The Perfect Estate Planning Storm

By: John A. House, ChFC

Together, current economic conditions and the New Tax Rules are intriguing!

There has never been a better opportunity than today!

Seldom in the history of the Tax Code has there been a Lifetime Unified Exemption that has been so attractive. How are you positioned to take advantage of this unique opportunity?

Proven Estate Planning Strategies remain today that may disappear in the future which can assist you in leaving a legacy to a philanthropic cause that is important to you and, at the same time, benefitting your family and those who you care about.

The tax law changes that occurred this year may have a favorable impact on your Philanthropic and Estate Planning.

Wonderful opportunities are available for the well-informed!

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The "Perfect" Estate Planning Storm

Are you prepared to take advantage of this unique opportunity?

If one is interested in taking advantage of several dynamic planning strategies that favorably impact philanthropic and estate planning outcomes, *now* may be the ideal moment in history!

Never in the history of the Tax Code has the *Lifetime Unified Exemption* been so attractive. For example, a husband and wife can jointly transfer, free of gift tax, $10,680,000 in assets to children and grand-children while alive! If *fractional discounts,* for lack of marketability and control are employed through Limited Liability Companies (LLC) and Family Limited Partnerships (FLP), the Unified Exemption may be expanded by 20% to 40%, dependent upon the type of gifted assets.

For those that understand and appreciate the difference between Gift Taxes (exclusive) and Estate (death) Taxes (inclusive), in con-junction with one of the lowest gift tax rates (40%) in history, as noted in the example on the right side of this page, it may be beneficial to actually pay gift taxes today, especially if significant asset appreciation is expected! Given the new, rather favorable federal gift tax rate (40%), one is further encouraged to consider this rather attractive option.

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The "Perfect" Estate Planning Storm is further enhanced by several current economic conditions:

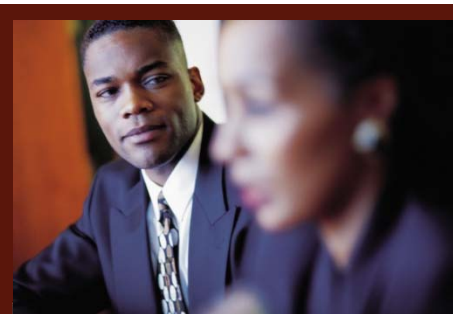
1) From a philanthropic perspective, the Federal Discount Rate (7520 Rate) is currently at historic lows, which makes use of Grantor and Non-Grantor-Styled Charitable Lead Annuity Trusts (CLATs) very attractive. (See attached CLAT explanation for further details.)

2) If families wish to initiate loans to the next generation for the acquisition of a business or to help with the purchase of a home, the Mid-Term/Long-Term loan rates are at extreme lows.

3) Because of the economic conditions related to the 2008-2009 market declines, lower valuations for real estate and business interests may occur, creating an ideal environment to transfer assets to the next generation.

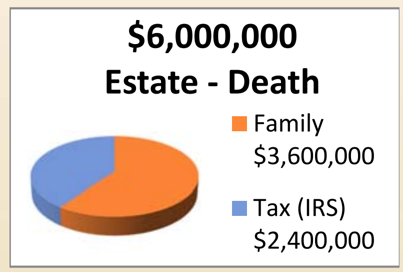
4) The Generation Skipping Tax Exemption, equal to the Unified Exemption ($5,340,000 per individual) is also at an all-time high.

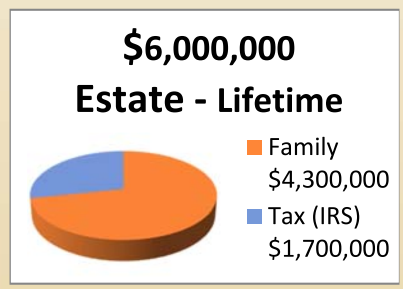
5) Under the new tax regime, the Unified Credit is "portable," thereby allowing more flexibility in the application of the Credit.



What is the difference between paying Gift Taxes while alive versus paying Estate Taxes upon death?

<u>Example</u>: Assumes that in both scenarios the Lifetime Unified Exemption (Unified Credit) has been totally exhausted. Therefore, both gift tax and death tax assessment occur with no offsetting Unified Credit. Let's also use the new Federal Gift and Estate Tax rate of 40%.





<u>Note</u>: Because gift taxes are deemed "Exclusive" when a gift of $4,300,000 occurs, the gift tax of 40% represents $1,700,000. Therefore, a potential tax savings occurs (when compared to taxes upon death--- $2,400,000) that approximates $700,000.

The Perfect Estate Planning Storm (continued)

Fortunately, the new 2014 Legislation did not negatively impact a number of important planning techniques such as:

Fractional discounts, for lack of marketability and control, remain available on properly accomplished intra-family transfers employing entity structures, i.e., Limited Liability Companies (LLC) and Family Limited Partnerships (FLP).

<u>NOTE:</u> New Federal Legislation does not preclude the ability to apply fractional discounts on family assets transferred from one generation to the next.

Under the new Federal tax rules, the Unified Exemptions are "portable," i.e., spousal flexibility, allowing one spouse to utilize the others exemption.

<u>NOTE:</u> The "portability regulations" were made permanent.

A Grantor-styled Irrevocable Trust that causes the Grantor to assume all income tax liability on the growth of the Trust assets, whereas the asset itself is deemed by the IRS to be "outside" one's taxable estate remain valid (assumes that the published rules are carefully followed).

<u>NOTE:</u> New Federal Legislation did not eliminate Grantor Styled Trusts.

Two types of CLAT's can be implemented:

1) Grantor-Styled CLAT

2) Non-Grantor styled CLAT

<u>Non-Grantor CLAT</u>

If you were to decide in favor of a Non-Grantor CLAT, you will receive no income tax deduction up front when you establish the Trust. And, you will incur no personal income tax liability on the potential growth of your CLAT assets. Importantly, upon completion of the "reversion period," you will have the choice of taking back the asset or passing it on to the next generation with any appreciation, ***free of transfer (gift) taxes, just as you do with a Grantor-styled CLAT.***

One should be aware that if the CLAT assets earn less than the 5% to 6% distribution rate, principal depletion will occur. To the contrary, if the underlying CLAT assets earn more than the cumulative distributions, the appreciation is not subject to gift taxes, assuming the CLAT assets are transferred to children.

Interestingly, through the use of a Non-Grantor Testamentary CLAT, created upon death, it is possible to totally eliminate the confiscatory estate tax assessment of those assets allocated to a "testamentary CLAT" and essentially divorce the IRS from your estate.

The CLAT Planning Strategy is well documented in the Tax Code, and can be accomplished without the risk of IRS scrutiny, assuming competent Legal Counsel and careful adherence to the statutory regulations.

<u>Grantor CLAT</u>

Under the current, very low 7520 Rate, both types of CLAT's are extremely attractive!

Assume, hypothetically, that you have experienced a 2014 taxable event (selling a business or a highly appreciated asset), and you have an interest in further support of your favorite charity. If you establish a Grantor-styled CLAT, 100% of the transferred assets are tax deductible today and can help serve as an offset to your capital gains transaction.

You may choose a distribution rate (usually 5% or 6% of the CLAT principal) and make distributions to a charity for a period of 14 to 16 years, i.e., a charitable contribution. You will not receive a deduction for each distribution, and you will incur a "phantom tax liability" on the growth or income gains of your CLAT principal throughout the duration of the Trust.

It is possible to reduce or eliminate the "phantom tax liability" through other planning techniques, just as it is possible to reduce the "reversion period" through the utilization of discounting strategies, i.e., FLP's or LLC's.

You have the choice at the end of the "reversion period" to reclaim the funding asset (CLAT Principal) or pass it on to your children. If you choose to reward your children with the CLAT Principal, under current tax law, there are no transfer (gift) taxes imposed, **regardless of the size or growth of the assets**!

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The Perfect Estate Planning Storm (continued)

The New Tax Rules do not limit the duration of all GST-styled Irrevocable Trusts to a 90-year term as originally proposed by the President.

NOTE: Under current law, it is possible in some states (no Rule Against Perpetuity) to forever perpetuate a Trust.

No restrictions were imposed upon the term of Grantor Retained Annuity Trusts (GRAT's).

NOTE: It is still possible to layer GRAT's and select short durations for maturity.

The New Tax Law did not eliminate the use of Qualified Personal Residence Trusts (QPRT's).

NOTE: Under the new law, a home can be transferred to an Irrevocable Trust at a discounted value, and be protected from judgment creditors and ultimately be removed from one's estate if the Grantor(s) outlive the "term" of the Trust.

Increased Income Tax Rates.

NOTE: Both income tax and capital gain tax rates have been increased.

Fortunately, there is now zero ambiguity on the following Rate Structures:

1. The Estate Tax Rate has increased to 40%.
2. The Gift Tax Rate has increased to 40%.
3. The Generation Skipping Tax Rate increases to 40% and is firmly established at $5,340,000.
4. The Lifetime Unified Exemption is firmly established at $5,340,000.
5. The Unified Exemption, upon death, is firmly established at $5,340,000.

Concluding Observations:

As evidenced by the tax and economic landscape, at least for the present, immense opportunities exist for the informed to reward the philanthropic organizations that they support and to further preserve the financial integrity of accumulated assets for children and grandchildren. Unfortunately, procrastination, being too busy and planning denial may prove to adversely impact your philanthropic and estate planning situation; **so be proactive and act today!**

Sources:

Trusts & Estates Magazine, May 2012, "Using Lifetime Exemptions Today"

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010

Department of Treasury

Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2012 – 2022"

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