Post-Election Estate Planning: What to Do For Clients In November and December of 2020

By: Martin M. Shenkman, Esq.
Jonathan Blattmachr, Esq., and
Robert Keebler, CPA

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

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

PEAK TRUST COMPANY
Elevated Trust & Wealth Management Solutions

Contact Information

By mail:

Boys Town

14100 Crawford St
Boys Town, NE 68010

By phone:

1-888-332-3219

Email:
giftplanning@boystown.org

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4 Topics Covered as Part of Post-Election Planning

- Part 1 – Non-tax planning – document changes all advisers should point out to clients considering Covid.
- Part 2 – Planning to pursue in late 2020. Use exemption and more despite uncertainty but reassess given that there was no Democratic sweep.
- Part 3 – Un-Planning - unwinding unwanted planning – or not.

Income Tax Planning in the Current Environment

Biden Proposals and Responses

President Elect Biden Tax Proposals & Responses

General Democrat Party Tax Policy Themes

- Additional payroll taxes on high-earners
- Increase the marginal rate imposed on high-income individuals
- Increase the capital gains rate imposed on high-income individuals
- Tax wealth generally; various ideas include an annual wealth tax & greater estate & gift taxes
- Increase the corporate income tax rate

Retro-Activity Risk

- Congress may have the ability to enact retro-active tax legislation thereby limiting the ability to front-run changes
- Retroactive taxation of transactions is possible if rationally related to a legitimate legislative. Pension *Benefit Guaranty Corporation v. R. A. Gray & Co.*, 467 U. S. 717 (1984); *United States v. Carlton*, 512 U.S. 26 (1994).

Former Vice President Biden Tax Policy Proposals

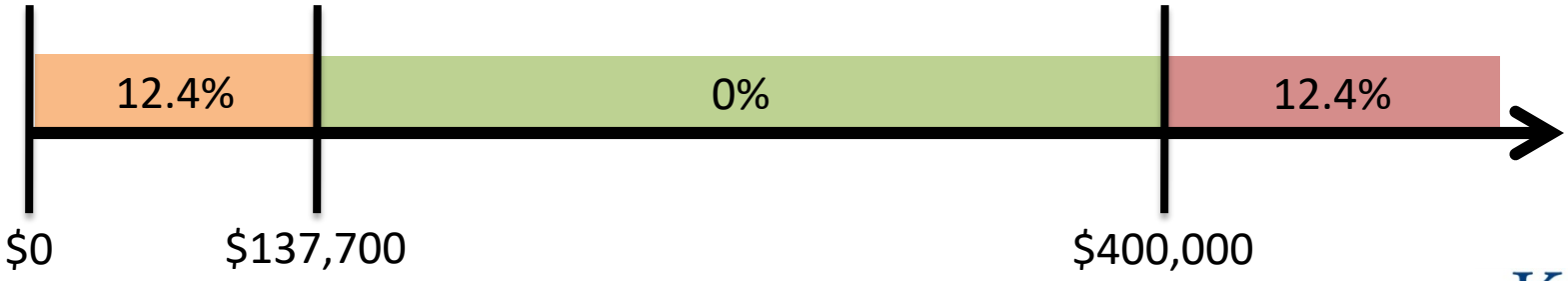
- Tax increases on over **$400,000** of income
  - Expand the 12.4% Social Security tax
  - Restore the 39.6% marginal rate
  - Cap the itemized deduction tax benefit to 28%
  - Restore the 3% PEASE limitation
  - Add a new Section 199A Deduction Phaseout

Former Vice President Biden Tax Policy Proposals

- **Taxes on Capital**
  - 39.6% rate applied to capital gains over $1,000,000
  - Eliminate the Basis "Step-up" at Death

Former Vice President Biden Tax Policy Proposals

- **Proposal to Expand Social Security Tax**
  - Applies to earned income over $400,000
  - The established 12.4% rate & employee/employer split retained
  - Creates a tax-free gap between the Social Security base and the $400,000 threshold



Former Vice President Biden Tax Policy Proposals

- **Solutions for Business Owners if Social Security Tax is Expanded**
  - S-corporation dividends
    - Recall, S-corporation dividends are not subject to employment taxes
    - As a solution, this assumes Congress does not close this "loophole" & the reduced salary is a "reasonable wage"

Former Vice President Biden Tax Policy Proposals

- **Solutions for Business Owners if Social Security Tax is Expanded**
  - Reorganize (or elect to be taxed) as a C-corporation
    - W-2 earners subject to the expanded tax would have a marginal rate of **55.8%** [39.6%+12.4%+2.9%+0.9%]
    - C-corporation owners with $400,000 - $1,000,000 of income under Biden's plan could have a effective rate on dividends of **45.1%** [28% + (1-.28) x 23.8%]
    - C-corporation owners greater than $1,000,000 of income under Biden's plan could have a effective rate on dividends of **51.9%** [28% + (1-.396) x 39.6%]

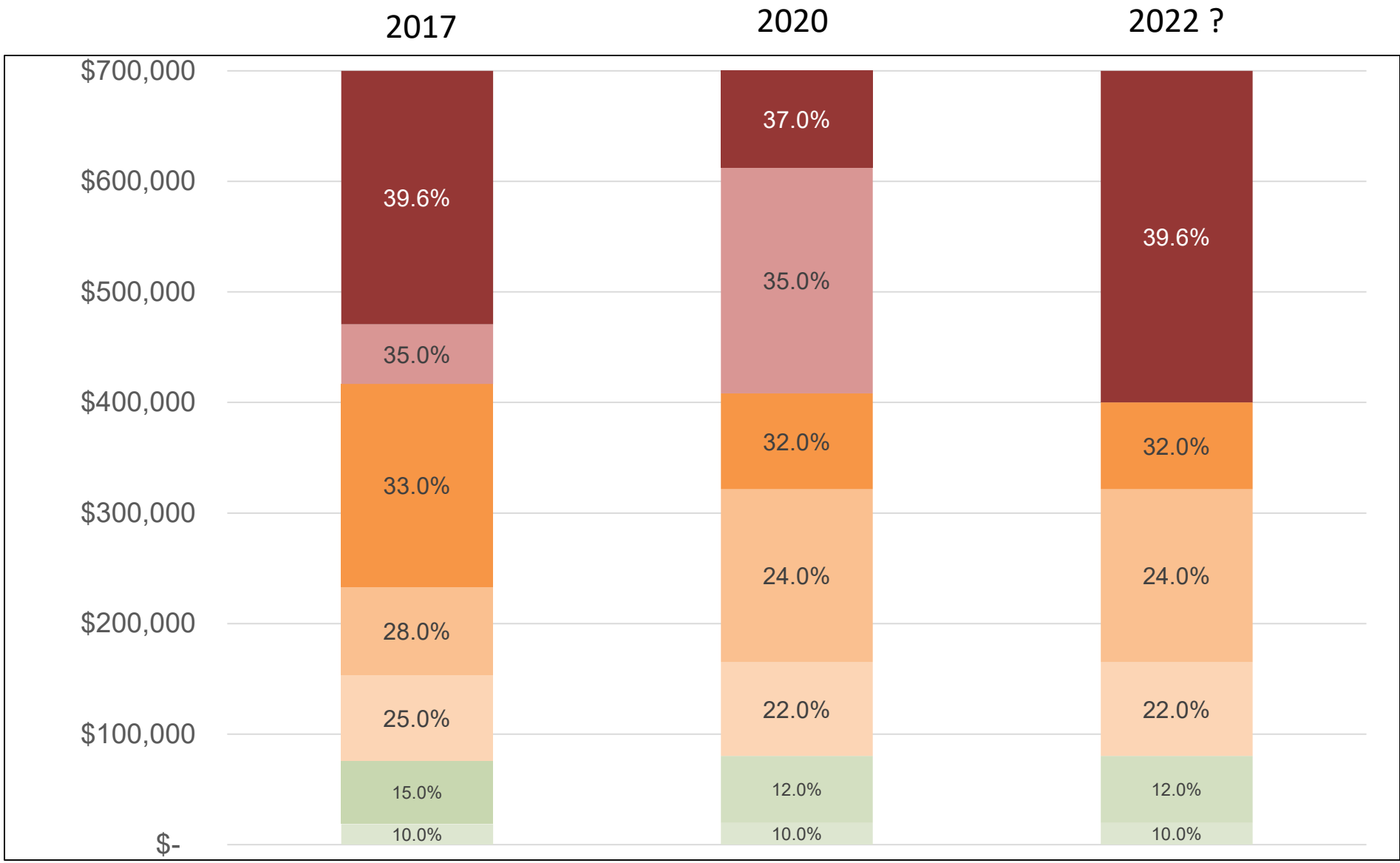
Former Vice President Biden Tax Policy Proposals

- **Solutions for Executive Compensation if the Social Security Tax is Expanded**
  - Incentive Stock Options (ISOs) – No FICA Tax on option spread
  - Non-Qualified Stock Options (NQSOs) – FICA Tax on option spread, but it's delayed until exercise
  - Deferred Compensation – No favorable treatment, but there's a timing benefit and the possibility of taking advantage of the "doughtnut hole"

Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the 39.6% marginal rate**
  - Would apply to income over $400,000
  - Unclear how it is affected by filing status

Married Filing Jointly



Former Vice President Biden Tax Policy Proposals

- **Accelerating 2020 income to plan for a 39.6%**
  - Roth conversions
  - Harvest gains
  - Defer loss harvesting
  - Defer business expenses

Former Vice President Biden Tax Policy Proposals

- **Proposal to Cap Itemized Deductions to a 28% Tax Benefit**
  - Rough justice to limit the regressive nature of itemized deductions

Itemized Deductions of $40,000

	Marginal Tax Rate				
	22%	24%	32%	35%	37%
Current Deduction Tax-Value	$ 8,800	$ 9,600	$ 12,800	$ 14,000	$ 14,800
Proposed Deduction Tax-Value	$ 8,800	$ 9,600	$ 11,200	$ 11,200	$ 11,200

Former Vice President Biden Tax Policy Proposals

- **Proposal to Cap Itemized Deductions to a 28% Tax Benefit**
  - Exact calculation method unclear however perhaps itemized deductions would be reduced by a ratio
  - For example, someone with $40,000 of itemized deductions subject to 39.6% marginal rate would reduce the deducible amount as follows:

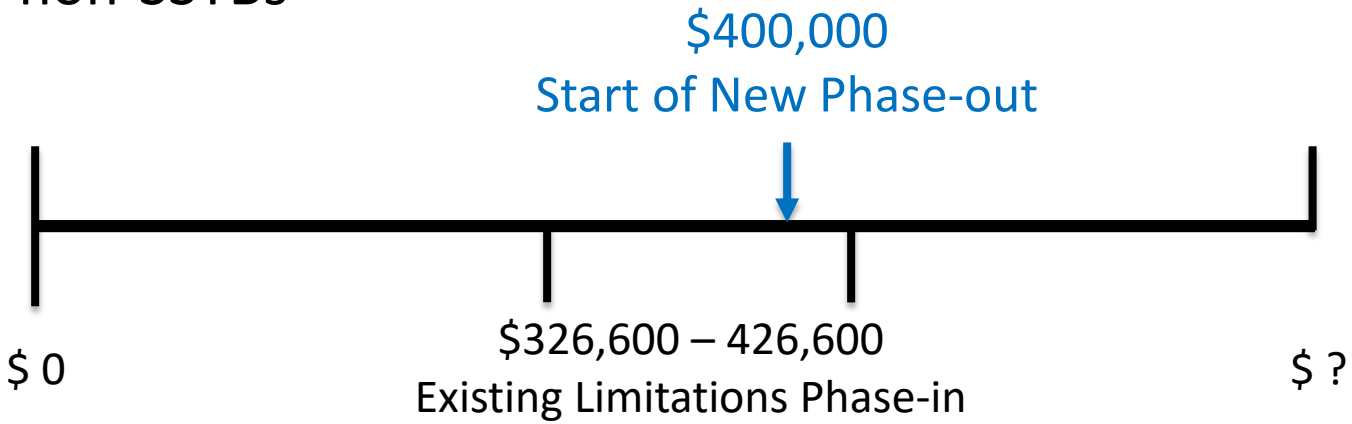
$$\$40{,}000 \times \frac{28\%}{39.6\%} = \$28{,}282.82$$

Former Vice President Biden Tax Policy Proposals

- **Proposal to Restore the 3% Pease limitation**
  - Would apply if income exceeds $400,000
  - Recall, the old Pease Limitation:
    - Applied after $313,800 (2017 MFJ) AGI threshold
    - Reduced itemized deductions by 3% of AGI over the threshold, up to 80% of itemized deductions
    - Standard deduction available if greater
    - Reduction only applied to charitable, SALT, mortgage interest, and miscellaneous itemized deductions only

Former Vice President Biden Tax Policy Proposals

- **Proposal to Add a New Section 199A Deduction Phaseout**
  - Would apply if income exceeds $400,000
  - There are few other details; Assumably, it is merely another limitation on the availability of the deduction for non-SSTBs



Former Vice President Biden Tax Policy Proposals

S-Corp Effective Rate - MFJ			
Shareholder's Income Level	Pre-2018:	Trump / TCJA	Biden Proposal:
$ 50,000	15.0%	9.6%	9.6%
$ 100,000	25.0%	17.6%	17.6%
$ 150,000	25.0%	17.6%	17.6%
$ 200,000	28.0%	19.2%	19.2%
$ 250,000	33.0%	19.2%	19.2%
$ 300,000	33.0%	19.2%	19.2%
$ 350,000	33.0%	25.6%	25.6%
$ 400,000	33.0%	28.0%	31.7%
$ 450,000	35.0%	28.0%	35.6%
$ 500,000	39.6%	28.0%	39.6%
$ 550,000	39.6%	28.0%	39.6%
$ 600,000	39.6%	29.6%	39.6%

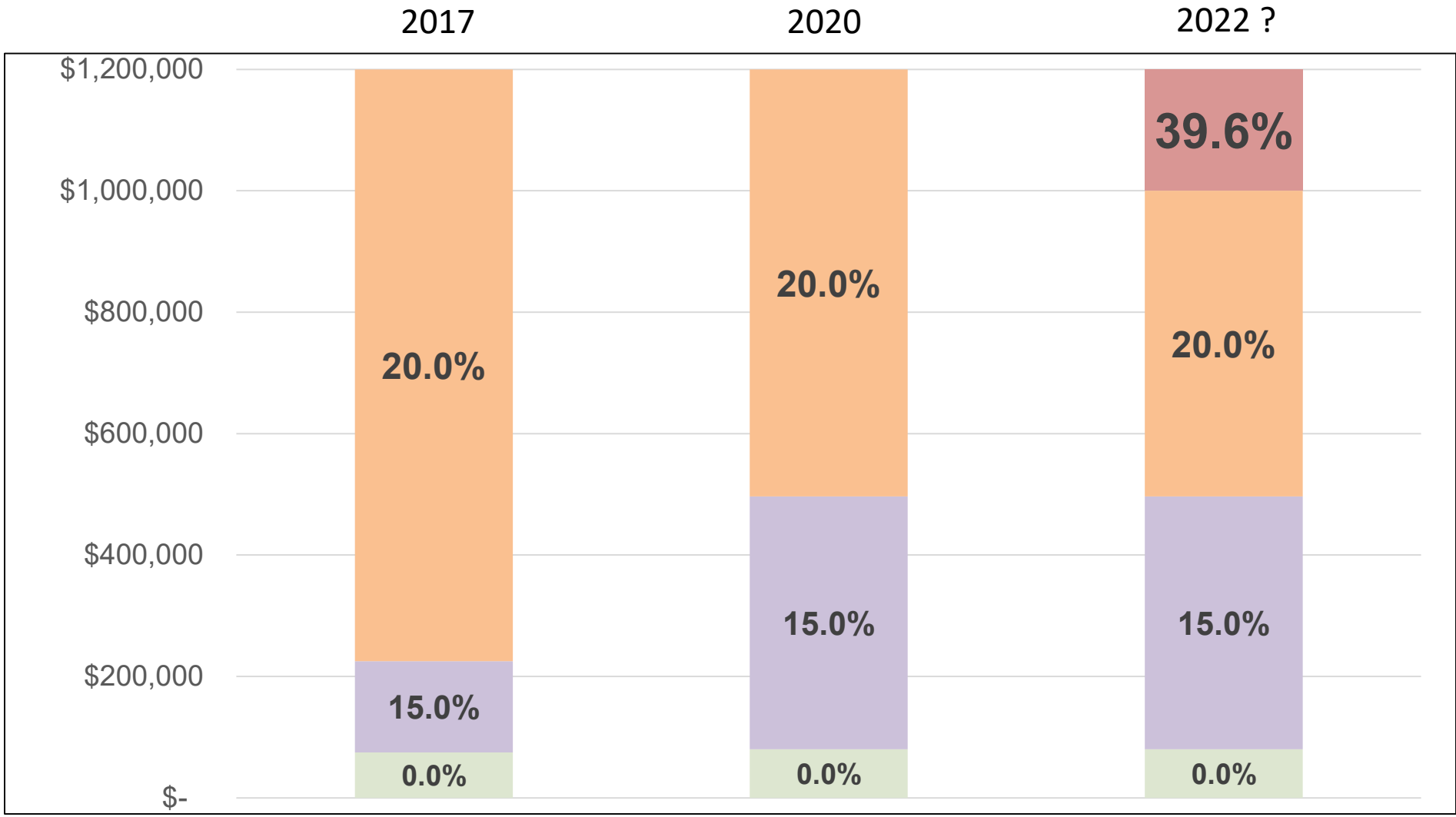
Former Vice President Biden Tax Policy Proposals

- **Proposal to eliminate the preferential rate for long-term capital gains and qualified dividends on income over $1,000,000**
  - Most significant proposal & a fundamental shift
  - Basically an increase from 20% to 39.6%
  - Expect many people to sell assets if it's set to take effect

Consider, for example, how risky funding a substantial sale CRT may be in 2020.

Married Filing Jointly

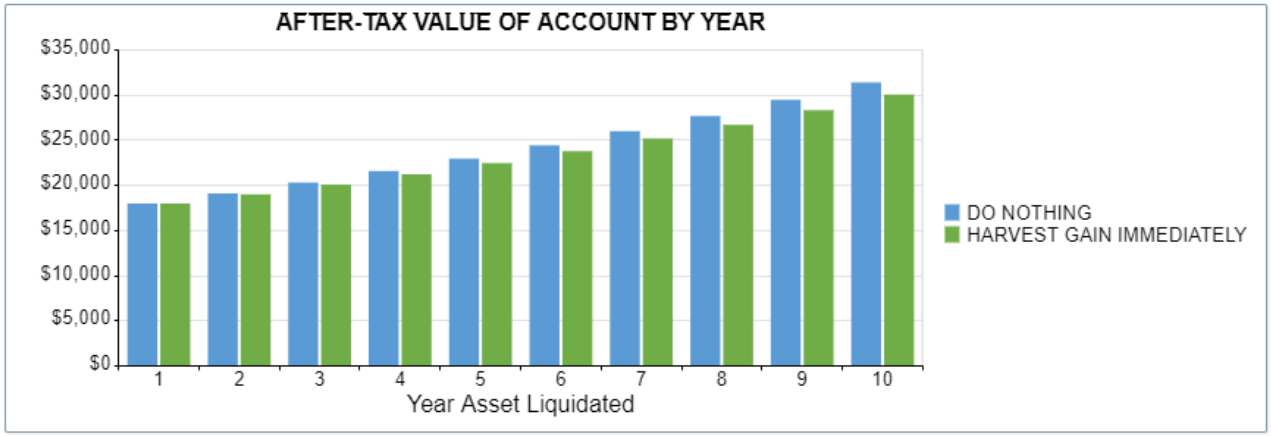
Capital Gain & Qualified Dividend Rates

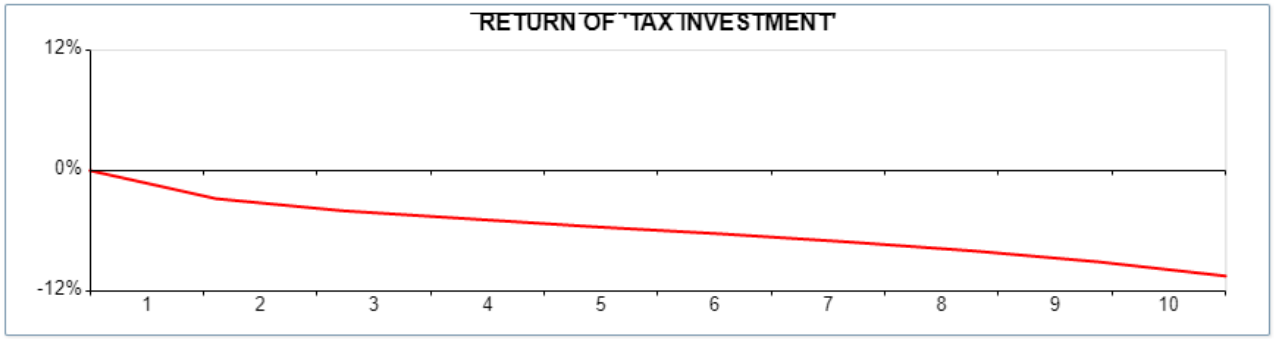


Input & Summary | Detail

GAIN HARVESTING CALCULATOR

CURRENT CAPITAL GAINS TAX RATE	20.0%
FUTURE CAPITAL GAINS TAX RATE	20.0%
BASIS OF ASSET	10,000
FMV OF ASSET	20,000
ASSUMED GROWTH RATE	7.0%





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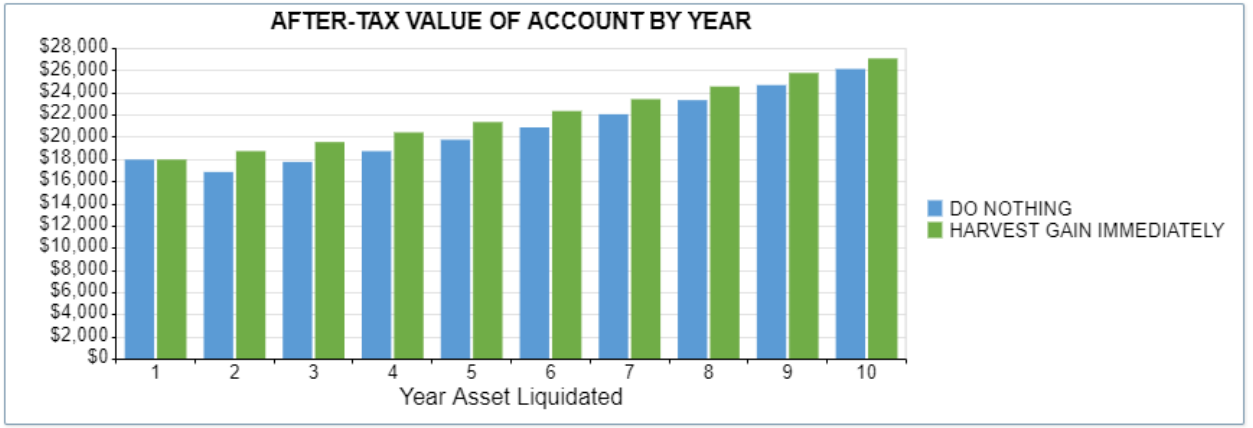

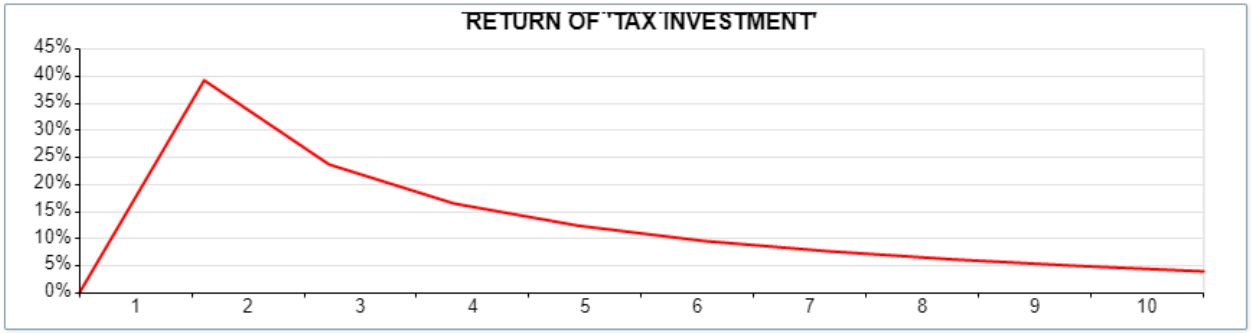

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Former Vice President Biden Tax Policy Proposals

- **Eliminate capital gains rate – deeper thinking**
  - A 39.6% capital gains rate will modify holding periods
    - **LONGER:** Sales discouraged by a high rate
    - **SHORTER:** High turnover strategies encouraged with no holding incentive
  - If the "step-up" in basis at death is retained, many people will be substantially more encouraged to hold onto assets until death
  - If the "step-up" in basis at death is repealed in-favor of a forced-recognition event, people will be encouraged recognize gains before death to:

    (1) Find better investments and

    (2) Avoid a 39.6% applying in the year of death instead of a 20% rate during life, for example

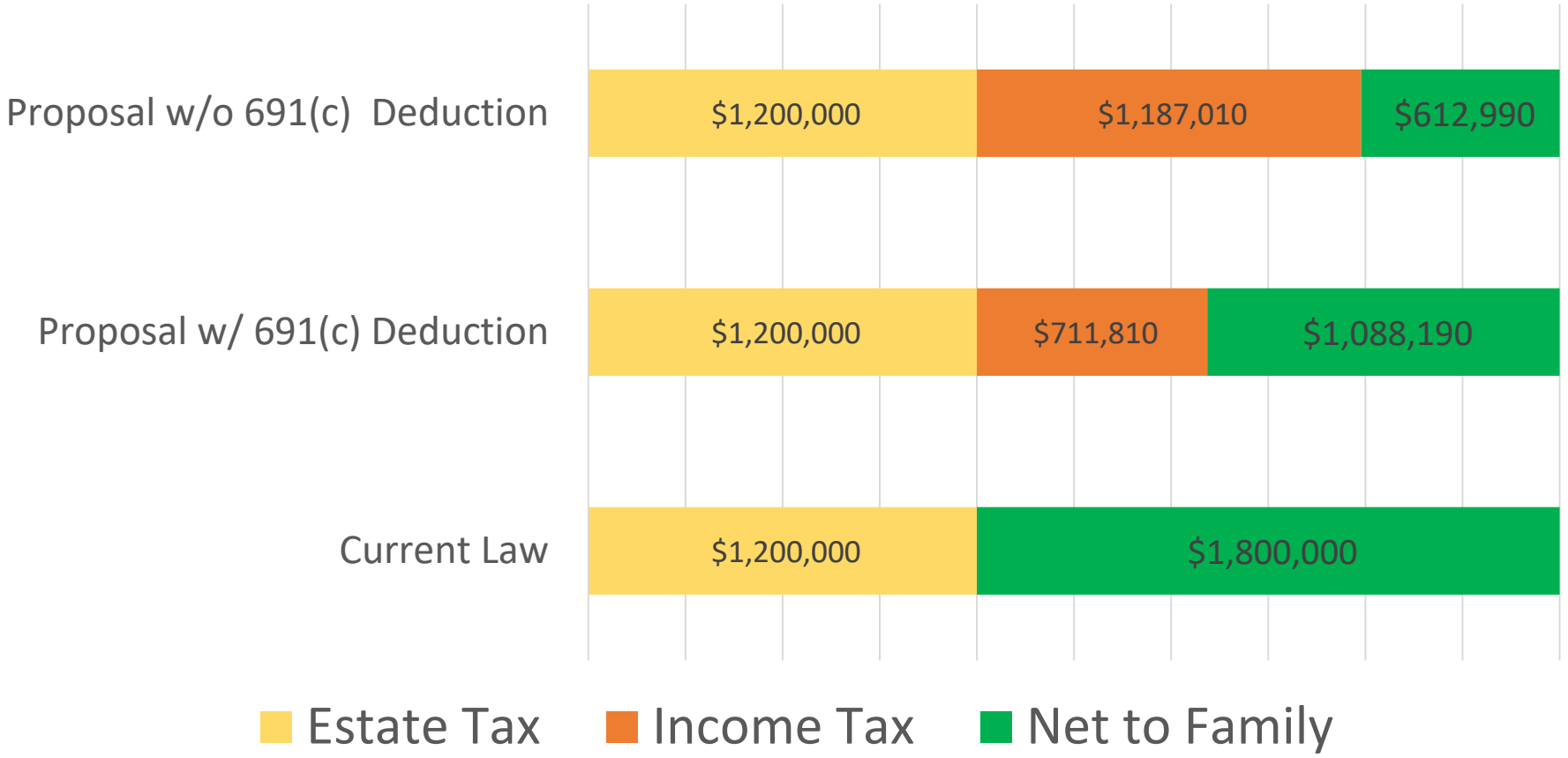
Former Vice President Biden Tax Policy Proposals

- **Planning Solutions for a 39.6% Long-Term Capital Gain Rate**
  - Installment Sales to Non-grantor Trusts
  - Hedges to Avoid Recognition Events
  - Charitable Contributions of Appreciated Property
  - Charitable Trusts
  - Tax-free Exchanges

Former Vice President Biden Tax Policy Proposals

- **Proposal to eliminate the Section 1014(a) Basis Adjustment at the – "The STEP-UP"**
  - *Most significant proposal & a fundamental shift in the taxation of wealthy individuals*
  - Unclear whether the proposed 39.6% rate would apply to gains in excess of $1,000,000
  - Unclear whether the proposal includes a income tax deduction for estate tax paid (or vice versa)
  - Presumably, gifting assets would also be a recognition event
  - Expect huge gifts & sales if it's set to take effect

Consider someone who bought 10,000 shares of Apple at average price of $2.50 just before the ".com bubble" burst and died at a $300 share price.



Former Vice President Biden Tax Policy Proposals

- **Business Income Tax Increase**
  - Increase corporate tax rate from 21% to 28%

C-Corp Effective Rate			
Shareholder's Qualified Divident Rate	**Pre-2018: 35%**	**Trump / TCJA: 21%**	**Biden Proposal: 28%**
0%	35%	21%	28%
15%	45%	33%	39%
18.8%	47%	36%	42%
23.8%	50%	40%	45%
43.4%			59%

Part 1: Documents in a Covid Environment

– It's Not Just for Lawyers – All Advisers have an Important Role

Estate Planning Documents

- In the current COVID-19 environment there are unique considerations for each of the core estate planning documents that practitioners should discuss with clients and that might require urgent update.
- If your client has elderly parents, or other loved ones, those relatives also may need immediate advice. Whether you assist those other family members or merely encourage your clients to get their parents/relatives back to their own lawyer, it could be helpful.
- Clients with college-age children need to make sure those children (legally adults) have at least a health care proxy and power of attorney.
- Consider offering low or no cost basic documents for client's adult single children as a goodwill measure.

Core Estate Planning Documents During COVID

Power of Attorney

Power of Attorney - 1

- As every practitioner is aware, a power of attorney is a legal document in which your client names a person, called an agent, to handle legal, tax, financial and other matters if the client cannot do so. Having a power of attorney in place now may be particularly important so that an agent can transact business for a client who might fall ill to COVID, or merely to help a well client avoid unnecessarily having to go to a bank or other business location.
- If your client has an existing document, adviser might typically review with the client:
  - Who they named as agent and successor agent. Are these still people that the client can rely on? Does the agent know that they have been named? Some clients name close friends or family who live at a distance. But in this difficult time, it may be best to have somebody local who can help the client address specific matters.

Power of Attorney - 2

  - Is the document so old that banks or others might be concerned about its validity?
  - What gift provisions are provided for?
  - Does the agent have authority to change beneficiary designations, e.g. to deal with decision making post-Secure Act?
- In “normal” times advisers might review with the client/principal the detailed powers given to the agent to determine if they should be restricted or perhaps made broader. Advisers may consider gift, tax and other provisions in these documents. While that still may be the ideal you should differentiate optimal provisions and documents from what might suffice to help your client for the time being. If important issues are identified, e.g. no or insufficient gifting power, it might be worth discussing with the client whether that issue should be addressed now by drafting and signing a new document, drafting a new document and signing when in-person meetings might again be feasible, etc.

Power of Attorney - 3

- Considerations new to the COVID situation:
  - Many powers of attorney are “springing” powers that become effective only if your client becomes incapacitated and cannot mange their affairs. If the document says your agent cannot act until the principal is incapacitated, you might want to counsel the client to change that immediately to a new power of attorney that lets the agent act immediately (i.e. not contingent on the principal being disabled) so that the agent can help you today. The restriction of only being effective when you are disabled might make your form useless in the current environment.
  - Another consideration has been brought to the fore by the current unique and difficult coronavirus experience. If you’re preparing a new document consider permitting the agent to communicate decisions via email, electronically signed documents, and perhaps even via Skype, FaceTime and similar services. It is not clear that banks or other providers will accept this, but it might nonetheless be worth considering. You might also hold banks and other third parties harmless for relying on such electronic communications to encourage them to be more accepting.

Core Estate Planning Documents During COVID

Living Wills/DNRs

Living Wills/DNRs - 1

- As practitioners know, this is a document in which you express healthcare wishes. This may include desires for medical treatment under different circumstances, end of life wishes, the desire for organ and tissue donations for medical research, for example research on PD, and so forth.
- Practitioners might review with clients whether an existing living will reflects the client's current wishes and what the client wants to communicate:
  - Who they named as agent and successor agent. Are these still people that the client can rely on? Does the agent know he/she has been named? Some clients name close friends or family who live at a distance. But in this difficult time, it may be best to have somebody local who can help the client address specific matters. Some clients name the same people they selected as financial agents without considering the differing roles.

Living Wills/DNRs - 2

  - Have client religious considerations been addressed?
  - Have funeral and burial/internment decisions been communicated? If so, do they reflect what the client currently wishes?
- In “normal” times advisers might review with the client the detailed provisions in this document (as well as the health proxy and HIPAA release). While that still may be the ideal practitioners should differentiate optimal provisions and documents from what might suffice to help your client for the time being during the COVID-19 challenges. If important issues are identified, discuss with the client whether that issue should be addressed now by drafting and signing a new document, drafting a new document and signing when in-person meetings might again be feasible, etc.

Living Wills/DNRs - 3

- One of the issues for practitioners to be particularly focused on in the current COVID-19 environment is whether documents expressly prohibit intubation. During the current coronavirus tragedy, intubation may be necessary for the client to survive a bout with the virus. This should be distinguished from a statement that the client may not want intubation if in a persistent vegetative state or terminally ill with a short time to live.
- Review the language in existing health care related documents generally. Too often when clients sign these documents, they view the issues as theoretical and do not always put the thought into some of the provisions that might be advisable. Those theoretical provisions may now be real due to COVID-19. Specially help them address what their living will or DNR says about intubation. Intubation is the process of inserting an endotracheal tube into the trachea to secure an airway and breathe for the patient (i.e., provide oxygen to the patient). The machine used to do this is a ventilator, which is also referred to as a breathing machine, or a respirator. Because of the nature of coronavirus, this may be essential to treat the patient/client for coronavirus.

Living Wills/DNRs - 4

- Many standard documents and forms include an absolute prohibition of intubation and could prove to be a death sentence if you or a loved one contracts coronavirus. Think about it. There is a shortage of ventilators. If your client is hospitalized and the medical facility has to make decisions which patients get to use the limited number of available ventilators, if the living will mandates not to be put on a ventilator, why would your client be allocated a scarce respirator? Review client documents and revise it if necessary.
- Another COVID-19 consideration may pertain to whether experimental medical treatments should be permitted? This might be critical to survival. For example, Remdesivir at the date of this outline is totally experimental. Many clients might wish to reconsider expressly permitting experimental treatments.

Core Estate Planning Documents During COVID

Health Care Proxies and HIPAA Releases

Health Care Proxies and HIPAA Releases - 1

- As practitioners know, a health care proxy, or medical power of attorney, is a document in which your client names an agent to assist if the client is unable to act for themselves. The health care proxy designates an agent to make medical decisions. A HIPAA release authorizes a named agent to access private health information and communicate with medical providers, but not make medical decisions for the client. The review of these documents, as well as the issues that affect these two documents, are similar.
- Be certain that the client have a signed documents and that they named people as agents, and successors, are able and willing to assist. If for example the client named a family member who lives a thousand miles away it may be preferable to have somebody closer by, certainly through the current COVID-19 circumstances.

Health Care Proxies and HIPAA Releases - 2

- There is an important change to these documents that should be considered. Typically, when an agent made medical decisions, they would been in the hospital speaking to the client's care providers and perhaps signing documents. With COVID-19 being so contagious, and many hospitals overwhelmed, this is not practical. Consider instead modifying your documents to expressly authorize electronic communication of decisions by the agent.
- Sample Clause: "***I expressly authorize my Agent to communicate decisions to any medical provider verbally, in person, by telephone, via email, via web conference including but not limited such services as Skype, FaceTime, or in any other manner appropriate to the circumstances. Further, I expressly hold harmless any medical provider for relying on such communications of decisions and directions by my Agent. The express purpose of this provision is to foster decision making by my Agent in remote or indirect manners that may be necessary or advisable given whatever circumstances accompany such decision making***."

Core Estate Planning Documents During COVID

Will and Revocable Trust

Will and Revocable Trust - 1

- As all practitioners know, a will is essential to name guardians if your client has minor children and provide for how assets will be distributed.
- In the current environment, and perhaps for the future, relying on a “pour–over will” and revocable trust rather than simply a will might become the default approach to documentation.
- As practitioners know, a pour over will pours or transfers assets on the testator’s death, from the estate, into a revocable trust that would then provide for the client’s dispositive plan. With probate courts closed a revocable trust might be a better option. It may also be easier to sign in the current situation.
- During “normal times” a practitioner might review a client’s will with the client to assure:
  - The persons named as executors to administer the estate, and trustees to administer any trusts formed under the will, are people that the client still feels confident in naming.
  - That the dispositive scheme is in fact what the client wants.
  - Many clients have ignored their documents for so many years or decades that little of what the documents contain is what they presently want.

Will and Revocable Trust - 2

- At the present time practitioners should endeavor to help clients identify whether the old existing will has the basic structure, provisions and people named that are generally consistent with the client's wishes. If it is, practitioners might advise clients to defer addressing correcting more minor issues until the current crisis has concluded, or perhaps drafting new documents now to be signed when it is safe for the client to meet with counsel to sign the documents, or to take other steps.
- If your client feels an urgency and importance to change their will, and perhaps replace it with a pour over will and revocable trust. Consider how as the attorney you can guide the client to validly sign a will, and whether remote or electronic signing will work in your state. Many states have passed emergency actions to permit some remote signing, witnessing and even notarization. The rules, discussed below, vary significantly from state to state, and in some cases will not suffice to practically get a document signed. Some states permit a "holographic will." But the rules vary by state and handwriting a will has to be done with great caution as your handwritten document won't practically be able to include many of the standard provisions that even a simple online form might include.

Part 2: Estate Planning Post-Election

Part 2 – Planning to pursue in late 2020. Use exemption and more despite uncertainty but reassess given that there was no Democratic sweep.

Post-Election Planning

Introduction and Overview

Introduction

- It appears that Biden is the President elect, but at this juncture the Senate is not determined.
- There could still be massive tax increases on the wealthy, including estate taxes. Even if there is limited or no change in Washington from the election raising funds to pay for the Coronavirus bailouts may require tax increases.
- Clients perhaps should still be advised to use their gift and GST exemptions before they may be changed, but there is more to it then that.
- There are many strategies (planning vehicles) and various options for each that practitioners should recommend clients consider now. These include: Domestic asset protection trusts (DAPTs and variations of them), spousal lifetime access trusts (SLATs), special power of appointment trusts (SPATs), Note sale transactions, GRATs, and more. How might this planning be revised or modified for various clients in light of the election status?

Where We Are Mid-November 2020

- What is the landscape of the post-election environment?
- US Senate – what happens in the GA run-off? If the Democrats get both seats it will be 50/50 in the Senate and VP Kamala Harris will break any tie vote.
- Senate has rule that any Senator can filibuster but 60 Senators can end a filibuster. But there are exceptions for judges and budget reconciliation. You do not need 60 votes, but a simple majority.
- 2001 Tax Act was passed in the same way with a 50/50 split and the VP Dick Cheney casting the final vote.
- The Republicans in 2017 passed tax legislation opposed by Democrats with a slim majority in the Senate through a budget reconciliation process which bypassed the 60-vote filibuster threat.
- It is unclear what tax changes may occur.

Biden May Issue Regulations

- Chevron Case – a federal agency and federal judges must follow regulations by agency in charge of statute unless arbitrary and capricious.
- President has authority to issue tax regulations so even if Democrats do not ultimately get 50% of the Senate, President Biden may issue a wide range of regulations:
  - Clawback of exemption.
  - Method of valuation might be changed by new regulations, e.g. 2704(b) Regulation.
  - So tax laws could change.

Might Changes be Retroactive?

- Retroactive effective date to 2021 legislation back to January 1, 2021 is still possible if the Democrats get equal representation in the Senate.
- To be retroactive the law must be rationally related to a legitimate legislative purpose.
- See Pension *Benefit Guaranty Corporation v. R. A. Gray & Co.*, 467 U. S. 717 (1984); *United States v. Carlton*, 512 U.S. 26 (1994).

Post-Election Planning Since There was No Democratic Sweep

- The election is concluded, and it appears that Biden is the President Elect.
- But control of the Senate is still uncertain and may have to wait until January runoff elections.
- So it still remains impossible to predict what might happen in terms of tax law changes.
- Harsh changes in the estate tax rules might still be enacted in 2021, but uncertainty remains. Perhaps it is less likely now that the predicted Democratic sweep did not occur, or is it?
- Be certain to caution clients about the risks that remain, as well as the string of assumptions leading to planning recommendations.
- Planning in many, but not all, instances might still make sense. Be alert to special planning circumstances that you might discuss with clients as to how planning might be changed considering the election.

Late 2020 Planning Environment Post-Election

- **Values**: Suppressed asset values remain for many businesses and equities. Discount rates may be higher because of uncertainty.
- **Interest**: Interest rates are at near historic lows (the Section 7520 rate for October 2020 is .4%). 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 and note sale transactions 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, etc., may prove very advantageous.

Goals to Address Post-Election

- **Access:**
  - Most clients will not shift significant wealth if they cannot have access to that wealth
  - The current economic problems (recession?), 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 regardless.
- **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 – thought might that be less likely without a Democratic sweep? But if the Democrats win the runoff races might that still be a possibility?

Forecasts, Insurance and More!

- Ideally before consummating any plan have the client's wealth adviser create a forecast to identify how much can be transferred, that the client can support their lifestyle without access to trust assets (even if it's a trust to which the client will have direct or indirect access), etc. That forecast can give the client comfort with the plan, deflect a challenge that there had to be an implied agreement with the trustee to make distributions, and counter a challenge that the transfers were a fraudulent conveyance.
- Recommend insurance. Before transfers are made if the client has adequate liability insurance, long term care coverage and life insurance, that may help support that the client was not making a fraudulent conveyance and that the client had adequate resources after the transfer. Review life insurance to insure the mortality risks of the plan. Consider life insurance to address premature death of a spousal beneficiary of a SLAT and the mortality risk of longer term GRATs.
- **Better planning is always a team effort not an activity for any one siloed professional**.

Specific Trusts and Planning Tools for the Current Environment

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. **SPATs** – Special power of appointment trusts that permit access but avoid self-settled trust status.
5. **GRATs** – Grantor retained annuity trusts are valuable in a low interest environment but what is different about 2020 GRATs?
6. **Note Sale Transactions** – for clients with estates well above the exemption amounts selling assets to lock in perhaps lower values, discounts before they are eliminated, notes at a low interest rate, etc. may be beneficial.
7. **Intentionally Defected Preferred Interest** – Retain a 2701 preferred interest that causes estate inclusion and the exemption used in the plan reverts to the donor.
8. **More options**….

Practitioners Should be Cautious

Take Steps to Protect the Client and The Practitioner

Practitioners Should be Cautious – Why is Client Asking For Ways Out?

- Should you structure a plan to be able to unwind it if the election or tax law results are different? What if giving a beneficiary the right to **disclaim** on behalf of an entire trust? What of a gift to a QTIP trust that will not use exemption if the marital deduction is not made. Might this suggest that the client is not comfortable with the planning? Or is the client comfortable and just hedging against uncertainty?
- Should you use a promise to pay to avoid transferring assets? Perhaps but consider why the client is not willing to transfer assets? If the client is uncomfortable with the planning is substituting a "**promise**" the right approach or perhaps the client should go back to their wealth adviser for forecasts to be certain that can comfortably make transfers? Perhaps more access has to be provided to the client for the client to be comfortable transferring assets.

Practitioners Should be Cautious – Do Promise Gifts Work?

- An enforceable promise to make a gift not based on adequate and full consideration in money or money's worth is treated as a taxable gift.
- If not paid before death, no estate tax deduction will be permitted but Rev. Rul. 84-25 will remove the promised amount from the promisor's adjusted taxable gifts.
- See 33 PA Stat. 6: "A written release or promise, hereafter made and signed by the person releasing or promising, shall not be invalid or unenforceable for lack of consideration, if the writing also contains an additional express statement, in any form of language, that the signer intends to be legally bound."
- Have interest accrue on the "promise." Is AFR interest sufficient?
- Of course, make the gift of a promise to a grantor trust.
- Donor of enforceable promise to make a gift should not split gift with spouse in year of gift.

Practitioners Should be Cautious – Consider Client Discomfort

- What is the reason the client is uncomfortable committing? Does the client appreciate the asset protection benefits the plan may provide? Why would the client then want to retain assets and use a promise or build in a disclaimer? There are certainly circumstances where these mechanisms make sense, but they may not make sense in all cases and in fact in some instances may indicate an underlying discomfort or even problem.
- Is the client so focused on using exemption to save taxes that they are not addressing whether the quantum of transfers are prudent?

Practitioners should be Cautious – Take Precautionary Steps

- Have clients sign a solvency affidavit even if the trust is not a DAPT and even if there is no state law requirement for such an affidavit.
- Have the client prepare and sign a balance sheet.
- Have lien, judgement, credit report and other due diligence completed to demonstrate that there are no outstanding issues.
- Have the client's wealth adviser prepare forecasts modeling out planning scenarios for decades to come.
- Offer the client options not one plan. Let the client choose.
- Apprise the client that every plan and technique has risks. Nothing is certain.

1. SLATs – Spousal Lifetime Access Trusts

Benefitting Grantor's Spouse With Less Creditor Issues (then A DAPT) or Perhaps No Estate Tax Inclusion

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.

SLATs: How to Make Them Work

- Create each SLAT in a different state. This is simple with document generation software as you merely select the state for each. (But it likely is best to use only DAPT jurisdictions in case the reciprocal trust doctrine applies.)
- 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. In fact, it may be best for the second trust to be a SPAT.
- A detailed checklist follows at the end of this section of the PowerPoint.

SLATs: Additional Ways to Provide Grantor Access - 1

- **Loans**: Consider granting to someone the power, in a non-fiduciary capacity, to force the trustee to make loans 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 which will cause the trust to be a grantor trust (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. This too will cause grantor trust status. However, the SLAT should not be authorized to pay a charitable pledge of the grantor.

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 with a home in another state, 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. Watch out for Section 2036 and consider that if a home is transferred into the trust if rent should be paid.
- **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 if that will not allow the grantor's creditors access to the trust. This permits the trustee of the 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.

Sample SLAT Provisions – Spouse as Beneficiary

- **Distributions to Spouse During Grantor's Lifetime**
- 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 (excluding, however, any Interested Trustee) may at any time and from time to time determine to the Grantor's Spouse and the Grantor's descendants in such amounts or proportions as the Trustee (excluding, however, any Interested Trustee) may from time to time select, for any purpose.
- Any net income not so distributed shall be accumulated and annually added to principal.

Sample SLAT Provisions

- **<u>Spouse's Lifetime Power of Appointment During Husband's Lifetime (Wife's SLAT for Husband would modify or exclude this Power)</u>**
- Trustee shall distribute such income and/or principal of the trust to such one or more persons out of a class composed of the Grantor's descendants and surviving spouses of the Grantor's descendants on such terms as the Grantor's Spouse may appoint by a signed writing that is acknowledged before a notary public specifically referring to this power of appointment and delivered to the Trustee provided, however, that any such appointment by the Grantor's Spouse shall only be effective if a trustee, who is non adverse within the meaning of Reg. § 25.2511-2(e), consents to the appointment in an acknowledged written instrument, and provided further, however, that this power of appointment may be exercised on the Grantor's Spouse's behalf by a guardian or attorney-in-fact appointed to represent the Grantor's Spouse and expressly authorized to do so.

Checklist of Differences to Integrate into SLATs - 1

- 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 although using DAPT jurisdictions for both may be best).
- 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.

Checklist of Differences to Integrate into SLATs - 2

- 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” withdrawal 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 without the annual lapse being a taxable gift. 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 or a taxable gift. However, this power may expose assets of the trust to the powerholder’s creditors in some states.
- As in *Levy,* 1983-453, and PLR 9643013 (not precedent), give one spouse a lifetime 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, although the power might be granted later through a decanting.

Checklist of Differences to Integrate into SLATs - 3

- Give one spouse the broadest possible special power of appointment 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 (or for any other reason), some or all of the proceeds of the policy is held in a qualified terminable interest property trust 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.

Checklist of Differences to Integrate into SLATs - 4

- 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 may expose 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 special powers of appointment 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. Consider a SPAT for one of the spouses.

Checklist of Differences to Integrate into SLATs - 5

- Create the trusts at different times. Is there enough time to make any difference in late 2020? In *Lueders' Estate v. Commissioner*, 164 F 2d. 128 (3d Cir. 1947), 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*,109 F 2d. 99 (2d Cir. 1940), cert. denied, 310 U.S. 637 (1940) 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, a short time might be sufficient in light of *Holman v. Comm'r*, 601 F 3d. (8th Cir. 2010) 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.

Checklist of Differences to Integrate into SLATs - 6

- Contribute different assets to each trust, either as to the nature or the value of the assets. However, if the purpose is to contribute $11.58 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.

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

- **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 2021 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.

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

- **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.

2. DAPTs – Domestic Asset Protection Trusts

Now 19 States Permit These Trusts

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.

DAPTs: What They Are Now

- Alaska enacted AS 34.40.110 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.

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.

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.

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.

- **Note**: Consider also adding a restriction on no distributions until 10 years + 1 day after funding.

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

Improving the Odds of Protection

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, the trust will be consider self-settled. Unclear if the person is not a fiduciary. Consider, therefore, a SPAT.
- Hence, if you try this, make sure the person who can add is not acting under a fiduciary duty.

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.

4. SPATs – Special Power of Appointment Trusts

A Safer Form of Domestic Asset Protection Trust

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.

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.

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.

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.

5. GRATs – Grantor Retained Annuity Trusts

Great In Low-Rate Environment but there Is So Much More to Consider

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.

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).

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

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).

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).

6. Split Purchase Annuity Trust

Split Purchase Annuity Trust

- Background: Under Section 2702 a retained interest in a trust, or an interest in an asset acquired in a split purchase, has zero value if family members hold the remainder interest.
- A special rule (not an exception) applies if the retained or acquired interest is a qualified annuity within the meaning of section 2702.
- GRAT estate inclusion risk can be avoided through a Split Purchase Annuity Trust.
- 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.

Split Purchase Annuity Trust

- 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 are likely to).

7. Note Sale Transactions in Late 2020

Why and How Clients Might Use Note Sales in Late 2020

Beyond the Exemption

- Interest rates are at historic lows, values of many assets remain depressed, discounts may be available now but eliminated in the future, grantor trusts may be impacted, and more.
- The traditional use of a note sale transaction to freeze values at low levels and lock in discounts before uncertain changes in the law may be a valuable benefit for some clients.

Off Label Application of Note Sales

- For some clients consummating a note sale may be the first step in a plan to use exemption by quickly cancelling notes before year end or even waiting to see how the GA runoff election and tax law develops.
- For other clients, a note sale may freeze assets outside their estate but provide a source of cash flow via interest and principal payments in future years.

Is a "Double Wandry" Twice as Good as a Mere Wandry?

- A Wandry clause, if successful, could leave significant equity in the client's estate. That could be a costly mistake if the Democrats secure the two GA runoff spots in the Senate and push through tax changes. Perhaps a better approach might be to use a double or two tier Wandry.
- Tier one applies like any typical Wandry.
- Simultaneously sign a sales contract effective on the same date as the initial transfer that sells any equity remaining in the client's estate as a result of the Wandry clause at the gift tax value as finally determined.

8. Intentionally Defective Deferred Interest

How Clients Might Use A Defective Preferred Interests under 2701 in Late 2020

Intentionally Defective Gift of Deferred Interest

- A donor can create an entity that has preferred interests that are not compliant with Section 2701 and participating interests.
- If the donor gifts or sells the participating interests to a trust for the donor's children, the donor will be treated as having made a gift of the value of the retained preferred interest without parting with any actual interest.
- Donor and children create a preferred partnership where parent acquires a non-qualified preferred interest and children (or a GST exempt grantor trust) acquires the common. The parent will be deemed to have made a gift of the value of the preferred. Parent will own the preferred until death, getting preferred payments and the value should remain the same at death on account of a right to put the preferred for its acquisition price.
- If the donor retains the interest until death, its value will be included in the donor's gross estate. Reg. 25.2701-5 will permit the estate to reduce the estate tax base by the value on the donor's prior gift that was attributable to the application of Section 2701.

Part 3: Un-Winding Estate Planning

Unwinding Unwanted Planning

Unwinding Unwanted Planning - 1

- Make all transfers in trust.
- Provide that the trustee (or at least one trustee) may disclaim any transfer offered to the trust and have the trust provide that the disclaimed property will go back to the donor.
- Is that allowed? It should be if local law so permits. For example, Alaska Statute 13.70.030(b)(1) provides: “a fiduciary may disclaim, in whole or in part, any interest in or power over property, including a power of appointment, if and to the extent that the instrument creating the fiduciary relationship grants the fiduciary the right to disclaim.”
- This almost certainly can work even in a state that does not have such a statute unless state law prohibits such a provision.
- And this almost certainly will be respected by the IRS and the courts. Cf. *Estate of Hoenig v. Commissioner*, 66 T.C. 471 (1976).

Unwinding Unwanted Planning – Beneficiary Disclaims - 2

- Consider including in irrevocable trusts a provision permitting one beneficiary to disclaim on behalf of all trust beneficiaries. That should give 9 months for clients to disclaim which under Sec. 2518 would result in the exemption not being used and the assets being restored and assets reverting to the settlor.

Unwinding Unwanted Planning – QTIP - 3

- Create a “QTIP’able” trust described in Section 2523(f) for the property owner’s spouse (if a US citizen).
- If the client wants to use the gift tax exemption, do not elect for marital deduction treatment, which will mean exemption is used. A partial election can be made if desired.
- One might want to see whether the assets transferred to the QTIP’able trust have increased or deceased in value in determining whether to elect marital deduction treatment.
- It is doubtful a *Clayton*-type QTIP can be used for gift tax purposes. It has only been approved for estate tax purposes. Treas. Reg. §20.2056(b)-7(d)(3).
- If the taxpayer wants to “undo” the transfer, then elect for marital deduction treatment so that no exemption is used. The trustee might invade the trust and transfer the assets to the beneficiary spouse who could return them to the grantor-spouse without any tax if the grantor is also a US citizen. But consider fiduciary liability to the QTIP’able trust’s remainder beneficiaries.
- This decision can be postponed until October 15, 2021 gift tax filing deadline.

Should Clients Unwind "Unwanted" Planning?

- Should clients really unwind planning already completed? Should clients stop planning that is in process?
  - Democrats might win the runoff seats and have equality in the Senate with the Vice President Harris breaking a tie vote.
  - 2022 elections.
  - 2024 elections.
  - 2026 exemption drops regardless.
  - Regardless of elections how will deficits be addressed?
  - What Regulatory actions might President Biden take?

Conclusion and Additional Information

Conclusions

- Core estate planning documents need to be updated. Covid will eventually diminish in importance but valuable planning lessons have been learned and can be implemented.
- Everything has changed, and it all may change again (or not). Even when the Presidential election is clarified, the runoff elections remain. Even when those are clarified, Regulatory actions and general political negotiations may have unanticipated results.
- Tax-oriented planning that provides access and asset protection benefits, should be considered.
- Now - Practitioners should be proactive to advise clients whether and how to proceed with planning.

Additional information

- Robert Keebler Robert.Keebler@keeblerandassociates.com
- Jonathan G. Blattmachr jblattmachr@hotmail.com
- Martin M. Shenkman shenkman@shenkmanlaw.com
- Interactive Legal sales@interactivelegal.com
- Peak Trust Company bcintula@peaktrust.com

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