ESTATE PLANNING BASICS

Presented by:
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Agenda

- Definition of Estate Planning
- Methods of Transferring Assets After Death
- Overview of Core Tax Regimes
- Typical Estate Plan Structures For Married Couples
- Advanced Estate Tax Planning Techniques
- Income Tax Efficiencies
- Incapacity Planning
- Story Problems

Estate Planning

Estate planning is a process in which people arrange for the orderly transfer of their assets, during lifetime and after death, to the people and organizations they wish to benefit. The overarching goal in this process is to carry out the estate owner's intent as precisely as possible. Components of this goal often include (1) minimizing various tax consequences for the estate owner, the estate itself and the beneficiaries, and (2) facilitating the efficiency of estate administration.

Methods of Transferring Assets after Death

- Beneficiary designation
- Transfer on death accounts
- Joint tenancy
- Community property with right of survivorship
- Will
- Revocable living trust

Federal Estate Tax

- The “gross estate” (IRC §2031)
- Unlimited marital deduction (IRC §2056)
- Unlimited charitable deduction (IRC §2055)
- Basic exclusion amount (IRC §2010(c)(3)) $5,450,000 for 2016
- Flat tax rate – 40% (IRC §2001)

Federal Estate Tax (cont’d)

- The American taxpayer Relief Act of 2012 (“ATRA”) fundamentally changed tax planning for married couples by making permanent both (1) the basic exclusion amount ($5 million in 2010, indexed for inflation thereafter) and (2) “portability” of a deceased spouse’s unused exclusion.
- How portability works: the Deceased Spousal Unused Exclusion (“DSUE”) amount may be added to the surviving spouse’s basic exclusion amount.
- To obtain portability of the DSUE, the surviving spouse must make an election on the deceased spouse’s estate tax return.

Federal Gift Tax

- Why the gift tax exists
- Annual exclusion for gifts of present interests $14,000 in 2016
- Taxable gifts (IRC §2503)
- Unlimited marital and charitable deductions
- Effect of a taxable gift
- Flat gift tax rate – 40%

Income Tax on Long Term Capital Gains

- Individuals pay a federal income tax on the net total of their capital gains in any given year.
- Capital gain is a profit that results from the sale of a capital asset, such as stock or real estate, where the amount realized in the sale exceeds the "cost basis" of the asset.
- The cost basis is equal to the purchase price, adjusted for certain factors such as capital improvements and depreciation.
- "Long term" capital gain rates apply to assets held more than one year.

Income Tax on Long Term Capital Gains (cont'd)

- For taxpayers whose ordinary income is taxed in the 25% to 35% federal tax brackets, the long term capital gains tax rate is 15%. For taxpayers in the 39.6% bracket, the capital gains tax rate is 20%.
- Taxpayers earning income above certain thresholds ($200,000 for singles, $250,000 for married couples filing jointly) pay an additional 3.8% tax on all investment income, including long term capital gain. Therefore, the top federal tax rate for long term capital gain is generally 23.8% (except when the asset sold is a commercial building).

Income Tax on Long Term Capital Gains (cont'd)

- Long term capital gain on commercial buildings which is attributable to amounts the taxpayer took as depreciation is taxed at 25%.
- Long term capital gain in California is taxed at the same rate as ordinary income. Therefore, the combined state and federal income tax rate on capital gain in California may be as high as 37.1%.
- Basis of property acquired from a decedent ("step-up" or "step-down") (IRC §1014).

Planning for Married Couples Post-ATRA

- Not long ago, the top federal estate tax rate was 55% and the combined state and federal long term capital gains rate for Californians was 24.6%. A couple's home exceeded the applicable exclusion amount in many cases. In short, the estate tax applied to many more couples than it does today; and its bite was more ferocious.
- Historically, federal estate tax basic exclusion amounts were much lower; and the estate tax rate was significantly higher than the combined state and federal long term capital gains rates. Accordingly, estate planning for married couples of even moderate wealth heavily emphasized estate tax planning. Less attention was paid to basis planning for the beneficiaries. ATRA has changed that.

Planning for Married Couples Post-ATRA (cont'd)

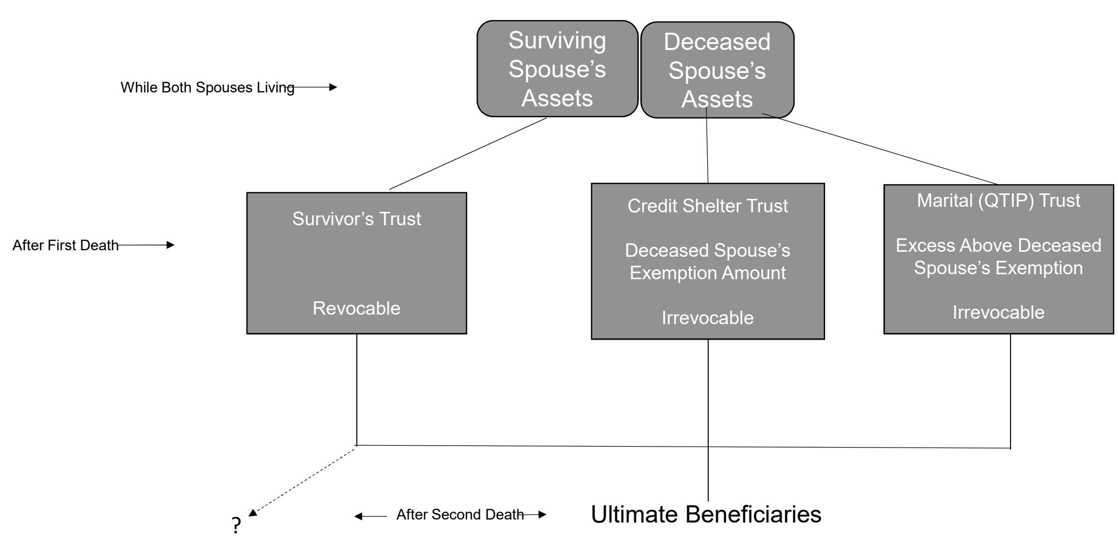
- The income, gift and estate tax regimes require that couples be sorted into three different planning groups:
  - Group One: Combined net worth less than one basic exclusion amount ($5,450,000 in 2016)
  - Group Two: Combined net worth between one and two basic exclusion amounts (more than $5,450,000 and $10,900,000 in 2016)
  - Group Three: Combined net worth greater than two basic exclusion amounts ($10,900,000 in 2016)

Planning for Group Three

Planning for Group Three will continue to follow traditional planning methods for higher net worth individuals:

- Revocable living trust with credit shelter trust (aka “bypass trust”) and QTIP trust
- Annual giving to family members
- Use of advanced estate tax planning techniques

TYPICAL REVOCABLE LIVING TRUST STRUCTURE (PRE-ATRA)*



*and post-ATRA for “Group Three” couples

Planning for Group One

- Ensure basis adjustment of capital assets on surviving spouse's death (avoid use of credit shelter trust).
- The biggest decision is whether the predeceasing spouse's assets will pass outright to the surviving spouse, or into an irrevocable (QTIP) trust for the benefit of the surviving spouse. The issue is testamentary control, not estate tax.
- Surviving spouse should consider making the portability election (on Form 706) after the first death, in case of unexpected wealth or appreciation of assets during the surviving spouse's overlife.

Planning for Group Two

- The most difficult planning group.
- The tax question for each couple is: which should be the priority? Basis planning (using portability)? Or estate tax avoidance (using a credit shelter trust)?
- Factors: age and health of each spouse; value of assets relative to the basic exclusion amount.
- Flexibility in the estate plan is crucial for Group Two.

Planning for Group Two (cont'd)

- As with Group One, start with this question: Putting tax questions aside, does the couple prefer that the predeceasing spouse's assets pass outright to the surviving spouse? Or into an irrevocable trust for the surviving spouse?
- If the couple prefers that the predeceasing spouse's assets pass outright to the survivor, the will or living trust should provide that any of the deceased spouse's assets disclaimed by the survivor will pass to a credit shelter trust. This allows deferral, until after the first death, of the decision to make basis planning the priority (using the portability election), or to make estate tax planning the priority (using the credit shelter trust).

Planning for Group Two (cont'd)

If the couple prefers that the predeceasing spouse's assets pass to a trust for the surviving spouse's benefit, the will or living trust should be designed so that the trust for the surviving spouse's benefit can qualify either as a marital deduction (QTIP) trust or as a credit shelter trust. If the survivor determines after the first death that basis planning is the priority, then the survivor makes the QTIP election and portability election with respect to the assets passing into the trust for the survivor. If the survivor determines that estate tax planning is the priority, then the trust for the survivor's benefit will function as a credit shelter trust.

Advanced Estate Planning Techniques

- Annual gifts
- Fractional interest discounts
- Sales to intentionally defective grantor trusts
- Qualified personal residence trusts (QPRTs)
- Grantor retained annuity trusts (GRATs)
- Charitable lead annuity trusts (CLATs)
- Irrevocable life insurance trusts (ILITs)
- Charitable remainder unitrusts (CRUTs)
- Dynasty trusts
- Self-cancelling installment notes
- Private annuities

Income Tax Efficiencies

- Income in respect of a decedent (IRD) and testamentary gifts made with retirement assets
- Qualified Charitable Distributions from IRAs (IRC §408(d)(8))
- Charitable remainder unitrust for sale of appreciated assets

Incapacity Planning

- Revocable living trust
- Durable power of attorney
- An attorney-in-fact's power to make gifts must be expressly stated in the power of attorney document. Otherwise, the attorney-in-fact does not have the power to make gifts. (California Prob. C. §4264(c))

Story Problem 1

Husband and wife own all of their assets as joint tenants, except that husband's IRA is in his name and wife is the designated beneficiary. Husband's will, accurately reflecting his intent, provides a $100,000 gift to Charity A "off the top" of his estate, regardless of whether he is the first or the second spouse to die. Husband dies first. How much will Charity A receive from husband's estate?

Story Problem 2

Bill is very frugal. He has two children. His son manages money very poorly and his daughter, age 57, handles money well. The daughter and her husband are not wealthy, but live comfortably. The daughter's husband is controlling and does not get along with Bill. Bill tells you, as a planned giving officer for Charity B, that his living trust provides for the entire trust estate, after his death, to be held in two charitable remainder unitrusts – one for his son and one for his daughter. The remainder beneficiary of both trusts is Charity B, which made a big difference in his life when Bill was an orphaned child. Bill's daughter is named as the successor trustee of the living trust because he doesnot want the trust to have to pay a corporate trustee, and Charity B is named as the trustee of the unitrusts for the same reason. Does anything about this situation concern you? If so, what should you do about it?

Story Problem 3

Helen, a widow, has a living trust that provides for a total of $200,000 in gifts "off the top" to her favorite charities. The balance of the trust estate is to be distributed in equal shares to Helen's three children. Helen's living trust assets include her home, several mutual fund accounts, and certificates of deposit. Helen also has an IRA worth $150,000 and her children are named as the beneficiaries of the IRA, in equal shares. What change should Helen make to her estate plan?

Story Problem 4

Muriel and Fred are happily married and have four adult children. They want the surviving spouse to be the sole beneficiary of the estate plan after the first spouse's death; and they want the balance to pass to the children equally after the surviving spouse's death. They are 60 years old and their estate is worth approximately $6 million. The estate includes a home in San Francisco, a vacation home, and a robust mutual fund portfolio. They are "buy and hold" type investors. In determining a structure for their estate plan, what are some of the major considerations?

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