

Strafford

Presenting a live 90-minute teleconference with interactive Q&A

Drafting Estate Defective Trusts: Income Reallocation, Basis Step-Up, Appreciation, Gift and State Death Tax Issues

TUESDAY, AUGUST 12, 2014

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

Today's faculty features:

Alvin J. Golden, Shareholder, Ikard Golden Jones, Austin, Tex.

**Edwin P. Morrow, III, Esq., Senior Wealth Specialist, Key Private Bank
Wealth Advisory Services, Dayton, Ohio**

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-866-961-9091** and enter your PIN when prompted. Otherwise, please send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

For **CLE** credits, please let us know how many people are listening online by completing each of the following steps:

- Close the notification box
- In the chat box, type (1) your **company name** and (2) the **number of attendees at your location**
- Click the **SEND** button beside the box

For **CPE** credits, attendees must **listen** throughout the program, including the Q & A session, and **record** verification codes in the corresponding spaces found on the CPE form, in order to qualify for full continuing education credits. Strafford is required to monitor attendance.

If you have not printed out the “CPE Form,” please print it now (see “Handouts” tab in “Conference Materials” box on left-hand side of your computer screen).

Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

Program Materials

FOR LIVE EVENT ONLY

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

“Estate-Defective” Trusts – Intentionally Causing Estate Inclusion for Tax Basis

Presented by: Ed Morrow III, JD, LL.M., CFP®
Senior Wealth Specialist, Key Private Bank
Al Golden
Shareholder, Ikard Golden Jones, P.C.
www.igjlaw.com

8/12/2014 Strafford CLE

Agenda

- Tax law changes, the increased importance of basis and income tax planning, & portability
- Marital trusts – loopholes, hidden problems
- Using 2036/2038/2041 to cause inclusion
- Adapting/administering bypass trust for basis
- Re-designing bypass trusts for better basis
- Narrowly crafting GPOAs for optimal effect
- Using the Delaware Tax Trap
- Seizing basis opportunity for irrevocable trusts
- Basis at first death; community property
- “Upstream” basis planning

What's New in Estate Tax Planning?

- “Permanent” \$5 million estate/gift/GST, adjusted for inflation (\$250,000 added in just two years with LOW inflation, up to \$5.34 million in 2014), with spousal “portability”
- In recent tax reform/budget talks, estate/gift tax was not even “on the table”. In recent Republican repeal proposal, **the gift tax is left intact.**

What's New in Income Tax Planning?

- **For 2013, new tax law (ATRA and ACA):**
 - New ordinary income rate of 39.6% and **20% LTCG/QD** on taxable income (not AGI) over:
 - \$400,000 (single) (in 2014, \$406,750)
 - \$450,000 (married) (in 2014, \$457,600)
 - \$11,950 (trusts/estates) (in 2014, \$12,150)
 - **Medicare Surtax of 3.8% (net investment income) or 0.9% (wages)**
 - Hits taxpayers with AGI over \$200k/\$250k
 - Trusts/estates AGI over only \$11,950 (\$12,150 in 2014)
 - Together, investments top at 43.4%/23.8%
(not counting Pease limitations or state income tax!)

The Challenge for Sub \$10.68 Million Estates

- The popular financial press, even sophisticated CFPs, CPAs, and yes, even attorneys are questioning bypass trusts or even the need for trusts at all for the “99%”
- The most common “solutions” cited are to ditch the trust altogether, use disclaimer funding, or use an “all to marital trust” approach – **all of these have significant issues.**

What's Now Involved in Estate Planning?

- Inter-vivos gifting is more complex and has to include income tax issues. Assets that most benefit from a new basis at death (inclusion in gross estate):
 - Self-created intellectual property (copyrights, art, etc.) (ordinary)
 - “Negative basis” or highly depreciated property (25% recapture)
 - Gold, artwork and collectibles (28% rate)
- Trade off now is between transfer tax not affecting 99% of taxpayers and capital gains tax (55%→40%, 15%→23.8% (plus state income taxes up to 13.3%))
- Income tax is more important now than estate tax even in “estate” planning, for most taxpayers.

What's Now Involved in Estate Planning?

Estate planning and trust design is now **far** more complicated and nuanced than in the past and could vary significantly based upon many variables, including:

- Size of the gross estate (taxable v. non-taxable)
- Future return (income and appreciation) of the assets
- Current tax basis and nature of the types of assets (e.g., to what extent will an adjusted basis benefit the client and the likely beneficiaries? Is it an IRA/QP?)
- Time horizon or life expectancy of the client and the likely recipients
- Spending/lifestyle of the client and likely recipients

What's Now Involved in Estate Planning?

Factors (cont.):

- Expected time to sale of the assets
- The client's state of residence
- State(s) of residence and marginal state income tax bracket(s) of the likely beneficiaries
- Expectations about future inflation and how that affects applicable exclusion amount (AEA)
- Other factors, such as expected future law changes, etc.

What's Now Involved in Estate Planning?

Bottom line: there's a new paradigm in town - income tax basis management and management of ongoing income tax after death

- It probably will be far fewer times that we'll advise a client to give away **significantly** appreciated assets during lifetime because of the carryover basis rules of IRC Sec. 1015 (but, "upstream?")
- However, ATRA **significantly** complicated the analysis for lifetime and AB Trusts --- will clients **pay** to have us (you) sort it all out? **Malpractice risk? Must** we point out the income tax perils of AB trusts for **CYA** purposes - similar to the old warning about not using the unified credit in the estate of the first spouse to die before portability – do your memos explain basis step up (AND down), fractional interest discounting, compressed tax rates, tax shifting and other **income** tax issues of AB trusts?!

Portability?

- Since the overwhelming majority of clients will not have taxable estates, the utility of portability will continue to be useful now that ATRA made it permanent (will states with separate estate tax systems follow? Hawaii, Delaware)
- Some commentators have even called portability a “game changer” because of the post-first death planning that it allows - it’s also been called a “fraud on the public”
- Specifically, by giving a surviving spouse or a QTIPable trust a legacy, you create the opportunity to get a new basis at the surviving spouse’s death, which you can’t get from a bypass trust without some advance planning

Portability?

Advantages of portability include:

- Simplicity
- It can create a better tax deferral result than attempting to fund a credit shelter portion with an IRD asset such as an IRA
- It provides protection for the poorer spouse being able to use the full AEA if that spouse dies first without having to give the poorer spouse enough assets to fully use that spouse's AEA, which the wealthier spouse may not want to do
(no need for intervivos QTIPs to equalize, *unless to exploit GST or avoid simultaneous death anomalies*)
- Portability may better optimize basis for mildly appreciating assets (although not necessarily if the surviving spouse lives for a long time after the death of the first spouse).

Portability?

Disadvantages of portability include:

- Not indexed like the Basic Exclusion Amount - it is **fixed**
- Does **not** apply to the GST tax, so the use of portability will cause the loss of the GST tax exemption of the first spouse to die (example: H dies w/\$5 million to W, who dies with \$10 million to only son, who then dies paying **\$2 million estate tax that could have been easily avoided if portability had been shunned or reverse QTIP used**)
- Outright bequests to the surviving spouse could cause the assets to pass in a manner other than what the first spouse to die wanted or expected, which could be a **killer** in blended families
- Outright bequests to a surviving spouse **expose** the assets to the creditors of the surviving spouse and, potentially, a new spouse

Portability?

Disadvantages of portability include (cont.):

- A surviving spouse will **lose** the first-passing spouse's DSUEA if he or she remarries and the new spouse predeceases him or her (you cannot avoid this potential \$2 million trap with pre-nup)
- Does **not** apply, at least at present, to state death tax, which can cost a lot of state death tax at the death of the surviving spouse
- Appreciation during the surviving spouse's overlife is included in the surviving spouse's estate, which could be **substantial** if the surviving spouse lives for a long time and the assets are properly invested (see Gassman's article, *\$28 million mistake*)
- Expense of **filing** timely Form 706 estate tax return
- Statute of limitations remains **open** as to the DSUEA until the surviving spouse's death

Portability?

Disadvantages of portability include (cont.):

- A bypass trust locks in the value of the AEA and can result in even **more** wealth transfer if the surviving spouse remarries and gift splits or harvests a DSUEA from the subsequent spouse
- Tax Apportionment (IRC 2207A plus ORC 2113.86 or other state statute) with QTIP/ portability hurts first to die's kids and favors the step-kids (e.g. – H leaves \$10 million to QTIP, W has \$10 million – ***who pays the approximate \$4 million tax?!***)
- Portability only works with a *surviving* spouse, so a **simultaneous** death could be disastrous (example:
W has \$10 million, marries H with \$0 – plane disappears)

Bottom line: Portability has its benefits and its place, but don't overuse it - there might be **better** options to harvest basis adjustments at or prior to the surviving spouse's death, and better options to mitigate ongoing income tax as well

Slide Intentionally Left Blank

A False Dilemma – Thinking Outside the Box

- Not an either/or choice between outright and bypass trust
- Neither is it an either/or choice between bypass and marital
- Some assets might benefit from a new basis, but others may be “wasting assets” that would not get a new basis, nor optimize use of AEA anyway, such as non-Roth qualified plans and IRAs, which may make more sense to leave outright or in marital trust.

See page 8-9 of CLE outline, example page 10

Marital Trusts – Simple Solutions?

- QTIP marital trust – most common choice – requires 706 and election and has Rev. Proc. issues, enables separate state QTIP election in many states (we no longer need this in Ohio)
- GPOA marital trust – less common, but may have various advantages over QTIP – no 706, no valuation issues, no Rev. Proc issues – but rigid GPOA required
- **Both force a STEP DOWN in basis, force out income, *cannot use broad lifetime limited powers of appointment (LPOAs) or spray income*, not as ideal for state/federal estate tax savings even w/portability, for all the reasons previously discussed**

See page 11-14 of CLE outline, example page 12

Marital Trusts – Simple Solutions?

- Overlooked problems with businesses, LLCs, real estate where fractional interests go into trust:
- Example: John leaves $\frac{1}{2}$ of home, $\frac{1}{2}$ of LLC (underlying value \$500,000 each) to QTIP. His wife *Jane has the other half*. She lives 8 years, the value doubles. Is the basis to the heirs (be it in trust or otherwise) \$1,000,000 for the home, \$1,000,000 for the LLC? Well, **this depends on the type of marital trust**. At 30% valuation “discount” for a non-controlling 50% share (LLC>TIC), it may be as low as \$350,000 FMV basis for each 50% share, \$1.4 million, not \$2 million – at \$600,000 lost basis times 23.8% (28.8%) plus up to 13% state capital gains tax that’s **nearly a two hundred thousand dollar mistake**

See page 11-14 of CLE outline, example page 12

Key Private Bank



Marital Trusts – The Clayton QTIP and “One Lung Trusts”

- A Clayton QTIP offers some advantages over disclaimer planning, is a great tool for adding flexibility, but still begs the question of what the ultimate decision will be as to division between bypass/QTIP and what those terms will be.
- Issues and Solutions to exploiting Clayton QTIPs:
Is the spouse executor? If so, is there a gift tax issue? Does the spouse have enough assets to care? Might asset protection be affected? How can we avoid the issue altogether by drafting the bypass trust so as to not cause a gift? What’s a “waterfall disclaimer”?
- See page 10 of Ed’s white paper, plus, Al’s comprehensive analysis of marital trust issues in his soon to be published ACTEC article

Understanding 2036/2038/2041

- Can taxpayers without a taxable estate now use IRC 2036 to argue “prearrangement”, retained interests AGAINST the IRS? E.g. I don’t pay rent back to my QPRT at the end of the term?
- Can IRC 2038 strings be used the same?
- Next few sections will discuss the other main estate inclusion section (other than outright ownership), that is best suited to affirmatively cause estate inclusion

Understanding Powers of Appointment

- Powers of Appointment (POA) have TREMENDOUS income tax planning potential for both stepping up basis and spraying income
- GPOA (general power of appointment) – power to appoint to yourself, your estate, or creditors of either – can be lifetime, or testamentary (only effective at death) – triggers gift tax/estate inclusion 2041/2514
- LPOA (limited powers of appointment) – power to appoint that excludes power to appoint to self, estate, or creditors or either – usually does NOT trigger gift tax or estate inclusion, except special circumstance (e.g. Delaware Tax Trap)

Other Ways For Bypass Trusts to Seize Basis

1. Trustee or trust protector's exercising discretion to distribute the entire trust to spouse or add GPOA
2. Adding GPOA by Private/Non-Judicial Settlement, court ordered amendment or reformation, decanting
3. Using "collateral power" LPOA held by non-fiduciary family member to distribute/decant to surviving spouse or trust for spouse with GPOA
4. Late QTIP? Really, really late?? (see pages 14-16)

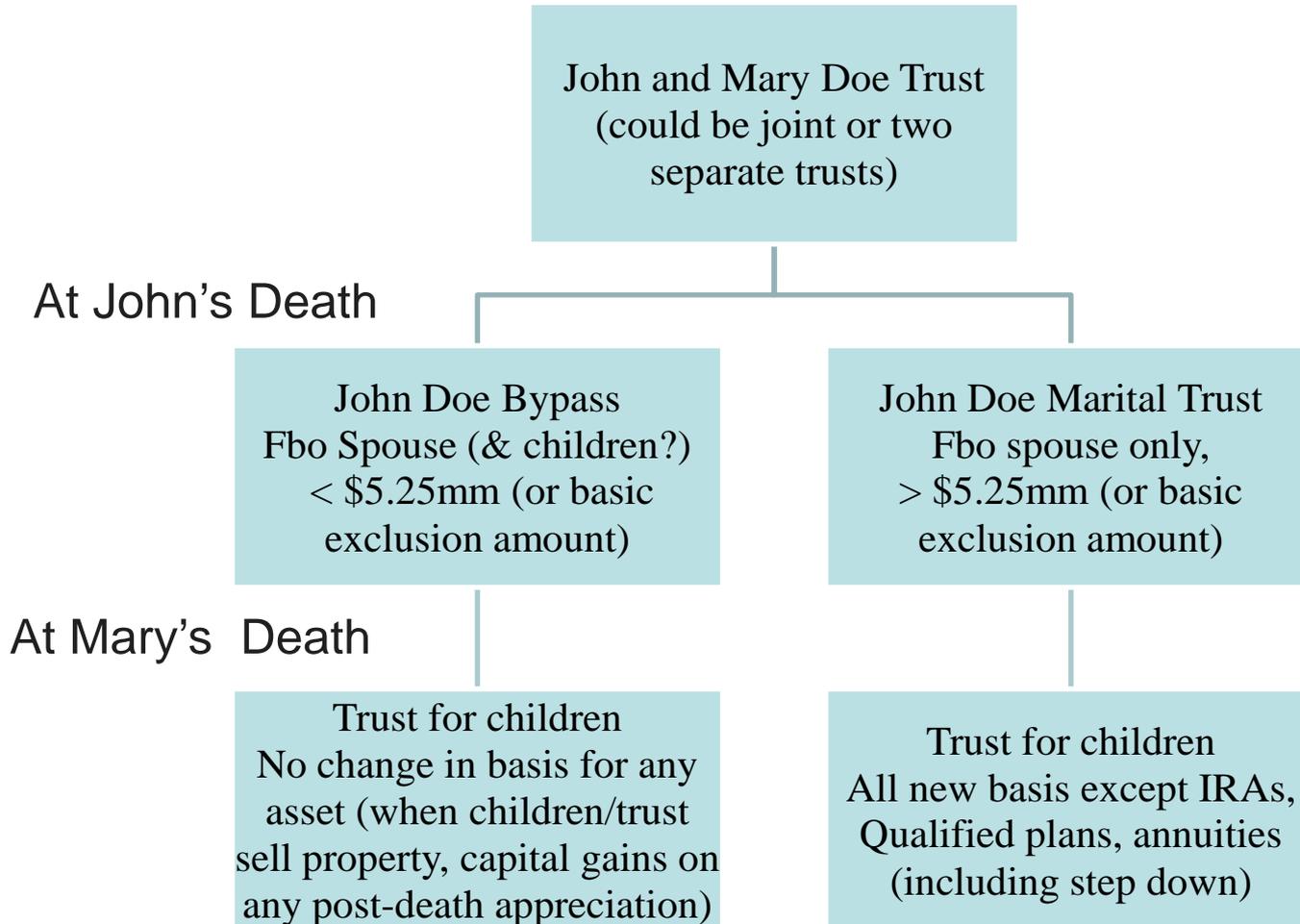
Other Ways to Adapt Bypass Trusts for Basis

5. Use LPOA that defaults to GPOA to the extent not exercised (do not default to powerholder's estate), exercise LPOA over IRD/high basis assets/cash, or more if needed to reduce estate
6. Use LPOA over entire trust, but exercise the power in a way so as to trigger the Delaware Tax Trap (IRC Section 2041(a)(3)). Exercise can be triggered by asset/formula
7. Use a formula testamentary GPOA with caps and ordering rules

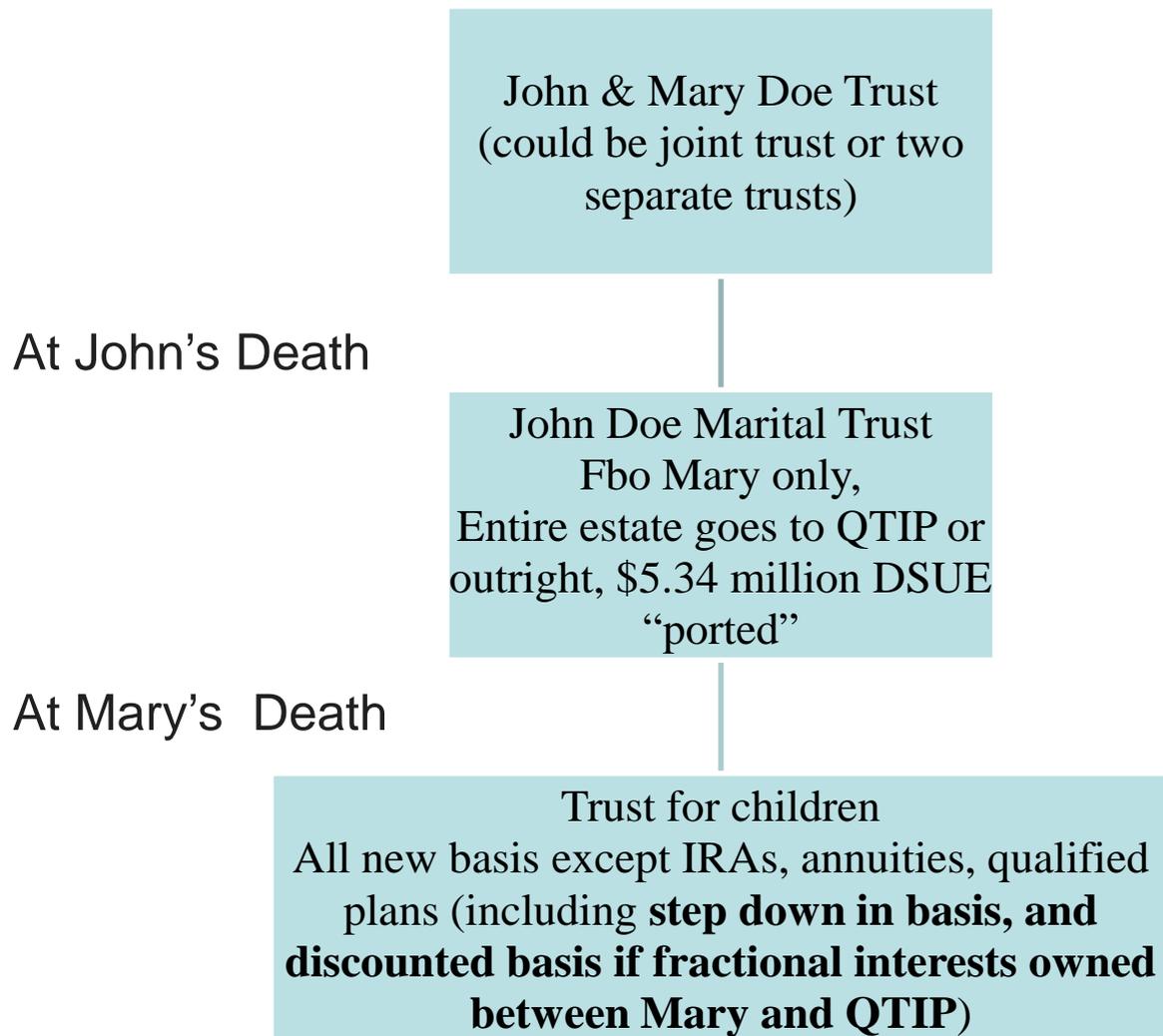
See page 15-16 of CLE outline – **Optimal Basis Increase**

Slide Intentionally Left Blank

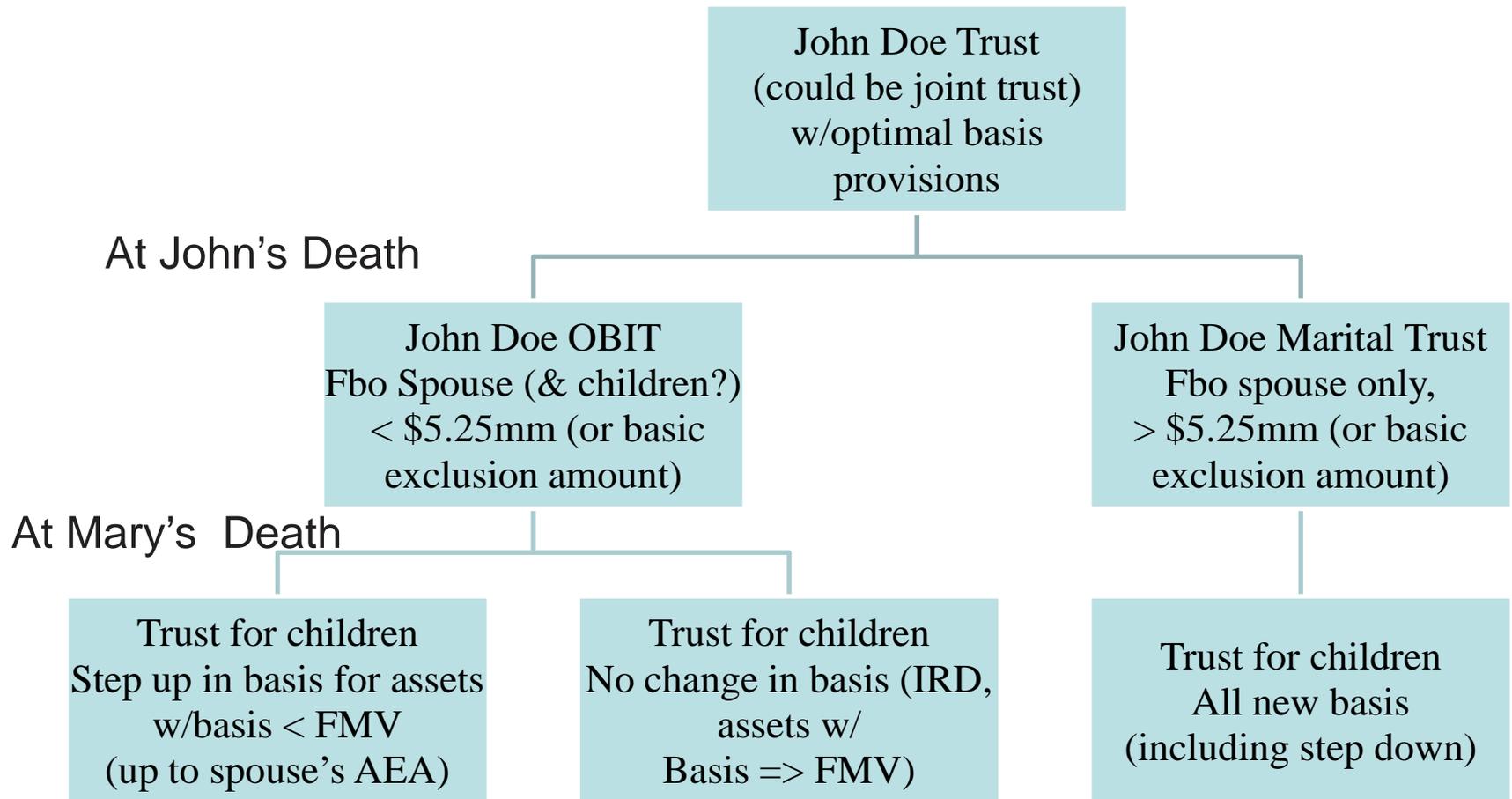
Traditional AB Trust - Basis Effect



Marital (QTIP) Trust – Basis Effect



Optimal Basis Increase Trust – Basis Effect



Uses GPOA or LPOA, Section 2041

To trigger estate inclusion and 1014 step up

Key Private Bank



Optimal Basis Increase Trust

- See page 17 of CLE example, a simplified list and columns of assets in bypass trust from \$2 million left to spouse in bypass trust, 8 years later:

<i>Traditional deductible IRA</i>	<i>basis \$0, FMV \$700,000</i>
Total “IRD” Property	basis \$0 FMV \$700,000
Apple Stock (the iPhone 9 flopped),	basis \$500,000, FMV \$200,000
Condo in Florida (hurricane depresses value),	basis \$1,000,000, FMV \$600,000
LT Bond portfolio (inflation depressed value)	basis \$400,000 FMV \$300,000
Various stocks that have decreased in value	basis \$150,000, FMV \$100,000
Total “loss” property	basis \$2,050,000, FMV \$1,200,000
Rental Real Estate	basis \$200,000, FMV \$600,000
Various stocks that have increased in value	basis \$400,000, FMV \$900,000
<i>ST Bond Portfolio, Money market, Cash</i>	<i>basis \$400,000, FMV \$400,000</i>
Gold	basis \$100,000 FMV \$200,000
Total “gain” property	basis \$1,100,000 FMV \$2,100,000
Total at Jane’s death	basis \$3,150,000 FMV \$4,000,000

- Ideally, clients want a step up for appreciated assets that would benefit from basis increase, and keep existing basis on assets that would otherwise be “stepped down” if in the estate

See page 17-19 of CLE outline

Key Private Bank



Optimal Basis Increase Trust

- Differing Basis Results at surviving spouse's death under three planning structures:

New Basis at Surviving Spouse's Death if using:	Ordinary Bypass	QTIP/outright	OBIT
<i>Traditional deductible IRA</i>	\$0	\$0	\$0
Apple Stock (the iPhone 9 flopped),	\$500,000	\$200,000	\$500,000
Condo in Florida (hurricane depresses value),	\$1,000,000	\$600,000	\$1,000,000
LT Bond portfolio (inflation depressed value)	\$400,000	\$300,000	\$400,000
Various stocks that have decreased in value	\$150,000	\$100,000	\$150,000
Rental Real Estate	\$200,000	\$600,000	\$600,000
Various stocks that have increased in value	\$400,000	\$900,000	\$900,000
<i>ST Bond Portfolio, Money market, Cash</i>	<i>\$400,000</i>	<i>\$400,000</i>	<i>\$400,000</i>
Gold	\$100,000	\$200,000	\$200,000
Total Basis for Beneficiaries at Jane's death	\$3,150,000	\$3,300,000	\$4,150,000

Capping Inclusion/GPOA to Soak Up AEA

- Adding/drafting GPOAs is easy when both spouses have estates under \$5.34 million (one AEA)
- Just as we do with “AB” splits, we want to cap the amount of the GPOA, as we typically cap the amount going to a marital trust, to optimize tax benefits.
- Trickier - Which assets do we want to soak up the “coupon” if the available exclusion amount is limited, and can we have assets chosen at the trustee’s discretion, the powerholder’s discretion? Could this force pro-rata inclusion? Do we want a \$500,000 block of stock with \$490,000 basis to soak up the same “coupon” as a \$500,000 building with basis of \$180,000? Only matters for mid-size/larger estates.

See page 21-23 of CLE outline

Crafting GPOAs For Fidelity/Protection

- GPOAs in marital trusts must be very narrow
- However, all other GPOAs can be narrowly crafted to prevent any unwanted exercise as a practical matter
- Can be conditioned on consent from a “non-adverse” party, essentially, a non-beneficiary – can even be a trustee!!! (though I personally would not use trustee)
- Testamentary GPOA not necessarily subject to powerholder’s estate’s creditors (except e.g. CA, note a difference in uniform act draft, 2nd/3rd restatements)

See page 28-30 of CLE outline

Using the Delaware Tax Trap In Lieu of GPOA

- Sounds crazy? What the heck is the Delaware Tax Trap (DTT)?
- IRC 2041(a)(3) – *complicated* – extending rule against perpetuities via LPOA – if you appoint to a trust granting a powerholder a POA, can this new power be *exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power*

See page 32-33 of CLE outline

Using the Delaware Tax Trap In Lieu of GPOA

- Nutshell - in apparently all states, if you exercise a LIMITED power of appointment to appoint to a trust which grants a beneficiary a PRESENTLY EXERCISABLE GPOA, it will trigger the DTT- 2041(a)(3), hence trigger estate inclusion, hence trigger a step up in basis.
- In Arizona, it is possible to “opt-in” to triggering the DTT by appointing to a trust with only an LPOA, but most states have closed this possibility to prevent inadvertent taxation – states should consider an “opt-in” state RAP statute that would enable this for better income tax planning for residents. Attorneys with Texas, Florida and Colorado bar assn committees have drafted legislation for consideration in those states.

See page 32-33 of CLE outline

Key Private Bank



Using the Delaware Tax Trap In Lieu of GPOA

- So, similar to the formula GPOA discussion, why not simply use a LPOA to appoint assets for which a basis increase/estate inclusion is desired, to a “Delaware Tax Trapping Trust” (sounds complicated, but you have all drafted these before without knowing it – it’s easy)
- Similarly, any IRD/cash/assets with basis higher than FMV might go to beneficiary and/or ordinary trust avoiding DTT
- Spouse can later pick and choose, amending the exercise, to choose assets children are most likely to sell first
- Chief drawback of “PEG” power is reduced asset protection, flexibility, increased estate inclusion for children – but, consider ideas in outline to mitigate these risks (5/5 lapse, non-adverse party consent, power over only remainder, using DAPT, etc)

See page 32-33 of CLE outline, extensive comparison page 40

Busting Spousal Disclaimer Myths

- You have all been taught that spouses using any disclaimer funding have to disclaim any powers of appointment in trusts receiving disclaimed assets
- This is wrong - or at least, overbroad
- A POA that can only trigger estate/gift tax, or that is limited by ascertainable standard, CAN BE retained. OBIT clauses meet this requirement

See page 46-47 of CLE outline, sample clauses

Slide Intentionally Left Blank

OBIT Techniques: Existing Irrevocable Trusts

- This is a **HUGE opportunity** to provide significant value for widows, widowers having bypass trusts, or anyone else who has inherited an interest in a GST exempt trust (often a non-exempt trust would have a GPOA anyway, but those are ideal)
- How many widows/widowers as beneficiaries of bypass trusts have over \$5.34 million of their own assets (or, whatever their AEA is, if their late spouse died recently, they may have more from DSUE, or could have less from prior taxable gifts). 1%?
- If they already have an LPOA, use the Delaware Tax Trap, unless GST concerns or the family situation rules out granting a presently exercisable GPOA (but consider mitigating ideas in outline).

See page 66 of CLE outline; review checklist for basis increase

OBIT Techniques: Existing Irrevocable Trusts

- If there is not an LPOA, DO NOT GIVE UP, there are many ways to effect an amendment, decanting, or reformation under the UTC or common law, even if no amendment/protector provision
- *Bosch*, et al, should not apply here the same as reformations for marital trusts, “see-through trusts” designed to qualify as a designated beneficiary, charitable trusts, etc.
- Doing nothing ensures no step up – a simple reformation may save family hundreds of thousands of dollars in capital gains tax
- Remember, LPOA/GPOAs do not have to be as broad as people often make them – we would make such a POA added for this purpose very narrow indeed

See page 66-72 of CLE outline

Optimizing Basis at *First* Death?

- Residents of non-community property states can establish an Alaska or Tennessee Community Property Trust, transferring lower basis, non-IRA type assets into such a trust. Makes more sense for long marriages where any asset would be “marital” in a divorce anyway
- Requires Alaska or TN trustee, such as Key Trust Co of Anchorage, Alaska – H&W can be co-trustees, direct investments.
- Since 1998, untested in courts, but at least no negative PLR or case, IRS silent on whether this works for IRC Sec. 1014(b)(6) double new basis (hopefully, a step up). Conflict of Laws indicates that a married couple can choose which state law to apply to their property interests – should not violate public policy
- Remember, community property can be double “stepped down”, but due diligence/monitoring may be able to prevent by agreement

See page 49 of CLE outline

Optimizing Basis at *First* Death?

- What about a Joint GPOA Trust? Give each spouse a lifetime GPOA over the other spouse's assets? (fka "poorer spouse funding technique")
- Alan Gassman refers to this as JEST – **J**oint **E**xempt **S**tep Up **T**rust – see Oct/Nov 2013 two part article in *Estate Planning*, which he co-authored with Tom Ellwanger and Kacie Hohnadell
- Several PLRs would deny step up (and even force a step down), but maybe the IRS is wrong – it can easily disavow PLRs
- My take is that the Alaska/TN Community Property Trust is slightly safer at least for mid-size or larger estates, but there are some plausible techniques to get around the IRS interpretation of IRC 1014; and, a JEST is cheaper (no separate ongoing trustee fee)

See page 50-58 of CLE outline

Optimizing Basis at *First Death*?

- Under the JEST plan, a couple would first create a jointly funded revocable living trust (two separate trusts could work as well - my own preference)
- Each spouse would provide the other with a testamentary GPOA, so that some of the assets of the trust, to the extent that there are sufficient assets in the trust, even if originally contributed by the surviving spouse, are included in the estate of the first spouse to die under IRC Sec. 2041. Accordingly, the assets of the **entire** trust obtain a new basis under IRC Sec. 1014 because they are **deemed** to have emanated from the deceased spouse.
- According to the JEST proponents, none of the credit shelter trust formed by the estate of the first spouse to die would be included in the surviving spouse's estate, even though the contributing surviving spouse is a beneficiary.

See page 50-58 of CLE outline

Optimizing Basis at *First Death*: § 2523/1014

Risks of JEST:

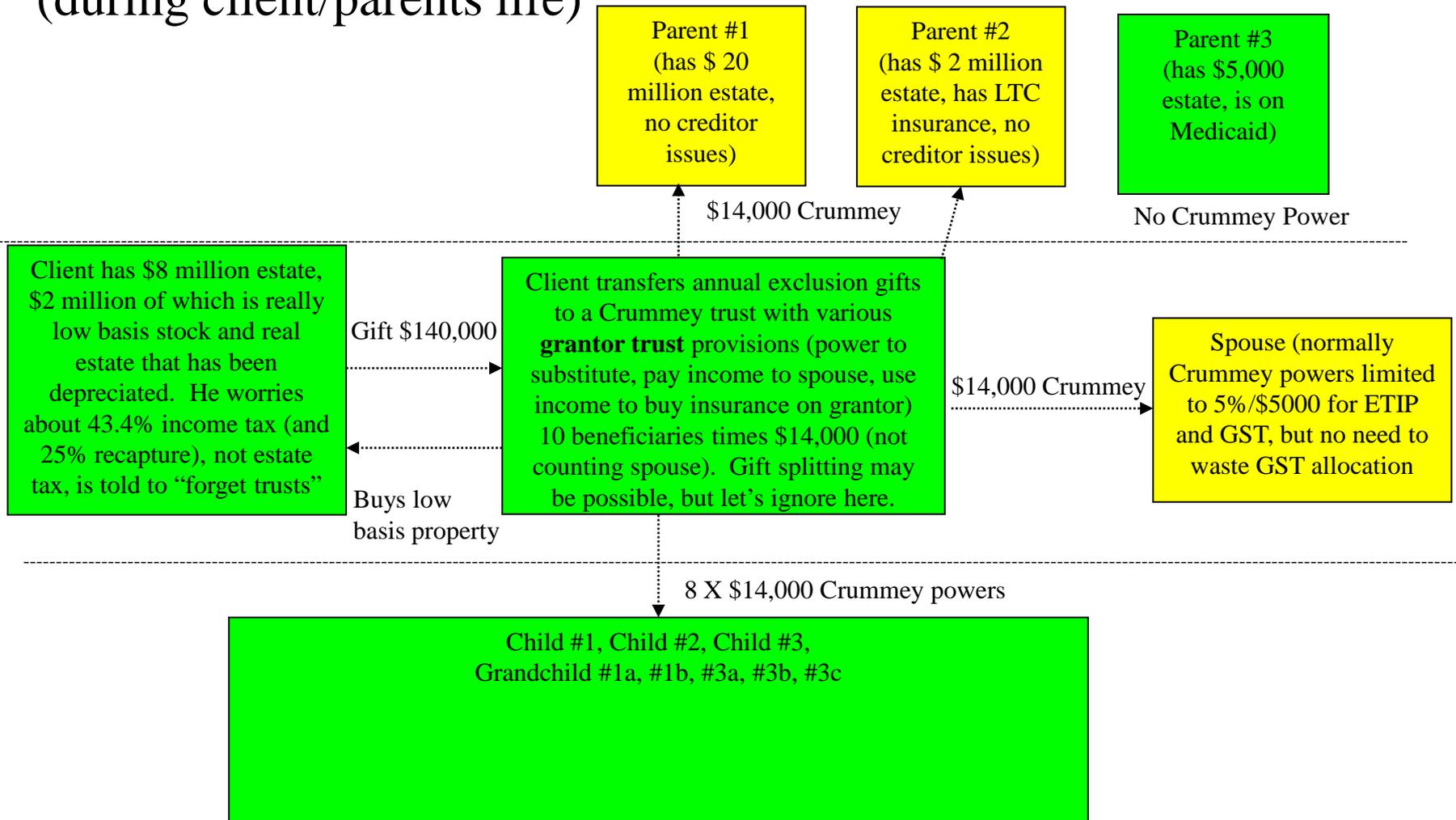
- Inclusion of the credit shelter trust in the estate of the surviving spouse under either IRC Sec. 2036 or 2038.
- Potential loss of creditor protection as to the surviving spouse unless the trust is formed in a DAPT jurisdiction.
- The above are highly unlikely since exercised GPOAs make the powerholder the settlor/grantor for state and tax law.
- The gift on death to the surviving spouse might not qualify for the lifetime marital deduction under IRC 2523. This one is the **most likely risk**, but there are several PLRs which allowed it.
- IRC Sec. 1014(e) could **deny the step up** because the assets go back to the donor within one year of the death of the first spouse to die. Of course, there are arguments against this and techniques to avoid this even if those arguments fail.

See page 50-58 of OBIT white paper outline, CCH article

Income Tax Basis Upstream Planning

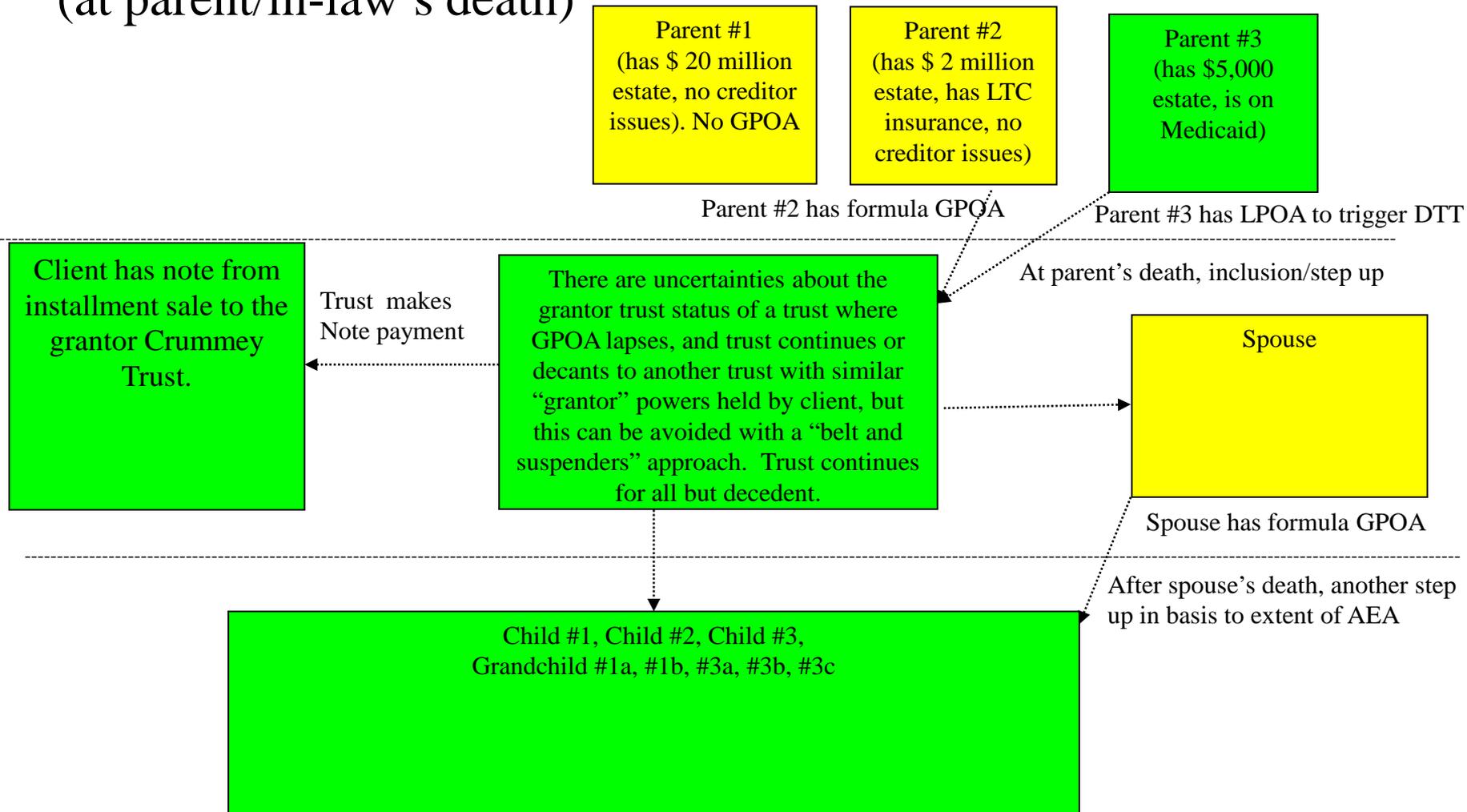
- Consider granting GPOAs in Crummey and other trusts to older beneficiaries, such as parents, parents-in-laws, provided they are appropriately circumscribed as discussed above. See CCH Estate Planning article, The Upstream Crummey Optimal Basis Increase Trust. This largely avoids the 1014(e) and 2523 issues discussed regarding JEST trusts
- This can be especially powerful for clients with low basis assets, especially depreciable assets (or LLC/LPs holding depreciable assets that terminate or make 754 election).

Upstream Gifting Crummey Optimal Basis Increase Trust (during client/parents life)



Typically Crummey powers have 30-60 day withdrawal window. Some complexity can be avoided if Crummey powers are limited to \$5,000/5% of corpus (here, \$50,000/yr), which avoids having to use “hanging powers”. However, with \$10.68 million of applicable exclusion amount to burn, many clients could avoid the complexity of hanging powers or even Crummey powers altogether. Parents, spouse and descendants are named beneficiaries, “wholly discretionary” probably needed to avoid Medicaid issue.

Upstream Gifting Crummey Optimal Basis Increase Trust (at parent/in-law's death)



Uncertainties under 1014(e) if parent dies within one year of gifts and property reverts to client/spouse or trust for client/spouse – avoid by requiring one year “curing”, do not sell the property (1014(e)(2) addresses “sale”) or, as discussed in Morrow/Gassman article, parents might appoint (or lapse causes to pass) property to trust for descendants, and children might have LPOA to appoint to mom/dad.

Income Tax Basis Upstream Planning – How to get more low basis assets “upstream”

- Installment sales to the Crummey grantor trust
- Short term GRATs pouring over into “upstream Crummey”
- Fractional interest discounting
- In short, all the techniques we traditionally use for those clients fortunate enough to otherwise be subject to estate tax

Conclusions – Optimizing Basis Efficiency

- Optimal basis increase trusts (OBITs) have all the upside of a traditional bypass trust, but partially (or fully) negates the two principal downsides (optimizing basis, better income tax options with spraying income or 678a).
- Avoids all the negatives of outright bequests or marital trusts (step down in basis, fractional discounting, trapping income with no spray/gifting ability);
- QTIPs/portability may still be optimal for basis for \$8-9 million estates (e.g. QRP/IRA rollover, \$8-\$9 million estate w/kids from same marriage), but suffer from weaker ongoing tax gifting/shifting options. If higher, it's possible that this combination causes more estate tax than traditional bypass – see comparison chart

Conclusions – More Material

- Updated material will be periodically added to Ed's white paper at <http://ssrn.com/abstract=2436964>
- Al's article, *Back to the Future - The Marital Deduction from Before ERTA to After ATRA*, should be published in ACTEC Journal shortly
- Contact Ed or CCH for CCH Estate Planning Review May 2014 article *The Upstream Crummey Optimal Basis Increase Trust*.

Questions?

Email Ed Morrow at edwin_p_morrow@keybank.com or edwin.morrow3@gmail.com

AI Golden's Law Firm website is at www.igjlaw.com