#**Comment**: This is a sample of a cover letter and memorandum that could be sent along with drafts of spousal lifetime access trusts to clients. While there are several concepts discussed in the memorandum, any memorandum sent should be customized to the circumstances of your client, and any paragraphs that do not apply to that client deleted.#

*DATE

Via Email
*CLIENTNAME
*CLIENT ADDRESS

Re: Draft Spousal Lifetime Access Trust#s.

Dear *CLIENTNICKNAMES:

Enclosed are drafts of the spousal lifetime access trusts ("SLATs") for each of you, along with a memorandum of thoughts for you to consider regarding the draft documents. A document summary is also enclosed but be certain to defer to the actual provisions of the trust.

If you have any questions, please call.

Sincerely,

FIRM NAME

By: _____
PRACTITIONER NAME

Encl. – Two SLATs, memorandum, article on reciprocal trust doctrine

***CLIENTNAME**
Draft Spousal Lifetime Access Trusts
Memorandum

We have highlighted certain provisions of the memorandum and certain documents. While these provisions deserve your careful attention, they should not be interpreted as implying that other aspects of these documents do not require attention. The entirety of all documents and communications should be read and understood.

Because the documents are lengthy, and in some instances complicated, we recommend that you let us "talk" you through these drafts before you begin your review as that will make it much easier for you. This can be done as a conference call, web meeting, or in person meeting, whichever is most convenient for you. Let us know how we can help.

If you have any questions or comments on the drafts as you review them, call or email us. Let us know when you would like to schedule a meeting to review the documents and your comments. Once we have all your comments, we will revise the documents and we can schedule a signing meeting. If you would like to review the revised drafts let us know and we can send you those (in hard copy or as PDFs via email) before the signing. Please let us know what will work best for you.

Thoughts to consider while reviewing the drafts include:

- Some provisions in the trusts have been highlighted. However, the entirety of both trusts should be reviewed. Please contact my office to arrange a time for a web or in person review at your convenience.
- Forecasts should be used to support and determine the values given to each trust. Assets should not be transferred to the trusts that will likely be needed to support your lifestyle.
- We discussed one or both SLATs owning interest in a vacation home. An LLC should be formed in the state where the SLAT is being established to own that property, and then authorized to do business in the state in which the home is located. While it may be simpler to have one SLAT own the entirety of the vacation home LLC, better asset protection may be achieved by having each SLAT own 50%. The IRS may argue that you have retained an interest in such a property that supports estate inclusion.
- The power of appointment given to each child is limited to your descendants. Would you want to make this broader?
- We could add a provision to each trust giving an independent non-fiduciary the power to add the descendants of your grandparents (which would include you) as a beneficiary. This structure is sometimes called a "hybrid asset protection trust." The purpose would be that if the estate tax is repealed that person at a future date could add you as a beneficiary. That could eliminate the mortality risk associated with the technique.
- The trusts have a provision prohibiting the trust protector from #NAME as trustee. It could be advantageous to have #NAME removed, e.g., if there is a lawsuit.

- We could give a person also acting in a non-fiduciary capacity the right to grant the settlor of each trust a power to control enjoyment of trust assets so that the exercise of the power could force any or all assets back into your estate under Code Section 2038 should estate inclusion become advisable under whatever new tax regime the Trump administration might enact.
- The reciprocal trust doctrine should be addressed with funding and administering these trusts. This is one of the reasons for having the trusts in different jurisdictions with different trustees and for some of the legal differences in each trust instrument. Ideally different assets should be transferred to each trust as well. The trusts should each be administered in accordance with their respective terms.

Some of the ancillary documentation and steps for the SLAT plan may include:

- A spousal waiver for both of you regarding the SLATs. This might support the avoidance of the rights either of you may have over assets given to the other's trust. Although this provision may have valuable estate tax benefits, it may have significant matrimonial implications. I am not a matrimonial attorney and cannot advise you as to the matrimonial implications to either of you of signing this document. If you have any questions, as these rights might be important, you should each consult with your own matrimonial counsel before signing.
- Counsel in each state in which each trust will be formed will have to provide an opinion of counsel that the trust is valid in that jurisdiction. It is imperative that counsel in the state where each trust will be formed be retained. An opinion of local counsel as to the validity of the trust is a necessary prerequisite to implementation.
- Each institutional trust company will have to review the trust for any changes necessary to their assuming the position of trustee.
- A range of ancillary documents for each trust company will be necessary to complete and provide to them, e.g. account opening documents, know your customer documentation, etc.
- You each will have to authorize us to complete lien and judgment searches. The performance of this due diligence will help identify any issues that may suggest transfers to the trust should not be made. If none are identified these steps might help deflect a later challenge by a claimant or the IRS based on a fraudulent conveyance, retained interest, and other theories. There is obviously no assurance that these steps will reflect any challenge.
- Other documentation may include:
    - Crummey notices. These should be completed properly, signed and sent to the appropriate donees.
    - Solvency affidavit which you should review, correct and then sign.
    - Declaration of Gift for gifts made to the trust.
    - Insurance for assets transferred in whole or part to the trusts may have to be revise to reflect the trusts as owners.
    - Income tax returns, from 1041 (grantor or non-grantor depending on how each trust was structured) may have to be filed.
    - A gift tax return reporting gifts to the trusts may have to be filed with the IRS.

- If entities are transferred to the trust appropriate entity documentation will have to be prepared.

Estate planning is inherently complex, subject to varying interpretations, and the laws change frequently. Ongoing review and maintenance of every plan and document is essential. There is no assurance that any particular result will be realized. There are risks and negative consequences to every planning step and technique, all of which have not been enumerated in this letter or other communications. By proceeding with this planning, you accept these risks.

By Bruce D. Steiner & Martin M. Shenkman

Beware of the Reciprocal Trust Doctrine

If not set up properly, a popular strategy could backfire

Many clients are planning to make large gifts before the end of 2012, to take advantage of what may be a fleeting opportunity to do so without incurring any gift tax. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010[1] temporarily increased the gift tax exemption from $1 million to $5 million in 2011 and $5.12 million in 2012.[2] The gift tax exemption is scheduled to revert to $1 million in 2013. Unless Congress acts to continue the current exemption, the end of 2012 will likely bring a stampede of clients seeking to capitalize on it before it reverts to $1 million in 2013.

To take advantage of the increased gift tax exemption, married clients may want to set up reciprocal trusts, in which the husband gives up to $5.12 million to a trust for the benefit of his wife and issue, and the wife gives up to $5.12 million to a trust for the benefit of her husband and issue. However, when applying what's known as the "reciprocal trust doctrine," courts often end up "uncrossing" the trusts. The doctrine states that if a husband creates a trust for his wife, and the wife creates a nearly identical trust for the husband, then the two trusts may be "un-crossed" and treated for tax purposes as if each spouse had created a trust for himself or herself.[3]

Here's how courts have ruled on attempts to set up reciprocal trusts and some advice on how to avoid the reciprocal trust doctrine.

Gift Splitting

The wealthiest clients can give $5.12 million (or $10.24 million combined for a husband and wife) to (or more likely in trust for) their children and grandchildren.[4] However, high-net-worth clients may not be comfortable making such large transfers, because they might need the assets someday. If so, one or both of the spouses may create trusts in an asset protection jurisdiction, so that the transferor can remain a discretionary beneficiary.[5]

One possibility is for the client to create a trust for the benefit of his spouse and issue, give $10.24 million to that trust and elect gift splitting.[6] This type of trust is essentially a credit shelter or bypass trust, except that it's created during life rather than at death. However, it's not clear that gift splitting is available in this case.[7] Gift splitting requires that the gift be to a person other than the donor's spouse.

A donor making modest gifts to a trust for the benefit of his spouse and issue may be willing to take the risk that gift splitting won't be allowed. However, a donor giving $10.24 million to such a trust shouldn't be willing to take that risk. If gift splitting isn't allowed, only $5.12 million of the gift will be covered by the donor's exemption, resulting in $1.792 million of gift tax at the 35 percent 2012 gift tax rate.

Reciprocal Trust Doctrine

The issue of reciprocal trusts first arose in *Lehman v. Commissioner*.[8] In *Lehman*, two brothers each created two trusts for the other. Each trust provided for income to the grantor's brother, gave the grantor's brother the right to withdraw $75,000 and provided that the remainder would go the grantor's issue. When the first brother died, the U.S. Court of Appeals for the Second Circuit uncrossed the trusts and held that the $150,000 that the decedent could have withdrawn from the trusts created by his brother was includible in the decedent's estate.[9]

As the doctrine evolved, there was a conflict among the lower courts as to whether the parties' motives were relevant. The Supreme Court resolved that issue in

Bruce D. Steiner, far left, is an attorney with Kleinberg, Kaplan, Wolff & Cohen, P.C., in New York. **Martin M. Shenkman** is an attorney in Paramus, N.J.

United States v. Grace.[10] In *Grace*, the decedent created a trust in which his wife received the income, the trustees had discretion to distribute principal to the wife and the wife had a testamentary special power of appointment (POA) in favor of her husband and the couple's issue. Two weeks later, the wife created a mirror image trust. The Supreme Court extended *Lehman*, holding that the reciprocal trust doctrine applies when the trusts are interrelated, "and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been if they had created trusts naming themselves as life beneficiaries."[11] The motive for creating the trusts wasn't relevant.

Post-*Grace* Rulings

The trend subsequent to *Grace* has been favorable for taxpayers. However, there's still a risk of the Internal Revenue Service and courts uncrossing reciprocal trusts. Importantly, there's never been a time, in the history of the transfer tax system, when so many taxpayers were motivated to make such large gifts in trust as the remainder of 2012.

In *Estate of Bruno Bischoff*,[12] a husband created trusts for each of his four grandchildren, with his wife as trustee. The trustee was authorized to apply income and principal for the benefit of the beneficiary or to accumulate the income. Each trust ended when the grandchild reached age 21. The wife created identical trusts the next day, with identical assets and her husband as trustee. The Tax Court uncrossed the trusts and held that the retained powers were within Internal Revenue Code Sections 2036(a)(2) and 2038(a)(1), such that the value of the trusts each spouse created was includible in their respective estates.

Estate of Green v. United States[13] is similar to *Bischoff*. In *Green*, a husband and wife each created trusts for each of their grandchildren. Each trust ended when the grandchild reached age 21. Each was the trustee of the trust the other created, and the trustee had the power to distribute the income and principal or to accumulate the income. However, the Sixth Circuit rejected *Bischoff*, holding that:

> . . . the settlor/trustee retained fiduciary powers to reinvest income and time distribution of trust income and corpus until the beneficiaries reach 21 years of age, do not constitute a retained economic benefit that satisfies the *core* mandate of Grace 'that the arrangement, to the *extent of mutual value*, leaves the settlors *in approximately the same economic position as they would have been in had they created trusts, naming themselves as life beneficiaries.*'[14]

In *Estate of Herbert Levy*,[15] a husband and wife each created a trust with identical assets, on the same day. Each was the trustee of the trust the other created. The couple's son was the residuary beneficiary of both trusts. However, the husband gave the wife the broadest possible special POA, exercisable during lifetime, in favor of anyone but herself, her creditors, her estate or the creditors of her estate. The wife didn't give the husband a similar power. The Tax Court, citing *Grace*, said that, as a result:

> Reciprocal transfers that are outright and not in trust can also be uncrossed.

> . . . decedent and his wife had *markedly different interests in, and control over,* the trusts created by each other. *The reciprocal trust doctrine does not purport to reach transfers in trust which created different interests and which change 'the effective position of each party vis a vis the* [transferred] property.'[16]

In Private Letter Ruling 9643013 (July 19, 1996), a husband created a trust for the benefit of his issue,

and his wife created a trust for the benefit of her husband and issue. Each spouse was a trustee of the trust the other created, together with a co-trustee (the same person in each case), who had the sole power to make discretionary distributions. The husband had a special POA over the trust his wife created, exercisable during his lifetime prior to Jan. 1, 2022, or by his will, in favor of his wife's issue and their spouses. The wife didn't have a special POA over the trust her husband created. The IRS held that, in view of the differences between the trusts, they weren't reciprocal.

In PLR 200426008 (March 10, 2004), a husband and wife created insurance trusts. Each was the trustee of the other's trust. In the trust the husband created, the wife had a special POA and limited withdrawal powers after her son's death. Furthermore, there were limitations on the ability to make distributions to the husband out of the trust the wife created. The IRS, citing *Grace* and *Levy*, held that the trusts weren't reciprocal.

Mandating distributions severely limits the flexibility of the trust.

Reciprocal Powers

Sometimes it's the taxpayer who wants trusts to be treated as reciprocal. In *Matter of Spear*,[17] the decedent died on Jan. 5, 1988, leaving a will dated June 22, 1987. He left cash bequests to his three grandchildren and left his residuary estate in trust for two grandsons, Jeremy and Jonathan, with the principal payable in stages ending at age 50. If a grandson died before age 50, the balance of his trust was payable to his issue or, if none, to his brother, if living, or, if not, to his brother's issue. Jeremy and Jonathan were the trustees of each of their trusts. They were both in their 20s, and neither of them had any issue.

Three weeks before the decedent died, his brother died and left him more than $1 million.[18] In addition, earlier in 1988, the Technical and Miscellaneous Revenue Act of 1988 (TAMRA)[19] was enacted. TAMRA made it clear that for a transfer in trust for a grandchild to qualify for the Gallo exclusion,[20] (that is, the exclusion of $2 million per grandchild for certain transfers made before Jan. 1, 1990, to or in trust for a grandchild), the trust had to be included in the grandchild's estate. Although each grandson couldn't exercise the discretionary power of invasion in his own favor, the executors argued that the reciprocal invasion power invites a trade and is tantamount to a general POA. The court agreed, noting that it had the power to provide direction when tax decisions must be made and there's a conflict of interest and directed that the trustees were required to exercise that power and vest the trusts in themselves. As a result, the court directed that the funds continue to be held in trust subject to each grandson having a general POA if he died before age 50.

Shortly after the decision in *Spear*, the IRS issued PLR 9235025 (May 29, 1992), which involved a testator who died on Aug. 8, 1990, leaving his residuary estate in separate trusts for his two children. Each child received the income of his trust and had a special testamentary POA exercisable in favor of the testator's children and grandchildren. Both children were the trustees of each of their trusts. One child died on April 6, 1991. The deceased child's executors sought a ruling that each child's power to distribute principal to the other for his "support, maintenance, comfort, emergencies and serious illness" constituted a general POA.[21] After concluding that the standard for distribution wasn't ascertainable, the IRS, citing *Grace* and *Spear*, uncrossed the trusts and held that the deceased child had a general POA over the principal of his trust, so it was includible in his estate.

Outright Reciprocal Transfers

While the discussion of reciprocal transfers mainly arises in the context of trusts, reciprocal transfers that are outright and not in trust can also be uncrossed. For example, in a situation in which each of two brothers made gifts both to his own children and to his brother's children, each brother's gifts to his nieces and nephews were treated as if made to his own children.[22] Similarly, in a situation in which a husband and wife made gifts to each other as custodians for their minor children under the Uniform Gifts to Minors Act, and the husband died, the property held by him as custodian for his minor children was included in his estate.[23]

Avoiding Reciprocal Trust Doctrine

There's no clearly defined line or safe harbor as to what constitutes a sufficient difference between two trusts to avoid the reciprocal trust doctrine. Therefore, to avoid the reciprocal trust doctrine, the best approach is to make the trusts as different as is practicable under the circumstances. Here are some suggested methods for differentiating the trusts:

1. Draft the trusts pursuant to different plans. A separate memorandum or portions of a memorandum dealing with each trust separately may support this.

2. Don't put a husband and wife in the same economic position following the establishment of the two trusts. For example, a husband could create a trust for the benefit of his wife and issue, and a 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 she isn't a beneficiary (that is, a trust that's not a domestic asset protection trust). Also, note that even if the trusts are uncrossed, it may be possible to avoid the consequences of the reciprocal trust doctrine by creating the trusts in an asset protection jurisdiction.[24]

3. Use different distribution standards in each trust. For example, one trust could limit distributions to an ascertainable standard, while the other 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.

4. 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.

5. 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 estate[25] or a taxable gift.[26] However, this power may expose assets of the trust to the powerholder's creditors.

6. As in *Levy* and PLR 9643013, give one spouse a special POA, but not the other. However, the absence of a POA reduces the flexibility of the trust. This might be viewed as particularly significant in light of the continued estate tax uncertainty.

7. Give one spouse the broadest possible special POA[27] and the other spouse a special POA exercisable only in favor of a narrower class of permissible appointees, such as issue or issue and their spouses.

> Contributing different assets may not negate the application of the reciprocal trust doctrine.

8. Give one spouse a POA exercisable both during lifetime and by will and the other spouse a POA only by will.

9. 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,[28] some or all of the proceeds of the policy are held in a qualified terminable interest property trust[29] or are payable to the surviving spouse outright. Alternatively, if each trust has a marital deduction savings clause, the provisions of the two could be different.

10. 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.

11. Instead of mandating distributions, give the beneficiaries control, or a different degree of control, at different ages. For example, each trust could specify different ages when each child can become a trustee, has the right to remove and replace his co-trustee[30] and has a special POA.

12. 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, a 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.[31]

13. Create the trusts at different times. In *Lueders' Estate v. Comm'r*,[32] a husband and wife each created a trust and gave the other the power to withdraw any or all of the trust assets.[33] 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*,[34] 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 exemption, 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 a limited liability company (LLC) and 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.

14. 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 illiquid assets or assets subject to contractual restrictions on sale (for example, 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.

In many instances, the richer spouse may have to give assets to the poorer spouse so that he will have sufficient assets to fund a $5.12 million trust. Query whether the IRS will argue that some time must elapse between the gift to the poorer spouse and the gift by the poorer spouse, to avoid the step-transaction doctrine.[35]

Endnotes

1. Public Law 111-312.
2. The exempt amount is in the form of a credit rather than an exemption. For convenience, it's referred to as if it were an exemption. The exempt amount is indexed for inflation for 2012, and the indexed amount is $5.12 million.
3. For a detailed discussion of the reciprocal trust doctrine, *see* Marc Merric, "The Doctrine of Reciprocal Trusts," *Steve Leimberg's Asset Protection Newsletter* #1271, 1275, 1282, 1332 and 1339 (2008); Cheryl L. Hader, "Planning to Avoid the Reciprocal Trust Doctrine," 26 *Estate Planning* 358 (October 1999); Elena Marty-Nelson, "Taxing Reciprocal Trusts: Charting a Doctrine's Fall from Grace," 75 *No. Car. L. Rev.* 1781 (1997).
4. For convenience, it's assumed that the donor and his spouse haven't previously made any taxable gifts. Of course, many clients who can afford to make large gifts will have previously made $1 million of taxable gifts, to take advantage of the $1 million gift tax exemption amount in effect from 2002 through 2010. For convenience, we've ignored

Oct 12, 2019, 07:39pm

Estate Planning For The 2020 Election Should Start In 2019: Planning Procrastinators May Lose

Martin Shenkman Contributor https://www.forbes.com/sites/martinshenkman/2019/10/12/estate-planning-for-the-2020-election-should-start-in-2019-planning-procrastinators-may-lose/#74193dfb2ae9

Retirement *I write about charitable giving and estate planning ideas.*

Don't close your eyes to planning. Waiting to do estate planning until after the 2020 election could be a mistake.

Waiting to See What Happens in 2020 May be Unwise

No one can predict the 2020 election but if the Democrats sweep seems pretty likely harsh estate tax, and perhaps wealth tax, legislation will follow. Smart folks, and not just the uber wealthy, are planning now. Most folks are planning procrastinators. “Let’s see what happens with the election.” “If the Dems win let’s see if they can even pass an estate tax law.” Wait and see may prove to be more like “You snooze you lose.” Let’s consider why:

· What might the effective date of new legislation be? Might the effective dates result in your planning not working? For example, often new legislation permits existing plans, say a trust, to be respected (called “grandfathered”) if new legislation is enacted. But what date will be selected? Its smarter to get our planning in place now as it may increase (but not guarantee) the odds of it being effective.

· There are distinct advantages to doing planning over a longer period of time. So planning now, in 2019, may not only increase the likelihood of your planning working, but it may make your planning less risky or more secure. That is the focus of the discussion following.

Start Planning in 2019 to Make Planning Safer

For many planning techniques time is your friend. If you have more time to implement a plan, that plan might be safer.

Wait and See Example: Jane is single and a physician. Although she is very careful in all she does, she always stresses over the risks of malpractice concerns. Her estate is worth about $4 million. Jane realizes that her estate is likely to grow over her future working years, and her investments will also grow, so that under the $3.5 million exemption the Dems have proposed she is worried she will face an estate tax. She has a modest retirement account, a $500,000 condo and say $3.5 million in investment assets. If the Dem proposals are enacted the gift tax exemption could be reduced to $1 million from the current $11.4 million. That could make it very difficult for Jane to move assets out of her estate into a protective trust. Jane could wait and see. So, if the Dems win in 2020 and propose new estate tax legislation she could begin exploring the planning process in early 2021. She might then set up a self-settled domestic asset protection trust. That is a trust of which Jane is a beneficiary. This is critical to Jane since as a single individual she needs to rely on herself for her financial security and she may need access to the assets she transfers to that trust. Jane will have to rush through the planning if that happens, compress the time to complete work, perhaps short cutting some of the steps she takes. That could make the success of her plan riskier. Further, with limited time Jane will have to transfer the assets she wants to protect into the trust at one time. Say that amount is $2.5 million of her $3.5 investment portfolio. That is a large single transfer and may expose her to greater risk of a claimant arguing that the $2.5 million transfer was a fraudulent

conveyance. That means that she transferred the assets to hinder, delay or defraud a creditor. That could jeopardize her entire plan.

Start Planning Now Example: Jane consults with her professional advisor team now. She weighs the benefits of waiting versus starting her planning now in 2019. The most compelling factor she realizes is that she is concerned about malpractice exposure far more than estate tax risks and that the longer she waits to plan the longer her assets will be at risk. Her advisers also helped her understand that by planning now, in 2019, she might reduce the risk of a fraudulent conveyance challenge that she faced in the wait and see approach. So Jane sets up a self-settled domestic asset protection trust ("DAPT") in October 2019. Before any assets are transferred she has her CPA create a personal balance sheet showing that she is solvent and will remain so even after all planned transfers. Jane's wealth adviser creates a financial forecast showing how Jane's wealth with grow over the years, and how, that even with the planned transfers to her trust, she will continue to have adequate resources for any possible needs. Jane, because there is ample time (in contrast to the last minute rush that might occur if she waits to see what happens) Jane's lawyer has lien and judgement searches completed to corroborate that there are no current known claims. All of this might help deflect a later challenge by a creditor. Jane also opts to fund the trust with gifts of $150,000 per month starting in November 2019. By March 2021 when it is anticipated that if there is a Dem sweep they might have tax legislation in the hopper, Jane will have gifted to the trust $150,000 x 17 months = $2,550,000. But these gifts will have been made in small increments over 17 months. Perhaps midway through the process Jane has her advisers update all of the protective steps outlined above as that may further enhance her ability to deflect a later challenge that she endeavored to defraud a claimant. This all may enhance the potential for Jane's plan succeeding for both tax and asset protection purposes.

Bottom line, planning now, may make your planning safer and more effective.

Reciprocal Trust Doctrine Challenge Might be Deflected By Starting Your Plan in 2019

Example: A couple wants to create spousal lifetime access trusts ("SLATs") to which each will gift $2 million to use some of their temporary exemption before it might be reduced by future legislation. The rationale for this plan is that each of the spouses may be a beneficiary of the trust the other spouse creates (and if appropriate all their descendants and others as well). That might be a great plan in that it may provide asset protection from creditors, remove the gifts and all future appreciation from your estate, and yet you still may have the ability to access the assets given away. But there is a risk that you face when spouses create SLATs for each other. Starting your planning in 2019 may help you reduce this risk.

The creation of SLATs by one spouse for the other may raise the issue of what is called the "reciprocal trust doctrine. Under this doctrine, if the first spouse creates a trust for the second spouse, and the second creates a nearly identical trust for the first, then the two trusts will "un-crossed" and treated for tax purposes (and perhaps even for asset protection purposes) as if each spouse had created a trust for himself or herself. The logic behind this treatment is that reciprocal trusts leave the two settlors in approximately the same economic position as they would have been if they had created trusts naming themselves as life beneficiaries The plan will fail.

How Can You Reduce The Risk Of A Reciprocal Trust Challenge?

Consider steps to make each trust and plan different. Some of the following might all help.

· The spouses should not be in the same economic position following the creation of the two trusts.

· Incorporate different distribution standards in each trust.

· Use different trustees.

· Give one spouse a special power of appointment, but not the other in the second trust.

· Have each trust give the spouse/beneficiary different powers of appointment in each other's trusts. These are rights to appoint trust assets. For example, give spouse one the broadest possible special power of appointment, and spouse two a more limited (a so-called "special" power of appointment) exercisable only in favor of a narrower class of permissible appointees, such as issue.

· Vary the beneficiaries between the trusts. For example, add your mother-in-law as a beneficiary of your trust but not of your spouse's trust.

· And here's the big reason to start your planning in 2019 and not wait. Create the trusts at different times. In one court case, Lueders' Estate v. Commissioner, the husband and wife each created a trust for the other spouse, but the trusts were created 15 months' apart. The court held that there was no consideration, or quid pro quo, for the transfers.

Example: Spouse 1 creates a trust for spouse 2 in November 2019. The trust gives spouse 2 a limited or special power to appoint assets to a limited class of people. The trust was formed in Nevada with an institutional trust company based in Nevada. The assets given to the trust included life insurance, securities and an interest in a family business. Spouse 1's mother is named a beneficiary. In October 2020 Spouse 2 creates a trust for spouse 1. The trust gives spouse 1 a broad limited or special power to appoint assets to anyone other than Spouse 1, Spouse 1's creditor, estate or estate creditors. The trust was formed in Alaska with an institutional trust company based in Alaska. The assets given to the trust included only securities. Spouse 1's mother is not named a beneficiary. While a number of steps were taken to differentiate each trust from the other, an important distinction might be having create the trusts 11 months apart and also in different tax years. If you wait until after the election both trusts might be created in 2021 on the event of new tax legislation being enacted. You might also lose the flexibility to separate the creation and funding of the trusts with much time. Plan now!

Step-Transaction Challenge Might be Deflected By Starting Your Plan in 2019

The step-transaction doctrine might be applied by the IRS to torpedo a wide range of tax planning techniques. The concept is based on the idea that if you compressed several different steps into one, the result of what the transactions might achieve may be different (and worse for you as the taxpayer).

Example: Wife owns 100% of the shares of a Family Business valued at $25 million. Wife Transfers 50% of the shares to Husband on March 1, 2020 after a new administration in Washington proposes harsh new estate tax legislation. On March 2 Husband establishes a non-reciprocal spousal lifetime access trust ("SLAT") for Wife. Wife establishes a non-reciprocal SLAT for Husband. On November 3, 2016 each spouse transfers a 35% non-controlling interest in Family Business stock to their respective trust. They value each 35% interest at $5,250,000 [$25 million enterprise value x 35% shares transferred x (1-.40 assuming a 40% aggregate discount for lack of control and marketability)]. There is a risk that the IRS may challenge this plan, on among other issues, a step-transaction theory. The IRS might assert that Wife actually funded both trusts and that there was no economic significance to the transfer from Wife to Husband followed by a transfer from Husband to his SLAT. The IRS might argue that if the various steps are aggregated the net result is equivalent to the Wife having gifted the stock to both trusts. The concept

underlying the step-transaction doctrine is that the stock merely passed through Husband's hands as part of an overall transfer plan by Wife.

Certainly the longer the time span between each step or component of a plan, the more each step in a plan can stand independently on its own. So if you are planning such transactions make the equity transfers now so that there is an opportunity for more time to pass before other transfers are consummated. If wife gave husband shares in November 2019, and Husband does not fund his SLAT with the shares until December 2020, that is both time and a tax year intervening between the steps. If instead you wait until legislation is proposed after the election (assuming a change in control in Washington) there may be inadequate time to militate against a step transaction challenge.

Other factors might affect the application of the step-transaction doctrine.

· Are there independent economic events that occur between transfers? A loan negotiated with a third party lender, a dividend declared, a new shareholders agreement negotiated and signed, may be relevant. The more events that occur, the more significant and independent they are, the more the facts might deflect such a challenge. The more time between Wife's gift to Husband and Husband's later gift of the stock to his trust the greater the opportunity for events of independent economic significance to occur. So, plan now, don't wait.

· If there is a binding commitment from the outset to undertake each step in a plan the application of the doctrine might be more likely.

· If the IRS can demonstrate that the various steps are really pre-arranged parts of a single transaction that may be used to challenge the plan.

· The IRS may evaluate each step and try to demonstrate that certain steps are meaningless unless all other steps occur.

Again, the bottom line remains that it may be quite advantageous to begin your planning now, not to wait.

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How To Use Exemption Now: Checklist For Spousal Lifetime Access Trusts (SLATs)

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Trusts are key to using exemption, saving taxes and protecting assets in the current environment.

Reality Check: With the coronavirus spreading, the stock market crashing and the evening news instilling fear, it's really hard to think about estate planning. True. But that might just be a critical step to preserving your wealth.

Use Exemption Now: The current estate, gift and generation skipping transfer tax (GST) exemption is a whopping $11,580,000. Whether your estate is larger then that or much lower, if you can use some or all of that exemption now there are a bunch of reasons to do so:

- The exemption is temporary and will drop by ½ in 2026 under current law.
- If there is a change in power in Washington (no predictions here, my Ouija Board has burnt out) the exemption could drop precipitously well before 2026. But consider this, whatever happens politically, the massive coronavirus bailouts will have to be paid for. Taxes may have to go up regardless of the political situation. That last point should motivate any one with wealth to plan now.
- Setting up irrevocable trusts now may provide asset protection benefits (i.e. protect assets transferred from malpractice claims and other suits). All the growth in the assets will be removed from your estate as well. We live in an incredibly litigious society and nothing tax-wise that happens in Washington is likely to change that. So, even if the Dems don't take over and the tax laws don't change, planning to use exemption can provide you with great asset protection.

How to Use Exemption: So, if you're going to take the plunge what type of plan might make sense for you?

- Using your exemption prudently, by assuring you have access to the funds transferred out of your estate in case you need them in the future, is likely to be a wise move. Access is essential for most people now given the fears of what might happen with the economy and the substantial reduction in wealth many people have realized in early 2020. In 2012 when it was anticipated that the exemptions would drop from $5 million to a mere $1 million in the following year, lots of people set up trusts. In too many instances those trusts were designed to benefit only children or later descendants. What about benefiting you? Many who set up those trusts later regretted doing so. Not just because the exemption did not decline as feared, but mostly because they lost any access to their own funds. Don't make the same mistake.
- If you're married, you can set up a trust that your spouse is a beneficiary of. That way your spouse can access assets transferred as a beneficiary and you don't lose the ability to benefit from the wealth you accumulated. Generally, that's a much smarter approach that what a lot of folks did in 2012 when planning for the possible reduction of the exemption. These trusts are sometimes called Spousal Lifetime Access Trusts or "SLATs."
- If you're single you might consider some variation of what is called a self-settled trust. Sometimes these are referred to, if set up in the US, as a domestic asset protection trust, or DAPT. This is a trust that you can have access to. Specifically, if you create a DAPT you are a beneficiary of your own trust. You have to do so in one of the 19 states that permit those types of trusts for it to have a chance of working. Most folks seem to agree that if you live in one of those 19 states these trusts work. Some suggest, however, that if you live in a non-DAPT state and create a DAPT in a state that permits them, that this technique may not work. In many jurisdictions, a self-settled trust is void as to the settlor's creditors. In New York, for example, EPTL 7-3.1 provides: "(a) A disposition in trust for the use of the creator is void as against the existing or subsequent

creditors of the creator." If you fall into that category, or perhaps just want to be more careful, there are options like Hybrid-DAPTs, special power of appointment trusts ("SPATs") and other variations. Those are beyond the scope of this article.

Checklist of SLAT Considerations: Let's say you're setting up a SLAT. What decisions might you want to take in crafting the document with your attorney and planning team? What ancillary steps might you want to discuss with your planners to help the plan? The checklist below will give you a starting point for those discussions.

1. **Forecasts**: Forecasts should be used to support and determine the assets you will give to the trust. For example, assets should not be transferred to the trusts that will likely be needed to support your lifestyle. Forecasts are also advisable to demonstrate that you are unlikely to need the assets transferred to the trust. That could be useful to deflect a challenge that the transfer was a fraudulent conveyance. The financial models should consider the current state of the markets and economy, your wealth, spending, income sources (e.g. a pension), etc. and help you demonstrate a reasonable amount of wealth that you might prudently transfer to your trust. Your financial picture might be such that you can transfer the entirety of your remaining exemption ($11.58 million if no taxable gifts were made in the past) to a SLAT. For others the amount will be much less. Bear in mind it is not only how much your net worth is, but how much you spend and might need that will set a cap on what is feasible to gift. So, you should have a forecast confirm what is reasonable to do. Few if any attorneys have the capabilities or software to do such modeling so this means that your CPA and/or financial adviser have to be active members of the team doing this planning with you and your attorney.
2. **Situs**: What state will you create your trust in? Most folks assume it should be the state where they live. Why? You can set up your trust in any state you choose so long as you name a trustee in that state. Why complicate matters? Because the laws are better in some states then in others, and some states have more favorable tax laws then other states. If you can, the safer route might be to create a trust in one of the 19 states that permit self-settled trusts or "DAPTs" as discussed above. Using different states for each spouse's trust: That can be done but requires modification to the planning and documents. If you and your spouse are both setting up SLATs you should discuss with your attorney, the benefits of using different states. For example, you might set up a SLAT for your spouse and descendants in Nevada, and your spouse might set up a trust for you and descendants in Alaska. The use of different states and different trust companies might help differentiate the trusts which may help deflect a challenge that the trusts are reciprocal (see below), which could undermine the planning. There are now 19 states that permit so-called self-settled trusts or DAPTs. It might be advisable to set up your SLATs in one of those states. Why? Let's say your spouse sets up a SLAT for you in your home state which doesn't permit self-settled trusts. You take a withdrawal of funds from the SLAT your spouse created for you and deposit it into a joint checking account. Your spouse uses that account to pay her personal bills. She has arguably benefited from the assets in the trust created for you which is not permitted. That might undermine the plan. However, if the trust is setup with appropriate safeguards in a DAPT jurisdiction it might survive that type of challenge. Remember the old adage, "better safe than sorry."
3. **Income tax treatment**: In many cases the SLAT you create will be characterized for income tax purposes as a grantor trust. That means you will pay the income taxes on the trust income personally. So using a trust friendly state might give you access to better laws, but while you are alive it might not provide any state income tax savings. You should also discuss with your advisors whether your SLAT might be set up to be a non-grantor trust to save state income taxes.
4. **Powers of Appointment**: Trusts generally should include what are called "powers of appointment." This is the right given to someone to appoint where trust property should be distributed. For example, your SLAT has a trust that permits distributions to your spouse and descendants while your spouse is alive. On your spouse's death you give your spouse the right to designate who should get the trust assets. The trust certainly should have a default of where assets should be distributed if your spouse doesn't act. Why give your spouse this right? It can add great flexibility. The world may be different when your spouse dies then it is now so that this flexibility is valuable. If it is a second or later marriage you might choose not to give such a power, or you might choose to restrict it to specified heirs. Even being able to exercise the power as to the terms of a trust that the heirs you limit the class of appointees to may be useful. It is common to limit a spouse's power of appointment to a testamentary power (only exercisable on the surviving spouse's death, e.g. under a will) and often to make the power a so-called "limited power of appointment." This gives your spouse the right to appoint trust assets in the SLAT under your spouse's will to anyone other than the spouse's estate, creditors of the spouse's estate, the spouse, or the spouse's creditors. These limitations avoid including the trust assets

in your spouse's estate but give wide latitude as to where to appoint them. That provides considerable flexibility but also could be viewed by you as negative because your spouse could appoint to a new spouse, etc. The power of appointment given to each child (or other heir) on their death might be limited to your descendants. But you might choose to make the power broader.

5. **Loans**: Another provision to consider is granting to someone the power, in a non-fiduciary capacity, to loan you trust assets if you created the trust. 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 you as the settlor of the SLAT (and to your spouse out of the SLAT your spouse creates for you) without adequate security for the loan (but the loan director might be require to charge adequate interest to avoid tax issues). The mere existence of this power may characterize the trust as a grantor trust for income tax purposes. In fact, historically that is why this power was used. But this mechanism may also provide another means for you to access trust assets should you require them. In other words, it's a great source of flexibility and preserving access (albeit as a loan) for you to assets you might gift away now to use your temporary exemption.
6. **Adding a Charity**: You might also infuse another means of indirectly "accessing" funds in your SLAT. You might give someone 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 your SLAT (and to your spouse out of the SLAT your spouse creates for you). How might this provide you a means of "access" to the trust you create? If you would like to make a charitable donation the charitable director can add the charity to your SLAT and the donation can be made out of SLAT funds not your funds. However, be careful, if the SLAT pays a charitable pledge you made that would be inappropriate and could torpedo the planning. The mere existence of this power may characterize the trust as a grantor trust for income tax purposes. In fact, historically that is why this power was used. But this mechanism may also provide another means for you to access trust assets should you require them.
7. **Vacation Home**: Your SLAT could possibly own an interest in a vacation home. And if your spouse uses the vacation home, you can as well. Bear in mind if that is to be done a limited liability company ("LLC") should be formed in the state where your 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. This complication would be necessary because a SLAT formed in say Delaware, could not own real property in say New York or California. But having the real property held by an LLC transmutes it from real estate to an intangible asset which a trust in a different jurisdiction can own.
8. **Income tax**: If your SLAT is structured to be a grantor trust (i.e., you pay the income tax) you might consider including a discretionary income tax reimbursement clause in your SLAT. This permits the trustee of your SLAT, in the trustee's discretion (it cannot be mandatory) to reimburse you for income tax you pay on trust income. If you ever anticipate such a reimbursement being made consult with your professional advisers in advance to be sure that the appropriate formalities are adhered to. Also bear in mind that a tax reimbursement defeats somewhat the point of the trust as it is removing trust assets from the protection of the trust back into your estate. So, a tax reimbursement provision can add valuable flexibility and give you more comfort creating a SLAT and making large transfers during these difficult times.
9. **Notice to beneficiaries**: Generally, beneficiaries should be given notice of the existence of a trust and the assets in a trust. However, if the assets you are gifting to your SLAT are primarily for the financial security of you and your spouse, you might prefer that heirs not be informed of the trust so that they are less likely to ask for distributions until you are certain that your spouse will never need the trust assets. You might form the SLAT in a state that permits so-called "silent trust provisions." These are states that permit the trust to include a provision prohibiting disclosures to later beneficiaries during your lifetime or your spouse's lifetime. That may serve to limit the disclosures and information that the trustee may give your descendants. There are pros and cons to this approach. You might prefer to limit access to information during your lifetimes but that also prevents the descendants who have a strong interest in knowing the status of the trust from having information to intervene if there is a concern or problem. Some people view this as an important point of comfort to get them to the point of being willing to make large gifts.
10. **Estate inclusion**: You could give a person, acting in a non-fiduciary capacity, the right to grant or give you as the settlor of the trust, a power to control enjoyment of trust assets. This mechanism could be used, if that person exercises the power, to force any or all trust assets back into your taxable estate (under Code Section 2038). Doesn't that defeat the point of the SLAT and all the planning? Yes, but it is another possible means of injecting further flexibility into the SLAT and your plan should estate inclusion become advisable under whatever new tax regime some future administration might enact.

11. **Life Insurance**: Many people have existing life insurance trusts (often called by the acronym for an irrevocable life insurance trust or "ILIT"). You can incorporate insurance provisions into your SLAT. That can avoid the need for yet another trust. It can greatly simplify planning. If you make a large gift to the SLAT to use exemption, then why bother making annual gifts to a separate life insurance trust? Just have the SLAT own the insurance and pay premiums. If this approach is used, you may be able to merge an existing life insurance trust into your SLAT. You should consider naming a separate life insurance trustee of the SLAT as well. Even if you do not believe you have plans to buy life insurance it is no big deal to build this flexibility in when you are creating your SLAT. It is simple to do and avoids the need to decant to add this flexibility to own life insurance if you wish you add insurance later.
12. **Hybrid DAPT**: You could add a provision to your SLAT giving an independent non-fiduciary the power to add the descendants of your grandparents (which would include you) as a beneficiary. This structure is sometimes called a "hybrid asset protection trust." The purpose would be that if the estate tax is repealed, or your spouse dies prematurely, and you need access to your SLAT (since you are no named a beneficiary of a SLAT you create) that person at a future date could add you as a beneficiary. That could eliminate the mortality risk associated with the technique. There are risks with this technique and an increased, but unmeasurable risk that such a provision might cause estate inclusion. For example, some suggest that a case in New York might indicate that hybrid-DAPTs may also be subject to challenge. In Iannotti v. Commissioner of New York State Dept. of Health, 283 AD 2d 645, 725 NYS, 2d 866 (2001), the court held that a trust protector had the power to amend the trust and thereby make the grantor a beneficiary. Based on this power, the court ruled that the grantor' creditors could reach the trust assets. Note, however, that the trust protector was subject to a fiduciary duty. Might having a trust protector only serving in a non-fiduciary capacity provide a different result?
13. **Final Takers**: Confirm the provision that provides who should receive trust assts if you and your spouse and all descendants die. Many documents provide as an assumed default, that on the death of the last of you and your spouse, if no descendants survive, assets pass ½ to each of your heirs at law. You might prefer instead to name specific people or charities. Remember SLATs should be set up as very long-term trusts so a broad lasting category of final takers makes sense.
14. **Reciprocal Trust Doctrine**: The reciprocal trust doctrine should be addressed with using these trusts if you create a trust for your spouse and your spouse creates a trust for you. The reciprocal trust doctrine suggests that if the two trusts are too similar (not a clearly defined concept) that the IRS or creditors could "uncross" the trusts so it will be treated as if you created a trust for yourself and your spouse created a trust for themselves. In a landmark case United States v. Grace the decedent created a trust in which his wife received the income, the trustees had discretion to distribute principal to the wife and the wife had a limited power of appointment she could exercise by will, in favor of the husband and their descendants. Two weeks later, the wife created a mirror image trust. The Supreme Court held that the reciprocal trust doctrine applied because the trusts were interrelated, "and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been if they had created trusts naming themselves as life beneficiaries." United States v. Grace, 395 U.S. 316 (1969). The motive for creating the trusts wasn't relevant. So, the more matters that can differentiate the trusts and planning from each other the better. Can you fund each trust at different times and with different assets? This is one of the reasons for having the trusts in different jurisdictions with different trustees. Also, when your lawyer drafts the trust documents, they should integrate legal differences in each trust instrument.
15. **Annual Demand Powers**: The Crummey Notices (notice of right of withdrawal) can be used to differentiate the trust you complete from the trust your spouse completes. The dollar figures of an annual exclusion gift ($15,000 per person) are not significant for many people relative to the exemption amount they give. However, if Crummey powers are provided try to adhere to them.
16. **Assets**: Please ensure that the ownership of assets intended to be held by the trust are properly transferred to the trust and registered in the name of the trust. If you have securities, you will gift to the SLAT they should be transferred to the SLAT account in the name and tax identification number of the SLAT. If you transfer entity interests a corporate attorney should draft appropriate assignments and amended and restated entity documentation reflecting the trust as owner.
17. **Gift Tax Return**: You will have to file a United States Gift Tax Return (Form 709) reporting the gifts to your SLAT. Your spouse will similarly have to file (there is no concept with gift tax returns of a single joint return for spouses).
18. **Waiver**: A spousal waiver may be signed with the beneficiary spouse (i.e., the spouse not gifting assts to the trust) waiving any claims or rights to the assets you transfer to the trust. If you have community property

assets you should have an attorney prepare the appropriate legal documentation to transmute and break that community property characterization before either spouse transfers assets to their SLAT.

19. **Local Counsel**: If you set up your SLAT in one of the 19 states that permit self-settled trusts as suggested above, you might have counsel in each state in which each trust will be formed provide a legal opinion that the trust is valid in that jurisdiction.
20. **Trust Company Review**: Each institutional trust company will have to review the trust for any changes necessary to their assuming the position of trustee. You should just keep this and other steps in mind should you think you will wait to see how the election turns out before acting. All the steps when done right take time.
21. **Searches**: You might complete a lien and judgment search on yourself before giving assets to a SLAT as part of the due diligence before funding the trust. The performance of this due diligence may help identify any issues that may suggest transfers to the trust should not be made. If none are identified these steps should help deflect a later challenge by a claimant or the IRS based on a fraudulent conveyance, retained interest and other theories.
22. **Solvency Affidavit**: Consider signing an affidavit confirming that you have no known claims (list any that you are aware of), will be solvent after the transfers to the trust, etc. This, we believe, is important to your corroborating that the transfers will not be a fraudulent conveyance.
23. **Gift**: You might prepare a "Declaration of Gift" for gifts made to the trust wherein you confirm that the transfers to the trust are intended to be characterized as gifts.

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