
Estate Tax Update and Advanced Estate Planning Techniques

Presented by Hal R. Terr, CPA, PFS, CPF, AEP

WithumSmith+Brown

Princeton, New Jersey



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Knowledge is Strength

Estate and Gift Tax after the 2010 ACT

- The Tax Relief Unemployment Insurance Reauthorization, and Job Creation Act of 2010 enacted on December 17, 2010 (the “2010 Tax Act”)
- Federal estate and GST tax is reinstated
- Increased exemption amounts for federal estate, gift and generation-skipping transfer (“GST”) taxes
- Legislation creates major wealth transfer planning opportunities



Historical Perspective

- 2001 legislation – The Economic Growth and Tax Relief Reconciliation Act of 2001 – reduced federal estate taxes over the past ten years
- The federal estate tax exemption amount increased from \$675,000 in 2001 to \$3.5 million in 2009
- The federal estate tax rate was reduced from 55% in 2001 to 45% in 2009
- Estate, gift and GST tax exemption amounts were no longer “unified”



Historical Perspective

- From 2001 to 2009 estate assets received a “step-up” in basis for income tax purposes
- Before the 2010 Tax Act, the federal estate tax was repealed in 2010 and instead applied a modified carryover basis treatment
- If no legislation had been passed in 2010, then beginning in 2011, the federal estate tax would have been reinstated with a \$1 million exemption and the estate tax rate was scheduled to increase to 55%



2010 Tax Act Is Good News for Taxpayers (At Least for Two Years)

- The 2010 Tax Act extends and improves federal estate, gift and GST tax benefits for 2010 through 2012
- The federal estate, gift and GST exemption amounts increase while decreasing the federal estate, gift and GST tax rates
- Effective retroactively from January 1, 2010 through December 31, 2012



Federal Estate and Gift Tax in 2011 and 2012

- Federal estate tax exemption of \$5.0 million (indexed beginning in 2012 in \$10,000 increments)
- Federal estate tax rate is 35%
- Basis step-up continues for estates of decedents dying during 2011 and 2012
- Estate, Gift and GST tax exemption amounts are unified
- Federal gift tax exemption is \$5 million (or \$10 million for a married couple electing “Gift Splitting” or using “Portability”)
- Federal Gift tax rate is 35%
- The next two years provide unprecedented opportunities for lifetime wealth transfers



Federal GST Tax in 2011 and 2012

- Federal GST tax applies to transfers to grandchildren and more remote descendants
- Federal GST tax exemption amount is \$5 million (indexed in beginning of 2012)
- Federal GST tax rate is 35%
- The next two years provide unprecedented opportunities for lifetime generational wealth transfers



State Estate Tax Laws Remain Unchanged

- New Jersey estate tax remains unchanged at \$675,000 exemption
- New York estate tax remains unchanged at \$1 million exemption
- Pennsylvania estate tax remains at zero for 2011 and 2012 but imposition of Pennsylvania inheritance tax remains unchanged



Estates of 2010 Decedents

- Default Rule for 2010 Estates - \$5 million federal estate tax exemption amount, income tax basis step-up treatment and 35% federal estate tax rate
- Optional Election for 2010 Estates – The executor of a 2010 estate may opt out of the federal estate tax and instead elect to have modified carryover basis rules apply
- Extension of time to file 2010 federal estate tax returns and pay estate tax until September 19, 2011 for 2010 decedents dying before December 17, 2010
- No extension of time state estate tax returns



Estates of 2010 Decedents

Modified Carryover Basis Rules

- Basis determined “as if transferred by gift”
- Carryover basis has a basis equal to the lesser of the decedent’s basis or the property’s FMV on the date of death
- Gifted property has the same basis as the donor’s, except when the donee sells the property at a loss, then basis is FMV on date of gift
- If basis determined by carryover basis, then holding period of decedent tacks onto the property
- If basis determined by FMV, then holding period is more than one year.



Estates of 2010 Decedents

Modified Carryover Basis Rules

- \$1.3 million increase to basis to non-spouse beneficiaries
- Increased by Decedent's Unused Capital Losses, Net Operating Losses and Casualty/Theft Losses, built-in losses on business or investment property
- \$3 million increase to Basis for property to Surviving Spouse
- Cannot increase basis over FMV of property at date of death
- Non-Resident Alien basis step-up is only \$60,000



Estates of 2010 Decedents

Modified Carryover Basis Rules

- Only applies to Property “Acquired From” the Decedent
- Property must be Owned by Decedent
- Ineligible Property
 - Gifts to Decedent Within Three Years Other than Spousal Gifts
 - Property the Decedent held a Power of Appointment
 - Income In Respect of a Decedent
 - Stock in any of the Following Entities: Foreign Personal Company, Domestic International Sales Corporation, Foreign Investment Company, Passive Foreign Investment Company



Estates of 2010 Decedents

- Property “Acquired From” the Decedent
 - Property acquired by bequest, devise or inheritance
 - Property acquired by the decedent’s estate from the decedent
 - Property transferred by the decedent during his lifetime to a qualified revocable trust
 - Property transferred during lifetime to another trust over which the decedent reserved the right to alter, amend, or terminate the trust in a way that would change the enjoyment of the trust; and
 - Any other property passing from the decedent by reason of death to the extent that it passes without consideration (JTWROS)



Estates of 2010 Decedents

- Qualified Spousal Property
 - Outright Transfer Property
 - Property acquired from decedent by the surviving spouse
 - Does not include terminable interest property – i.e. life estate
 - Qualified Terminable Interest Property (QTIP)
 - Surviving spouse has qualifying income interest for life
 - Spouse receives income at least annually and no person, except for the spouse, has a power of appointment over the property



Estates of 2010 Decedents

Reporting Requirements For Modified Carryover Basis:

- Statement filed by the Executor with the Decedent's Final Income Tax Return – Proposed Form 8939
- Transfers at Death Reported to IRS for Estates over \$1.3 million
 - Need to Provide Name and TIN of the Recipient of the Property;
 - Accurate Description of the Property;
 - Adjusted Basis of the Property in the Hands of the Decedent and its FMV at time of death;
 - Decedent's Holding Period in the Property;
 - Information to Determine if Gain on Sale of the Property would be Treated as Ordinary Income;
 - Amount of Basis Increase Allocated to the Property under the \$1.3 million and \$3 million basis adjustments; and
 - Any other Information that the regulations may prescribe.



Estates of 2010 Decedents

Methods of Allocating Basis Increase

- Allocation Made by the Executor
- Divide total basis increases among the beneficiaries on a per capita basis
- Allocate basis increase to the assets most likely to sell in the near future
- Allocate to ordinary income property or property passing to beneficiaries in the highest tax bracket
- Allocate basis increases in proportion to each property value as it relates to the total value of all assets available for basis increase, not to exceed FMV
- Allocate basis increases in proportion to each property's appreciation as it relates to the total appreciation in all assets available for basis increase, not to exceed FMV



Estates of 2010 Decedents

Penalties for Failure to File Required Information

- Failure to Report to Beneficiaries or Donees
 - Must be done within 30 days of reporting information to IRS
 - \$50 for each Failure to Report
- Failure to Report to IRS
 - \$10,000 for Failure to File Timely Return
- Reasonable Cause Exception
 - No Penalty Imposed with Respect to any Failure due to Reasonable Cause
- Intentional Disregard
 - Failure to Report due to Intentional Disregard of the Rules is subject to 5% of the FMV of the Property for which Reporting was Required



Summary of 2010 Federal Estate, Gift and GST Tax Laws

- Gift tax exemption amount \$1 million
- Estate tax reinstated – exemption amount \$5 million
- Option to elect out of estate tax and instead elect modified carryover basis
- GST tax reinstated – exemption amount \$5 million
 - Allocate Exemption to Existing ILITs
- Gift and Estate tax rate is 35%
- GST tax rate of 0%
 - Elect out of Automatic Allocation of GST Exemption



Portability

- 2010 Introduces New Concept of “Portability”
- Surviving spouse can use unused portion of federal estate and gift tax exemption amount of the “Last Deceased Spouse”
- Portability does not apply to GST Exemption
- Applies only when Predeceased Spouse dies in 2011 or 2012
- Currently sunsets in two years
- Not as simple as it seems



Portability

- Before Portability
 - Simple Will leaving all property to a Surviving Spouse
“Wasted” the Deceased Spouse’s Exemption
 - Surviving Spouse Received all Assets free of transfer tax under the Unlimited Marital Deduction
 - But on Subsequent Death of Surviving Spouse, only one Exemption was available



“Deceased Spousal Unused Exclusion Amount”

- The question is not how big predeceased spouse’s estate is, but how big the taxable estate is, after application of marital deduction
- That is why you get the same portability effect whether first deceased spouse has a \$50 million estate and leaves it all to a surviving spouse, or first spouse dies penniless
- In either case, the estate uses none of the \$5 million basis exclusion amount, and it is converted into a Deceased Spousal Unused Exclusion Amount (“DSUEA”) for the surviving spouse



Portability Planning Pointers

- Executor of first deceased spouse must file estate tax return on timely basis, even if no tax was due
- Executor must make an affirmative election to allow the surviving spouse to use the unused exemption
- Statute of limitations will remain open indefinitely, but presumably only to determine the proper amount of unused exemption –continues exposure to valuation and inclusion issues



Portability Planning Pointers & Questions

- Complexity and uncertainty abounds
- Only applies to “Last Deceased Spouse”
 - Example: H1 dies (with W as sole beneficiary) and thus W’s applicable exclusion amount becomes \$10 million. If W remarries, and H2 then dies (with no unused exemption of his own), W’s applicable exclusion amount decreases back to \$5 million.



Portability Planning Pointers & Questions

- Surviving spouse who remarries can only pass on his or her own unused exemption
 - Not the DSEUA from spouse number 1
- Mere remarriage does not remove right to unused exemption
 - Example: H1 dies and W's applicable exclusion amount is now \$10 million. If W remarries, and W dies, then her applicable exclusion amount is still \$10 million but H2's applicable exclusion amount is likely only \$10 million, not \$15 million.



Portability Planning

- Credit Shelter Trust (or Disclaimer Trusts) still recommended and beneficial
- Provides professional investment management and asset protection for surviving spouse
- Shelters intervening growth in asset value and accumulated income from estate tax on second death
- Permits use of predeceased spouse's GST exemption
- Protects expectancy of children from diversion by surviving spouse
- Avoids uncertainties and risks associated with remarriage or divorce scenarios under new rules



Chasing the Sunset

- All of the 2010 Tax Act changes will “sunset” and expire at the end of 2012 unless additional legislation is passed.
- 2013 Sunset:

Gift tax exemption amount	\$1 million
Estate tax exemption amount	\$1 million
GST tax exemption amount	\$1.36 million

(indexed from 2011)

Estate, Gift and GST tax rate at 55%



Chasing the Sunset

- If no further legislation is passed before 2013, the federal estate tax exemption amount is scheduled to decrease to \$1 million and the estate tax rate is scheduled to increase to 55%
- Individuals should take advantage of the opportunities presented by the increased exemption amounts of the 2010 Tax Act while they can



Certain Lifetime Wealth Transfer Techniques Still Available

- Irrevocable Life Insurance Trust (“ILITs”)
- Grantor Retained Annuity Trusts (“GRATs”)
- Qualified Personal Residence Trusts (QPRTs”)
- Sales to Intentionally Defective Grantor Trusts (“IDGTs”)
- Valuation Discounts



Immediate Gift Planning Opportunities in 2011

- Annual Exclusion Gifts – still \$13,000 per donee
- Tax-Free Gifts for Tuition and Medical Care if paid directly to provider of services
 - Does not apply to gifts to Qualified State Tuition Program – 529 Plans
- Taxable Gifts:
 - 2010: \$1million lifetime gift exemption in 2010
 - 35% Gift tax rate on taxable gifts over \$1 million
 - 2011: \$5 million lifetime gift exemption in 2011
 - 35% Gift tax rate on taxable gifts over \$5 million
- Doubled with gift splitting



Immediate Gift Planning Opportunities in 2011

- Utilize the additional \$4 million of gift tax exemption to shelter future growth from estate tax – identify assets with highest likelihood for appreciation
- Use high-basis assets for these gifts if possible
- Consider incurring a gift tax at the 35% rate for low-basis assets
- Gift tax paid on the gift will increase cost basis in the hands of the donee (up to FMV of the asset gifted)
- Currently, lifetime taxable gifts reduces future state estate taxes



Lifetime Gifting Tax Exclusive

Nature of Gifts

- Gift tax imposed on the donor is calculated based on the value of the gift passing to the donee – tax exclusive
- Estate tax is calculated based on the total value of the taxable estate, regardless of the net amount passing to the beneficiaries of the estate – tax inclusive



Lifetime Gifting Tax Exclusive

Nature of Gifts (cont'd)

	<u>At Death</u>	<u>By Gift</u>
Net Asset Value	\$1,000,000	\$1,000,000
• Effective Tax Rate	35%	25.93%
• Total Tax	\$(350,000)	\$(259,300)
• Savings		\$90,700



Existing Estate Planning Tools Survive the 2010 Tax Act

- Irrevocable Life Insurance trusts still remain a key planning tool
- Restrictions on Grantor Retained Annuity Trusts (GRATs) were not included in 2010 Tax Act
 - Technique for removing from taxable estate income/appreciation on investment assets in excess of IRS assumed rate
 - Proposed minimum 10 year term and taxable remainder interest



Existing Estate Planning Tools Survive the 2010 Tax Act

- Qualified Personal Residence Trusts (QPRTs)
- Increased availability in light of enhanced gift tax exemption and reduced fair market value of residential real estate
- Intra-family Loans – December Applicable Rates
 - Short-Term AFR (3 years or less) .20%
 - Mid-Term AFR (over 3 years, up to 9 years) 1.27%
 - Long-Term AFR (over 9 years) 2.80%



Grantor Retained Annuity Trust (GRATs)

- GRAT is an irrevocable trust into which a grantor makes a one-time transfer of property
- Grantor retains the right to receive a fixed amount of principal and interest at least annually for a specified term of years
- At the end of the earlier of grantor's death or term of interest, the property remaining in the trust passes to the remainder beneficiaries
- Grantor pays income tax on earnings of property in the GRAT



Grantor Retained Annuity Trust (GRATs)

- Taxable value is calculated based on IRS interest rate (Section 7520 rate)
- Gift tax imposed only on the remainder interest
- For the GRAT to be successful:
 - Grantor must outlive the term
 - GRAT property must appreciate above the Section 7520 rate
 - GRAT document must be properly drafted



Grantor Retained Annuity Trust (GRATs)

- Restrictions on Grantor Retained Annuity Trusts (GRATs) were not included in 2010 Tax Act
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 - Proposed minimum 10 year term and taxable remainder interest



Intentionally Defective Grantor Trust (IDGT)

An IDGT is a type of trust where all income earned by the trust is taxed to the grantor because the trust is considered incomplete (“defective”) for income tax purposes, but completed for estate and gift tax purposes

Defective nature of trust also allows for a “tax-free” gift to the trust’s beneficiaries when grantor pays income taxes otherwise attributable to the trust or its beneficiaries



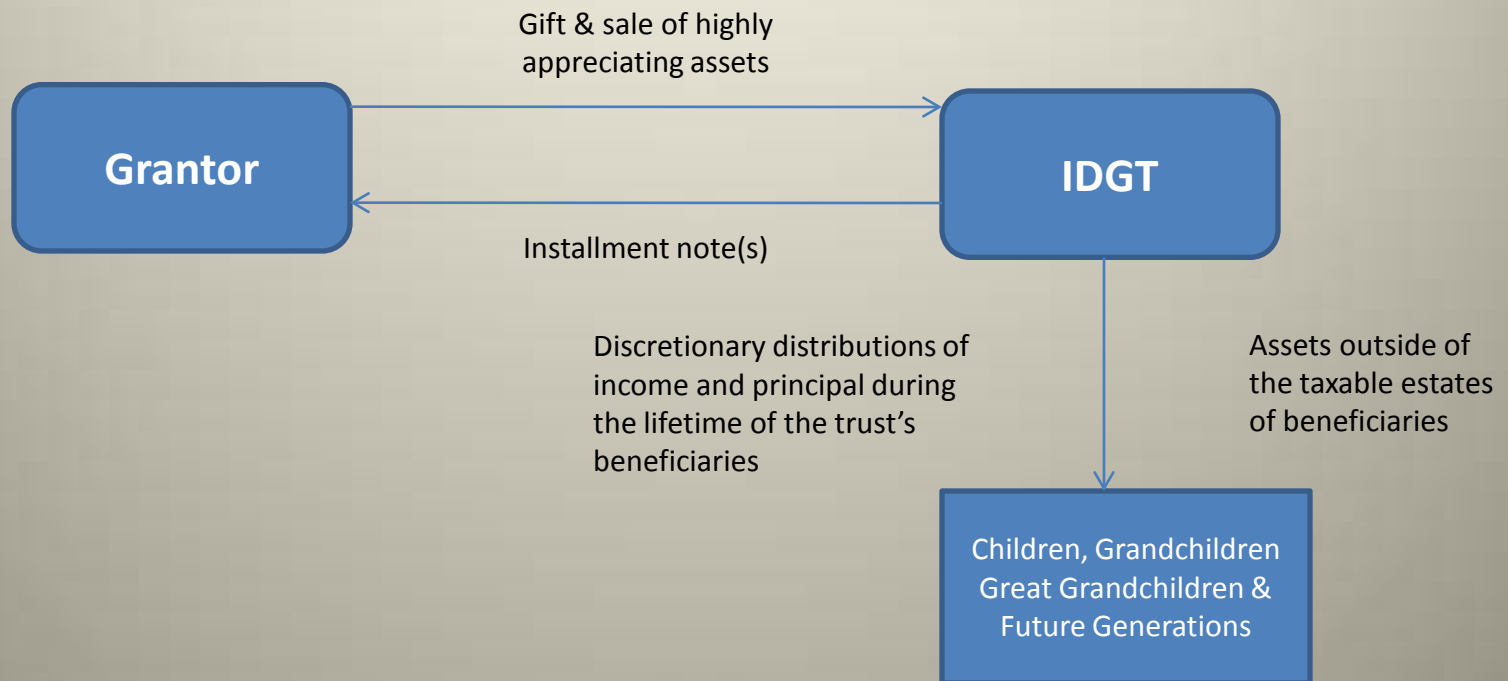
Installment Sales to an IDGT

Summary of Technique

- A type of transaction whereby a grantor sells a highly-appreciating asset to an IDGT in exchange for an installment note
 - Note, however, that the grantor should generally make an initial gift (at least 10% of the total transfer value) to the trust so that it has sufficient capital to make its payments to the grantor
 - To the extent that the growth rate on the assets sold to the IDGT is greater than the interest rate on the installment note taken back by the grantor, the “excess” is passed on to the trust beneficiaries free of any gift, estate and/or GST tax
 - No capital gains tax is due on the installment sale to the trust because the trust is “defective” for income tax purposes
 - Interest income on installment note is not taxable to the grantor because the trust is ‘defective’ for income tax purposes
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Installment Sale to an IDGT

Overview of Technique



Dynasty Trust

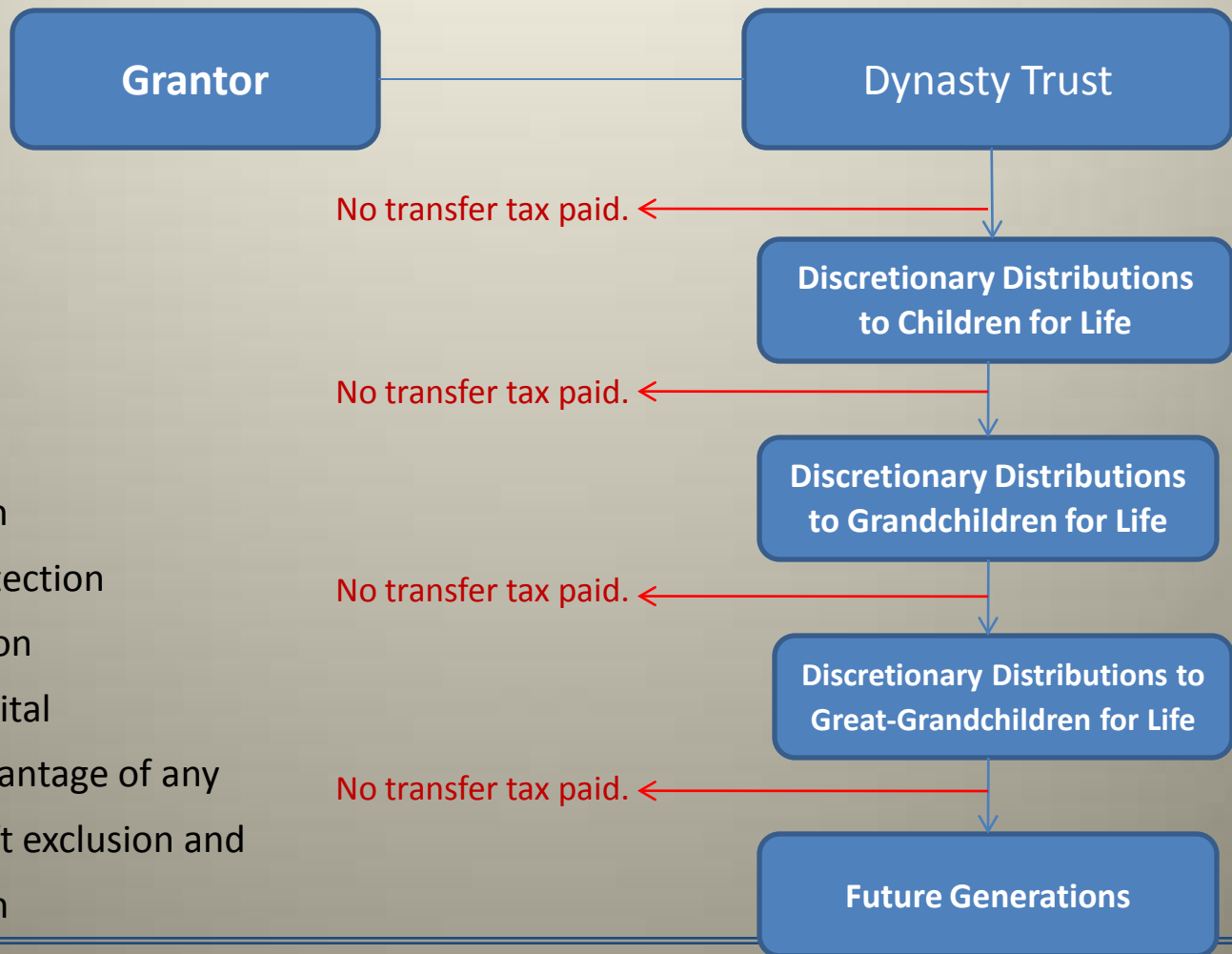
Summary of Technique

- A type of trust which benefits multiple generations where none of the assets held by the trust are included in either the grantor's taxable estate or any of the beneficiaries' taxable estates
- However, under the tax law, whenever a transfer is made by the grantor to a "skip person" (e.g. grandchild, great grandchild, etc.) or a trust for their benefit (e.g. dynasty trust), a second level of tax is imposed on the transfer (in addition to gift tax)
- Notwithstanding, a grantor is allowed a lifetime GST exemption on the first \$5 million of taxable transfers to "skip persons"
- Thus, if the grantor allocates all or a portion of his/her GST exemption to the entire transfer, none of the transfer will be subject to GST tax either in the current year or future years



Dynasty Trust

Overview of Technique



Advantages

- Creditor protection
- Divorce protection
- Estate Tax protection
- Dispositive plan protection
- Spendthrift protection
- Consolidation of capital
- *Gift should take advantage of any remaining lifetime gift exclusion and lifetime GST exclusion

Leveraging Transfers Through Valuation Discounts

- If the value of the transferred assets can be discounted by application of well-established factors, the amount of assets that can be transferred via the increased exemption amount is substantially expanded
- Common discount factors include lack of marketability, lack of control, restrictions on subsequent transfers, and estimated income tax liability on “built-in gains”
- Despite repeated threats of “loophole closing”, valuation discounts withstand IRS scrutiny



Common Vehicles to Qualify for a Discounted Transfer

- Transfers of undivided partial interests in real estate
- Transfers of a partial interest in a family business
 - Recapitalization to voting and non-voting stock
- Transfers of a partial interest in a family holding company, such as an LLC holding investment assets or a co-owned family asset, such as a vacation home



Family Limited Partnerships

Some of the guideline that support bona-fide nature of FLP are as follows:

- Create the FLP using a valid written agreement under state law. (*Estate of Kimbell v. United States, 91 AFTR 2d, 585*);
- Document the non-tax reasons for establishing the partnership;
- Separate partnership assets from personal assets. Clients should attain a separate tax identification number for the partnership, establish a separate bank account for the FLP, and maintain proper books and records. (*Estate of Harper v. Commissioner, 83 TCM 164*);
- Transfer the title of assets contributed to the FLP as soon as reasonably possible. (*Estate of Harper v. Commissioner, 83 TCM 1641*);
- Wait reasonable time for transfer of limited partnership interests after title of assets are contributed to the FLP to avoid indirect gift (*Linton v. United States, 104 AFTR 2d 2009-5176*), (*Heckerman v. United States, 104 AFTR 2d 2009-551*)



Family Limited Partnerships

- Do not contribute the bulk of the transferor's assets to the FLP. Personal residences, automobiles and other personal items should not be used for funding an FLP. (*Estate of Strangi v. Commissioner, 85 TCM 1331*);
- The general partner(s) should manage the FLP pursuant to their fiduciary duty mandated under state law. Generally the investment philosophy of the FLP should not mimic that of the general partner. (*Estate of Kimbell v. United States, 91 AFTR 2d, 585*);
- Make sure all distributions from the FLP are performed on a pro-rata basis as outlined in the partnership operating agreement. (*Estate of Thompson v. Commissioner, 84 TCM 374*);
- Engage in transactions with non-related parties, rather than exclusively with family members. (*Estate of Thompson v. Commissioner, 84 TCM 374*);
- Ensure that the FLP will be a going concern after the death of the original partner.



Charitable Remainder Trust

Irrevocable Trust used to Diversify Concentrated Low-Cost Basis Assets in Tax-Efficient Manner for Charitably-Minded Individuals

- Trust that makes annual or more frequent payments to donor and/or donor's spouse during lifetime. Remaining assets in the trust then pass to a qualified charity
- Donor receives a current income tax charitable contribution deduction for the value of the charity's interest in the trust.



Charitable Remainder Trust

- No immediate taxation on the sale of the asset. Income taxes are paid upon receipt of distributions from the trust. Reinvestment of the full amount of the proceeds can generate larger payments to donor and/or donor's spouse during lifetime.
- If children are income beneficiaries, present value of interest in the trust (as of the donor's date of death) is included in donor's estate.
- Can use income tax savings or portion of distributions to fund Life Insurance Trust to replace assets going to charity.



Charitable Remainder Trust

Charitable Remainder Annuity Trust (CRAT)

- Pays Fixed Amount each year, Regardless of whether there is Sufficient Trust Income Available
- Exists with Fairly Simple Administration
- Inflation may cause Annuity Payment to Lose some of its Value over Time
- Prohibits the Additional Contributions of Assets



Charitable Remainder Trust

Charitable Remainder Unitrust (CRUT)

- Allows Annual Payment to Increase when Value of Trust Property Increases
- Involves More Complicated Administration
- Allows for the Additional Contribution of Assets
- Net Income Only Charitable Remainder Unitrust (NIMCRUT)
 - Pays out Income to Beneficiary only when it Produces Income
 - Prior Year Deficiency Can Be Paid to the Beneficiary when the Trust Earns Income over the Payout Rate



Charitable Remainder Trust

FLIP Charitable Remainder Trust

- Begins as a NIMCRUT and Switches to a Standard Charitable Remainder Trust
- Switch either at Specified Date or Triggering Event
 - Cannot be at the Discretion or Control of Trustee
 - Examples are Sale of Unmarketable Assets, Marriage, Divorce, Death or Birth of a Child
 - Switch Occurs the Beginning of the First Year Following the Year of the Triggering Event or Date Occurs
- Beneficial when Assets used to Fund CRUT are Illiquid and Produce Little or no Current Income (e.g. Raw Land) but Payments can be made when the Asset is Sold



Charitable Remainder Trust

Implementation

- Consult Legal Professional to Draft Trust Agreement
- Select Non-Charitable Beneficiary, Charitable Beneficiary and Trustee
 - Grantor Can Reserve Right to Change Charitable Beneficiary While Alive
- Select Assets to Fund the Trust
- Select the Term of the Trust (Lifetime vs. Term of Years), Annual Payment Amount or Annual Percentage
- Select an Appraiser to Value Unmarketable Assets
- Annual Split-Interest Tax Return Required to be Filed



Charitable Remainder Trust

Example

- Resident New Jersey Couple, both Age 60, Contribute \$1 Million of Appreciated Stock in May 2011 with \$0 Cost Basis to a Charitable Remainder Trust. The Couple will Receive a 9% Payout each year for their Lifetime.
- Assumptions
 - The Investments of the Trust earn 10% per year.
 - Federal Estate Tax Rate of 35%
 - Couple funds an Irrevocable Life Insurance Trust with \$10,000 per year to fund a \$1 million Second-to-Die Insurance Policy.



Charitable Remainder Trust

Results

- No CRT and Sale of Asset
 - After 10 years \$888,235 to Heirs
 - After 20 years \$1,517,234 to Heirs
 - After 30 years \$2,591,655 to Heirs
- No CRT and No Sale of Asset
 - After 10 years \$1,110,294 to Heirs
 - After 20 years \$1,896,542 to Heirs
 - After 30 years \$3,239,568 to Heirs



Charitable Remainder Trust

Results

- Charitable Remainder Trust
 - After 10 years \$517,710 to Heirs and \$1,104,622 to Charity
 - After 20 years \$1,422,122 to Heirs and \$1,220,190 to Charity
 - After 30 years \$2,995,126 to Heirs and \$1,347,849 to Charity
- Charitable Remainder Trust with Replacement ILIT
 - After 10 years \$1,291,066 to Heirs and \$1,104,622 to Charity
 - After 20 years \$2,185,478 to Heirs and \$1,220,190 to Charity
 - After 30 years \$3,768,482 to Heirs and \$1,347,849 to Charity



Charitable Lead Trust

Essentially the Reverse of a Charitable Remainder Trust

- Trust that makes annual or more frequent payments to charity during the term of the trust (either term of years or donor's lifetime). Remaining assets in the trust then passes either back to the donor or transferred to other non-charitable beneficiaries.
- Income stream to charity can either be:
 - CLAT - fixed annuity based on initial Fair Market Value
 - CLUT - specified percentage of trust assets each year
- Two types for income tax purposes
 - Grantor – Donor receives a current income tax charitable contribution deduction for the value of the charity's interest in the trust. All trust income and expenses recognized on donor's individual income tax return.
 - Non-Grantor – No charitable income tax deduction for the donor but trust is a separate tax paying entity.



Charitable Lead Trust

Advantages

- Provides a Gift and Estate Tax Haven for Assets Expected to Appreciate in Value
- Allows Individual to Donate to Charity and Keep Assets Within the Family
- Allows Individual to Postpone the Non-Charitable Beneficiary's Receipt of Trust Assets
- Does not Require any Minimum Percentage Payout to Charity
- Reduces Potential Federal Estate Tax Liability



Charitable Lead Trust

Disadvantages

- Income Tax Deduction available only if the Donor is Considered the “Owner” of the Trust
- Requires an Irrevocable Commitment
- Requires the Charitable Payment to be made Each Year, regardless of whether there is Sufficient Income Available
- Should be Structured as a CLUT if Grandchildren are Ultimate Beneficiary, CLAT if Children are the Ultimate Beneficiary



Charitable Lead Trust

Implementation

- Consult Legal Professional to Draft Trust Agreement
- Select Non-Charitable Beneficiary, Charitable Beneficiary and Trustee
- Select Assets to Fund the Trust
- Select the Term of the Trust (Lifetime vs. Term of Years) and Payment Method (Annuity vs. Unitrust)
- Select an Appraiser to Value Unmarketable Assets
- Annual Split-Interest Tax Return Required to be Filed



Charitable Lead Trust

Example

- Resident New Jersey Individual Contributes \$1 Million of Appreciated Stock in May 2011 to a Charitable Lead Annuity Trust. The Charity will Receive \$70,000 Payout each year for a Term of Years.
- Assumptions
 - The Investments of the Trust earn 10% per year.
 - Federal Estate Tax Rate of 35%



Charitable Lead Trust

Results

- No Charitable Lead Trust
 - After 10 years \$1,160,761 to Heirs
 - After 20 years \$2,072,870 to Heirs
- Non-Grantor Charitable Lead Trust
 - After 10 years \$1,235,736 to Heirs and \$1,115,620 to Charity
 - After 20 years \$1,656,709 to Heirs and \$4,009,250 to Charity
- Grantor Charitable Lead Trust
 - After 10 years \$1,485,488 to Heirs and \$1,115,620 to Charity
 - After 20 years \$2,081,405 to Heirs and \$4,009,250 to Charity



Pre-Immigration Tax Planning

- Estate tax residency is based on citizenship or domicile – no mechanical test
- Factors examined include:
 - The time spent by the individual in the US and other countries.
 - The location of the individual's family, friends and primary service providers.
 - The location of the individual's religious and social activities.
 - The use of a locally issued or an international driver's license.
 - The individual's mailing address for financial statements.
 - The location of the individual's business interests.



Pre-Immigration Tax Planning

- Factors examined include:
 - The location of the individual's most cherished and valuable family possessions.
 - The location of bank and financial accounts. As in the case of investments, the size and degree of use of these accounts are often significant.
 - The domicile (if any) claimed by the individual on official documents. Formal declarations of domicile, visa applications, homestead property tax exemption forms, and similar public documents are often considered strong evidence of intent.
 - The domicile (if any) claimed by the individual on estate planning documents, such as wills and trusts. In the case of a decedent, the selection of the primary probate jurisdiction is crucial for purposes of this analysis.
 - The relative size, cost, value, and nature of dwellings (18.) The particular locality of an individual's dwelling unit. An apartment in a vacation resort is less likely to be accepted as one's domicile than a similar abode in a non-vacation area.
 - The jurisdiction(s) where the individual pays income or related taxes and files tax returns. The IRS places particular emphasis on this factor.



Estate Tax Residency

- Noncitizen/Nonresidents
 - Gift Tax
 - Subject to U.S. gift tax on transfers during life of U.S. situs real or tangible personal property
 - Cash is considered tangible personal property for these purposes
 - No lifetime exemption, though do have benefit of annual exclusion



Estate Tax Residency

- Noncitizen/Nonresidents
 - Estate Tax
 - Subject to U.S. estate tax on transfers at death of U.S. situs real, tangible or intangible property
 - Exemption for bank accounts, but not brokerage accounts
 - Nonresidents entitled to much smaller exemption than U.S. citizens and residents



Pre-Immigration Planning

- Determine the situs of assets
 - To the extent consistent with goals, a gift of non-U.S. assets prior to arrival can save transfer taxes
- Consider transferring assets to others or to trust prior to arrival
 - Watch string provisions if it's a permanent move
- If existing trusts are reachable by string provisions, consider releasing appropriate powers
 - Remember adjustments for certain gifts made within 3 years of decedent's death (IRC 2035)



First Thing You Need to Know When a Client Passes Away

- Do Not Let Anyone Do Anything Without Consulting the Right Advisors
- Jacob Jankelovits et ux. V. Commissioner, T.C. Memo, 20080285, No. 24615-06
 - Bank's failure to give proper information is no excuse



DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS

- Distributions from Qualified Plans or Traditional Individual Retirement Accounts (IRAs) are generally taxable at ordinary income tax rates when received
- Taxation can be deferred if distribution is transferred tax-free to an IRA
- Required Minimum Distributions (RMDs) from IRA when participant attains age 70 ½
- Distributions not taxable from Roth IRAs and account owner is not required to begin RMD at age 70 ½



Revenue Ruling 2005-36

- Year of Death Required Minimum Distribution
 - If not taken by account owner prior to their death, the named beneficiary and not the estate of the decedent is required to take the distribution prior to December 31 in the year of account owner's death
 - IRA beneficiary who takes year of account holder's death RMD can do subsequent disclaimer



Beneficiary Designation Forms

- Periodically review them to be sure that:
 - They still exist
 - They are up-to-date
 - They are in concert with the overall financial and estate plan



“Good” Beneficiary Designation Form

- Names beneficiary
- Names contingent beneficiary
- May allow for contingent, contingent beneficiary
- Allows for disclaimer planning



“Bad” Beneficiary Designations

- Wrong person is named (i.e. former spouse)
 - Divorce does not necessarily override a beneficiary designation form
- No contingent beneficiary
- Estate is the named beneficiary
- Multiple beneficiaries including charity or estate



Beneficiary Determination Date

- Beneficiary is determined on September 30th of the year following death
- Can use this time to “eliminate” a “bad” beneficiary
 - Split accounts
 - Cannot distribute through estate
 - Cannot add a beneficiary
- Beneficiary can disclaim interest
 - Importance of Beneficiary Designation Forms



Rollovers

- Generally, any distribution to an account participant or the spousal beneficiary of a deceased participant can be rolled over to an IRA
- Exceptions are:
 - Any payments that are part of a series of substantially equal periodic payments
 - Any required minimum distribution
 - Any hardship distribution from a qualified plan
- Non-spouse beneficiaries cannot do rollovers



Post-mortem Non-spousal Rollovers

- Effective for tax years beginning after December 31, 2006
 - Non-spousal beneficiaries are permitted to rollover a qualified retirement plan via trustee-to-trustee transfer into an inherited IRA
 - Inherited IRA must be set up under the deceased qualified plan owner's name
 - i.e. John Smith, Deceased IRA, f/b/o Jane Smith (beneficiary)



Company Plan Rollover to Inherited IRA

- Suggestion is to open Inherited IRA first
 - Make sure it is titled correctly and it is an inherited IRA account
- Arrange for Trustee-to-Trustee transfer
 - No IRA relief if not done correctly
 - Not a 60 day rollover so no PLR relief available



Company Plan Rollover to Inherited IRA

- IRS Notice 2008-30
 - IRS ruled that the direct rollover to an inherited IRA can be to an inherited Roth IRA if beneficiary meets income and filing requirements
- Inherited IRA cannot be converted to an inherited Roth IRA



Estate Named as Beneficiary

- RMDs computed as if no designated beneficiary is named
 - Death before Owner's Required Beginning Date (RBD)
 - Entire benefit to be distributed on or before December 31 of the year in which the fifth anniversary of the owner's death occurs
 - Death after RBD - Owner's single life expectancy calculated in the year of death and reduced by one each year thereafter
- If spouse is beneficiary of estate and authority to direct distributions to him/herself (i.e. executor), then spousal rollover is allowed



Spousal Rollovers and Transfers

- Spouses are the only beneficiaries who can take a deceased spouse's interest in a retirement plan and make it their own
- They are also the only one who can get a (former) spouse's interest in a retirement plan in a tax-free transaction (i.e., QDRO for qualified employer plans)



Spousal Options

- Spouse can treat decedent's IRA as their own if SOLE beneficiary
- Spouse can rollover his/her share of account into his/her own IRA even if not sole beneficiary
 - Any year of death required distribution must be taken first prior to rollover or treating as own
 - Spouse becomes owner and all rules apply (e.g. early distributions prior to age 59 ½)



PLR 2004-50057

- Under 59 ½ spouse beneficiary permitted to rollover husband's plan benefits into IRA in husband's name with wife as beneficiary
- Wife is then able to avoid 10% penalty for distributions received as beneficiary
- After attaining age 59 ½, spouse can rollover balance into IRA in own name



Non-Spouse Beneficiary

- Account Owner Death Before RBD
 - Entire benefit to be distributed on or before December 31 of the year in which the fifth anniversary of the owner's death occurs
 - Minimum distributions to a designated beneficiary over beneficiary's life expectancy must begin by December 31 of the year after the year in which the owner died



Non-Spouse Beneficiary

- Account Owner Death After RBD
 - If No Designated Beneficiary – Owner's single life expectancy calculated in the year of death and reduced by one each year thereafter
 - Non-Spouse Designated Beneficiary – Beneficiary's single life expectancy calculated in the year of death and reduced by one each year thereafter. Can use longer of owner's or beneficiary's life expectancy
 - Use Single Life Table to determine life expectancy



Non-spouse beneficiary

- Death of beneficiary (after determination date) has no effect on post-death distribution schedule
- Beneficiary can name a beneficiary to avoid probate in beneficiary's estate
 - Contingent beneficiary has no rights to account once primary beneficiary has accepted account



Trust as beneficiary

- It may be beneficial to name trust as beneficiary:
 - Protect children of a prior marriage
 - To fund credit shelter trust so not to waste estate exemption
 - Management of IRA assets/distributions for beneficiaries not capable to manage on their own



Qualified Trust as Beneficiary

- Under Reg. 1.401(a)(9)-4, a trust is considered qualified if:
 - Valid trust under state law;
 - Irrevocable or will become irrevocable upon the death of account owner;
 - Trust beneficiaries are properly identifiable from the trust document; and
 - Proper documentation has been provided to the administrator of the plan or IRA by September 30 after death of account owner.



Qualified Trust as Beneficiary

- QTIP trust as beneficiary
 - Used to control distribution of remaining plan assets
 - RMD based on spouse's life expectancy
 - Cannot delay until spouse attains age 70 ½
 - Spousal rollover is not allowed



Qualified Trust as Beneficiary

- Credit shelter trust as beneficiary
 - Not best asset to fund credit shelter trust since it is a depleting asset (IRD property)
 - Used if other assets are not available to utilize estate exemption
 - If spouse is beneficiary, use spouse's life expectancy to determine RMD
 - If spouse is not a beneficiary, use oldest child's life expectancy to determine RMD



Disclaimers

Rules for Disclaimers

- Must be in writing
- Must be made no more than 9 months after the later of the death or beneficiary attaining age 21
- Beneficiary cannot have accepted any benefits
 - Cannot trade securities within the account
- Account will pass without any direction on the part of the disclaimant to either the account owner's spouse or to a person other than the disclaimant



Disclaimers

Special Rule for 2010

- Date for disclaimer extended to September 17, 2011
- Nine months from the date of the 2010 Tax Relief Act



Disclaimers

- Spouse is primary beneficiary and credit shelter trust is contingent beneficiary
 - Spouse can disclaim all or part to make sure credit shelter trust is funded
- Child is primary beneficiary and credit shelter/marital trust is contingent beneficiary
 - Only works if child disclaims interest in account and trust (two disclaimers needed)



Disclaimers

- Child is primary beneficiary and Spouse is contingent beneficiary
 - Child can disclaim the IRA
 - Spouse can rollover IRA into account in his/her own name
 - Spouse names child as beneficiary of new IRA



Disclaimers

- Spouse is primary beneficiary, child is contingent beneficiary and grandchild is contingent contingent beneficiary
 - Spouse disclaims all or part and it goes to child
 - Child disclaims all or part and it goes to grandchild
 - Can utilize GST exemption
 - If split prior to September 30, each beneficiary gets own life expectancy



Net Unrealized Appreciation

- Exception to distributions taxed at ordinary income tax rates is the Net Unrealized Appreciation (“NUA”) rules
- Available when employer stock is an investment option in qualified retirement plan
- NUA is the difference between the fair market value of the stock at distribution and the cost basis
- Cost basis is the value of the stock when it was contributed to or purchased by the plan



How Does NUA Strategy Work?

- Lump-sum distribution of qualified plan
 - Must be a distribution of participant's balance within a single calendar year from all of employer's qualified plans of the same type
 - Distribution must be paid after participant reaches age 59 ½ or as a result of separation of service, disability or death
 - If separation of service is after age 55, 10% penalty for early distribution from qualified plan does not apply



How Does NUA Strategy Work?

- Qualified Employer Stock
- Must be issued by the employer
- Directly contributed to the plan by the employer or purchased with pre-tax dollars contributed by either the employee or employer
- Withdrawn from the plan in-kind as part of a lump sum withdrawal
 - Does not apply if the employer stock is liquidated and taken in cash



How Does NUA Strategy Work?

- Participant pays ordinary income tax on the value of the stock received up to the cost basis
- Income tax on NUA is deferred until the employer stock is sold, which can be after the participant attains age 70 ½
- NUA is taxed at preferential capital gains tax rates (currently 15%) upon subsequent sale of stock
- NUA is taxed at long-term rates no matter how long owned outside of the plan, even if only 1 day



How Does NUA Strategy Work?

- Appreciation above NUA is taxed under regular holding period rules
- Non-employer stock investments can be rolled over tax-free to an IRA
- Available to the participant and beneficiary of the qualified retirement plan
- Not required to receive entire balance of employer stock as in-kind distribution
- Opportunity is lost once the employer stock is rolled over to an IRA



Inherited IRA

- IRA is Income Respect to Decedent
 - Income tax deduction for the estate tax attributable to IRD property
 - Determined by computing Federal estate tax with and without IRD property, the difference between two amounts is the deduction
 - Allocated on pro-rata basis when distributions are received
 - Schedule A miscellaneous deduction not subject to 2% AGI limitation or AMT



Questions

- Hal R. Terr
 - Phone: 609-520-1188 x1157
 - Email: hterr@withum.com

