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Estate Planning in Uncertain Times

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Overview

- Legislative Changes/Proposals
- Planning for Flexibility in the Context of a SLAT
  - Powers of Appointment
  - Decanting
  - Private Settlement Agreements
  - Trust Protector
  - Divorce Protections
  - Audit Protections

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Legislative Changes/Proposals

- CARES Act
- SECURE Act
- Infrastructure Bill
- Spending Bill

CARES Act

- New deduction for charitable donors who do not itemize but make a cash gift – Law allows up to a $300 deduction - available in 2021 and includes $600 for married couples
- Increase in the deduction limits up to 100% of AGI for cash gifts to charities in 2020 (and now 2021) – Does not include gifts to donor advised funds

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SECURE Act

- Limited stretch IRAs for non-spouse beneficiaries
- Inherited IRAs need to be fully distributed within 10 years after the death of the participant

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Tax Proposals

- September 13, 2021 proposals:
  - Raise capital gains rate by 5%
  - Lower estate tax exemption
  - Remove effectiveness of certain estate planning (grantor trusts, valuation discounts)
- Effective dates were scary
- Recent Biden proposal and subsequent modifications to the bill in the House did not include any of the above provisions

Tax Proposals

- Current Version of the Bill contains a new Section 1A to the Code which provides a surcharge of:
  – 5% on MAGI in excess of $10 million; and
  – Additional 3% on MAGI in excess of $25 million.
- MAGI is AGI less investment and business interest
- For estates and trusts surcharge applies at $200k and $500k
- Effective January 1, 2022

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Planning for Flexibility in Uncertain Times in the Context of a SLAT

– Powers of Appointment
– Decanting
– Private Settlement Agreements
– Trust Protector
– Divorce Protections
– Audit Protections

Spousal Lifetime Access Trust (SLAT)

- Variation of an irrevocable “grantor” trust
- Could involve a gift or sale transaction
- One spouse creates an irrevocable trust for the benefit of the other
- Beneficiary spouse could be the trustee of the irrevocable trust

Spousal GST Trust

- The value of the assets transferred into the Spousal GST Trust (and their growth) should escape the federal and state estate tax system permanently.
- The spouse may enjoy the assets as if they were never transferred.
- Future flexibility for distributing the assets upon the beneficiary spouse's death remains in place.

Spousal GST Trust - Example

- Mr. Smith creates an irrevocable trust for the benefit of Mrs. Smith.
- Mr. and Mrs. Smith each own 495 nonvoting units and 5 voting units in their company (post re-cap)
- Mr. Smith transfers his 49.5% nonvoting interest in the business to the new spousal trust.
- Transfer could be by gift or sale.

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Spousal GST Trust – All Gift

- If the Smith's business is worth $25M, then Mr. Smith's 49.5% interest is worth $8,043,750 using a 35% discount for lack of control and lack of marketability of the nonvoting units

- Mr. Smith's gift of the 49.5% uses $8,043,750 of his lifetime giving exemption

- All future growth and income from this interest is outside of the estate tax system

Spousal GST Trust – Sale

- Mr. Smith gives a seed gift of $804,750 to a new irrevocable grantor trust
- Mr. Smith sells his 49.5% of nonvoting interests in the business to the grantor trust for $8,043,750 (the appraised value)
- Trust pays a $804,750 down payment and gives Mr. Smith a promissory note for $7,239,375 with annual interest at 1.08% (Nov. AFR) that matures in 9 years.
- Cash flow from business pays down note each year.
- If Business distributes $825,000 per year, then trust will have $408,375 to make payments on note.
- Note payments are approx. $78,185/year.

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Spousal GST Trust – Gift v. Sale

- In both structures the value of the transferred interest, income/distributions with respect to the interest and future increases in value are out of the estate tax system.
- Under sale the value of the promissory note is still part of Mr. Smith's estate.
- Gift uses more estate tax exemption than sale.

Spousal GST Trust – Gift v. Sale

- Treatment of distributions/note payments:
  - For sale: Payments on promissory note do not impact estate tax analysis
  - For gift: Distributions increase assets that are part of the estate tax analysis
- Spousal trust is a "grantor" trust with respect to Mr. Smith so need a plan for paying income taxes

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Spousal GST Trust – Endgame

- Possible creation of a spousal trust by Mrs. Smith for Mr. Smith's benefit
  - Could gift or sell her 49.5% nonvoting interest to the second spousal trust
  - Be aware of the Reciprocal Trust Doctrine

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Spousal GST Trust – Endgame

- A future sale of the business could result in material assets being held in each spousal trust:
  - Funds held in spousal trusts would be out of the estate tax system
  - Funds would be accessible to Mr. and Mrs. Smith as beneficiaries of the trusts
  - Mr. and Mrs. Smith can spend assets outside of the spousal trusts before using any assets inside the spousal trusts

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Planning In Uncertain Times with a SLAT

- Irrevocable Trust? Still options.
- Potential Changes Needed For Irrevocable Trusts
  - Give beneficiaries powers of appointment, add special needs provisions, add spendthrift provisions, change situs, name trust protector, deal w/ tax issues, change age of control for beneficiaries, clarify trust terms, give trustee powers (i.e. guaranty debts of a beneficiary)
- Powers of Appointment
  - For Spouse
  - For Children

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Planning In Uncertain Times with a SLAT

- Decanting
  - ORC 5801.18 “Trustee’s power to make distributions in further trust”
  - Absolute discretion in first trust vs. limited discretion
- Private Settlement Agreements
  - ORC Section 5801.10
  - Cannot change the interests of the beneficiaries except for tax reasons or alter a material purpose of the trust
  - Court not involved
  - May be difficult to obtain consent of all beneficiaries

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Planning In Uncertain Times with a SLAT

- Ohio Statutes for Court Approval of Modifications to Irrevocable Trusts
  - ORC Section 5804.11(A)
  - ORC Section 5804.11(B)
  - Modification for unanticipated circumstances or to achieve settlor’s tax objectives
  - Provide most protection against third party challenges, but public records/more costly

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Planning In Uncertain Times with a SLAT- Trust Protector

- Use of Trust Protector to add flexibility to irrevocable Trusts – especially SLATs.

- A trust protector is an independent third party who can act in a non-fiduciary capacity. It is not a person who monitors the trust and does not have to act in the best interests of all beneficiaries.

Planning In Uncertain Times with a SLAT – Trust Protector

- Carefully select the Trust Protector and be mindful of the discussions with client about the Trust protector powers.
  - Some wealth advisers can serve
  - Attorneys can serve– drafting attorney may want to avoid serving
  - Friends, CPAs, other non-subordinate relatives could serve

- Trust protector can have broad or limited powers.
  - Broad powers include ability to add beneficiaries; remove beneficiaries; change beneficial interests in trust – these powers could be used in lieu of decanting. Can change beneficial interests where a private settlement agreement or even decanting might not allow for such change.
  - Limited powers might include removing a trustee or changing who can qualify to serve as trustee; changing trust terms only to qualify a beneficiary for Medicaid without having to count the trust assets as a countable resource.

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Planning In Uncertain Times with a SLAT – Divorce

- Planning for possible divorce when drafting SLATs
- Need to discuss this issue – even though it may be uncomfortable
  - Is the SLAT asset separate property of the spouse/beneficiary? Avoid advising on state law property issues – leave that for the divorce attorneys.
- Trust Protector can be involved if there is a divorce. Spouses and their attorneys can decide to what extent the trust will be used for spousal support, and request Trust Protector to keep spouse as beneficiary or add grantor as a wholly discretionary beneficiary.
  - Spouse can be removed as beneficiary upon divorce in the terms of the trust, but that provision can be waived by a third party to keep spouse in as a beneficiary

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Planning In Uncertain Times with a SLAT - Divorce

- Careful of ethical issues when representing the married couple and drafting that a spouse is removed as beneficiary upon divorce.
  - Does attorney represent both spouses? If yes, the attorney should explain to both spouses if one spouse is removed upon divorce.
  - Discuss with the couple what makes best sense for unlikely divorce and add Trust Protector to add flexibility so both spouses (and their separate attorneys) in a divorce have options.
- Trust Protector power in divorce or otherwise to add grantor as a discretionary beneficiary
  - Trust Protector may add the grantor as a discretionary beneficiary if the assets of the trust will not be subject to the claims of creditors of the grantor.
  - Need lapse of time and circumstances are such that it is clear that the Grantor did not intend to become a beneficiary at the outset.

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Planning In Uncertain Times with a SLAT

- Incomplete valuations and unsettled law regarding defined value gifts
  - *Wandry* case
  - Be careful of how gifts are worded; Language matters
    - Use value for the gift if paying gift tax is concern due to uncertainty of actual value of asset.
    - Use exact language in *Wandry*
    - Prepare gift tax return consistent with gift.
    - Avoid condition subsequent to a gift – the gift must be known at date of gift what the gift is (even if the value is not yet known)

Planning In Uncertain Times with a SLAT

- Uncertainty of IRS attacks on gifts of LLC interests or LP interests
  - Is sole purpose to take discounts, transfer wealth and maintain control?
  - IRS may argue inclusion in the client's estate where the client has retained control to change beneficial enjoyment of the company assets that are now in trust
  - 2036(a) – did grantor retain ability to alter beneficial enjoyment of the beneficiaries?
    - Retained control may be the ability of grantor to vote with others on liquidation and distribution of cash to members
    - Independent trustee may help
  - Doesn't apply where there is consideration given
  - Non-tax purpose for the LLC is less likely to be a concern

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Conclusion

- Take advantage of tax, estate, and succession planning opportunities while also maintaining flexibility when planning in uncertain times.

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Questions?

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