

# PRACTICAL ESTATE PLANNING IDEAS FOR 2011 & 2012

## Tulsa Estate Planning Forum

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# I. MAJOR FEATURES OF ESTATE & GIFT TAX LAW 2011-2012 (*"2010 ACT"*)

Effective in 2011 and 2012:

- 2010 Act extended provisions of EGTRRA for two years to 2011 and 2012
- Made changes to FET, FGT and FGST
- FET: \$5.0M Exception; 35% Tax Rate Exemption indexed for lifetime after 2011

- FGT: \$5.0M Exemption; 35% Tax Rate
- FGST: \$5.0M Exemption
- Basis: Stepped up to DOD value
- Portability of Exemption between spouses (Section 2010(c)(4)) – “DSUEA”
  - Death in 2011 or 2012
  - Election required by First Decedent’s “Executor”
  - Election must be on Timely Filed Federal Estate Tax Return; Irrevocable
    - *Even Small Estates must File Return*

- Applies to FET And FGT but NOT to FGST
- Useful Application to Gifts by Surviving Spouse in 2011 and 2012 to Increase Lifetime Gifts
- “Sunset” of Law after 2012:
  - 2001 Law (pre-EGTRRA law) Reinstated with \$1.0M Exemption and 55% top tax rate
  - Sunset Language raises GST issues: “as if EGTRRA had never been enacted”
  - Uncertain Effect in Distributions from GST Trusts after 2012

# OTHER PROVISIONS IN 2010 TRA

- 6166 Expanded
- \$100,000 Charitable IRA Rollover
- “Fixes” for GST Transactions in 2010
- Imposes FET on 2010 Decedents Who must “Elect Out” to Avoid Estate Tax
  - Election out of GET will Require Selecting Assets for Limited Basis Step-up (Form 8939)

- 2011 Greenbook Proposals *(issued 2/14/2011)*:
  - FET \$3.5 M Exemption and 45% Rate Effective after 2012
  - Portability Permanent
  - Limit GST to 90-Year Period *(Prospectively Effective)*
  - Establish “Disregarded Restrictions” by Regulation *(Prospectively Effective)* for Validity of Discounts in Family – Controlled Entities
  - GRATS: 10-Year Term; Remainder to Exceed Zero; No Decreasing Annuity Payments *(Prospectively Effective)*
- Rumors of Changes in 2011
  - Shorter Window of Time if You’re Nervous

## II. ESTATE PLANNING GOALS REMAIN THE SAME

- “Eliminate Estate Taxes to the Extent Possible” – A Standard Request
- Provide Assets for Surviving Spouse and Children (the Distribution Plan)
- Protect Spouse and Children from Creditors and Divorces
- Provide for Flexibility because Tax Law is Uncertain

- Protect Against Increase in Estate Value
- Manage IRA Distributions
- Accomplish Goals during Lifetime and at/after Death
- Other Goals Frequently Requested
- Difference in 2011-2012: Window of Opportunity

### III. LIFETIME TRANSACTIONS IN 2011 & 2012

- Driven by Increased FGT Exemption to \$5.0M or \$10.0M per couple
- Present Interest Gifts Remain Possible (\$13.0/donee/annum)
- Discounting of Family Business Interests Remains Possible (for now)
- Remove Future Appreciation from Donor's Estate

# • Clawback Risks at DOD of donor – appear unlikely

- But even if Clawback Occurs, the Gift Removes Appreciation
- Could Produce Liquidity Issues if Clawback Occurs
- Clawback Could Cause Apportionment Issues between Beneficiaries
- Protection Possibilities: Donor/Donee Agreements; Provision in Will or Trust

*CAVEAT: SELECTING AMONG THESE GIFTING  
OPTIONS REQUIRES SERIOUS FINANCIAL PLANNING  
SO THAT  
(A) FAMILIES' BASIC NEEDS ARE MET AND  
(B) THE STRUCTURES ARE RECOGNIZED AS VALID*

# • Outright Gifts of Cash, Properties

- “Large” Amounts Most Likely Go to Trusts
- Consider Durable Power of Attorney that Authorizes Attorney-in-fact to make Gift on Behalf of Incapacitated Client
  - Gifts to the Attorney-in-fact should be Limited to Avoid Grant of General Power of Attorney to that Person
- Basis Carryover – Step-up when Donor Dies is Lost
  - ***VERY IMPORTANT – Compare Capital Gain Rate Savings vs. Estate Tax Savings***
  - Possibly No Gift is Best

- Forgiveness/Cancellation of Loans –
  - Value is Principal and Accrued Interest (Regs. § 25.2512-4), but Other Factors may be Applicable to Get a Discount
  - Income Tax Risk upon Cancellation of Note?
    - Not if Transaction is in the Nature of a Gift and Not as a Discharge of Debt
    - Installment Sale Note Cancellation can Result in Income Tax under Section 453B Rules
  - Alternative: Pay Cash and Gift Cash Instead of Forgiving

# Gifts of Residences

- QPRT – More Attractive with Larger FGT Exemption;
  - Shorter Term Possible
  - Not as Good when § 4520 Rates are Low
- Sale-Lease after Term to grantor Trust has advantages

# ILITS – Higher Exemption Allows Prefunding; Possible Pay Off of Split-Dollar Loans

- Crummey Provisions Still Available
- Be Careful that Insured does Not have Incident of Ownership under Crummey Clause or Grantor Trust Provisions

# Gift to Grantor Trust (having § 671ff provisions)

- Income Taxed to Donor/Grantor
- Toggle Possibility

# Create Lifetime Credit Shelter Trust for Spouse

- Protection; Asset Appreciation
- No Marital Deduction; Not a QTIP
- Use FGT Exemption
- Have limited POA to Allow Donor to be Discretionary Beneficiary if Donor Survives

- **Problem:**

- No Basis Step Up on Death of Donor or Donor's Spouse for Assets in the Credit Shelter Trust

- **Solutions:**

- Distribute Assets to Spouse before her DOD
- Purchase Assets from the Trust
- Allow disinterested Trustee to give Spouse a General POA

# Reciprocal But Non-Reciprocal Trusts created by Spouses for Each Other with Independent Discretionary Trustee Powers

- Use Grantor Trust
- No Marital Deduction – Not a QTIP
- Removes Income
- Life Insurance can Build Value
- Creditor Protection
- Non-Reciprocal Trusts Protect both Spouses Regardless of Order of Deaths

# Dynasty Trusts for Multi-Generations

- RAP in Oklahoma is limited
- Estate Tax Savings Substantial over the Years
- GST Risks due to “Had Never Been Enacted” Clause in 2010 Act
- Possibly new 90-Year GST Rule under 2011 Greenbook Proposals

# Alternatives to Avoid the Gift

- Loan to Grantor Trust – Donor Receives Note
- Sale to Grantor Trust – Grantor/Seller Receives Note
  - “Seed” Money – 10%
- GRATs – Still Allowed without Limit on Term
- CLATs – “Zeroed Out” CLAT is Easier while Interest Rates are Low due to Lower “Hurdle Rate”

# IV. TESTAMENTARY PLANNING IN 2011-2012

- Uncertainty after 2012 must be Considered
- Need to Correct existing documents to avoid unintended consequences
  - Formula Clauses referring to IRC should be reviewed
  - Fall-Back Provision in Case Federal Estate Tax Law Repealed
- Use Independent Trustee or Other Independent Party to Make Changes or Direct Distributions
- Portability not yet Safe to Plan for Due to Sunset in 2012
  - Consider including Direction for Executor to Elect that Surviving Spouse Receive Decedent's Exemption

# Testamentary Distribution Plans during Uncertainty

- Depends on Each Client /Family Situation
- Joint Trusts for Small Estates?
- Basic Strategy: Get Assets to a Credit Shelter (Bypass) Trust to Shield Assets Permanently Against Estate Tax
  - A-B Trusts with Formulas
  - Disclaimer Trusts
  - Disadvantage: No Basis Step-up after Original Spouse's Death
    - Include Protection Mechanisms Discussed under Lifetime Gifts to Trusts

# Charitable Options to Reduce Estate Taxes

- Family Foundation or DAF as Beneficiary
- CLAT
- Good during Years of Low Interest Rates
- Risk of “outliving” the CLAT’s Usefulness as Family Ages
- CRUT

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