

Best Vehicles for Estate Tax Planning Now – and Best Ways to Draft Them

SLATs, DAPTs, GRATs, SPATs, Split Purchase TrustsSM and more
 By: Jonathan G. Blattmachr, Esq. and Martin M. Shenkman, Esq.

PEAK TRUST COMPANY
 Financial Trust & Wealth Management Solutions

InterActive Legal

A KEY ESTATE PLANNING GUIDE Law Easy

1

1

Best Vehicles for Estate Tax Planning Now – and Best Ways to Draft Them

Handout materials are available for download or printing on the HANDOUT TAB on the gotowebinar console. If the tab is not open click on that tab to open it and view the materials.

PEAK TRUST COMPANY
 Financial Trust & Wealth Management Solutions

InterActive Legal

A KEY ESTATE PLANNING GUIDE

ChronicIllnessPlanning.org

2

2

General Disclaimer

- The information and/or the materials provided as part of this program are intended and provided solely for informational and educational purposes. None of the information and/or materials provided as part of this power point or ancillary materials are intended to be, nor should they be construed to be the basis of any investment, legal, tax or other professional advice. Under no circumstances should the audio, power point or other materials be considered to be, or used as independent legal, tax, investment or other professional advice. The discussions are general in nature and not person specific. Laws vary by state and are subject to constant change. Economic developments could dramatically alter the illustrations or recommendations offered in the program or materials.

3

3

Thank you to our sponsors

- InterActive Legal
 - Vanessa Kanaga
 - (321) 252-0100
 - sales@interactivelegal.com







4

4


Thank you to our sponsors

- Peak Trust Company
 - Nichole King
 - Phone: 702.462.6677
 - Toll Free: 844.391.2789
 - NKing@peaktrust.com




5

5



**AMERICAN
BRAIN
FOUNDATION**

Jane Ransom, Executive Director
jransom@americanbrainfoundation.org
 AmericanBrainFoundation.org

6

6

Introduction and Overview

Planning In the Current Environment

7

7

Introduction

- The presenters will consider several strategies (planning vehicles) and various options for each – domestic asset protection trusts (DAPTs and variations of them), spousal lifetime access trusts (SLATs), special power of appointment trusts (SPATs), and more.
- We will demonstrate drafting documents to implement the different strategies, illustrating the power of document drafting software, so that attorneys aren't starting from scratch when drafting complex structures.
- This webinar will provide an overview of "high-end" strategies that clients should implement now before the tax planning landscape may change yet again.

8

8

Specific Trusts for the Current Environment: How to Plan and Draft Them

1. **SLATs** – spousal lifetime access trusts that permit each spouse to be a beneficiary of the trust created by the other spouse
2. **DAPTs** – self-settled domestic asset protection trusts that permit access by naming the grantor as a beneficiary
3. **Hybrid DAPTs** – non-self-settled trusts that permit access by giving someone a non-fiduciary power to add beneficiaries from a class that includes the grantor.
4. **GRATs** – Grantor retained annuity trusts.
5. **SPLATsSM** – Split purchase annuity trusts - two parties purchase an interest in an asset (e.g. the client and a GST exempt trust) and share ownership much like a GRAT
6. **SPATs** – Special power of appointment trusts that permit access but avoid self-settled trust status.
7. **Split Purchase TrustsSM** – Like a SPLAT, but for real property
See BNA Portfolio 8362nd (3rd is in process) for sample SPLAT and Split Purchase Trust

9

9

This is Planning for the CLIENT Not Just Heirs

- Asset protection benefits the client, not just the client's heirs. Litigation and bankruptcies increase when the economy falters, hence the uncertainty in the current environment makes asset protection planning quite important.
- Non-grantor trust status (e.g., so-called "ING Trusts") may also save the client current income taxes (given the likelihood of rates increasing to pay for bailouts). Lower income taxes is the same as building wealth. We will not, however, address non-grantor trust planning in this presentation due to time limitations.

10

10

Current Planning Environment

- **Values:** Suppressed asset values (at the time of this writing the stock market has declined about 20% from its highs, and businesses are hemorrhaging during stay home orders). Discount rates may be higher because of uncertainty.
- **Interest:** Interest rates are at near historic lows (the Section 7520 rate for April 2020 is 1.2%). Rev. Rul. 2020-09. For comparison, in 1989, the Section 7520 rate was at a high of nearly 12 percent, and in March of 2009, it was almost 3 percent. Family loans, note sale transactions, and GRATs are a techniques that are enhanced when interest rates are low.
- **Deficits and Taxes:** The massive federal bailout – and more may be coming – will eventually require that taxes on the wealthy (and the not-so-wealthy) be raised. While no one can forecast what tax law changes may occur, it seems logical that estate taxes will increase, perhaps markedly so. Therefore, shifting assets out of an estate using current favorable laws, such as by using note sales to grantor trusts, GRATs, etc., may prove very advantageous.

11

11

Goals to Address in Planning

- **Access:**
 - Most clients will not shift significant wealth if they cannot have access to that wealth
 - The current economic problems (recession?), stock market decline, and uncertainty exacerbate the need for access if clients are to plan now
 - The techniques to use now are more robust and different than what many practitioners did in 2012 (and we all recall some "buyer's remorse" with 2012 planning)
- **Exemption:** Use of exemption and estate reduction before laws become less favorable
 - Plan to reduce client's estates before tax laws are changed to be harsher
 - In 2026 the exemption declines by half
- **Asset protection:**
 - All planning should protect assets for the client as well. This will help motivate clients to act. It's not just about helping heirs but protecting the client as well.
- **Wealth Tax:** Possibly avoiding a future wealth tax

12

12

How I Use Document Generation Software

- Document generation software lets you mold the planning and documents to the client, rather than molding the client into the forms you happen to have in your form library.
- We will explain the benefits of using document generation software to create each of the strategies/documents that should be considered.
- Document generation software can help you create robust, flexible, documents tailored to each client's individual circumstances.
- Many attorneys have administrative staff draft documents based on notes. I, however, usually collaborate with an experienced attorney to draft documents. Drafting using software is quick and having two attorneys draft at the same time permits careful consideration of the myriad of options document generation software can offer, results in a better end document, and dramatically reduces revisions after the document is created.
- We use GoToMeeting to collaborate and draft while out of the office

13

13

1. SLATs – Spousal Lifetime Access Trusts

Benefitting Grantor's Spouse Without Creditor Issues or Estate Tax Inclusion

14

14

SLATs: How They Work

- Each spouse creates a trust for the other spouse, avoiding the state law creditor and tax Reciprocal Trust Doctrines.
- This occurs by making the trusts sufficiently different so the doctrines will not apply.
- The trusts can be created at different times, with different assets and trustees, and with very different terms.

15

15

SLATs: How to Make Them Work

- Create each SLAT in a different state. This is simple with document generation software, you merely select the state for each.
- In one trust, the beneficiary spouse can be entitled to distributions each year, have a lifetime broad special power of appointment, can change trustees (within Rev. Rul. 95-58 safe harbor), withdraw under HEMS.
- In the other trust, the beneficiary spouse would have no entitlement to distributions (perhaps is not even a current beneficiary), no power to change trustees, and no power of appointment, but could become eligible to receive a distributions only upon exercise by a trusted child of a power to add beneficiaries.
- You can readily select different options for each trust using document generation software, or use preselected forms that incorporate differences.
- Do not let child know of her right to receive distributions until after trust is created.
- A detailed checklist follows at the end of this section of the PowerPoint.

16

16

SLATs: Additional Ways to Provide Grantor Access - 1

- **Loans:** Consider granting to someone the power, in a non-fiduciary capacity, to loan the grantor trust assets. Some might refer to this as a "loan director," but other titles might be used as well. A loan director can determine to loan funds to grantor of the SLAT without adequate security for the loan (but the loan director could be required to charge adequate interest to avoid tax issues). This mechanism provides the grantor another means to access trust assets should the grantor require them.
- **Charity:** You might also infuse another means of the grantor indirectly "accessing" funds in a SLAT. Give someone, in a non-fiduciary capacity, the power to add charitable beneficiaries. This person might be called a "charitable director," but other titles might be used as well. A charitable director can determine to add charitable beneficiaries to a SLAT. This provides the grantor an indirect means of "access" to the SLAT by making a charitable donation the charitable director can add the charity to the SLAT and the donation can be made out of SLAT funds not the grantor's funds. However, the SLAT cannot pay a charitable pledge of the grantor.

17

17

SLATs: Additional Ways to Provide Grantor Access - 2

- **Vacation Home:** A SLAT could own an interest in a vacation home. And if the grantor's spouse/beneficiary uses the vacation home, the grantor presumably can as part of the spouse's family. Bear in mind if that is to be done a limited liability company ("LLC") should be formed in the state where the SLAT is governed and administered. That LLC should be authorized to do business in the state where the vacation home is located. That LLC would own the vacation home property and in turn the trust could own some or all of the interests in the LLC.
- **Income Tax Reimbursement:** If the SLAT is structured to be a grantor trust (i.e., the grantor pays the income tax on trust income) consider including a discretionary income tax reimbursement clause. This permits the trustee of your SLAT, in the trustee's discretion (it cannot be mandatory) to reimburse the grantor for income tax paid on trust income. A tax reimbursement provision can add valuable flexibility and access to the grantor.

18

18

Checklist of Differences to Integrate into SLATs - 1

25

- The following checklist is from Steiner and Shenkman, "Beware of the Reciprocal Trust Doctrine," *Trusts & Estates* magazine:
- Draft the trusts pursuant to different plans. A separate memorandum or portions of a memorandum dealing with each trust separately may support this.
- Don't put a husband and wife in the same economic position following the establishment of the two trusts. For example, the husband could create a trust for the benefit of his wife and issue, and the wife could create a trust for the benefit of her issue, in which her husband isn't a beneficiary. Or one spouse could be a beneficiary of the trust he creates, if the trust is formed in an asset protection jurisdiction such as Alaska, Delaware, Nevada or South Dakota, and the other spouse could create a trust in which he isn't a beneficiary (that is, a trust that's not a domestic asset protection trust).
- Use different distribution standards in each trust. For example, one trust could limit distributions to an ascertainable standard, while the other trust could be fully discretionary. However, limiting distributions to an ascertainable standard reduces flexibility may prevent decanting and may expose the trust assets to a beneficiary's creditors.

25

Checklist of Differences to Integrate into SLATs - 2

26

- Use different trustees or co-trustees. If each spouse is a trustee of the trust the other spouse creates, add another trustee to one or both trusts. If adding another trustee to each trust, consider adding a different trustee for each trust and using different institutional trustees.
- Give one spouse a noncumulative "5 and 5" power, but not the other. This power permits the holder to withdraw up to the greater of \$5,000 or 5 percent of the trust principal each year. The amount the powerholder could have withdrawn at the time of death is includible in his estate. However, the lapse of the power, not in excess of the greater of \$5,000 or 5 percent of the trust assets each year, isn't considered a release of the power includible in the powerholder's estate²⁴ or a taxable gift. However, this power may expose assets of the trust to the powerholder's creditors.
- As in *Levy* and PLR 9643013, give one spouse a special power of appointment, but not the other. However, the absence of a power of appointment reduces the flexibility of the trust. This might be viewed as particularly significant in light of the continued estate tax uncertainty.

26

Checklist of Differences to Integrate into SLATs - 3

27

- Give one spouse the broadest possible special power of appointment²⁶ and the other spouse a special power of appointment exercisable only in favor of a narrower class of permissible appointees, such as issue, or issue and their spouses.
- Give one spouse a power of appointment exercisable both during lifetime and by will and the other spouse a power of appointment exercisable only by will.
- In the case of insurance trusts, include a marital deduction savings clause in one trust, but not the other. A marital deduction savings clause provides that if any property is included in the grantor's estate because the grantor dies within three years after transferring a policy on his life to the trust, some or all of the proceeds of the policy is held in a qualified terminable interest property trust²⁸ or is payable to the surviving spouse outright. Alternatively, if each trust has a marital deduction savings clause, the provisions of the two could be different.

27

Checklist of Differences to Integrate into SLATs - 4

28

- Create different vesting provisions for each trust. For example, the two trusts could mandate distributions at different ages, or in a state that has repealed or allows a transferor to elect out of the rule against perpetuities, one trust could be a perpetual dynasty trust. However, mandating distributions severely reduces the flexibility of the trust, throws the trust assets into the beneficiary's estate for estate tax purposes and exposes the assets to the beneficiary's creditors and spouses.
- Instead of mandating distributions, give the beneficiaries control or a different degree of control, at different ages. For example, the ages at which each child can become a trustee, have the right to remove and replace his co-trustee, and have a special power of appointment could be different in each trust.
- Vary the beneficiaries. For example, one spouse could create a trust for the spouse and issue, and the other spouse could create a trust just for the issue. Note that if, for example, the husband creates a trust for his wife and their first child, and the wife creates a trust for her husband and their second child, the gifts could still be viewed as reciprocal.

28

Checklist of Differences to Integrate into SLATs - 5

29

- Create the trusts at different times. In *Lueders' Estate v. Commissioner*, a husband and wife each created a trust and gave the other the power to withdraw any or all of the trust assets. Inasmuch as the trusts were created 15 months' apart, the Third Circuit, in applying *Lehman*, held that there was no consideration or *quid pro quo* for the transfers. However, it should be noted that *Lueders* preceded *Grace*, in which, while the trusts were created two weeks apart, the Supreme Court held that the motive for creating the trusts wasn't relevant. If the difference in time is a factor post-*Grace*, a short time might be sufficient in light of *Holman v. Comm'r*, in which a gift of partnership interests six days after the formation of the partnership wasn't a step transaction. The closer we get to the end of 2012 and the possible end of the \$5.12 million gift tax exempt amount, the more difficult it will be to interpose any meaningful time difference between the formation of the two trusts. Practitioners should also bear in mind that if the same transaction includes funding an LLC, then making gifts to the trusts that are to qualify for fractional interest or other discounts, they will be dealing with the challenge of two dating issues: the difference between the trusts, and the maturation period of assets in the LLC prior to gift or sale.

29

Checklist of Differences to Integrate into SLATs - 6

30

- Contribute different assets to each trust, either as to the nature or the value of the assets. However, if the purpose is to contribute \$5.12 million to each trust, it may not be feasible to contribute assets of different value, and in any event varying the value of the trust only serves to reduce the amount to which the reciprocal trust doctrine may apply. Contributing different assets may not negate the application of the reciprocal trust doctrine, since the assets in a trust may be susceptible to change over time. However, if one trust is funded with non-liquid assets, or assets subject to contractual restrictions on sale (e.g., operating agreement restrictions on transfer of interests in an LLC) that may be viewed as a more meaningful difference in assets that may not be susceptible to ready modification.

30

Should Both or Only One Spouse Fund a SLAT? - 1

[Redacted]

- **Example - 1:** Husband and wife have a combined estate of \$16 million and are willing to make \$8 million in total gift transfers in 2020 to safeguard a portion of their temporary exemptions. If each of husband and wife transfer \$4 million to a non-reciprocal spousal lifetime access trust ("SLAT") they will have safeguarded \$8 million of exemption (and any future growth on those assets) in case the law changes. In 2026 when the exemption declines by half, to \$5 million each (ignoring inflation adjustments) each spouse will be left with \$1 million of exemption. So if you add the \$4 million each spouse used in the 2020 planning and the \$1 million each has left in 2026, the couple will have preserved \$10 million of exemption. Good, but they can do better. If in 2020 with a Dem sweep and the estate tax exemption is reduced to \$3.5 million, the couple will have no further exemption left, but they'll be hugging their estate planning for having helped them safeguard \$8 million before those changes.
- But then the total exemption safeguarded is only \$8 million. Is that optimal? Maybe. But perhaps not. Consider having one spouse, not both, use current exemption thereby preserving more exemption for future planning.

31

31

Should Both or Only One Spouse Fund a SLAT? - 2

[Redacted]

- **Example - 2:** Assume the same facts as in the above example. Husband and wife have a combined estate of \$16 million and are willing to make \$8 million in transfers to irrevocable trusts to secure a portion of their temporary exemptions. But instead of setting up two non-reciprocal SLATs as in the above example, the wife gifts \$8 million to a DAPT. Her husband and all descendants are beneficiaries of the trust. So with husband as a beneficiary, so long as he is alive and they remain married she has indirect access to the \$8 million through husband. You could incorporate a mechanism into the trust to add wife in as a beneficiary in the future (see hybrid DAPT below) just in case her husband dies prematurely or divorces. If the exemption drops to \$5 million in 2026 as the law currently provides. Wife used \$8 million of her exemption so she'll have none left. But, since husband did not use any of his exemption in the plan, he will still have \$5 million of exemption left in 2026. So his \$5 million of exemption and the \$8 million of exemption the wife used in 2020 means the couple has preserved \$13 million of exemption, \$3 million more than had they used the non-reciprocal SLAT approach in the prior example.

32

32

2. DAPTs – Domestic Asset Protection Trusts

No Longer Void Everywhere in the US: 19 States Permit

[Redacted]

33

33

DAPTs: What They Were

- General rule throughout the US before 1987: any trust from which a distribution may be made to the Grantor by the Trustee is considered "self-settled" and the trust property was permanently subject to the claims of the Grantor's creditors regardless of the motivation for creating the trust. It is just a rule.
- New York EPTL 7-3.1 says "A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator."
- Section 548(e) of the US Bankruptcy Code pulls into the bankruptcy estate any self-settled trust or similar device if it was created to hinder, delay or defraud a creditor and bankruptcy is commenced within ten years.

34

34

DAPTs: What They Are Now

- Alaska enacted AS 34.4.110 providing complete asset protection for a self-settled trust if the Grantor was not trying to defraud a known creditor (plus other requirements).
- Now 19 states protect self-settled trusts from claims of the Grantor's creditors.
- Does this work in other states? It's not certain, but likely if all "Ps and Qs" are followed—e.g., all persons and assets involved are in a "DAPT" state.
- The trust should be excluded from the Grantor's gross estate if the gift to the trust is complete. See Rev. Rul. 76-103, Rev. Rul. 2004-64, and PLR 200944002 (not precedent). This may provide a complete "bullet proof" reason for creating the trust.

35

35

DAPT Planning and Drafting Options

- Have assets held in underlying LLC that DAPT holds only a non-controlling interest in.
- Perform lien and judgement searches, have a balance sheet, and have client sign a solvency affidavit regardless of whether state law requires.
- Consider client changing domicile to DAPT jurisdiction if feasible. With 19 states having DAPT legislation there may be a nearby state.
- Prohibit distributions for 10 years plus 1 day to avoid 548(e) of the Bankruptcy code.
- Prohibit distributions if grantor is married as spouse can receive distributions.
- Prohibit distributions if grantor's net worth is in excess of some stated amount.
- Provide a non-fiduciary the power to remove the grantor as a beneficiary.
- Using document generation software makes it easy and efficient to select from a range of options that might be appropriate for any particular client's circumstances.

36

36

DAPTs – Drafting Options

- Grantor ability to become beneficiary only after a period of time

BENEFICIARY IDENTIFICATION

Grantor is to be a beneficiary (or only beneficiary) who may receive distributions from the trust during the Grantor's lifetime

Yes No

Purpose of self-settled trust

Asset protection only (not estate tax exclusion) Estate tax exclusion

Grantor eligible to receive distributions from the trust only after a certain period of time after property is transferred to trust.

No

Yes, only after one year

Yes, after ten years and one day

Yes, using a custom period

One or more beneficiaries (other than the grantor) be granted Crummey powers of withdrawal in order to be able to qualify transfers to this self-settled trust for the gift tax annual exclusion

Yes No

Grantor involved in any pending or threatened court action Grantor involved in any administrative proceeding

37

DAPTs – Drafting Options

- Multiple Beneficiary Options

ADDITIONAL BENEFICIARY DETAILS

BENEFICIARY DETAILS

Trust beneficiaries during the grantor's lifetime

The grantor only

The grantor and the grantor's spouse only

The grantor, the grantor's spouse and the grantor's descendants

The grantor, the grantor's spouse, the grantor's descendants and the spouses of the grantor's descendants

The grantor and the grantor's descendants

The grantor, the grantor's descendants and the spouses of the grantor's descendants

The grantor and a custom drafted class of other beneficiaries

The grantor, the grantor's spouse and a custom drafted class of other beneficiaries

38

DAPTs – Drafting Options

- Grantor not a beneficiary if spouse is a beneficiary
- Grantor can be removed as a beneficiary

DETAILS ON GRANTOR ELIGIBILITY

Grantor will be eligible to receive distributions from the trust only at such times, if any, that the grantor is not married to and living with another as a married couple

Someone will be able to permanently eliminate the grantor as a beneficiary of the trust

Who will be allowed to eliminate the grantor as a trust beneficiary

The trustee(s) (other than the grantor who is serving as a trustee)

The trust protector

Other person

39

DAPTs – Drafting Options

- State Law Requirements/Fraudulent Transfers

Grantor eligible to receive distributions from the trust only after a certain period of time after property is transferred to trust.

No
 Yes, only after one year
 Yes, after ten years and one day
 Yes, using a custom period

One or more beneficiaries (other than the grantor) be granted Cummeys powers of withdrawals in order to qualify transfers to this self-settled trust for the gift tax annual exclusion.

Yes, 10%
 No

Grantor involved in any pending or threatened court action Grantor involved in any administrative proceeding

- Reversionary Disclaimer Option

Reversionary Disclaimer

Include option to provide for "reversionary" disclaimer Name of the person who should be regarded as the Principal Beneficiary of the trust and who may disclaim gifts made to the trust

40

Sample DAPT Provisions - 1

- Distributions to Grantor, Spouse and Descendants During Grantor's Lifetime**
- During the Grantor's life, the Trustee shall administer the trust (the "Lifetime Trust") pursuant to this paragraph:
- The Trustee may, but shall not be required to, distribute as much of the net income and/or principal of the Lifetime Trust as the Trustee may at any time and from time to time determine to such one or more of the Grantor, the Grantor's Wife and the Grantor's descendants in such amounts or proportions as the Trustee may from time to time select for the recipient's health, education, maintenance or support in his or her accustomed manner of living.
- However, no distribution shall be made to the Grantor during any period that the Grantor is married to and living with another person as a married couple and provided, further, however, that no distribution shall be made to the Grantor until one year after the initial contribution to this trust.

41

41

Sample DAPT Provisions - 2

- Power to Eliminate Grantor as Beneficiary.** The Trust Protector may, by acknowledged instrument delivered to the Grantor, permanently and irrevocably eliminate the Grantor as a beneficiary of each trust hereunder. [OBJ:APT 1009002]
- Note:** Consider also adding a restriction on no distributions until 10 years after funding.

42

42

3. Hybrid DAPTs – A DAPT Without a Grantor as Current Beneficiary

Improving the Odds of Protection

43

43

Hybrid DAPTs: What They Are

- A Hybrid DAPT is a DAPT created for other family members (e.g., Grantor's spouse and descendants) but with some ability to add the Grantor in as a beneficiary.
- The power to add can be made conditional by time (e.g., only after 10 years in an attempt to avoid Bankruptcy Code 548(e), or when grantor is not married and is not living with another as the Grantor's spouse).
- Does it work? *Ianotti*, 725 NYS 2d 866 (2001) suggests not if the person who can add the Grantor (e.g., Trust Protector) is acting under a fiduciary duty.
- Hence, if you try this, make sure the person who can add is not acting under a fiduciary duty.

44

44

Hybrid DAPTs

- If the grantor may be added as a beneficiary have the trust divided into two separate trusts and add the grantor as a beneficiary of only that portion of the trust that is necessary.
- Sample Language:
 - **Division of Trusts.** The Trustee may divide any trust into two or more separate trusts and administer them as separate trusts, either before or after the trust is funded.

45

45

4. GRATs – Grantor Retained Annuity Trusts

Can They Work In Low-Rate Situations

████████████████████

46

46

GRATs: What and When Useful

████████████████████

- Background: Under Section 2702 a retained interest in a trust, or a split purchase, has zero value if family members hold the remainder interest.
- A special rule (not an exception) applies if the retained interest is an annuity, resulting in "GRATs."
- GRAT downside: (1) no GST Exemption leverage, (2) some estate tax inclusion (difficult to use for client with short life expectancy).
- Good news: low Section 7520 rates mean high value for the retained annuity interest, so a lower taxable gift.
- GRATs work only when the return is greater than the Section 7520 rate – they slice off upside volatility above that amount.
- Typical structure: Short-term Rolling GRATs. However, these could be "outlawed" by requiring a minimum 10-year term and a gift of at least 25% of the value contributed to the GRAT.

47

47

GRATs: ILIT Funding Tool

████████████████████

- Irrevocable life insurance trusts (ILITs) are a ubiquitous planning tool. Many ILITs are funded using annual exclusion gifts. This technique is also on the chopping block under proposed legislation. The Sanders tax proposal, for example, includes a cap on annual exclusion gifts of \$20,000 per donor (not per donee). That could undermine the funding in many traditional life insurance trusts.
- Practitioners may want to consider, in the current environment given what some view as an increased risk of harsher tax legislation to pay for the current bailouts, using GRATs to "pre-fund" future life insurance premiums in ILITs. If the insurance trust is not GST exempt, a GRAT could be structured to pour into the insurance trust as its remainder beneficiary and thereby infuse capital now before restrictions are created on ILIT Crummey Trust funding. If the ILIT is GST exempt, it could borrow at the low applicable Federal rate (AFT) from the successful GRAT and without income tax effect if each is a grantor trust as to the same grantor.
- See, IRC Section 2503(b); S. 309 §10(a).

48

48

GRATs: Should Structure Change?

- Consider whether longer term GRATs should be used instead of short-term.
- Consider laddered GRATs (e.g., 4, 6, 8, and 10 year). But note that this will change GRAT administration and in particular how GRATs are immunized when successful.
- Will GRATs provide asset protection? Choose the jurisdiction carefully.
- Consider asset splitting GRATs, each started at a different date, with different duration, different annuity retention, and different remainder beneficiaries

49

49

Illustration of a Successful 99 Year GRAT Continued

- Client Funds GRAT with \$ 1 Million When the Section 7520 Rate Is One Percent to Pay \$11,000 a Year to the Client or Her Estate for 99 Years. The Value of Remainder Is Nearly Zero.
- When the Client Dies, What Is Included in Her Estate Is the Lesser of the Whole Trust or the Annuity/Section 7520 Rate In Effect When She Dies.
- Client Dies When the Section 7520 Rate Is Still One Percent. Hence, the Amount Includible No More than \$11,000/.01 or \$11,000 x 100 or \$1,100,000 (or the Value of the Trust If Less than That).

50

50

Illustration of a Successful 99 Year GRAT

- Client Dies When the Section 7520 Rate Is Five Percent. Hence, the Amount Includible Is \$11,000/.05 or \$11,000 x 20 or \$220,000 (or the Value of the Trust If Less than That).
- Client Dies When the Section 7520 Rate Is Ten Percent. Hence, the Amount Includible Is \$11,000/.1 or \$11,000 x 10 or \$110,000 (or the Value of the Trust If Less than That).
- If the Section 7520 Rates Goes Up Before Death, the Client Could Sell Her Annuity Interest (Without Gift Tax) for Its Value As So Determined to a GST Exempt Trust (Perhaps, the Trust That Is the Remainder Beneficiary of the GRAT and May Be a Grantor Trust).

51

51

5. SPLATsSM – Split Purchase Annuity Trusts

How and When They Can Work

52

52

SPLATs

- Background: Under Section 2702 a retained interest in a trust, or a split purchase, has zero value if family members hold the remainder interest.
- A special rule (not an exception) applies if the retained interest is an annuity, resulting in "GRATs."
- GRAT downside: (1) no GST Exemption leverage, (2) some estate tax inclusion (difficult to use for client with short life expectancy).
- Good news: low Section 7520 rates mean high value for the retained annuity interest, so a lower taxable gift.

53

53

SPLATs - Continued

- One can avoid the GRAT estate inclusion through a split purchase annuity trust ("SPLAT").
- Client and a GST-exempt trust enter into an agreement by which client purchases an annuity for life (or a term of years) in an asset, and the GST-exempt trust purchases the remainder interest in the asset.
- Values are determined by standard actuarial tables meaning there is no gift if the underlying property is correctly valued.
- Because the Section 7520 rates are low, the client pays a significant amount for the annuity interest.

54

54

SPLATs - Continued Further

- Can be used for clients with short life expectancy (if death is not imminent).
- No estate tax inclusion.
- GST exemption can be leveraged
- Cannot "zero-out" the value of the remainder if annuity is retained for life.
- Value of the retained annuity will drop as the Section 7520 rates increase (as they eventually will).

55

55

6. SPATs – Special Power of Appointment Trusts

A Safer Form of Domestic Asset Protection Trust

56

56

DAPT and Hybrid DAPT Limitations Suggest SPATs

- DAPTs are self-settled trusts and, therefore, potentially subject to claims of the Grantor's creditors, foiling asset protection and estate tax avoidance
- So why not avoid using a self-settled trust, and, which is a trust from which the TRUSTEE can make a distribution to the Grantor?
- And instead create a trust for the Grantor's family that prohibits the Trustee from ever making a distribution to the grantor or "Decanting" to a trust of which the grantor is a beneficiary.

57

57

SPATs: Safer for Asset Protection and Estate Tax Exclusion

- One or more individuals, who are not beneficiaries, are granted special "collateral" lifetime powers of appointment, which can be exercised in favor of members of a class that includes the Grantor (such as descendants of the Grantor's mother).
- Make the power exercisable only with the consent of a trusted third party (e.g., the client's lawyer or cousin).
- Exercise should be made outright only and exercised only if the Grantor has a need.

58

58

SPATs – Drafting Options

- Special power of appointment:

SPECIAL POWER OF APPOINTMENT

DRAFTING TIP: With a SPAT, creation of a non-grantor trust requires either a) that the powerholder of the special power of appointment be an adverse party or b) that the special power only be exercisable with the consent of an adverse party. Any exercise of the special power may result in a gift by the adverse party(ies). It will not always be clear whether a certain person is adverse for grantor trust purposes. See Help Text below and Drafting Tip that will appear upon selection of the option to require consent to exercise the special power for additional information.

Special power of appointment held by: Name of Powerholder:
Carol Roberts

Individual
 Group

Delay time until power of appointment can be exercised

Require consent to exercise power

Permissible appointees under special power of appointment

Descendants of grantor's parents
 Descendants of grantor's grandparents
 Custom list

DRAFTING TIP: By delaying the time at which the power of appointment is effective, you may be able to create a period of time before the power may be exercised in which the trust is deemed to be a non-grantor trust even if the person holding the power or the power whose consent is required (or both) is non-adverse. This may be a viable option to make non-reciprocal trusts or to add an extra argument against a claim that the SPAT is a self-settled trust. Selecting this option will give you an option to indicate the period of time during which the power is not exercisable. Not selecting this option will make the power immediately exercisable.

59

59

SPATs – Drafting Options

- Multiple options for special power of appointment (time of exercise):

SPECIAL POWER OF APPOINTMENT

DRAFTING TIP: With a SPAT, creation of a non-grantor trust requires either a) that the powerholder of the special power of appointment be an adverse party or b) that the special power only be exercisable with the consent of an adverse party. Any exercise of the special power may result in a gift by the adverse party(ies). It will not always be clear whether a certain person is adverse for grantor trust purposes. See Help Text below and Drafting Tip that will appear upon selection of the option to require consent to exercise the special power for additional information.

Special power of appointment held by: Name of Powerholder:
Carol Roberts

Individual
 Group

Delay time until power of appointment can be exercised

Require consent to exercise power

What is the time period before the power becomes exercisable:

After 1 year
 After 10 years
 Custom

DRAFTING TIP: By delaying the time at which the power of appointment is effective, you may be able to create a period of time before the power may be exercised in which the trust is deemed to be a non-grantor trust even if the person holding the power or the power whose consent is required (or both) is non-adverse. This may be a viable option to make non-reciprocal trusts or to add an extra argument against a claim that the SPAT is a self-settled trust. Selecting this option will give you an option to indicate the period of time during which the power is not exercisable. Not selecting this option will make the power immediately exercisable.

60

60

SPATs – Drafting Options

- Multiple options for special power of appointment (consent required):

Special power of appointment held by:
 Individual
 Group

Delay time until power of appointment can be exercised
 Require consent to exercise power

DRAFTING TIP: By delaying the time at which the power of appointment is effective, you may be able to create a period of time before the power may be exercised in which the trust is deemed to be a non-grantor trust even if the person holding the power or the person whose consent is required (or both) is non-adverse. This may be a viable option to make non-reciprocal trusts or to sell an estate agreement against a claim that the SPA is a self-settled trust. Selecting this option will give you an option to indicate the period of time during which the power is not exercisable. Not selecting this option will make the power immediately exercisable.

Whose consent is required for exercise of the power of appointment
 Adverse party Other

DRAFTING TIP: If you are creating a non-grantor trust and have not provided for an adverse party to exercise the special power of appointment, the person whose consent is required cannot be the Grantor and must be adverse to the exercise of the power of appointment in order to avoid triggering grantor trust status. Be aware that a conservative reading of Estate of Regier, 313 F.3d 1161 (11th Cir. 2002) indicates that the exercise of the power of appointment by a beneficiary of the trust will result in a potentially taxable gift by the beneficiary. In the context of a trust, this may not be an unreasonable obstacle and the value for any gift is a discretionary, not an adverse, beneficiary. It is difficult to determine and may well be an adverse beneficiary. See Regier, 313 F.3d 1161 (11th Cir. 2002). Use this tool to explore the effect of the SPA on the trust's classification. (Drafting Tip 11, 11 Sept. 2018). If you are creating a grantor trust or have provided for an adverse party to exercise the special power of appointment, you may consider whether to require the consent of a knowledgeable third party, such as a partner in the law firm representing the grantor, in order to exercise the power of appointment to ensure that assets are not inadvertently diverted away from the grantor. Use of a nonadverse party does not have gift tax consequences as there can be no gift. Do not give the "trustee," as trustees, the power to consent to the exercise of the power of appointment because there is a risk that the trust will be considered a self-settled trust because the power will not be exercisable in a non-fiduciary capacity.

61

SPATs – Drafting Options

- Multiple options for trust structure (complete vs. incomplete gift):

TRUST STRUCTURE

Structure of Trust
 Completed gift
 Incomplete gift

DRAFTING TIP: Selecting the option to create a completed gift will allow the user to create a non-grantor trust (if the gift will be irrevocable, the trust probably will be a grantor trust). However, it is very important that the user be aware of not inadvertently creating a grantor trust by ensuring that the power of appointment can only be exercised by an adverse party or with the consent of an adverse party and that the grantor is not given other grantor trust powers, such as the power of substitution. In addition, a conservative approach would be to create the SPA in a jurisdiction with DAPT legislation because any trust to a grantor trust to the extent that it is available to the creditors of the grantor. A valid reciprocal gift will need effective power to trust distributions received by the grantor or the remainder by the grantor of a special lifetime power of appointment in addition to the limited limited testamentary power of appointment retained by the grantor.

62

SPATs – Drafting Options

- Multiple options for trust structure (beneficiary selection):

BENEFICIARY DETAILS

Trust beneficiaries during the grantor's lifetime
 Grantor's Wife only
 Grantor's Wife and the grantor's descendants
 Grantor's Wife, the grantor's descendants and the spouses of the grantor's descendants
 The grantor's descendants
 The grantor's descendants and the spouses of the grantor's descendants
 A custom drafted class of other beneficiaries
 The grantor's Wife and a custom drafted class of other beneficiaries

Requires that all distributions to Wife during lifetime trust be made with consent of adverse party
 Yes No

DRAFTING TIP: You can name an adverse party or parties to give consent to distributions to the spouse. If you do not choose to name specific adverse parties to consent to the distribution to the spouse, or upon the death of each partner, the default provision will be the oldest individual to whom a portion of the remaining trust assets would be distributed upon the death of the grantor.

63

SPAT – Sample Provision - 1

- Notwithstanding anything to the contrary herein, from and after one (1) year from the date of this Trust Agreement and until the Grantor's death, Carol Roberts shall have the power acting solely in a non-fiduciary capacity, to appoint some or all of the then remaining income and principal of the trust to or for the benefit of any one or more persons who are descendants of the Grantor's grandparents, by a signed writing acknowledged before a notary public specifically referring to this power of appointment; provided however, that no such exercise of this special power of appointment may be made without the written consent of Molly Smith, acting in a non-fiduciary capacity.

64

64

SPAT – Sample Provision - 2

- Notwithstanding anything to the contrary herein, no powerholder shall have the power to appoint the principal of this trust during the Grantor's lifetime to himself or herself, to his or her estate, to his or her creditors, or to the creditors of his or her estate if such powerholder is otherwise a permissible appointee of this special power of appointment. The exercise of this power of appointment shall be effective upon delivery of the written exercise to the Trustee and the execution of a written consent to the exercise by Molly Smith. No powerholder shall have an obligation to exercise, or not to exercise, the power of appointment given in this paragraph nor shall any person whose consent is required for the effectual exercise of such power of appointment have an obligation to give such consent.

65

65

7. Split Purchase TrustsSM

Sometimes Better Than a QPRT

66

66

Split Purchase Trusts

- Background: Under Section 2702 a retained interest in a trust, or split purchase, has zero value if family members own the remainder interest.
- Personal Residence Exception, Leading to QPRTs
- QPRT Downside: (1) no GST Exemption leverage, (2) full estate tax inclusion (so retained term must be short and can't be used for someone with a short life expectancy), and (3) client must move or pay rent
- Short term means little value retained as Section 7520 rates have been so low.

67

67

Split Purchase Trusts Continued

- The personal residence exception applies even if there is a "split-purchase" of a home.
- Client and spouse can purchase a life estate and an existing GST-Exempt trust buys the remainder (through a split purchase trust) but cannot offset with contingent reversion.
- Use normal actuarial valuation tables. There can be no gift if purchased from third party and death is not imminent.

68

68

Split Purchase Trust Continued Further

- The trust purchasing the remainder should be a grantor trust as to the purchaser of the life estate (or that person's spouse).
- Use an "old and cold" trust (or have the spouse create it).
- Have client buy a term of years for more value in the part purchase (and therefore lower remainder value)
- Can use an existing home.

69

69

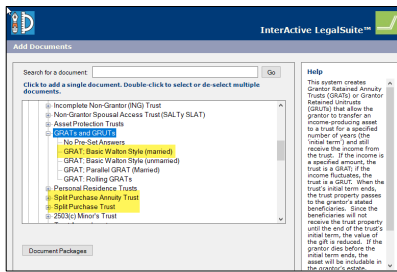
Split Purchase Trust Advantages and Disadvantages

- Can be used for a client with a short life expectancy (unless death is imminent).
- GST Exemption can be leveraged.
- Client can reside in the home for life (without needing to pay rent).
- However, value of life estates will be low because Section 7520 rates are low.
- Cannot further reduce the remainder value by including a contingent reversion.

70

70

Drafting GRATs, SPLATs, and Split Purchase Trusts



71

Conclusion and Additional Information

72

72

Conclusions

- A wide array of strategies are ripe for planning now, particularly those ideal in low interest rate and low value environments. This presentation has discussed 7 of these.
- Drafting software puts more options at your disposal, without having to draft from scratch (and allows your forms to be continually and seamlessly updated when laws change).

73

73

Additional information

- Interactive Legal
vkanaga@interactivelegal.com
- Peak Trust bcintula@peaktrust.com
- Jonathan G. Blattmachr
jblattmachr@hotmail.com
- Martin M. Shenkman
shenkman@shenkmanlaw.com

74

74

CLE Credits

- For more information about earning CLE credit for this program or other Martin Shenkman programs please contact Simcha Dornbush at NACLE. 212-776-4943 Ext. 110 or email sdornbush@nacle.com

75

75