent Trustee with unlimited power to distribute
- Independent Trustee can grant a GPOA
- Formula GPOA
- Delaware Tax Trap



# Asset Protection Issues

## Traditional By-Pass Trust

1. Division of assets to fund separate by-pass trusts often destroyed asset protection during both spouses' lifetimes – e.g., division of TBE property. Note new statutes providing for TBE protection for transfers to revocable trusts
2. Discretionary beneficial rights in spouse should be protected by spendthrift clause
3. Caution with by-pass trust techniques to attain basis adjustments
  - Independent Trustee with unlimited power to distribute
  - Independent Trustee can grant a GPOA
  - Formula GPOA
  - Delaware Tax Trap

## Portability QTIP/Disclaimer Plan

1. Spendthrift creditor protection, at least as to principal
2. Mandatory income interest in QTIP Trust – creditors may be able to reach income once distributed --more exposed to creditors than a totally discretionary by-pass trust
3. Discretionary principal rights should be beyond creditors' reach
4. Disclaimers to fund disclaimer/by-pass trust
  - Surviving spouse may need to be solvent at the time of disclaimer
  - Some states treat a disclaimer by an insolvent person as a fraudulent transfers
  - May disqualify spouse for Medicaid benefits
5. Clayton QTIP
6. Using DSUE for gifts to Self Settled “Grantor” Irrevocable Gift Trust

# Consider Diversifying Approaches for Applicable Exclusion Amount Usage and Planning to Create Flexibility in Estate Plans

- Exclusion up 500% since 2003 – Diversify Approach
  - Techniques
  - Assets
- Flexibility, flexibility, flexibility
  - Disclaimers
  - Partial QTIPs, reverse QTIPs
  - Independent Trustees with broad powers to distribute
  - Decanting and merger
  - Protectors and Powers of Amendment

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