

ESTATE PLANNING FOR MARRIED CLIENTS IN A WORLD WITH PORTABILITY AND THE MARITAL DEDUCTION

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Transfer Taxes – TCJA 2017 (pp. 1-2)

▶ Unified Transfer Tax System

- \$10,000,000 exclusion/exemption for gift, estate and GST tax - for years between 2019 and 2025
- Indexed for inflation using "Chained CPI" (C-CPI-U)
 - **\$11.4 million for 2019 (Exhibit A)**
- For years 2011-2017 (and after 2025), \$5 million adjusted for inflation - \$5.49 million for 2017
- 40% rate on excess

▶ Income Tax Rates are Higher

- Trusts and estates hit the top bracket at:
 - \$12,500 for 2017 and 2018; \$12,750 for 2019
 - \$12,950 for capital gains in 2019
- 3.8% additional NII tax

▶ Portability is Permanent

The Analysis Has Changed

- ▶ Ordinary income tax rates exceed estate tax rates
- ▶ Higher capital gain rates (23.8%) make basis more important
- ▶ High estate tax exclusion makes estate tax savings illusory for most people
- ▶ The definition of "married couple" has changed
- ▶ For couples in the \$2 to \$22 MM range, is the complexity and federal income tax exposure worth trust's non-tax benefits?

Portability (pp. 2-15)

- ▶ Allows surviving spouse to "inherit" or "port" unused gift and estate tax exclusion of deceased spouse
- ▶ Enacted in 2010; made permanent by ATRA 2012
- ▶ Vocabulary: (p. 3)
 - "Basic Exclusion Amount"
 - "Applicable Exclusion Amount"
 - "Deceased Spousal Unused Exclusion Amount" (DSUE amount)
 - "Executor"
 - "Last deceased spouse"

Example 1, the Basics: (p. 3)

- ▶ H dies in 2011 with \$3 million estate
- ▶ \$2 million to spouse; \$1 million to children
- ▶ DSUE amount available to W = \$4,000,000
 - $\$5,000,000 - \$1,000,000 = \$4,000,000$
- ▶ Wife's 2011 Applicable Exclusion Amt=\$9,000,000
 - Basic Exclusion Amount: \$5,000,000
 - DSUE amount: \$4,000,000
 - Applicable Exclusion Amount: \$9,000,000
- ▶ Wife's 2019 Applicable Exclusion Amt=\$15,400,000
 - Basic Exclusion Amount: \$11,400,000
 - DSUE amount*: \$ 4,000,000
 - Applicable Exclusion Amount: \$15,400,000

*DSUE amount does not adjust for inflation

Final Regulations

- ▶ Making the election
 - Timely filed estate tax return (pp. 5-6)
 - "Complete and Properly Prepared" return (no short form, but . . .) (p. 7)
 - "Executor" makes the election (or opts out of election) (*See Est. of Vose*) (p. 6)
 - Court-appointed executor, if any, controls election
- ▶ Computation of DSUE amount (pp. 8-9)
 - DSUE amount available for porting is lesser of:
 - Basic Exclusion Amount; or
 - the Deceased Spouse's *Applicable* Exclusion Amount, less taxable estate (including adjusted taxable gifts)

Final Regulations (cont.)

- ▶ Last Deceased Spouse (p. 9)
 - Remarriage by itself okay (so long as new spouse survives)
 - Measured at time of gift by surviving spouse
- ▶ Using the DSUE amount (pp. 9-10)
 - Can be used (with caution) immediately after death, but must be sure that election is made, etc.
 - Early use ensures post-gift appreciation removed from tax and may prevent loss on re-marriage
- ▶ Ordering rule (p. 11)
 - Gifts by surviving spouse use DSUE amount first
 - Very favorable construction maximizes DSUE benefit



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Example 4, Use DSUE First: (p. 8)

- ▶ H1 dies in 2011 with \$2 million DSUE amount
- ▶ W's Applicable Exclusion Amount = \$7 million
- ▶ W makes gift of \$1,500,000
 - W's Applicable Exclusion Amount then \$5,500,000
- ▶ W remarries and predeceases H2, leaving all to H2
- ▶ DSUE amount passing to H2 = \$5,000,000:
 - W's Basic Exclusion Amount: **\$5,000,000**
 - W's Applicable Exclusion Amount: **\$7,000,000**
 - Less Taxable Gifts: **(\$1,500,000)**
 - Unused Applicable Exclusion Amount: **\$5,500,000**
 - DSUE amount (lesser of BEA or unused AEA) **\$5,000,000**

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Example 5, Omit Taxable Gifts: (pp. 8-9)

- ▶ W makes taxable gifts of \$6 million while married to H1, paying gift tax on \$1 million
 - ▶ H1 dies leaving \$5 million DSUE amount to W
 - ▶ Under the Statute
 - Basic Exclusion Amount: \$5,000,000
 - Plus DSUE amount: \$5,000,000
 - Less Taxable Gifts: (\$6,000,000)
 - Remaining Exclusion: **\$4,000,000 -BUT . . .**
 - ▶ Under the Regulations
 - Basic Exclusion Amount: \$5,000,000
 - Plus DSUE amount: \$5,000,000
 - Less Taxable Gifts: (\$5,000,000)*
 - Remaining Exclusion: **\$5,000,000 – ☺**
- *Exclude any amount on which gift taxes were paid**

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Examples 7-8, Timing of Gifts: (pp. 9-10)

- ▶ W dies June 2, 2011 leaving her entire estate to H
- ▶ In July, H makes taxable gift of \$7 million
- ▶ On March 1, 2012, W's executor timely elects to extend the filing of W's estate tax return until September 2, 2012
- ▶ On April 15, 2012, H files a gift tax return claiming W's \$5 million DSUE amount
- ▶ If W's executor elects portability on an estate tax return, filed by September 2, 2012, H may use DSUE amount

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Examples 9-10, Who is the Last Deceased Spouse?: (pp. 10-11)

- ▶ W1 dies in January 2011 leaving her entire estate to H
- ▶ H marries W2 in February 2011
- ▶ H makes \$7 million taxable gift in March 2011
- ▶ W2 dies in June 2011
- ▶ If W1's executor elects portability, H may use W1's DSUE amount for gift
 - W1 was his "last deceased spouse" on date of gift
- ▶ H cannot use W2's DSUE amount
 - W2 was not his last deceased spouse on date of gift

Portability Quiz:

- ▶ H1 dies with \$2 million estate payable to children. H1's executor elects portability so \$3 million DSUE amount passes to W.
- ▶ W now has an \$8 million AEA; she marries H2
- ▶ W dies with an estate of \$1 million passing to her children. W's executor elects portability.
- ▶ What DSUE amount does H2 receive from W?
 - \$7 MM (W's \$8 MM AEA less her \$1 MM TE)?
 - \$4 MM (W's \$5 MM BEA less her \$1 MM TE)?
 - \$5 MM (Lesser of (i) W's \$5 MM BEA or (ii) W's \$8MM AEA less her \$1 MM TE)

Applicable Exclusion Using DSUE From Multiple Deceased Spouses

- ▶ H1 dies leaving \$10 million DSUE amount to W
- ▶ W's Applicable Exclusion Amount = \$21.40 million
- ▶ W makes taxable gift of \$2,000,000
 - W's Applicable Exclusion Amount then \$19,400,000
- ▶ W marries H2 who dies leaving \$11 million DSUE amount to W – W then dies
- ▶ W's Applicable Exclusion Amount = \$24,400,000
 - W's Basic Exclusion Amount still: \$11,400,000
 - H1's DSUE amount applied to W's gifts: \$ 2,000,000
 - H2's unused DSUE amount: \$11,000,000
 - W's Applicable Exclusion Amount: \$24,400,000

Example 12, Black Widow: (pp. 11-12)

- ▶ H1 dies in 2011 with \$5 million DSUE amount
- ▶ W's Applicable Exclusion Amount = \$10 million
- ▶ W makes gift of \$5,000,000
 - Applicable Exclusion Amount then \$5,000,000
- ▶ W marries H2 who dies with \$5 million DSUE amount passing to W
- ▶ W makes another gift of \$5,000,000
 - Applicable Exclusion Amount then \$5,000,000
- ▶ W marries H3 and W dies
- ▶ W's executor may elect portability, so DSUE amount to H3=\$5,000,000!
 - Prior gifts covered by DSUE amounts from H1 and H2
 - W's Basic Exclusion Amount still \$5,000,000



Portability and State Death Taxes

- ▶ 17 States and DC have a state estate and/or inheritance tax (p. 35)
- ▶ States with portability of excess state exemption
 - Hawaii
 - Maryland (after 2019)

Portability and State Death Taxes

- ▶ Consider state death tax bypass trusts
- ▶ Example: State with \$1 million exclusion—H dies with estate of \$6 million
- ▶ State with state-only QTIP Trust:
 - \$1 million passes to Bypass Trust
 - \$4 million passes to state-only QTIP Trust
 - \$1 million passes to federal and state QTIP Trust
 - Executor makes all state and federal QTIP elections
- ▶ State with **no** state-only QTIP Trust
 - \$1 million passes to Bypass Trust
 - \$5 million passes to QTIP Trust
 - Executor makes federal QTIP *and portability* elections
- ▶ Result in either case: Full transfer tax deferral and preservation of both state and federal exclusions

Nonresident Issues (pp. 12-13)

- ▶ Nonresident, noncitizen decedent cannot leave DSUE amount
 - No portability election available
- ▶ Nonresident, noncitizen surviving spouse cannot use DSUE amount (unless allowed by treaty)
 - But could preserve it
- ▶ Final DSUE amount when using QDOT Trust not measured until QDOT terminates

Observations About Portability

- ▶ Consider addressing DSUE amount in pre- or post-nuptial agreements (p. 13) (See Exhibit B; *Est. of Vose*)
- ▶ Gifts using DSUE amounts from multiple deceased spouses is permitted (pp. 11-12)
- ▶ Beware of your tax apportionment language (p. 41)
- ▶ Consider transmission expenses
 - Reducing marital deduction gives higher income tax deduction but reduces DSUE amount
 - Deducting them for estate tax purposes means no income tax deduction, but larger DSUE amount

More Observations About Portability

- ▶ Consider authorizing (or directing) executor to file Form 706 at surviving spouse's request (pp. 4-5)
- ▶ Must file timely estate tax return (p. 5)
 - Automatic 6-month extension (file Form 4768)
 - Up to 2 years after date of death **IF** below filing threshold, i.e. pure portability return (follow Rev. Proc. 2017-34)
- ▶ **You MUST discuss portability** with every Executor of a married decedent **and DOCUMENT the discussion and decision** about filing (Exhibit C)

Outright to Spouse + Portability vs. Trust Planning (p. 14)

- ▶ Need to elect by filing IRS Form 706
- ▶ No creditor or divorce protection for surviving spouse
- ▶ Spouse may dispose of inherited assets
- ▶ No estate tax shelter for appreciation
- ▶ No portability of GSTT exemption
- ▶ Possible loss on remarriage
- ▶ REMEMBER: You must still consider the portability election, even if trust planning used

Marital Deduction Formula Gifts (pp. 15-22)

- ▶ Optimal division of estate assets between Marital and Bypass gifts
- ▶ Avoid capital gain on funding

Historically:

- ▶ Shift post-death appreciation to Bypass gift
- ▶ Shift income-producing assets to Bypass gift

Four Income Tax Issues with Funding

- ▶ Distributions carry out DNI (pp. 16-20)
- ▶ Gain (or Loss) on funding (pp. 20-21)
- ▶ Unauthorized non-pro rata distributions (p. 21)
- ▶ Income in Respect of a Decedent (IRD) (pp. 21-22)

DNI Carry Out Rules (pp. 16-20)

- ▶ No DNI carry out for specific bequests
- ▶ No DNI for specific sums of money
 - "Specific Sum of Money" requires ascertainability
 - Impact on formula bequests
- ▶ The Tier Rules (p. 18)
- ▶ The Separate Share Rule (pp. 18-19)
- ▶ Income from property specifically bequeathed (pp. 19-20)

Income Tax Issues

- ▶ Distributions carry out DNI
- ▶ Gain (or Loss) on funding (pp. 20-21)
- ▶ Unauthorized non-pro rata distributions
- ▶ Income in Respect of a Decedent (IRD)

Income Tax Issues

- ▶ Distributions carry out DNI
- ▶ Gain (or Loss) on funding
- ▶ Unauthorized non-pro rata distributions (p. 21)
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Income Tax Issues

- ▶ Distributions carry out DNI
- ▶ Gain (or Loss) on funding
- ▶ Unauthorized non-pro rata distributions
- ▶ Income in Respect of a Decedent (IRD) (pp. 21-22)

Types of Formula Clauses (pp. 22-27)

- ▶ Pecuniary Clauses:
 - "True Worth" (p. 24)
 - Fund with *date-of-distribution* values
 - "Minimum Worth" (pp. 24-25)
 - Fund with *lesser* of estate tax or date of distribution values
 - "Fairly Representative" (p. 25)
 - Fund with *federal estate tax* values
- ▶ Fractional Share (pp. 25-26)

Funding Various Formulas (pp. 27-29)

- ▶ Select the funding date (pp. 27-28)
- ▶ Do the math (p. 28)
- ▶ Review goals (p. 28)
 - Minimize capital gains
 - Maximize Bypass Trust?
- ▶ Evaluate non-tax factors (p. 28)

Lessons in Funding (pp. 28-29)

- ▶ True Worth Gifts
 - *Fund the formula gift with depreciated (or the least appreciated) assets*
 - ▶ Minimum Worth Gifts
 - *Fund the Bypass gift with appreciated (or the least depreciated) assets*
- Both:
- ▶ Fairly Representative
 - ▶ Fractional Share
 - *Indifferent as to which specific assets go to fund which gift*

Other Issues When Funding (pp. 29-32)

- ▶ Valuation issues (pp. 29-30)
- ▶ Other tax effects (pp. 30-32)
 - Terminating distributions
 - Funding post-death revocable trusts
 - Deducting interest on pecuniary bequests
- ▶ Non-tax issues
 - Economic viability
 - Benefits dependent upon owner
 - Beneficiary preferences
 - Use of partnerships?

A New Estate Planning Paradigm (pp. 32-42)

- ▶ Are Bypass Trusts out? (pp. 32-34)
 - Administrative cost/complexity
 - No basis adjustment at second death
 - High income tax rates on accumulated income
 - Problems with special assets (retirement plans, residences, S-corps and other pass-through entities)
 - Managing downsides (investments, distributions)
 - Disclaimer Bypass Trusts (p. 34)
 - Adds flexibility to the estate plan
 - At cost of special power of appointment
 - Not "simple," e.g. requires disclaimer within 9 months

Is All to QTIP the Solution? (pp. 37-41)

- ▶ Compare/contrast QTIP Trusts (pp. 37-38)
 - Creditor/divorce protection
 - Less retained income for compressed tax brackets
 - New cost basis at second death (if QTIP elected)
 - Preserve GSTT exemption (by "reverse" QTIP election)
 - No estate tax savings (but DSUE amount available)
- ▶ QTIP drawbacks (pp. 39-40)
 - No "sprinkle" power
 - Estate tax exposure (above DSUE amount)
 - High income tax rates
 - Rev. Proc. 2001-38 and the Rev. Proc. 2016-49 solution (pp. 39-40)
 - Clayton QTIPs (pp. 40-41)
 - The QTIP Tax Apportionment Trap (p. 41)

How about a "LEPA" Trust? (p. 42)

- ▶ Life Estate Power of Appointment Trust
- ▶ All income to spouse—like QTIP Trust
- ▶ No need to file an estate or gift tax return
- ▶ Automatic basis adjustment at death
- ▶ Spouse must have unrestricted GPOA to appoint to self or estate
 - Inter vivos vs. testamentary
- ▶ BUT:
 - Spouse may appoint assets elsewhere
 - Possible creditor exposure – inter vivos vs. testamentary GPOA?
 - No "reverse LEPA" election for GSTT purposes

Clients' Estate Planning Goals

	Outright to Spouse	All to Bypass Trust	All to QTIP Trust	All to LEPA Trust
Keep it Simple	Y	N	N	N
Creditor/Divorce Protection	N	Y	Y	Y/N
Control Ultimate Disposition	N	Y	Y	N
Management Assistance	N	Y	Y	Y
Sprinkle/Spray to Kids, etc.	N*	Y	N	N
Preserve GSTT Exemption	N	Y	Y	N
Avoid High Trust Income Taxes	Y	N	Y**	Y**
Avoid Estate Tax on Appreciation	N	Y	N	N
New Cost Basis at 2 nd Death	Y	N	Y	Y

*But enhanced gifting possible using DSUE Amount

**Due to less income accumulation, but no ability to shift income

What Drives the Estate Plan

- ▶ Total net worth
- ▶ Age (and age difference of spouses)
- ▶ Presence of out-of-state property (state death tax exposure)
- ▶ Occupation/creditor exposure
- ▶ Spending habits/growth expectations
- ▶ Client tolerance for complexity
- ▶ Client desire for control
- ▶ Blended family vs "traditional" family
- ▶ Clients' views of "permanency" of tax laws
- ▶ Asset mix

Clients' Asset Mix and Step-Up*

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"Step-Up" Important

Copyrights, Trademarks, Patents & Artwork	---- Ordinary & Long-Term
"Negative Basis" Commercial Real Estate LPs	---- Ordinary & Long-Term
Artwork, Gold & Other "Collectibles"	----- 28% Long-Term
Low Basis Stock	----- 20% Long-Term
Roth IRA Assets	----- Tax Free—No Surcharge
High Basis Stock	----- Minimal Gain
Fixed Income	----- Typically Minimal Gain
Cash	----- Basis = Face
Passive Foreign Investment Co (PFIC) Shares	---- No "Step-up" Allowed
Stock at Loss	----- Losses Erased
Variable Annuities	----- Partially IRD
Traditional IRA & Qualified Plan Assets	----- Typically All IRD

"Step-Up" Not Important

What Works Now – Inter Vivos Planning

- ▶ Intra-Family Loans (pp. 43-45)
- ▶ Outright Gifting (pp. 46-49)
- ▶ Irrevocable Life Insurance Trusts (pp. 49-51)
- ▶ Sale to Intentionally Defective Grantor Trust (pp. 52-57)
- ▶ Accidentally Perfect Grantor Trusts (pp. 57-61)
- ▶ Grantor Retained Annuity Trusts (pp. 62-65)
- ▶ Qualified Personal Residence Trusts (pp. 65-68)
- ▶ Private Foundations (pp. 68-74)
- ▶ Donor Advised Funds (pp. 74-75)
- ▶ Charitable Lead Annuity Trusts (pp. 75-77)
- ▶ Charitable Remainder Trusts (pp. 78-82)
- ▶ Health and Education Exclusion Trusts (HEETs) (pp. 83-86)
- ▶ Self-Cancelling Installment Notes (pp. 87-89)
- ▶ Private Annuities (pp. 89-91)
- ▶ The Preferred Partnership "Freeze" (pp. 91-94)

Intra-Family Loans (pp. 43-45)

- ▶ Easy to understand
- ▶ IRS interest rates are still low (although increasing)
- ▶ Use term loans with stated interest
- ▶ Interest may generate taxable income to lender
- ▶ Consider using mortgage to make interest deductible to borrower
- ▶ Consider using grantor trust as borrower

Outright Gifting (pp. 46-49)

- ▶ Easy to understand
- ▶ Annual exclusion gifts and the power of compounding
- ▶ Giving discounted assets
- ▶ Larger gifts within gift tax exclusion
- ▶ Effect of paying gift tax
- ▶ Post-gift income shifted to donee
- ▶ Note: Carryover basis

Are Discounts Still Available? (pp. 55-56)

Proposed 2704 Regs. withdrawn

- Executive Order 13789
- Notice 2017-38 – issued July 7, 2017
- ▶ Doing it Right – *Estate of Purdue* (p. 54)
 - Significant non-tax business purpose
- ▶ Doing it Wrong – *Estate of Powell* (p. 54)
 - Power of attorney and conflicting fiduciary duties

Irrevocable Life Insurance Trusts (pp. 49-51)

- ▶ Life insurance death benefit included in insured's taxable estate if insured owns or controls the policy
- ▶ No estate tax if insured has no "incidents of ownership"
- ▶ Child-owned insurance vs. ILIT
- ▶ Transfers of existing policies – the three-year rule
- ▶ Avoiding the three-year rule:
 - Have new insurance acquired by ILIT from inception
 - Transfer of existing policy for "adequate and full consideration in money or money's worth"
 - Avoiding "transfer-for-value" rules
- ▶ Other ideas for life insurance

Sale to an Intentionally Defective Grantor Trust (pp. 52-57)

- ▶ Sale and interest on note ignored for income tax purposes
- ▶ Trust must be credit-worthy
- ▶ Best when appreciation exceeds AFR
- ▶ Best if sold assets appreciate rapidly
- ▶ Best if cash flow from asset services the debt
- ▶ Can allocate GSTT exemption to trust
- ▶ Respect the transaction!

Accidentally Perfect Grantor Trusts (pp. 57-61)

- ▶ Shifting wealth to older-generation family members is no longer taboo
- ▶ Transfer property into trust to avoid senior's lifetime creditors and maintain control
- ▶ Junior creates grantor trust and gives or sells low-basis assets to trust
- ▶ Trust grants low-net-worth senior beneficiary general power of appointment over appreciated assets

Accidentally Perfect Grantor Trusts (pp. 57-61)

- ▶ GPOA results in basis adjustment at death of senior beneficiary
 - If power is not exercised, trust remains grantor trust as to junior
 - If power is exercised, trust becomes complex trust
 - Limited by depreciation or depletion?
- ▶ May allocate senior beneficiary's GSTT exemption
- ▶ **RESULT:** Assets pass at senior's death into creditor-proof, estate-tax-exempt, GST-tax-exempt trust f/b/o junior or other descendants, with new cost basis, without estate tax or gift tax

Grantor Retained Annuity Trusts (pp. 62-65)

- ▶ Expressly sanctioned by Code and Regulations
- ▶ Best whenever appreciation exceeds IRC 7520 rate
- ▶ Short-term vs. Long-term GRATs
- ▶ Best if gifted assets appreciate rapidly
- ▶ Best if annuity payments not made in kind

Qualified Personal Residence Trusts (pp. 65-68)

- ▶ Expressly sanctioned by Code and Regulations
- ▶ Transfer personal residence to trust, retaining use for set period
- ▶ Gift is current value of residence, discounted to present value over QPRT term
- ▶ Longer term reduces value of gift, but benefit lost if grantor dies during term
- ▶ Lower value of gift if interest rates are high
- ▶ Must rent house after term ends – use grantor trust as "landlord"

Private Foundations (pp. 68-74)

- ▶ “Private” charitable giving but public annual reports
- ▶ Typically grant-making charitable trust or non-profit corporation
- ▶ Contributions are income tax-deductible
 - Up to 30% of AGI for cash; 20% for appreciated property
 - Deduction limited to basis for tangible property
- ▶ Foundation is income tax-exempt except 2% excise tax
- ▶ Foundation handles compliance
- ▶ Must distribute at least 5% of assets annually
- ▶ Subject to numerous excises taxes for impermissible actions

Donor Advised Funds (pp. 74-75)

- ▶ “Private” charitable giving through public charity fund
- ▶ Allows donor to “advise” on grants
- ▶ Contributions are income tax-deductible
 - Up to 60% of AGI for cash (years 2018-2025); 30% for appreciated property
- ▶ Charitable fund handles investments and all compliance
- ▶ No requirement to distribute 5% annually
- ▶ May name one or more successor advisors to continue legacy

Charitable Lead Annuity Trusts (pp. 75-77)

- ▶ Trust pays annuity to charity for number of years or lifetime; remainder passes to non-charities
- ▶ Gift to non-charities is future interest so no annual exclusion
- ▶ IRS assumes assets will grow at 7520 rate
 - 'Best of' current or two preceding months' rate
- ▶ Annuity and amount of taxable gift are valued at time of funding – not at end of charitable term
- ▶ Can be inter vivos or testamentary

Charitable Lead Annuity Trusts (pp. 75-77)

- ▶ Grantor decides income tax options at set-up:
 - Non-Grantor Trust: no charitable deduction; trust pays tax on income less charitable deduction
 - Grantor Trust: up-front charitable deduction; Grantor pays all tax on trust income
 - Grantor Trust risk: If grantor trust status terminates before term expires, must recapture part of income tax deduction
- ▶ May allocate GSTT exemption at funding but not finally determined until trust termination – exemption grows at 7520 rate
- ▶ Transferred assets – Caution about using closely-held business interests or debt-financed property
 - Excess business holding and self-dealing rules

Charitable Remainder Trusts (pp. 78-82)

- ▶ Trust for grantor or others for one or more lives or term \leq 20 years, remainder to charity
- ▶ Trust is income tax-exempt
- ▶ Trust must track undistributed income by category
 - CRT distributions carry out income on "WIFO" basis
 - Ordinary, ST cap gain, LT cap gain, exempt, principal
- ▶ Income tax deduction for actuarial value of gift to charity (best when interest rates are high)
- ▶ Taxable gift if non-charitable interest not kept by grantor
- ▶ Can postpone recognition of gain for long period
- ▶ Watch out for UBTI (including debt-financed income)

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Health and Education Exclusion Trusts (pp. 83-86)

- ▶ Health and Education Exclusion or 2503(e) Trust
- ▶ Qualified 2503(e) payments (tuition and medical) aren't taxable gifts so aren't GST taxable transfers
- ▶ Problem: Gift to trust for skip persons only is direct skip (i.e., GSTT transfer), even if funds are later used for non-taxable purposes
- ▶ But, trust for grandchildren plus non-skip person (e.g., charity) is not a GSTT transfer
- ▶ Non-skip beneficiary's interest must be significant
- ▶ Distributions from trust that are qualified transfers are not subject to GST tax
- ▶ Targeted in last administration's "Greenbook"

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Self-Cancelling Installment Note (pp. 87-89)

- ▶ Note given as part of sales transaction but note terminates on earlier of term or death of seller
- ▶ Self-cancelling feature requires risk premium of higher interest or principal
 - Unclear if 7520 rate can be used to determine premium
- ▶ Best if seller not expected to reach life expectancy, but must not be terminal (50% chance of death within one year)
- ▶ Best when interest rates are low
- ▶ Risk sale not recognized as bona fide, causing inclusion of sold assets in seller's estate

Private Annuity (pp. 89-91)

- ▶ Lifetime annuity given as part of sales transaction
- ▶ Best when interest rates are low and seller not expected to reach life expectancy
 - To offset risk of living beyond life expectancy, consider annuity for earlier of term or death
- ▶ Clear that 7520 rate applies to set annuity, as long as seller is not terminal (50% chance of death within one year)
- ▶ Proposed regs. say all gain recognized on sale
- ▶ If paid from trust or limited fund, exhaustion test must be met (payable until age 110)

The Preferred Partnership Freeze (pp. 91-94)

- ▶ Involves transfer of common interest, retention of preferred interest in family-controlled entity
- ▶ Applicable retained interest per IRC § 2701
 - Distribution or liquidation right, put, or call
 - Valued at zero unless exception applies
- ▶ Exception to applicable retained interest rules if preferred interest provides for qualified payment
- ▶ Qualified payment
 - Fixed annual payment
 - Paid within 4 years or accrues interest

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Technique Comparison

	"Income" to Grantor	Decreases Estate	Basis Adjust	GST	Funding?
Outright Gifts	N	Y ¹	N	N	N/A
ILIT	N	Y	Y	Y	N/A ⁹
Sale to Kids	Y	Y ¹	Y ²	N	Note
Sale to Non-Gr Trust	Y	Y ¹	Y ²	Y	Note
Sale to IDGT	Y	Y ¹	N ³	Y	Note
Accidentally Perfect Gr Trust	Y	Y ¹	Y ⁵	Y	Note
GRAT	Y	Y ¹	N	N ⁶	Annuity ⁸
QPRT	N	Y	N	N ⁶	Occupancy ⁸
CLT	N	Y	N	Y ⁷	Remainder?
CRT	Y	Y	N ⁴	N ⁴	Ann. or uni.
HEET	N	Y	N	Y	N/A
Private Annuity	Y	Y, maybe	N	Y	Annuity
SCIN	Y	Y, maybe	Maybe	Y	Note
SLAT	?	Y	N	Y	N/A

1 By appreciation

2 But at cost of capital gain recognition

3 While grantor trust status stays in place

4 Doesn't matter

5 At death of power holder (not at time of transfer), plus 1014(b)(9) issue

6 Not until end of ETIP

7 Funding amt plus growth at AFR, can allocate more at end of term

8 During initial term; with QPRT, rent obligation unless repurchase

9 Hedge technique

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