ESTATE AND ESTATE TAX PLANNING FOR FLORIDIANS

Tuesday, April 18, 2023

Presented By:

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Estate Planning Council Diversity Fellowship and Award

Purpose, Eligibility and Selection Process:

The Estate Planning Council Diversity Fellowship and Award is funded by contributions from Gassman, Crotty & Denicolo, P.A. and the Diversity Committee of the members of the Suncoast and Pinellas County Estate Planning Councils. The purpose of this one-year fellowship is to: introduce estate planning and elder law as a viable career opportunity for students of color; and to promote serving communities of color, which have been underserved in the areas of elder law and estate planning.
Students of color in their second or third years, in good academic standing, are eligible to apply for this one-year fellowship.

Applications for this fellowship and award will be reviewed by the Stetson Financial Aid and Awards Committee. The Faculty Committee will select two Fellows.

Fellows will be selected for the 2023-24 academic year (Fall 2023 and Spring 2024 semesters). Fellows will be invited and encouraged to attend estate planning council meetings immediately.

Fellows will receive recognition as Fellows and receive a financial award of $1,500 per semester. The award will be paid through the Stetson University College of Law Business Office.

Additional Information:

Fellows will work together and attend one of the local Estate Planning Councils, by attending the respective group's monthly breakfast or lunch meetings. They will meet, shadow, and work with lawyer members of Estate Planning Councils.

Each student Fellow will be assigned two mentors who are active in the estate planning community and will be expected to have regular meetings with their mentors.

Each Fellow, working with their mentor, will create an educational presentation on estate planning and end-of-life documents. The Fellows will arrange for the presentation to be given at a location where people of color gather (for example Community Centers or Churches). In addition to creating the program, the Fellows will be responsible for scheduling and making the presentation. They will be accompanied by their mentor when they do the presentation. Hours spent creating the presentation, arranging the presentation, and giving the presentation will count as legal pro bono for Stetson's pro bono requirement.

FLORIDA NEW TORT REFORM STATUTE

The statute of limitations for “ordinary negligence” is now two years instead of four years.

The statute of limitation for professional malpractice is still two years from the time the cause of action is discovered, or should have been discovered, with the exercise of due diligence.

An action for bad faith against a liability insurance carrier will not exist if the carrier tenders the policy limits (or the amount demanded if less than the policy limits) within 90 days after receiving actual notice of a claim.

Mere negligence alone is insufficient to constitute bad faith, and the insured and representative of the insurance have a duty to act in good faith in furnishing information regarding the claim and making demands on the insuror.

With respect to medical expenses in a personal injury or wrongful death action, there will be disclosure of factoring of Letters of Protection and whether the injured person could have received the health services from Medicare or an insurance carrier and what they would have cost. A defendant can discover who and how a plaintiff was referred to medical providers. The attorney/client privilege will not apply with respect to this.

In an action for damages against an owner, landlord or manager of real estate brought by a person lawfully on the property who was injured by a criminal act of a third party, the judge and jury must consider the fault of all persons who contributed to the injury.



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FLORIDA NEW TORT REFORM STATUTE, Continued

By January 1, 2025, the owner or operator of a multi-family residential property can have a crime prevention through Environmental Design Assessment that may help relieve the owner from certain kind of liabilities.

In a negligence action, a party found to be greater than 50% at fault for his or her own harm may not recover any damages. This does not apply to certain actions for personal injury or wrongful death arising from medical negligence.



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Compensation of Attorney for the Personal Representative – 2022 Florida Statute 733.6171

733.6171 Compensation of attorney for the personal representative.—(1) Except as provided in paragraph (2)(d), attorneys for personal representatives are entitled to reasonable compensation payable from the estate assets without court order.

(2)(a) The attorney, the personal representative, and persons bearing the impact of the compensation may agree to compensation determined in a different manner than provided in this section. Compensation may also be determined in a different manner than provided in this section if the manner is disclosed to the parties bearing the impact of the compensation and if no objection is made as provided for in the Florida Probate Rules.

(b) An attorney representing a personal representative in an estate administration who intends to charge a fee based upon the schedule set forth in subsection (3) shall make the following disclosures in writing to the personal representative:1. There is not a mandatory statutory attorney fee for estate administration.

2. The attorney fee is not required to be based on the size of the estate, and the presumed reasonable fee provided in subsection (3) may not be appropriate in all estate administrations.

3. The fee is subject to negotiation between the personal representative and the attorney.

4. The selection of the attorney is made at the discretion of the personal representative, who is not required to select the attorney who prepared the will.

5. The personal representative shall be entitled to a summary of ordinary and extraordinary services rendered for the fees agreed upon at the conclusion of the representation. The summary shall be provided by counsel and shall consist of the total hours devoted to the representation or a detailed summary of the services performed during the representation.

(c) The attorney shall obtain the personal representative's timely signature acknowledging the disclosures.

(d) If the attorney does not make the disclosures required by this section, the attorney may not be paid for legal services without prior court approval of the fees or the written consent of all interested parties.

(3) Subject to subsection (2), compensation for ordinary services of attorneys in a formal estate administration is presumed to be reasonable if based on the compensable value of the estate, which is the inventory value of the probate estate assets and the income earned by the estate during the administration as provided in the following schedule:(a) One thousand five hundred dollars for estates having a value of $40,000 or less.

(b) An additional $750 for estates having a value of more than $40,000 and not exceeding $70,000.

(c) An additional $750 for estates having a value of more than $70,000 and not exceeding $100,000.



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Compensation of Attorney for the Personal Representative – 2022 Florida Statute 733.6171, Cont'd

(d) For estates having a value in excess of $100,000, at the rate of 3 percent on the next $900,000.
(e) At the rate of 2.5 percent for all above $1 million and not exceeding $3 million.
(f) At the rate of 2 percent for all above $3 million and not exceeding $5 million.
(g) At the rate of 1.5 percent for all above $5 million and not exceeding $10 million.
(h) At the rate of 1 percent for all above $10 million.
(4) Subject to subsection (2), in addition to fees for ordinary services, the attorney for the personal representative shall be allowed further reasonable compensation for any extraordinary service. What is an extraordinary service may vary depending on many factors, including the size and complexity of the estate. Extraordinary services may include, but are not limited to:(a) Involvement in a will contest, will construction, a proceeding for determination of beneficiaries, a contested claim, elective share proceeding, apportionment of estate taxes, or any adversarial proceeding or litigation by or against the estate.
(b) Representation of the personal representative in audit or any proceeding for adjustment, determination, or collection of any taxes.
(c) Tax advice on postmortem tax planning, including, but not limited to, disclaimer, renunciation of fiduciary commission, alternate valuation date, allocation of administrative expenses between tax returns, the QTIP or reverse QTIP election, allocation of GST exemption, qualification for Internal Revenue Code ss. 6166 and 303 privileges, deduction of last illness expenses, fiscal year planning, distribution planning, asset basis considerations, handling income or deductions in respect of a decedent, valuation discounts, special use and other valuation, handling employee benefit or retirement proceeds, prompt assessment request, or request for release of personal liability for payment of tax.
(d) Review of estate tax return and preparation or review of other tax returns required to be filed by the personal representative.
(e) Preparation of the estate's federal estate tax return. If this return is prepared by the attorney, a fee of one-half of 1 percent up to a value of $10 million and one-fourth of 1 percent on the value in excess of $10 million of the gross estate as finally determined for federal estate tax purposes, is presumed to be reasonable compensation for the attorney for this service. These fees shall include services for routine audit of the return, not beyond the examining agent level, if required.
(f) Purchase, sale, lease, or encumbrance of real property by the personal representative or involvement in zoning, land use, environmental, or other similar matters.
(g) Legal advice regarding carrying on of the decedent's business or conducting other commercial activity by the personal representative.
(h) Legal advice regarding claims for damage to the environment or related procedures.
(i) Legal advice regarding homestead status of real property or proceedings involving that status and services related to protected homestead.
(j) Involvement in fiduciary, employee, or attorney compensation disputes.
(k) Proceedings involving ancillary administration of assets not subject to administration in this state.



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Compensation of Attorney for the Personal Representative – 2022 Florida Statute 733.6171, Cont'd

(5) Upon petition of any interested person, the court may increase or decrease the compensation for ordinary services of the attorney or award compensation for extraordinary services if the facts and circumstances of the particular administration warrant. In determining reasonable compensation, the court shall consider all of the following factors, giving weight to each as it determines to be appropriate:(a) The promptness, efficiency, and skill with which the administration was handled by the attorney.

(b) The responsibilities assumed by and the potential liabilities of the attorney.

(c) The nature and value of the assets that are affected by the decedent's death.

(d) The benefits or detriments resulting to the estate or interested persons from the attorney's services.

(e) The complexity or simplicity of the administration and the novelty of issues presented.

(f) The attorney's participation in tax planning for the estate and the estate's beneficiaries and tax return preparation, review, or approval.

(g) The nature of the probate, nonprobate, and exempt assets, the expenses of administration, the liabilities of the decedent, and the compensation paid to other professionals and fiduciaries.

(h) Any delay in payment of the compensation after the services were furnished.

(i) Any agreement relating to the attorney's compensation and whether written disclosures were made to the personal representative in a timely manner under the circumstances pursuant to subsection (2).

(j) Any other relevant factors.

(6) If a separate written agreement regarding compensation exists between the attorney and the decedent, the attorney shall furnish a copy to the personal representative prior to commencement of employment, and, if employed, shall promptly file and serve a copy on all interested persons. A separate agreement or a provision in the will suggesting or directing that the personal representative retain a specific attorney does not obligate the personal representative to employ the attorney or obligate the attorney to accept the representation, but if the attorney who is a party to the agreement or who drafted the will is employed, the compensation paid shall not exceed the compensation provided in the agreement or in the will.



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Home-Based Businesses; Local Government Restrictions– 2022 Florida Statute 559.955

(1) Local governments may not enact or enforce any ordinance, regulation, or policy or take any action to license or otherwise regulate a home-based business in violation of this section.
(2) A home-based business that operates from a residential property as provided in subsection (3):(a) May operate in an area zoned for residential use.
(b) May not be prohibited, restricted, regulated, or licensed in a manner that is different from other businesses in a local government's jurisdiction, except as otherwise provided in this section.
(c) Is only subject to applicable business taxes under chapter 205 in the county and municipality in which the home-based business is located.
(3) For purposes of this section, a business is considered a home-based business if it operates, in whole or in part, from a residential property and meets the following criteria:(a) The employees of the business who work at the residential dwelling must also reside in the residential dwelling, except that up to a total of two employees or independent contractors who do not reside at the residential dwelling may work at the business. The business may have additional remote employees that do not work at the residential dwelling.
(b) Parking related to the business activities of the home-based business complies with local zoning requirements and the need for parking generated by the business may not be greater in volume than would normally be expected at a similar residence where no business is conducted. Local governments may regulate the use of vehicles or trailers operated or parked at the business or on a street right-of-way, provided that such regulations are not more stringent than those for a residence where no business is conducted. Vehicles and trailers used in connection with the business must be parked in legal parking spaces that are not located within the right-of-way, on or over a sidewalk, or on any unimproved surfaces at the residence. Local governments may regulate the parking or storage of heavy equipment at the business which is visible from the street or neighboring property. For purposes of this paragraph, the term "heavy equipment" means commercial, industrial, or agricultural vehicles, equipment, or machinery.
(c) As viewed from the street, the use of the residential property is consistent with the uses of the residential areas that surround the property. External modifications made to a residential dwelling to accommodate a home-based business must conform to the residential character and architectural aesthetics of the neighborhood. The home-based business may not conduct retail transactions at a structure other than the residential dwelling; however, incidental business uses and activities may be conducted at the residential property.
(d) The activities of the home-based business are secondary to the property's use as a residential dwelling.
(e) The business activities comply with any relevant local or state regulations with respect to signage and equipment or processes that create noise, vibration, heat, smoke, dust, glare, fumes, or noxious odors. Any local regulations on a business with respect to noise, vibration, heat, smoke, dust, glare, fumes, or noxious odors may not be more stringent than those that apply to a residence where no business is conducted.



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Home-Based Businesses; Local Government Restrictions– 2022 Florida Statute 559.955, Continued

(f) All business activities comply with any relevant local, state, and federal regulations with respect to the use, storage, or disposal of any corrosive, combustible, or other hazardous or flammable materials or liquids. Any local regulations on a business with respect to the use, storage, or disposal of any corrosive, combustible, or other hazardous or flammable materials or liquids may not be more stringent than those that apply to a residence where no business is conducted.

(4) Any adversely affected current or prospective home-based business owner may challenge any local government action in violation of this section. The prevailing party in a challenge may recover reasonable attorney fees and costs incurred in challenging or defending the action, including reasonable appellate attorney fees and costs.

(5) The application of this section does not supersede:(a) Any current or future declaration or declaration of condominium adopted pursuant to chapter 718, cooperative document adopted pursuant to chapter 719, or declaration or declaration of covenant adopted pursuant to chapter 720.

(b) Local laws, ordinances, or regulations related to transient public lodging establishments, as defined in s. 509.013(4)(a)1., that are not otherwise preempted under chapter 509.



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PRIMARY ESTATE TAX PLANNING TECHNIQUES TO BE FAMILIAR WITH

1. Divert business opportunities and income to the next generation
2. Use Annual Gifting and "Crummey Trusts"
3. Use Irrevocable Life Insurance Trusts
4. Use Split Dollar Arrangements in conjunction with life insurance
5. Use Defective Grantor Trusts for income and estate tax efficiency
6. Use discount vehicles and entities
7. Use Installment Sales to Defective Grantor Trusts to "lock in discounts" and freeze growth
8. Use Self-canceling installment notes when life expectancy may be very short
9. Using Grantor Retained Annuity Trust
10. Use Private Annuities when life expectancy may be very short
11. Use Credit Shelter Trusts
12. Use Portability only after careful consideration
13. Use Qualified Personal Residence Trusts
14. Use Charitable Lead Trusts
15. Use Administrative Notes to allow beneficiaries to buy assets that would pass to a private or public foundation.
16. Use Private and Public Foundations
17. And more.

Partial Checklist For Estate Tax Planning

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Partial Checklist For Estate Tax Planning

1. A list of assets, liabilities, insurances, and specific account information.

2. Verify real estate ownership by checking property appraiser website and look at deeds.

3. Check tax returns and financial statements, incorporate/entity documents - do these match up? (Almost never)

   A. Suggest update and consistency discussions.

4. Receive and review present estate tax documents - but often easier, less expensive, and safer to replace most documents.



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Partial Checklist For Estate Tax Planning

5. Understand relationships and dynamics as between family members.

A. What happens on the death of the primary producer - economic soundness - is there enough life insurance?

B. What happens on death of economically dependent spouse - will primary earner be well protected?

C. Is the family confident that the present or anticipated investment and/or business base will definitely support both spouses and as necessary for descendants - if not consider additional life insurance and savings plan.

D. What will happen upon the disability of the primary bread earner and/or family business CEO - consider disability insurance discussion - many or fewer clients don't need disability insurance anymore and may decide to drop the coverage.

E. How to facilitate maximum funding of a Credit Shelter Trust on first death that can become a Clayton QTIP Trust to the extent that portability would instead be elected.



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Partial Checklist For Estate Tax Planning

6. What is the relationship with each child and existing grandchild, and philosophy of support and inheritance?

7. Is life insurance properly positioned under Irrevocable Life Insurance trusts?

   A. If both spouses formed a life insurance trust, did they know about the reciprocal trust doctrine?
   B. How long do they plan to live in their home - if "forever" may be strong candidates for Qualified Personnel Residence Trust ("Q-TIP") - also for vacation home that may stay in the family.

8. What is the successorship plan for the family business?

   A. Moving it to one or more descendants
   B. Will be sold eventually.
   C. Does family need help thinking this through?



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Partial Checklist For Estate Tax Planning

9. Charitable goals or interests?

10. Estate Tax Planning:

A. What can be discounted, frozen, and diverted to spousal limited access trust formed by one spouse, and irrevocable trusts for descendants formed by the other spouse?

B. Converting discounted member interests into low-interest long-term promissory notes can be very advantageous.

C. Should promissory notes be placed in LLCs with multiple members for creditor protection purposes?

D. The ability to pay the income tax on income received by entities outside of the estate tax system ("Defective Grantor Trusts") can be very strong.

11. What will the plan be for any large IRA accounts?

A. Convert to ROTH and pay the income tax from otherwise a state taxable assets.

B. If surviving spouse is in poor health it may make sense to liquidate an IRA, pay the income tax, and sell what remains for a self-canceling installment note or private annuity.



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Partial Checklist For Estate Tax Planning

For Floridians:

A. Consider a JEST Trust to allow full step-up in basis on the first death and funding Credit Shelter Trust system with all available assets.

B. JEST Trust may be owned 3% by spouse with high creditor risk issues and 97% by other spouse.

C. Consider homestead creditor protection, property tax implications, and forced heirship issues.

D. Consider 10% Cap loss on non-homestead properties transferred or more than 50% of an entity owning non-homestead property.

E. Consider the Florida Community Property Trust - Has anyone actually formed one?

F. QPRT can convert to annuity trust consistent with Florida Statute 222.14 for creditor protection of the Grantor during the remaining possessory term.

G. GRAT payment rights can qualify as annuities under Florida Statute Section 222.14 if properly drafted. Also include a "Facility of Payment" clause.

H. New SLAT legislation would allow Grantor to be beneficiary after death of primary beneficiary spouse.

I. New legislation will increase rule against perpetuities period from 360 years to 1,000 years. See you then!



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Underutilized Basis Planning Strategies

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Underutilized Basis Planning Strategies

Individuals and families who seek advice from estate, financial and tax planning advisors can receive significantly different advice and information on recommended and possible planning strategies.

This is not the fault of the tax, financial or legal advisor, given the significant complexity of various strategies, and time and effort that it can take to be well versed with respect thereto.

We were recently asked to provide a list and discussion of strategies that may be underused or unknown to many advisors.

The list that we provided is as follows, and not necessarily in order of prevalence, impact or importance:

1. <u>FMV Income Taxes On Death.</u>

Estate planning and receiving a new fair market value income tax basis for appreciated assets.

The U.S. income tax system provides for elimination of the capital gain element that exists to the extent of the difference of the value of property owned or considered as owned by a deceased person, and the original cost or lower depreciated income tax basis thereof.

This can be a challenging area, given that married couples would ideally have all assets owned by the first dying spouse in non-community property states in order to get a new fair market value income tax basis on the death of the first dying spouse.



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Underutilized Basis Planning Strategies

Married couples who live in community property states, which include California, Texas, Nevada, Wisconsin, Louisiana . . . can receive a new fair market value income tax basis on community property assets on the death of one spouse, but couples in most of these states also face the risk of using community property assets if either spouse is sued, because of the way that creditor rights work in these states.

A typical married couple living outside of a community property state does not know to ask their estate and tax planners how they can receive a new income tax basis on marital assets on the first death, but strategies for this exist, and can facilitate allowing the surviving spouse to sell assets in order to diversify after the first death without loss of significant value to capital gains taxes.

When rental and business property is involved, the stakes are even higher because the surviving spouse can have the benefit of new depreciation deductions, to save significant income taxes after the first death.

2. Joint Exempt Step-Up Trust ("JEST").

The strategies that are available to assist a married couple who do not live in a community property state, or a married couple living in a community property state that would like a greater degree of creditor protection include the Joint Exempt Step-Up Trust ("JEST"), which can allow the first dying spouse to have what is known as a "general power of appointment" over the Trust assets, and to have the assets subject to such power held in a separate trust for the primary benefit of descendants that can also benefit the surviving spouse, if certain requirements are met.

Literature on how the JEST Trust works can be found atchrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://gassmanlaw.com/wp-content/uploads/2019/10/Florida-Revocable-Trust-Debate.1d.pdf



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Underutilized Basis Planning Strategies

The JEST Trust can also be used to assure that a married couple funds a Credit Shelter Trust that can benefit the surviving spouse without being subject to federal estate tax on the death of such spouse.

For example, most married couples will fund a Credit Shelter Trust on the first death, only to the extent of assets owned by the first dying spouse, or one-half of community property assets, but Private Letter Rulings and Technical Advisory Memoranda exist, which provide a roadmap for how to have the assets of the first dying spouse, or assets in the JEST Trust fund a Credit Shelter Trust on the first death.

For example, a married couple with high earnings and a healthy savings rate may be relatively young and have $14,000,000 worth of joint assets, with each spouse having $12,000,000 of estate tax exemption.

With proper drafting and situation of assets, the full $12,000,000 of exemption of the first dying spouse may be used by the funding of a Credit Shelter Trust, or Credit Shelter Trusts, with a full step-up in income tax basis for such assets.

3. <u>Stepped up basis on the death of an older relative.</u>

Suppose that a married couple in their 60's have parents in their 80s with relatively short life expectancies.

Assume that the married couple owns an apartment complex worth $10,000,000 that has an income tax basis of $2,000,000.

Assume that each spouse has one parent and that each parent has a net worth of less than $2,000,000.



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Underutilized Basis Planning Strategies

Spouse 1 may transfer the apartment complex to Spouse 2, as Trustee of a Spousal Limited Access Trust that would benefit Spouse 2, the descendants of Spouse 1 and Spouse 2 and their parents, as reasonably needed for health, education, maintenance and support.

Each parent is additionally given the power to appoint Trust assets to creditors of the parent's estate.

The power of appointment is limited to not exceed the value of assets that the parent can own without being subject to federal estate tax, and provides that it will apply to the assets in the Trust that have the highest excess of fair market value over income tax basis, if limited to not include all assets in the Trust.

Under the Treasury Regulations, the power may be limited to being exercisable only with the consent of individuals named in the Trust document who are not considered to be fiduciaries or beneficiaries for purposes of determining if the power can be exercised.

One parent dies and the assets receive a new fair market value income tax basis, so that depreciation restarts until the death of the second parent, at which time the assets go to a fair market value basis and depreciation restarts again.



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Estate Tax Basics

The federal estate tax is imposed on citizens and residents of the United States.

An estate tax return is due if the gross estate of the individual exceeds his or her exemption amount.

The total exemption amount for an individual in 2023 is $12,920,000, minus previous “taxable gifts.”

A gift in 2023 that exceeds the $17,000 per year per person gift tax “exclusion” causes reduction in the exemption of the donor.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

1. An out-of-state lawyer can practice occasionally in Florida, when the lawyer:
   a. Does not have an office or purport to have an office in Florida.
   b. Does not advertise for clients in Florida
   c. Services clients who have sought the lawyer out from Florida or were clients of the lawyer before moving to Florida.
   d. See next page.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

1. Florida has no individual, Trust or S corporation income tax or tax filing requirements.
2. Florida C corporations pay an income tax based upon approximately 5.5% of taxable income, which is deductible on the corporate return so that the total tax rate is approximately 25.895%.
3. Florida does impose unemployment taxes and Worker's Compensation insurance requirements, but not on income that passes by K-1 ownership to a working shareholder or partner.
4. Florida imposes a sales tax on any commercial rental, and also on any residential rental that is for more than six months based upon 5.5% at the state level and between one-half percent (0.5%) and two percent (2%) at the county level. For most counties this totals approximately 6.5%.
5. Florida is not a community property state. The only community property owned by a Florida couple will be community property that they brought with them from a community property state, or property that might be designated as community property by use of an Alaska, Tennessee, Kentucky, or Florida Community Property Trust.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

6. Florida has unlimited creditor protection for annuity contracts, the cash value of permanent life insurance contracts, IRAs, pension accounts, 529 plans, and also homestead that qualifies within the acreage limitations (up to half-an-acre within the city limits and up to 160 acres outside of the city limits).

   - A last-minute transfer into homestead to avoid creditors cannot be set aside because the Florida Constitution trumps the Four-Year Florida Fraudulent Transfer Statute. Welcome OJ Simpson.
   - The 2005 Bankruptcy Act responded to the above by providing that anything over $125,000 (as indexed for CPI each 3 years since 2005)($189,050 for 2023) put into the homestead within the ten years before filing bankruptcy for the purpose of avoiding a creditor can be set aside in bankruptcy, and also requiring that Florida law will not apply in bankruptcy unless the debtor has lived in Florida for 730 consecutive days (if he or she moves here), and that to be protected the homestead has to be owned 1,215 days (notwithstanding that the property was not the homestead of the debtor for the entire 1,215 days).
   - Moral of the story – high risk individuals who plan to live in Florida may want to purchase a future homestead and hold it as tenants by the entireties until they move to Florida. They can rent it out as an Airbnb or otherwise use or lease it until then.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

7. Limited liability companies and limited partnerships – the sole remedy of a debtor who owns an ownership interest in a multiple member LLC or a limited partnership will be a charging order.

   Many Florida based insurance carriers charge significantly more to insure residential property held under an LLC than when held under an individual's name or a Trust.

   Sometimes we form an LLC which owns a Trust, which owns the property and the insurance rates will be the same as if the Trustee of the Trust owns the property – yes, this makes no sense.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

8. Most wealthy Floridians have separate Trusts for each spouse "because that is the way it has always been done."

Some Floridians wish to emulate community property Joint Trusts in an attempt to receive an income tax step-up on the first death by using a JEST Trust. Many couples prefer a JEST Trust that locks assets up on the first death to protect the surviving spouse and common descendants from an inheritance and management standpoint, realizing that this will not qualify as a tenancy by the entireties' asset.

Other clients prefer to sign a MARITAL ASSET PROTECTION SYSTEM ("MAPS") agreement so that the surviving spouse is required to place a certain percentage of the net worth and possibly a percentage of future savings into an Asset Protection Trust formed in a APT jurisdiction for the future welfare of the surviving spouse and descendants.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

9. Florida recognizes tenancy by the entireties and provides complete creditor protection where the judgment is only against one spouse or the other. The creditor (other than the IRS, the SEC, the FTC or the Department of Justice) cannot reach the tenancy by the entireties property, with the possible exception of if there is joint debt other than on the homestead and the debtor spouse goes into bankruptcy.

   - A joint account with right of survivorship or joint assets owned with right of survivorship may not qualify as tenants by the entireties assets, if not properly titled.
   - Married couples who live in states that do not recognize tenants by the entireties may nevertheless have tenants by the entireties' protection in Florida real estate if they file bankruptcy because the federal bankruptcy law recognizes tenancy by the entireties as a creditor protected asset, and that the law of the situs of real estate will apply when real estate is owned.
   - Property deeded to "Mary Smith and John Smith, a married couple" or "John Smith and Mary Smith, husband and wife" is considered to be owned as tenants by the entireties if the deed goes to a married couple using the above verbiage. Delaware has a statutory tenancy by the entireties trust that may allow someone who has not yet moved to Florida to have tenancy by the entireties ownership of non real estate assets before they move to Florida.
   - It is easy to make a joint bank account **not** qualify as a tenancy by the entireties account.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

10. Florida has a 30% elective share that can be satisfied by leaving 37.5% of the "elective share estate" into a Trust that pays the spouse income as amounts reasonably needed for health, education, and maintenance. Attila the Hun can be the Trustee.

    The Florida Statutes provide a presumption that a law firm or lawyer can charge on a percentage basis to facilitate for probate administration, preparing a Form 706, and that the personal representative of an estate can charge a percentage for personal representative services.

    The Florida Statutes also provide that the Trustee of a Revocable Trust may charge 75% of the rate that would apply to a Probate administration. By analogy, law firms sometimes charge 75% of what a Probate charge would be for administrating a Revocable Trust.

    At least one jury trial determined that a law firm breached its duty to a family by failing to plan to reduce or avoid significant percentage fees, but the percentage fee practices continue.

    Most non-wealthy couples who establish Revocable Trusts hold them jointly, and then it may be possible for a Joint Trust to qualify as a tenant by the entireties asset if properly drafted.

    Most Joint Trusts seen by the author are not properly drafted for this.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

11. Florida has a statute which allows DESIGNATED REPRESENTATIVES to be appointed under a Trust document to waive or receive notice for one or more beneficiaries who will then not have any right to receive notice.

When one beneficiary has a Power of Appointment that can divest other beneficiaries, then, those other beneficiaries are not considered to be "Qualified Beneficiaries" for notice or consent purposes unless the Trustee has the discretion to give distributions to them before the death of the individual who can divest them.

12. Florida has new statues on Spousal Limited Access Trust (SLAT), Community Property Trust, and obtaining orders to confirm automatic homestead on transfer on death.

13. Florida has a documentary stamp tax on promissory notes based upon 35 cents per 100 dollars – maximum $2,450.



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KEY FACTS ABOUT FLORIDA LAWS AND PRACTICES

14. Durable Powers of Attorney signed on or after October 1, 2011 will have no force or effect if:

    a. The exact action to be taken by an Agent is not explicitly set forth in the Power of Attorney document.

    It is not sufficient to provide that "my Agent can take any action that I would be able to take if I were acting."

    b. Seven (7) primary activities cannot be engaged in by the Agent unless the Principal has initialed explicit statements as to what those items are.

    It is not sufficient to only initial once indicating that any two (2) or more of the seven (7) items apply - each item must be separately initialed.

    c. A Post-September 30, 2011 "Springing Power of Attorney" has no force or effect whatsoever.

    A Power of Attorney that says "this Power of Attorney will only be effective in the event of my incapacity" will have no power at all.

    On the other hand, a Power of Attorney that says "I have entrusted the original of this document to ABC Law Firm and no Agent can act unless he or she has the original or a certified copy confirmed to have been delivered by the ABC Law Firm to the Agent because the ABC Law Firm has determined that the Agent should be able to act."



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BECOMING A FLORIDIAN

- Domicile is based on intention - what state does the person actually call “home.”

- For most Floridians, Florida is the only place they live, whether they have lived here for years, or moved here from another state. The moment they arrive with all of their belongings in the moving van they are Floridians.

- The question is less clear for those who have homes or otherwise spend many weeks both in Florida and in other jurisdictions and who may wish to claim income taxes, inheritance taxes, estate taxes, and other bounties that apply to their residences.

- While many northern states take the position that a person has not really left until they have just about completely deserted the state, Florida law recognizes the residency of someone who moves here and intends to make Florida their primary place of abode.



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BECOMING A FLORIDIAN (Continued)

There are many steps that can be taken to help prove that Florida is an individual's primary residence, including:

1. Have a great moving in party and invite your tax advisors – open bar preferred;
2. File for the Florida homestead property tax exemption
3. Execute a new Florida Will and restate or amend trust documents;
4. Refer to Florida residence in all estate planning documents;
5. Register to vote in Florida, and then actually vote;
6. File a federal income tax return with the IRS at the location applicable to Florida residents (Austin, TX if no payment is enclosed, or Charlotte, NC if payment is enclosed);
7. Change the address on your passport;
8. Obtain a Florida's driver's license and license plates;
9. Open a Florida bank account;
10. Send announcement cards and let everyone know that you moved to Florida;
11. Have your car insurance; homeowner's insurance, and other coverages show that you are a Florida resident;
12. Have your church, synagogue, and similar affiliations in Florida; and
13. Make sure that everyone sends all of your mail and other items to Florida, for at least most of the year.



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TENANCY BY THE ENTIRETIES

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TENANCY BY THE ENTIRETIES

- Tenancy by the entireties("TBE") "immunity" dates back to the English common law and the time when a married woman could not hold property individually. TBE was a form of property whereby a husband and wife could hold property as an indivisible unit.

- An ownership interest in TBE property is non-severable without consent of both spouses, except in limited situations. **The property is not divisible on behalf of one spouse alone, and therefore cannot be reached to satisfy the obligations of only one spouse.** However, creditors owed monies by both the husband and the wife can attach the TBE property.

- States other than Florida which recognize TBE, at least to some extent, include Arkansas, Delaware, Michigan, Pennsylvania, Rhode Island, Washington, D.C., Missouri, Tennessee, Hawaii, and Vermont. Where one spouse lives in Florida and another spouse lives in one of the other states that recognize TBE property, most likely the creditor protection will apply for the Florida resident spouse. The treatment of the other spouse will be subject to the law of where the other spouse resides.



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Definition Of Tenancy by the Entireties

Joint tenancy with right of survivorship is not enough because the law requires that "the 6 unities" exist. The 6 unities may be summarized as follows:

1. Unity of possession - Both spouses have joint ownership and control - it may be acceptable that a deposit agreement allows either spouse to withdraw independently of the other on the theory that the power to withdraw is an expression of an authority of agency given by each spouse to the other.

2. Unity of interest - Each spouse has the same interest in the account - it is not a problem if one spouse deposits all or most of the funds into the account as long as each spouse has the same interest immediately after the deposit.

3. Unity of time - The interests of both spouses in the asset must originate simultaneously in the same instrument, such as on the signature card. **Do not try to convert an individual account into a tenancy by the entireties account. Instead, transfer assets from the individual account to a new tenancy by the entireties account.**



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Definition of Tenancy by the Entireties

4. Unity of title - Both spouses must have ownership under the same title.

5. Survivorship - On the death of one spouse, the other spouse becomes the sole owner of the entireties property. A general power of appointment given to one spouse over joint assets may vitiate tenancy by the entireties status.

6. Unity of marriage - Of course, the owners must be legally married under Florida law.

   Non-residents who own property in Florida can also claim the tenancy by the entireties immunity. In Re Cauley, 374 B.R. 311, 316 (Bankr. M.D. Fla. 2007).



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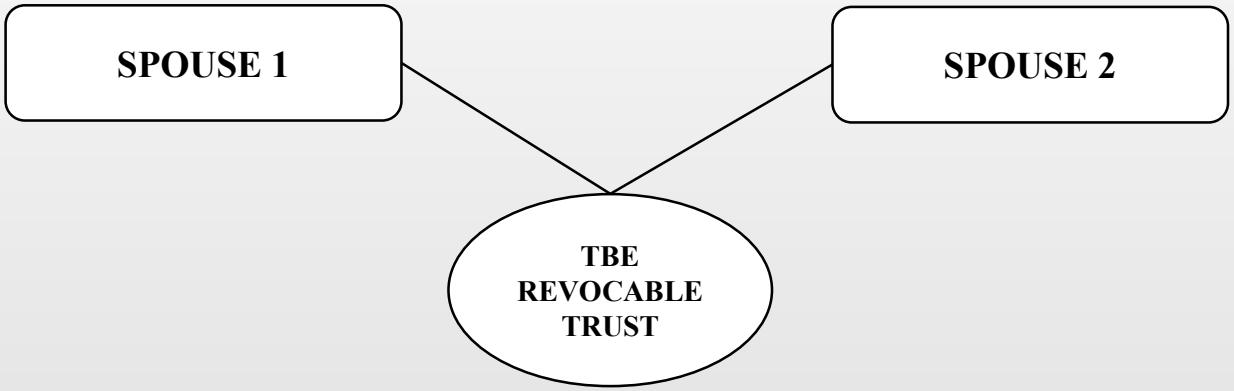
SPECIAL TENANCY BY THE ENTIRETIES ISSUES

- Joint Accounts. Not with USAA, Strong Mutual funds and many others. You must read the account agreement to be sure. Better to set up a TBE LLC to own accounts.
- Stock Certificates and Shareholder Agreements.
- Tax Reporting and Tax Refunds.
- Tangible Personal Property.
- Automobiles and Other Registered Vehicles.
- Real Estate Owned Outside of Florida.



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TBE Revocable Trust



Carefully drafted Trust provides that all beneficial interests are owned as tenants by the entireties, and solely owned by surviving spouse after first death -

Then acts as a simple Revocable Trust for the surviving spouse.

Surviving spouse must have total control over the Trust after the first death to qualify under tenancy by the entireties.

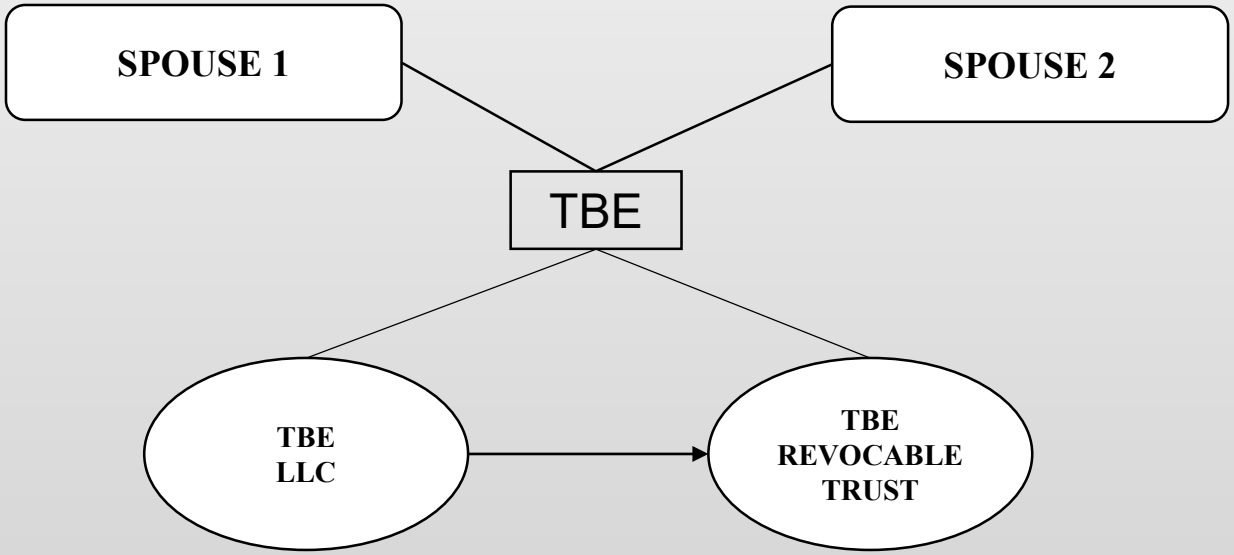
Question ?

Why not have Credit Shelter/QTIP Trust provisions that would be activated to the extent that the surviving spouse disclaims TBE Trust assets? - To be a true TBE Trust, the beneficial interest disclaimed would need to flow through the probate estate of the first dying spouse, but could be poured back into the Trust and then handled by "if a disclaim occurs" provisions, or under Testamentary Trust provisions in Last Will and Testament.

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TBE Revocable Trust/ LLC Combo – Hold the Fries!

TBE LLC ownership will pass to Revocable Trust by pay-on-death clause on death of surviving spouse.





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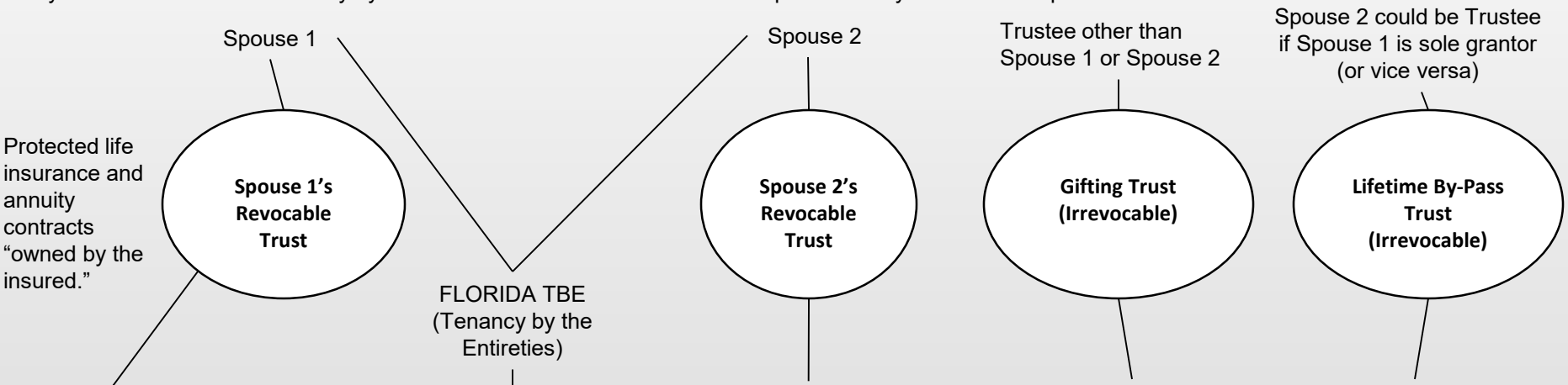
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DETERMINING HOW TO BEST ALLOCATE ASSETS AS BETWEEN A MARRIED COUPLE - PART I

General Rules:

-Typically want each trust funded with at least $11,200,000 worth of assets on death for estate tax planning.

- May be funded from ½ of tenancy by the entireties assets via disclaimer and probate or by life insurance/pension/IRA assets.



1. Assets held directly by revocable trust are subject to Spouse 1's creditor claims.
2. Direct ownership of limited partnership or LLC not in TBE may have charging order protection **(meaning that if a creditor obtains a lien on the limited partnership or LLC, the Spouse 1 cannot receive monies from the limited partnership or LLC without the creditor being paid).**

1. Only exposed to creditors if **both spouses owe the creditor, if one spouse dies and the surviving spouse has a creditor, the spouses divorce, or state law or the state of residence changes.**
2. On death of one spouse, surviving spouse may disclaim up to ½ (if no creditor is pursuing the **deceased** spouse) to fund By-Pass Trust on first death.

1. Safe from creditors of Spouse 1 but exposed to creditors of Spouse 2 (Maintain large umbrella liability insurance coverage to protect these assets.)
2. On Spouse 2's death, can be held **under a protective trust, which will** continue to be safe from creditors of Spouse 1, subsequent spouses, and "future new family."

1. Safe from creditors of both spouses.
2. If divorce occurs, should not be subject to rules for division of property between spouses.
3. May be controlled by the "entrepreneurial spouse" by using a Family Limited Partnership.

1. **Safe from the creditors of the Grantor's spouse.**
2. If funded by one spouse, may benefit other spouse and children during the lifetime of both spouses.
3. Otherwise can be identical to gifting trust pictured to the left.

SEE NEXT PAGE FOR SECOND TIER PLANNING

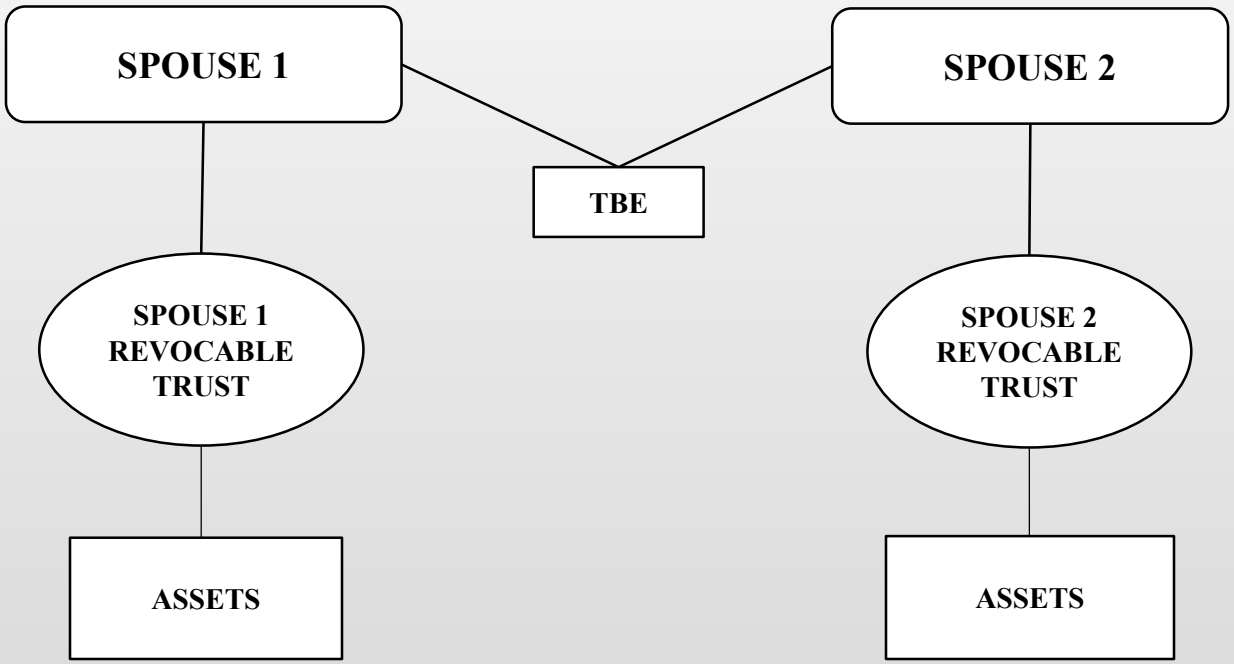
A COMMON SOLUTION - to use a limited partnership or similar mechanisms and have no assets directly in the "high risk" spouse's trust, half to two-thirds of the assets held as tenants by the entireties, and half to two-thirds of the assets directly in the "low risk" spouse's trust.



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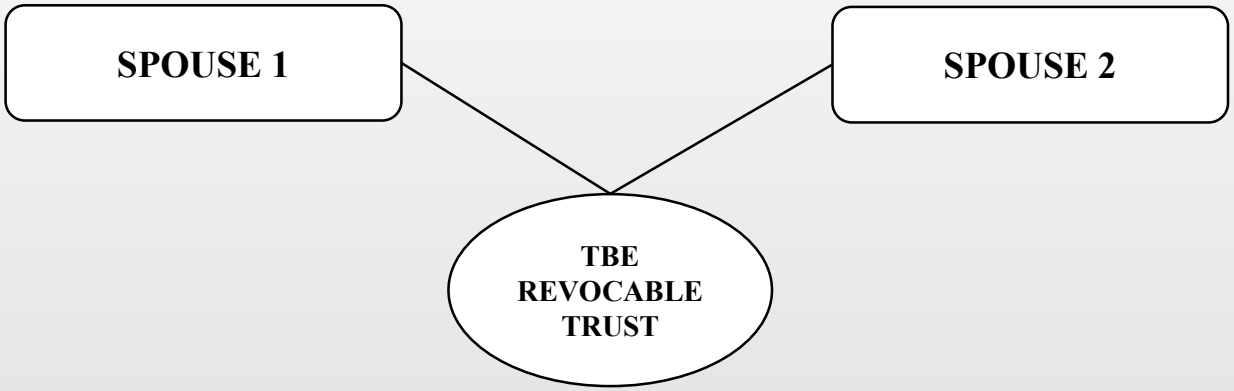
Traditional Wealthy Floridian



Couple elects to hold assets as TBE, so that surviving spouse can disclaim his or her "half" (may not be exactly half) to be probated to Revocable Trust of first dying spouse - but must also disclaim any Power of Appointment. TBE assets funded solely by one spouse may be disclaimed by the other spouse entirely - not just half - under Treasury Regulation Section 25.2518-2(c)(4)(ii) and Example 9 thereunder.

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TBE Revocable Trust



Carefully drafted Trust provides that all beneficial interests are owned as tenants by the entireties, and solely owned by surviving spouse after first death -

Then acts as a simple Revocable Trust for the surviving spouse.

Surviving spouse must have total control over the Trust after the first death to qualify under tenancy by the entireties.

Question ?

Why not have Credit Shelter/QTIP Trust provisions that would be activated to the extent that the surviving spouse disclaims TBE Trust assets? - To be a true TBE Trust, the beneficial interest disclaimed would need to flow through the probate estate of the first dying spouse, but could be poured back into the Trust and then handled by "if a disclaim occurs" provisions, or under Testamentary Trust provisions in Last Will and Testament.



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CREDITOR EXEMPT ASSETS	ASSETS THAT ARE DIFFICULT FOR A CREDITOR TO OBTAIN	ASSETS EXPOSED TO CREDITORS
Homestead *-Up to half acre if within city limits.* *-May be immune from fraudulent transfer statute.*	Limited partnership and similar entity interests.	Individual money and brokerage accounts.
IRA *-Includes ROTH, Rollover, and Voluntary IRAs, but possibly not inherited IRAs.*	Foreign trusts and companies.	Joint assets where both spouses owe money.
Permanent Life Insurance *-Must be owned by insured.*	Note – foreign entities are very rarely recommended and must be reported to IRS -	Personal physical assets, including car, except for $4,000 exemption ($1,000 if homestead exemption is claimed in bankruptcy).
401(k) *-Maximize these!*	Foreign bank accounts.	One-half of any joint assets not TBE where one spouse owes money.
Tenancy by the Entireties (joint where only one spouse is obligated) *- Must be properly and specially titled – joint with right of survivorship may not qualify.*	**Vocabulary:** **EXEMPT ASSET** – An asset that a creditor cannot reach by reason of Florida law – protects Florida residents. **CHARGING ORDER PROTECTION –** The creditor of a partner in a limited partnership, limited liability limited partnership, or properly drafted LLC can only receive distributions as and when they would be paid to the partner. **FRAUDULENT TRANSFER** - Defined as a transfer made for the purpose of avoiding a creditor. Florida has a 4 year reach back statute on fraudulent transfers. A fraudulent transfer into the homestead may not be set aside unless the debtor is in bankruptcy. It takes 3 creditors of a debtor who has 12 or more creditors to force a bankruptcy. Upon filing a Chapter 7 Bankruptcy, an individual debtor may be able to cancel all debts owed and keep exempt assets, subject to certain exemptions. Annuities and life insurance policies are not always good investments, and can be subject to sales charges and administrative fees. There is a lot more to know- but this chart may be a good first step.	
529 College Savings Plans		
Annuity Contracts		
Wages of Head-of-Household		
Wage Accounts (for 6 months)		
Up to $4,000 of personal assets – or possibly less in bankruptcy.		



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ASSET PROTECTION CHECKLIST – Page 1

	PROTECTED OWNERSHIP CATEGORIES	NOTES		LIABILITY INSULATION	NOTES
1	Assets exempt by Florida Constitution, Statute, Common Law or Federal Law. (*Note: The above exceptions do not apply to the IRS, FTC, SEC, or other "Super Creditors", such as the Department of Justice when pursuing RICO perpetrators.)*		1	Make sure housekeeper, in-laws, and all others are covered if they drive your cares or reside in your residence.	
1(a)	Homestead.		2	Car ownership, and which parent signed to be responsible for the driving of a minor.	
1(b)	Tenancy by the entireties.		3	Car driving by children, spouses, employees and others.	
1(c)	Pension and IRA.		4	Firewall protection provided by LLC's, companies and various partnerships (LLP's, LP's and LLLP's).	
1(d)	Life insurance policies.		5	Triple Net Lease language to protect landlord – must give tenant total control of property.	
1(e)	Annuities		6	Managers may get sued.	
1(f)	529 Plans		7	Delegate to management company.	
1(g)	Disability and Social Security Benefits		8	Guests may sign releases.	
1(h)	Others		9	Independent contractor arrangements.	
2	Charging Order Protection.		10	Bartenders for personal parties.	
3	Property owned by others.		11	No guests on wave runners.	
4	Property sold for Note or annuity payment rights.		12	No alcohol served to anyone under the age of 21.	
5	Third Party Settled Trusts.		13	Appropriate underlying and umbrella liability insurance – for each property, car, 4-wheeler, etc. But beware of exceptions and illegal situations that will not be covered.	
6	Self-Settled Trusts in Asset Protection Trust jurisdiction.				
7	Foreign assets, entities and accounts in jurisdictions that do not recognize U.S. judgments.				
	BUSINESS AND INVESTMENT CONSIDERATIONS			**OTHER CONSIDERATIONS**	
1	Liability and casualty insurance review, with personal use interaction and business umbrella to be considered.		1	Income and estate tax avoidance – buy a felony to avoid paying IRS taxes or to conspire to help someone avoid such payment – same applies as to debt owed directly to the FDIC and certain other governmental creditors.	
2	Friendly lenders.		2	Marriage and divorce – ex-spouse cannot invade TBE assets held with new spouse or invade new spouse's interest in a homestead or TBE homestead.	



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ASSET PROTECTION CHECKLIST – Page 2

	BUSINESS AND INVESTMENT CONSIDERATIONS	NOTES		OTHER CONSIDERATIONS	NOTES
3	Separate activities and exposures.		3	Impact on an estate plan.	
4	Leasing arrangements with landlord rent right secured by UCC-1 on tenant's property.		4	Federal and state criminal law.	
5	Car use.		5	Exposure of the advisor.	
6	Car ownership.		6	Exemptions that apply on death – do not make life insurance or annuities payable to an estate or to a trust that provides that estate obligations must be paid.	
7	Delegate to offshore employees.		7	Client guarantee.	
8	Employee causes of action – make sure they have Workers' Compensation.		8	Confidentiality – use an anonymously owned LLC from Wyoming, Delaware or Colorado to serve as manager of operational LLC's and Trustee of Homestead Land Trust, and file Certificates of Authority in each county where real estate is located.	
9	Separate intellectual property rights.		9	Equity Stripping – debt secured by a mortgage or lien on valuable assets at risk may be payable to arm's-length lenders or related party lenders under a number of various arrangements.	
10	Alcohol at events.		10	Make your children self-supporting.	
11	Using independent contractors.		11	Get divorced soon, or not at all.	
12	Client/Patient/Supplier Arbitration Agreements.				
13	Consider New Parent F Reorganization to separate assets within a company without triggering capital gains.				
14	Consider factoring accounts receivable to a related company that may be held for descendants.				
15	Trusteed or Partnership/LLC based Buy/Sell Life Insurance Arrangement.				
16	Consider leasing use of equipment on a triple net basis – be sure all activities are insured.				
17	Pension contributions.				



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THE CPA'S CHECKLIST FOR FLORIDA CREDITOR PROTECTION PLANNING AND MAINTENANCE

1.	Do the clients know about tenancy by the entireties protection?	
2.	Are the clients' assets held as tenants by the entireties? a. Were the right boxes checked when they opened an account? b. Do they have out of state real estate that needs to be placed under a Florida LLC? c. How will the client's fund a bypass trust on the 1st death if everything is owned jointly? – Disclaimer planning. d. Are K-1's being issued to both spouses or to the correct spouse or entity? If a husband and wife own S-Corporation stock or a partnership interest as tenants by the entireties is it proper to be issuing separate K-1's to them for 50% each of the interest? Often the CPA's file is the only place to find documentation on how stock and LLC interests are owned. e. How do stock certificates read? f. What names are on contracts? g. Is property held in a state that allows for tenancy by the entireties? h. Have the clients considered a TBE owned LLC or family limited partnership. i. Do their LLC's have proper operative language?	
3.	Is the homestead more than ½ an acre within the city limits or more than 160 acres in the county? Homestead is owned as tenants by the entireties as well?	
4.	Do they understand that the cash value of a life insurance policy is only protected when it is owned by the insured individual?	
5.	Is life insurance payable to protective trusts that can benefit the surviving spouse and descendants without being subject to their creditor claims? Does the client own life insurance policies on any other person - if so, it will not be creditor protected.	
6.	Is there an inherited IRA - inherited IRAs are not protected from creditors under recent Florida case law.	



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THE CPA'S CHECKLIST FOR FLORIDA CREDITOR PROTECTION PLANNING AND MAINTENANCE

7.	Who is responsible for making sure that LLCs are properly established and maintained? An improperly drafted LLC will not provide a Florida client with charging order protection or tenancy by the entireties status, even if intended to do so. Many lawyer do not know how to do this properly, so how can accountants and clients themselves even attempt this? Single member LLC's do not have charging order protection. WARNING - It violates the unauthorized practice of law rules to set up LLC's and to provide legal documents for LLC's. This puts the CPA firm at risk for malpractice and licensing purposes.	
8.	Do the clients own assets that may cause liability, such as investment real estate, a business or even a charitable activity? Should these be placed in separate LLCs for liability insurance insulation purposes? a. Some clients think that a flow-through tax entity allows creditor claims to flow through, which is not of the case. b. Many clients think that revocable trusts will shield them from creditor claims. There is a big difference between avoiding probate and avoiding creditors. c. Who is the manager? Exposure of the manager? d. Do insurance carriers on agencies know how assets are owned?	
9.	Are proper formalities being followed so that one company or person is not considered an alter ego of the other for liability insurance insulation purposes. Are financial statements being prepared? For example, many CPA firms prepare a form 1065 for an entity taxes as disregarded simply to help confirm appropriate fiscal conduct and accountability.	
10.	Is the client being realistic about what their risks and exposures are with respect to potential upside down loan situations, guaranties, and real estate debt that may not be renewed. Why do some clients wait until it is too late? A nudge here and there can save significant problems.	
11.	How much should the CPA know? Will communications with the CPA and other parties become discoverable? Understand CPA client Florida litigation privilege – copies of letters or information given to third parties will be discoverable.	



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THE CPA'S CHECKLIST FOR FLORIDA CREDITOR PROTECTION PLANNING AND MAINTENANCE

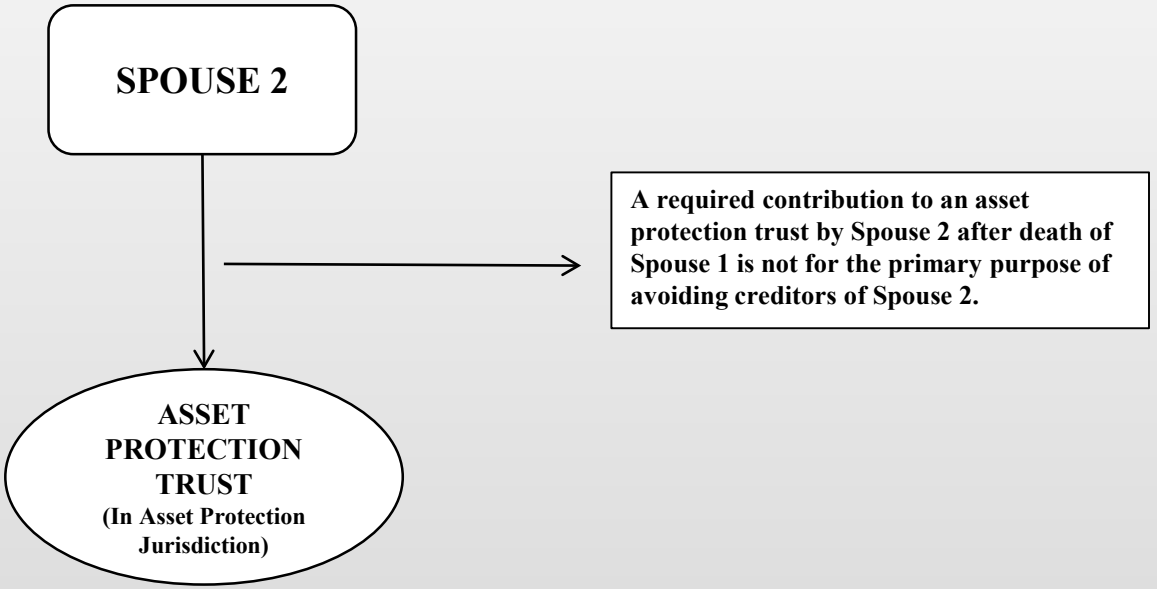
13.	Is the client being accurate and truthful on financial statements provided to lending institutions? How specific do these statements need to be on issues such as joint assets and changes thereto. Proper footnoting is crucial.	
14.	Are insurance agencies and carriers aware of exactly what is being insured? Is the client telling the insurance carrier that the car is personal and not for business, while telling the IRS that the car is 90% business and is owned by a company? Can someone working for the CPA firm call the applicable insurance agencies to make sure that everything is coordinated? Make sure client understands exclusions, such as animals, pools, civic activities, church or synagogue activities, etc.	
15.	What is the client's cash-burn rate? Are they waiting for the economy to turn around, and what if it does not and when do they run out of cash?	
16.	Schedule an annual review?	
17.	Consider new entities and trusts, including protective trust systems and limited liability entities. Segregate voting from non-voting under entities.	
18.	Annual input from and participation with qualified lawyer.	
19.	Debt at the Debtor's Best Friend a. Is there one creditor who should be ahead of the others? b. Are all loans documented by promissory notes and secured by mortgages and/or security agreements? c. Review various debt-associated strategies, such as cross-collateralization and sale lease backs.	



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Marital Asset Preservation System (MAPS)





Spouse 1 dies. Spouse 2 is required by written agreement to establish asset protection trust in asset protection jurisdiction with all unprotected assets, and contractual obligation to preserve these for common descendants. A standby unsigned, but trust company approved, Trust Agreement can be approved by both spouses during lifetime of Spouse 1 and/or nominally funded.

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Marital Asset Preservation System (MAPS)

One of the primary purposes for utilizing the Marital Asset Preservation System ("MAPS") is to ensure that married couples keep their marital assets in the family for generations to come. In general, conscientious estate and tax planners will do their very best to meticulously plan and preserve assets for a surviving spouse, while also enabling the surviving spouse to leave assets to common descendants of the decedent, and with the minimal amount of taxes and probate expenses.

However, there is one question that is routinely left out of the discussions between married couples and estate planners during the planning process:

Would you like some assurance that your marital assets will only pass to your common descendants upon the death of the survivor of you?

The answer to this question is usually a resounding "yes", and as such, requires the surviving spouse to protect the marital assets by not allowing them to be left to a subsequent spouse or some other future significant other.

That answer leaves the estate planner with some rather intricate issues and challenges, not to mention more work and an added layer of complexity to design and implement the various trust systems and strategies to be used.

Once the clients have decided that this is the right strategy for them, the planner must explain that upon the death of one spouse, the surviving spouse may serve as Trustee or Co-Trustee of one or more irrevocable trusts, with the power to change the trusteeship within pre-agreed parameters. These irrevocable trusts may only allow the surviving spouse to have access to assets and monies as needed for the spouse to maintain the standard of living that has been enjoyed during the marriage, and to provide support for common descendants. There are several restrictions that can be placed on a surviving spouse, one of which is to allow them to only make distributions outside of the family based upon an annual allowance that might be used for charity, religious organization dues and donations and gifts to friends based upon guidelines that can be set forth in the documents.

There can also be limitations placed on how much compensation might be paid to third parties for services like housekeeping, nursing, private lessons, personal trainers and otherwise. There can also be limited access for charity, church or synagogue donations, and other defined causes.

<u>An Ability to Provide Limited Benefits and Compensation to a Subsequent Spouse.</u>

While it is commonly assumed that the "next spouse" might threaten to deprive descendants of marital wealth, and might place the surviving spouse in jeopardy of losing assets that would be needed for his or her well-being, there is also the possibility that the subsequent spouse will contribute meaningfully both to the preservation and enhancement of marital assets, and with respect to providing care and support for the surviving spouse. It could be both unfair and counterproductive for the surviving spouse to not be able to allow a subsequent spouse to contribute meaningfully to marital assets, and to be compensated for providing necessary services, whether personal, nursing, or managerial, where this is clearly in the best interests of the surviving spouse, and possibly one or more of the descendants of the original marriage.

For this reason, the authors also provide that the MAPS Agreement or system may be amended by one or more of the adult descendants of the original couple, and/or an independent Trust Protectors or other advisors, to take into account appropriate circumstances and formal requests for changes.

The above normally fits well and naturally under a credit shelter/marital deduction trust arrangement that will typically be established on the death of a first dying spouse where federal estate tax is a possible concern, but quite often a good many assets will be owned outright by the surviving spouse or jointly with right of survivorship, and IRA and qualified retirement plans are typically best left to a surviving spouse to enable postponement of having to take taxable distributions.

The planner must therefore explain that those assets that are not naturally captured under a trust system on the first death of a spouse will need to be either: (1) contributed to a trust system by the surviving spouse, as encouraged or required by planning documents, and possibly a Marital Asset Preservation System (MAPS) Agreement; or (2) have the surviving spouse contractually bound by a MAPS Agreement requiring them to maintain existing marital assets, and any income derived from those assets for the surviving spouses life, and also direct that those assets be left for only common descendants upon the surviving spouse's death.

The author commonly uses one or both of these alternatives. These techniques are often coupled with carefully drafted trust provisions, as well as an explanation in the trust document to ensure that every possible step is satisfied and that the MAPS objectives are met.

One issue for couples having more than the $22,800,000 exemption level situation, or expectation thereof, is whether limitations placed on inherited assets would cause loss of the federal estate tax marital deduction and consequent income tax to be paid on the first death. Each individual presently only has a $11,400,000 estate and gift tax exemption amount, which must be considered. This issue is especially important when the surviving spouse is contractually bound to preserve and leave the assets for subsequent descendants, as opposed to receiving the assets as the sole owner without any legal entanglements.

Generally, there is no marital deduction allowed for dispositions that do not at least allow the surviving spouse to have all income from marital deduction trust property and to be the sole beneficiary of a trust holding such property for his or her lifetime. A marital deduction may also not be received for assets that are paid outright to a surviving spouse who has significant contractual limitations on what he or she is able to do with the property.

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Marital Asset Preservation System (MAPS)

In states that do not recognize community property, most planners will use separate revocable trusts for affluent husbands and wives for estate planning, because of established customs and the complexities associated with using joint trusts. In such situations, it is possible to have the revocable trust of the surviving spouse become irrevocable upon the death of the first surviving spouse. For purposes of federal estate and gift taxes, this event will be considered an incomplete gift because it provides the surviving spouse with the right to veto payments to any person other than the surviving spouse during their remaining lifetime, and the power to appoint trust assets to common descendants of the married couple.

Alternatively, in states that do recognize community property, we find that joint trusts are becoming more prevalent.

An objective for many estate and tax planners, regardless of the state in which they live, is to have the first dying spouse's death cause a step-up in the income tax basis to a fair market value for any and all family assets. This strategy should be utilized to the extent that the family would benefit from having an increased basis, which would essentially take any property that appreciated during the decedent's lifetime and provide the surviving spouse with the ability to not recognize any gain on such property when they come into possession.

Many planners in non-community property states are using Joint Exempt Step-Up Trusts ("JEST"), which may enable clients to receive this stepped-up basis on all joint trust assets upon the death of the first dying spouse. When the first spouse dies, assets held by the joint trust are used to fund a credit shelter trust for the benefit of the surviving spouse and descendants. These assets now held by the credit shelter trust will receive a full step-up in basis, and escape tax liability upon the surviving spouse's death.

Life insurance can also be integrated into the arrangement by having the death benefit payable to an irrevocable trust, which may be a separate trust that owns the policy so as not to be subject to federal estate tax on the death of the first dying spouse.

Waiver of Marital Rights.

Most states have statutes which provide a surviving spouse with a minimal outright disposition, most commonly known as the Elective Share. In addition, some states provide a surviving spouse with homestead inheritance and other rights which may be waived during the estate planning process while both spouses are living.

The estate planner will have to be very careful with respect to disclosing conflict of interest issues and evaluating whether one or both spouses should be required, or at least strongly urged, to seek independent legal counsel before being legally bound to have limited access and control to marital and inherited assets after the death of one spouse. In the event that a conflict of interest does arise, the estate planner should withdraw and require the spouses to retain separate counsel. Furthermore, because the planner represented both spouses, they are prohibited from representing either one of them against the other, even with informed consent.

ABA-Model Rule 1.7 addresses the rules for Current Client Conflicts of Interest. In essence Rule 1.7(a)(1) states that, a lawyer shall not represent a client if representing one client will be directly adverse to another client. However, this Rule is not an absolute bar to representing a client when there is a conflict. Subsection (b) provides that a lawyer may represent a conflicted client if (1) they believe they can provide competent representation; (2) it is not prohibited by law; (3) it does not involve one client asserting a claim against another client, both of whom are represented by the lawyer; and (4) each client gives informed consent. In the context of marital inheritance, subsection (b)(3) will almost always bar the attorney from representing one client over another, even with informed consent.



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HOMESTEAD CREDITOR PROTECTION

- In Florida, there is unlimited protection for homestead property and improvements thereon of up to one half-acre in the city or 160 acres in the county, provided the owner is an individual (or perhaps a revocable trust) who resides legally and permanently on the property and is a U.S. citizen or Green Card holder.

  See *Davis v. Davis* Fla. 1st DCA 2003 case that decided that acreage in the county could be used for business without loss of homestead exemption, and Bankruptcy Court case of *In re Radtke, 2006, which held otherwise, and observed that the Florida Supreme Court has not opined on this issue.*

- The person must be a permanent resident of Florida and intend to make the property his or her permanent residence.

- Need not qualify for real estate homestead tax exemption to have the benefit of Constitutional creditor protection.

- Florida homestead protection "trumps" fraudulent transfer statutes (*Havoco of America, Ltd. v. Hill)*

- Beware of bankruptcy law limitations and the ten-year fraudulent transfer look-back period, and the other bankruptcy rules described on the next slide.

- It is optional to file an Affidavit of Homestead under Florida Statutes which is an evidentiary instrument.

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NOT TO BE CONFUSED

STATE HOMESTEAD TAX EXEMPTION		STATE CREDITOR EXEMPTION	
1	**WHAT IS IT?** Saves approximately $1,000 of taxes (2% of $50,000), plus the 3% cap on future increases applies.	1	**PROVIDES PROTECTION FROM CREDITORS**
2	**HOW TO QUALIFY?** Normally, one or more individuals reside on the property and call it their homestead. There is no size limit.	2	**MUST BE RESIDENTIAL HOMESTEAD PROPERTY WHERE THE OWNER LIVES AS PRIMARY RESIDENCE.** The law only protects up to half an acre if within city limits, and up to 160-acres if outside of city limits (or if was outside of city limits and was annexed while primary residence).
3.	**REGISTRATION REQUIREMENTS.** **Must reside on the property when the bell strikes January 1st (have to move in before New Years). **Must register with Property Appraiser Office by March 1st of the following year. **Homestead tax status begins the January 1st after the move-in, if the March 1st registration deadline is met.	3	**NO REGISTRATION REQUIREMENTS AND NO DEADLINES FOR MOVING IN – PROTECTED FROM THE MOMENT OWNED (EXCEPT AS TO A JUDGMENT AGAINST THE PROPERTY THAT EXISTED BEFORE IT WAS "HOMESTEADED.")**



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The 30-Day Rental exception for Florida's homestead tax law

- The homestead owner can rent out a home for up to thirty days each calendar year without losing the homestead exemption under Florida Statute Section 196.061, which was enacted effective July 1, 2013.

- The question of whether to convert a primary or vacation home into rental property in order to be able to deduct the real estate taxes without the $13,850 for a single person, or $27,700 for a married couple, itemized deduction limitation, or the $10,000 limitation on property taxes enacted under the Tax Reform Act of 2017 will cause many Florida homeowners to convert houses to rental status.



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REAL ESTATE AD VALOREM TAXES

- Annual ad valorem tax rate is just under 2% of “appraised value”, with a $50,000 exemption (a proposal to raise this exemption is on the ballot for November) for homestead and a 3% or CPI (whichever is lower) annual cap on increases.
    - Portability of the 3% or CPI cap is allowed.
    - Many issues can arise on homestead exemption planning with trusts and joint non-spouse owners and in other situations.
- To qualify for tax homestead exemption, the client must own the property and reside on it at 12:00 am January 1, and a special homestead exemption application must be filed with the county property appraiser on or before March 1.
- Many counties require the actual homeowners to physically appear to sign the registration materials under penalty of perjury – do not commit a felony by taking homestead exemption in two states at the same time.



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PORTABILITY OF THE HOMESTEAD TAX EXEMPTION

Homestead property owners are able to transfer their Save Our Homes benefit, up to $500,000, to a new homestead within the two years of giving up their previous homestead. This is called portability. When a homestead having the 3% cap advantage is sold, then the owner has until the second tax year following the year of sale to declare a homestead that will receive the differential advantage.



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THREE WAYS TO GET THE HOMESTEAD TAX EXEMPTION WITHOUT OWNING THE HOUSE

1. **Resident is the beneficiary of a trust that provides her with the right to reside on the trust property as if it were homestead.**

2. **Resident has use under a 98-year – or longer – lease.**

NOTE: A leasehold estate may qualify for homestead creditor protection.

3. **Resident has a life estate in the homestead.**

- **Send the draft document to property appraiser/lawyer thereof to confirm whether it will qualify for the exemption**
- **Must only qualify on January 1st and the exemption will apply for the rest of the year**



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Make Sure To Have Appropriate Language In Your Trust That Will Own Homestead Property

The following language applies to a Trust where the Grantor is the beneficiary and the homestead is owned by the Trust:

Homestead Real Property. I reserve the right to reside on any real property placed in this Trust as my permanent residence during my lifetime. In doing so, I intend to retain the requisite beneficial interest and possessory right in and to such property to comply with Florida Statutes Section 196.041, as amended, so that my retained beneficial interest and possessory interest shall constitute, in all respects, "equitable title" as that term is used in Section 6, Article VII of the Constitution of the State of Florida and applicable statutes. Such use, possession and enjoyment shall be without rent or other financial obligation. Notwithstanding anything herein to the contrary, my interest in any such "homestead" property shall be deemed an interest in real property, not personalty. If the homestead laws of the State of Florida apply, or appear to apply, to cause a disposition of such property in a manner not contemplated under my estate plan, then the Trustee shall have discretion to take such actions as are deemed appropriate by the Trustee in order to compensate for such deviation from my estate plan. With reference to any real estate held under this trust arrangement, I shall be considered the named insured on any liability, casualty, or other insurance policy relating to such real property, as appropriate to facilitate coverage that would typically apply for an owner entity. The preceding sentence has been provided based upon announcements by some insurance carriers in Florida that this type of provision is required to facilitate appropriate coverage.

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Make Sure To Have Appropriate Language In Your Trust That Will Own Homestead Property

The following language (or something similar) will need to be included in any Trust Agreement that is contemplated to own the homestead property of a beneficiary of the Trust:

> Notwithstanding anything to the contrary in paragraphs (1) and (2) above, as to any real estate owned under this Trust which is held in a county in Florida where the Primary Beneficiary resides, and any replacement real estate thereto the Primary Beneficiary shall have all rights of occupancy, use, and possession of such real estate as would apply to the owner of a life estate, as Homestead real estate, and thus shall have all equitable rights to use of such real estate consistent with Section 6, Article VII, of the Florida Constitution and Florida Statute 196.041(2), and as required by any applicable County Property Appraiser to qualify for homestead tax exemption and applicable increase caps and portability unless said Primary Beneficiary elects to the contrary by a written instrument executed.



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HOMESTEAD DISPOSITION/DEVISE LIMITATIONS

- The Florida Constitution prevents a married homeowner from transferring or mortgaging the homestead property without the consent of the owner's spouse, or an appropriate waiver. Consider using an LLC to avoid such requirements.

- The Florida Constitution restricts the devise of the homestead on death if the owner is survived by a spouse or minor child, except that homestead may be devised to the owner's spouse if there is no minor child, or may be owned jointly with right of survivorship with a spouse.

- However, the Florida Constitution does not address how homestead property descends upon the death of the owner of the homestead. The descent of homestead property is controlled by Fla. Stat. 732.401, which now gives the surviving spouse a choice (effective October 1, 2010):

  - a life estate (the right to live there for life) with remainder interest owned by the decedent's descendants; or

  - a 50% tenant in common interest between the spouse and decedent's descendants.



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Spousal Homestead Waivers Through Deed

Section 732.7025, Florida Statutes

Under this new provision a spouse may waive the his/her right to inherit homestead property through the execution of a deed, which would otherwise prevent the devising spouse from devising the homestead property to someone other than the spouse.

This statute requires the following language or substantially similar language to be included in the deed:

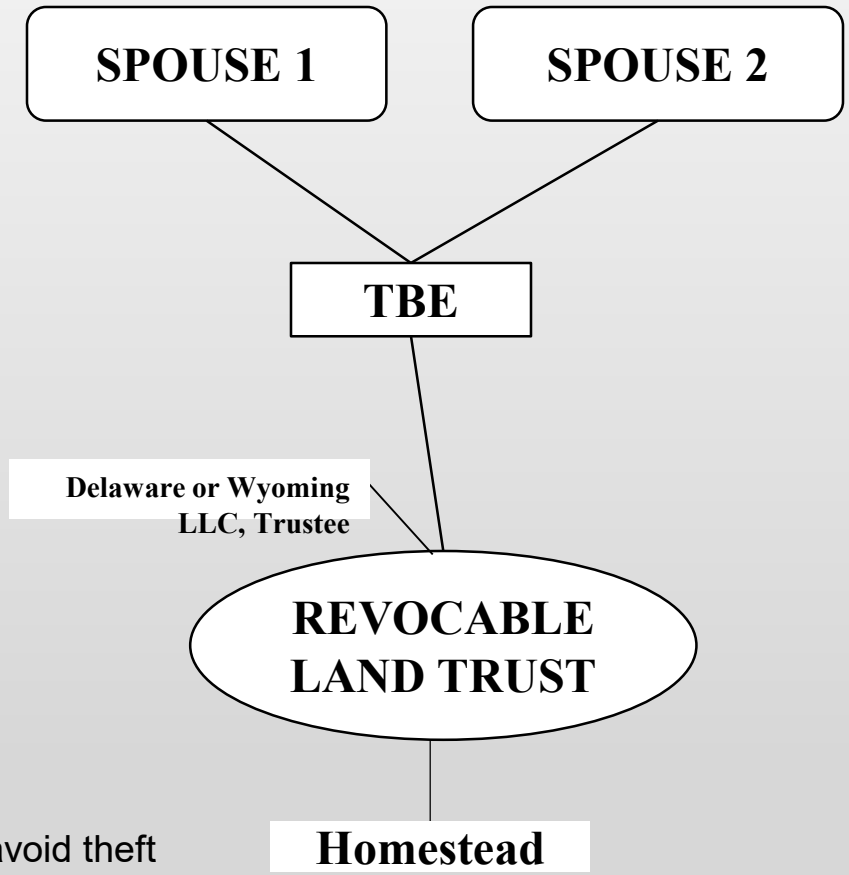
> By joining this Deed, I intend to waive homestead rights that would otherwise prevent my spouse from devising the homestead property devised in this Deed to someone other than me.

This statutory waiver codifies case law which allowed attempts to waive spousal interests in the homestead valid. This waiver language is not a waiver of the protection against the owner's creditor claims during the owner's lifetime and after death. Additionally, the language is not a waiver of the restrictions against alienation by mortgage, sale, gift, or deed without the joinder of the owner's spouse.



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Homestead Confidentiality



- "Statement of Authority" to avoid theft
- Use SunBiz.org

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Confidential Rental House Ownership Strategies

***Rental houses - limiting liability while also qualifying for appropriate insurances.**

SPOUSE 1
(or Revocable Trust of Spouse 1)



(rental house)

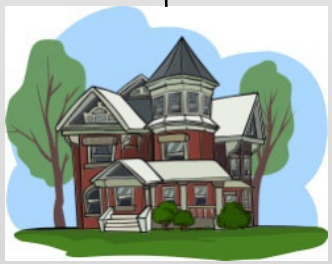
- **Spouse 1 or Revocable Trust of Spouse 1 owns rental house.**
- **House can cause creditor problems.**

SPOUSE 1
(or Revocable Trust of Spouse 1)

Separate Manager

(Judgment proof Uncle or Nephew)

LLC



(rental house)

- **Should limit liability but good luck getting insurance.**

SPOUSE 1
(or Revocable Trust of Spouse 1)

Separate Manager

(Judgment proof Uncle or Nephew) - has full management authority.

LLC

Spouse 1, Trustee

(Trustee has no authority to manage the property, but can only direct the LLC to change title)

LAND TRUST



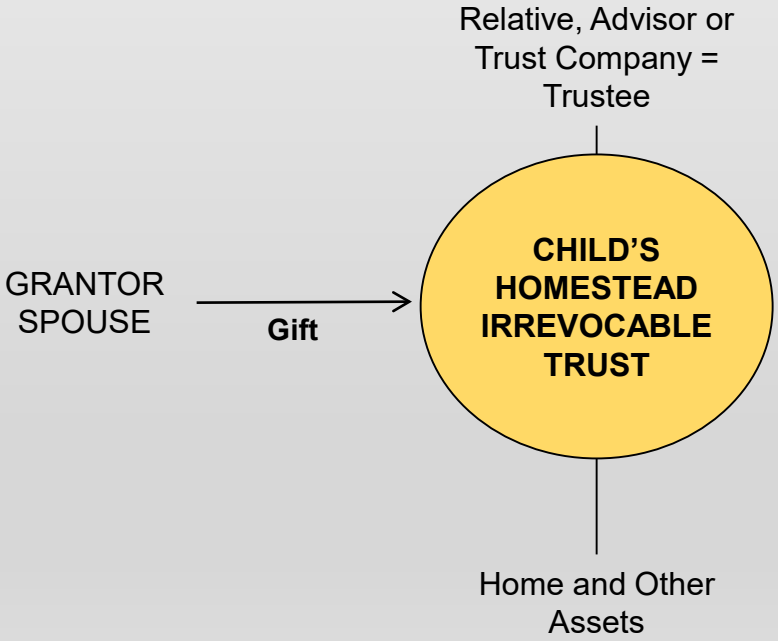
(rental house)

- **Some insurance carriers will like this better.**

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CHILD'S HOMESTEAD IRREVOCABLE TRUST

- Can own a home used by a child to benefit the spouse and descendants
- Can qualify for the State Homestead Exemption and 3% cap
- Can be considered as owned by the Child for income tax purposes under Internal Revenue Code Section 678 to qualify for the $250,000 income tax exemption on sale
- Can be controlled by the Trustee and used for the benefit of various family members
- Will insulate family members from liabilities associated with ownership of the home



Trust assets can be applied for the health, education, maintenance and support of the Trustee-Spouse and children.

One or more children may reside in the house to qualify for the Florida Tax Homestead Exemption.

For income tax purposes, the Trust can be considered as owned by the child who lives in the house so that the house can be sold income tax free to the extent of up to $250,000 in appreciation.

The Trust will not be subject to creditor claims of any family member unless (1) the transfer to the Trust by the Grantor Spouse is a "fraudulent transfer," or (2) the child has a right to withdraw more than the gift tax exclusion amount in any calendar year.

NOTE – The Trust must be appropriately drafted, funded, and administered to achieve the above results.

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COMPARISON OF METHODS TO PURCHASE HOMES FOR THE CHILDREN

	$250,000 Exemption on Sale of Home	$50,000 Homestead Exemption and 3% Per Year Cap on Valuation	Divorce	Control	Notes
Father and Mother loan money to the child. Child purchases and owns home.	Child gets income tax exemption.	Child gets homestead exemption and cap.	Loan will be repaid to parents. Equity may be subject to claim by spouse if this is not waived by Prenuptial Agreement.	Child controls the house. However, we may be able to call the Note to force a sale.	Note: Child gets equity above Note.
Father and Mother own the home and the child lives in the house.	No.	Generally no. However, it may be possible to obtain these with a 99-year lease.	Better protected.	Father and Mother control.	
Via Child Funded Homestead Bypass Trust.	Child gets income tax exemption.	Child gets homestead exemption and cap.	Better protected.	Friend, relative, advisor or trust company would be Trustee of the Trust and would retain control.	Note: Creditors may be able to get into the Trust. It may be possible for Trustee to transfer the house to the child's individual name in the event of a Creditor issue.
Direct Client Funded Homestead Bypass Trust.	No	Child gets homestead exemption and cap.	Better protected.	Mother would be Trustee of the Trust and would retain control.	Note: The $250,000 exemption is lost, but no creditor of the child should be able to get the assets.
One-half purchased by child and one-half owned by Father and Mother.	One-half.	One-half.	One-half, better protected.	Each controls one-half.	



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WISDOM ABOUT YOUR HOME

- Buying a completed home from a reputable contractor or builder with excellent warranties, after close inspection, is acceptable.

- Buying a home that you will remodel anytime soon, or building your own home, can be a much more expensive, unpredictable and stressful experience.

- Buying a used home with close inspection that includes review for mold and Chinese wallpaper is normally the best move.

- Please see a psychologist before concluding that you need more than 3,500 square feet to live a comfortable life with your family. Anything over 3,500 square feet is luxury or for in-laws or more than two children.

- One of the best things about any house is who the neighbors are. It may be a great strategy to raise your children in an upper middle class environment, and not in a "rich people only" gated community.

- Your home will grow in value at less than average, because your home is one year older every year.

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WISDOM ABOUT YOUR HOME, CONTINUED

- 1 divided by 60 years is 1.667% depreciation per year. If houses are going up by 4% a year, then your house is going up in value by 2.33% a year, and you have to maintain it!
- If acquisition and selling costs are 10%, then you have to live in the home 4.3 years on average to recoup the cost of buying and selling it.
- "I would rather rent than own" is not a bad conclusion if you would otherwise buy a house that is too small or not where you will eventually settle.
- Statistically speaking, there is as much chance of losing money as there is in making money if you will hold a house for less than 4 years.
- The money you set aside for your future "dream home" in ten years will hopefully grow at a much higher rate than 2.33% per year. A long term conservatively allocated stock and bond or mutual fund equivalent portfolio may average 10% over ten or twenty years by comparison, and doesn't leak when it rains, develop mold, or need to be repainted or redecorated.



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THE 10% CAP TRAP – NON-HOMESTEAD PROPERTY TAX ASSESSOR ANNUAL LIMITATION ON INCREASING VALUE.

- The Florida Constitution was amended in 2008 to provide non-homestead property owners with protection against substantial increases in their annual property tax assessments.
- The Florida Constitution now prohibits the assessment of certain non-homestead property from increasing by more than 10% per year, except for School Board taxes – in most counties the total tax is approximately 2% of tax assessor value, with the schoolboard taxes constituting approximately 1/3 of that (2/3% schoolboard and 1 1/3% other taxes – it is the 1 1/3% portion that is capped at 10% per year in value increases.
- The two statutes that effectuate the amendment are F.S. 193.1554 (applying to non-homestead residential property) and 193.1555 (applying to other certain residential and nonresidential real property).
- The cap does not apply to agricultural or conservation property or other certain real estate that qualifies for favorable ad valorem tax treatment.



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UNDERSTANDING THE "NONHOMESTEAD RESIDENTIAL PROPERTY" AND "COMMERCIAL" PROPERTY ASSESSMENT LIMITATION STATUTES

F.S. 193.1554 "Assessment of non-homestead residential property"

- "Non-homestead residential property" is defined under F.S. 193.1554 to mean any residential property that contains nine or fewer dwelling units, including vacant property zoned and platted for residential use, and that does not receive the Florida Homestead Exemption

F.S. 193.1555 "Assessment of certain residential and nonresidential real property"

- "Certain residential property" means residential property with more than nine units; that is non-homesteaded residential property not assessed under F.S. 193.1554
- "Nonresidential real property" is defined under F.S. 193.1555 to mean real property that is not:
  - Agricultural land or land used exclusively for noncommercial recreational purposes
  - Conservation land
  - Tangible personal property held for sale as stock in trade
  - Livestock
  - Property receiving the homestead exemption
  - Residential real property which contains nine dwelling units or fewer.



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COMMERCIAL PROPERTY INCLUDES NON-HOMESTEAD RESIDENTIAL PROPERTY WHICH CONTAINS 10 OR MORE DWELLING UNITS

- 10 or more unit Non-homestead Residential Property = Commercial Property

- Notwithstanding the names “Residential” and “Commercial,” F.S. 193.1555 (applying to commercial property) includes non-homestead residential real property which contains 10 or more dwelling units



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THE 10% CAP TRAP – NON-HOMESTEAD PROPERTY TAX ASSESSOR ANNUAL LIMITATION ON INCREASING VALUE.

- Non-homestead residential property is afforded greater protection from a potential forfeiture of the 10% cap than is commercial property.
- Certain actions by the non-homestead landowner will result in a loss of the 10% cap on assessment such as:
  - Changes in ownership or control
  - Application for the homestead exemption
  - Splitting or combining property during the previous year
  - Improvements to commercial property that increase the value by 25% or more
- The two most common “cap traps” are changes of ownership or control and qualifying improvements.



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THE 10% CAP TRAP – CHANGES OF OWNERSHIP

- A change of ownership or control is defined as “any sale, foreclosure, transfer of legal title or beneficial title in equity to any person, or the cumulative transfer of more than 50 percent of the ownership of the legal entity that owned the property when it was most recently assessed at just value.”
- F.S. 193.1554, relating to non-homestead residential property, excludes the following from being treated as a change of ownership:
  - Transfer of title to correct an error
  - Transfers between legal and equitable title
  - Transfers between married spouses
  - The cumulative transfer of more than 50 percent of the ownership of publicly traded companies if the transfer of the shares occurs through the buying and selling of shares on a public exchange.



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CHANGES OF OWNERSHIP, ADDITIONS, AND IMPROVEMENTS

Changes that will trigger loss of cap for non-homestead residential property	Changes that will trigger loss of cap for commercial property
Sale or Foreclosure	Sale or Foreclosure
Transfers to/from an LLC or other entity	Transfers to/from an LLC or other entity
A transfer of more than 50% of the entity which owns the property	A transfer of more than 50% of the entity which owns the property
	Adding an improvement to the property which increases the value by 25% or more
	Transfers between spouses

*Although improvements to non-homestead residential property will not trigger a loss of the cap, F.S. 193.1554 provides that the improvements (not the entire property) will be assessed at just value on January 1 following substantial completion of the improvements.



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HOMESTEAD AND THE QUALIFIED PERSONAL RESIDENCE TRUST ("QPRT")

1. During the initial possessory term the Homestead Exemption will continue if proper language provides the Grantor with all normal possessory and use rights of a life tenant.

2. Effective upon the end of the possessory term the Grantor can execute a written 98-year lease and a memorandum of a lease to be recorded in the public records to allow the Homestead Tax Exemption and 3% per year cap to continue.

3. (Draft QPRT to provide for annual annuity payment if property is sold and not replaced during possessory term to qualify the annuity payment for creditor protection under Florida Statute Section: 222.)



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QPRT TRUST PLANNING DEMONSTRATION

Age of Client	68
Initial Value of Home	$860,000
Fractional Discount Assumed	15.00%
Discounted Value of ½ of Home	$365,500

	Gift Component (with respect to each QPRT)		Value of ½ of Home at End of QPRT Term Assuming 7% Growth	Estate Tax on Value at End of Term Assuming 35% Estate Tax Rate	Estate Tax Savings on ½ of Home at End of QPRT	Estate Tax Savings on Entire Value of Home at End of QPRT	Estate Tax Savings After 16 Years Assuming 7% Growth on ½ of House	Estate Tax Savings After 16 Years Assuming 7% Growth on Entire House
6 Year QPRT	Gift %	**73.220%**						
	Value of Gift	$267,619.00	$645,314.05	$225,859.92	$132,193.23	$264,386.96	$350,633.96	$701,267.92
8 Year QPRT	Gift %	**64.328%**						
	Value of Gift	$235,118.84	$738,820.06	$258,587.02	$176,295.43	$352,590.85	$362,009.05	$724,018.10
10 Year QPRT	Gift %	**55.528%**						
	Value of Gift	$202,954.84	$845,875.08	$296,056.28	$225,022.09	$450,044.17	$373,266.45	$746,532.90
12 Year QPRT	Gift %	**46.916%**						
	Value of Gift	$171,477.98	$968,442.38	$338,954.83	$278,937.54	$557,875.08	$384,283.35	$768,566.70
14 Year QPRT	Gift %	**38.633%**						
	Value of Gift	$141,203.62	$1,108,769.68	$388,069.39	$338,648.12	$677,296.25	$394,879.38	$789,758.76
16 Year QPRT	Gift %	**30.840%**						
	Value of Gift	$112,720.20	$1,269,430.41	$444,300.64	$404,848.7	$809,697.15	$404,848.57	$809,697.15

Probability of Death Before Certain Age
Current Age 68

2 years (70)	4.18%	6 years (74)	14.31%	10 years (78)	27.33%	20 years (88)	68.53%
4 years (72)	8.92%	8 years (76)	20.45%	15 years (83)	47.24%		



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EstateView QPRT Chart

Married Couple, Ages 74 and 75 - Each Spouse Places 1/2 of $1.9 Million Dollar Home Into 8 Year QPRT - With 15% Valuation Discount

1	2	3	4	5	6	7	8	9
Year	Calendar Year	Value of Home Growing at 3% Per Year	Annual Rent Paid (8% of the home value)	Total Rent Paid	Total Rent Invested at 7%	Estate Reduction (column 3 + column	Use of Gift Exemption	Estate Tax Savings (column 7 - column
1	2021	$1,900,000	$0	$0	$0	$0	$0	$0
2	2022	$1,957,000	$0	$0	$0	$0	$0	$0
3	2023	$2,015,710	$0	$0	$0	$0	$0	$0
4	2024	$2,076,181	$0	$0	$0	$0	$0	$0
5	2025	$2,138,467	$0	$0	$0	$0	$0	$0
6	2026	$2,202,621	$0	$0	$0	$0	$0	$0
7	2027	$2,268,699	$0	$0	$0	$0	$0	$0
8	2028	$2,336,760	$0	$0	$0	$0	$0	$0
9	2029	$2,406,863	$192,549	$192,549	$206,027	$2,612,891	$961,331	$660,624
10	2030	$2,479,069	$198,326	$390,875	$418,236	$2,897,305	$961,331	$774,390
11	2031	$2,553,441	$204,275	$595,150	$636,810	$3,190,251	$961,331	$891,568
12	2032	$2,630,044	$210,404	$805,553	$861,942	$3,491,987	$961,331	$1,012,262
13	2033	$2,708,946	$216,716	$1,022,269	$1,093,828	$3,802,774	$961,331	$1,136,577
14	2034	$2,790,214	$223,217	$1,245,486	$1,332,670	$4,122,884	$961,331	$1,264,621
15	2035	$2,873,920	$229,914	$1,475,400	$1,578,678	$4,452,598	$961,331	$1,396,507
16	2036	$2,960,138	$236,811	$1,712,211	$1,832,066	$4,792,204	$961,331	$1,532,349
17	2037	$3,048,942	$243,915	$1,956,126	$2,093,055	$5,141,997	$961,331	$1,672,267
18	2038	$3,140,411	$251,233	$2,207,359	$2,361,874	$5,502,285	$961,331	$1,816,382
19	2039	$3,234,623	$258,770	$2,466,129	$2,638,758	$5,873,381	$961,331	$1,964,820
20	2040	$3,331,662	$266,533	$2,732,662	$2,923,948	$6,255,610	$961,331	$2,117,712
21	2041	$3,431,611	$274,529	$3,007,191	$3,217,694	$6,649,305	$961,331	$2,275,190
22	2042	$3,534,560	$282,765	$3,289,956	$3,520,252	$7,054,812	$961,331	$2,437,393
23	2043	$3,640,596	$291,248	$3,581,203	$3,831,887	$7,472,484	$961,331	$2,604,461
24	2044	$3,749,814	$299,985	$3,881,188	$4,152,872	$7,902,686	$961,331	$2,776,542
25	2045	$3,862,309	$308,985	$4,190,173	$4,483,485	$8,345,794	$961,331	$2,953,785
26	2046	$3,978,178	$318,254	$4,508,427	$4,824,017	$8,802,195	$961,331	$3,136,346
27	2047	$4,097,523	$327,802	$4,836,229	$5,174,765	$9,272,289	$961,331	$3,324,383
28	2048	$4,220,449	$337,636	$5,173,865	$5,536,036	$9,756,485	$961,331	$3,518,062
29	2049	$4,347,063	$347,765	$5,521,630	$5,908,144	$10,255,207	$961,331	$3,717,551
30	2050	$4,477,474	$358,198	$5,879,828	$6,291,416	$10,768,891	$961,331	$3,923,024
31	2051	$4,611,799	$368,944	$6,248,772	$6,686,186	$11,297,985	$961,331	$4,134,662
32	2052	$4,750,153	$380,012	$6,628,784	$7,092,799	$11,842,952	$961,331	$4,352,648
33	2053	$4,892,657	$391,413	$7,020,197	$7,511,611	$12,404,268	$961,331	$4,577,175
34	2054	$5,039,437	$403,155	$7,423,352	$7,942,986	$12,982,423	$961,331	$4,808,437
35	2055	$5,190,620	$415,250	$7,838,601	$8,387,303	$13,577,924	$961,331	$5,046,637
36	2056	$5,346,339	$427,707	$8,266,308	$8,844,950	$14,191,289	$961,331	$5,291,983
37	2057	$5,506,729	$440,538	$8,706,847	$9,316,326	$14,823,055	$961,331	$5,544,690
38	2058	$5,671,931	$453,754	$9,160,601	$9,801,843	$15,473,774	$961,331	$5,804,977
39	2059	$5,842,089	$467,367	$9,627,968	$10,301,926	$16,144,015	$961,331	$6,073,074
40	2060	$6,017,351	$481,388	$10,109,356	$10,817,011	$16,834,363	$961,331	$6,349,213

Income Tax Analysis

Year	Calendar Year	Value of Home Growing at 3% Per Year	Tax Basis	Gain on Sale	Income Taxes (28.8%)	Estate Tax Savings Less Income	Income Taxes (41.8%)	Estate Tax Savings Less Income
1	2021	$1,900,000	$1,655,000	$245,000		$0		$0
2	2022	$1,957,000	$1,655,000	$302,000		$0		$0
3	2023	$2,015,710	$1,655,000	$360,710		$0		$0
4	2024	$2,076,181	$1,655,000	$421,181	Step Up Applies	$0	Step Up Applies	$0
5	2025	$2,138,467	$1,655,000	$483,467		$0		$0
6	2026	$2,202,621	$1,655,000	$547,621		$0		$0
7	2027	$2,268,699	$1,655,000	$613,699		$0		$0
8	2028	$2,336,760	$1,655,000	$681,760		$0		$0
9	2029	$2,406,863	$1,655,000	$751,863	($216,537)	$444,087	($314,279)	$346,345
10	2030	$2,479,069	$1,655,000	$824,069	($237,332)	$537,058	($344,461)	$429,929
11	2031	$2,553,441	$1,655,000	$898,441	($258,751)	$632,817	($375,548)	$516,020
12	2032	$2,630,044	$1,655,000	$975,044	($280,813)	$731,450	($407,569)	$604,694
13	2033	$2,708,946	$1,655,000	$1,053,946	($303,536)	$833,041	($440,549)	$696,028
14	2034	$2,790,214	$1,655,000	$1,135,214	($326,942)	$937,680	($474,519)	$790,102
15	2035	$2,873,920	$1,655,000	$1,218,920	($351,049)	$1,045,458	($509,509)	$886,998
16	2036	$2,960,138	$1,655,000	$1,305,138	($375,880)	$1,156,469	($545,548)	$986,802
17	2037	$3,048,942	$1,655,000	$1,393,942	($401,455)	$1,270,811	($582,668)	$1,089,599
18	2038	$3,140,411	$1,655,000	$1,485,411	($427,798)	$1,388,583	($620,902)	$1,195,480
19	2039	$3,234,623	$1,655,000	$1,579,623	($454,931)	$1,509,889	($660,282)	$1,304,538
20	2040	$3,331,662	$1,655,000	$1,676,662	($482,879)	$1,634,833	($700,845)	$1,416,867
21	2041	$3,431,611	$1,655,000	$1,776,611	($511,664)	$1,763,526	($742,624)	$1,532,566
22	2042	$3,534,560	$1,655,000	$1,879,560	($541,313)	$1,896,079	($785,656)	$1,651,737
23	2043	$3,640,596	$1,655,000	$1,985,596	($571,852)	$2,032,610	($829,979)	$1,774,482
24	2044	$3,749,814	$1,655,000	$2,094,814	($603,307)	$2,173,236	($875,632)	$1,900,910
25	2045	$3,862,309	$1,655,000	$2,207,309	($635,705)	$2,318,080	($922,655)	$2,031,130
26	2046	$3,978,178	$1,655,000	$2,323,178	($669,075)	$2,467,271	($971,088)	$2,165,257
27	2047	$4,097,523	$1,655,000	$2,442,523	($703,447)	$2,620,937	($1,020,975)	$2,303,408
28	2048	$4,220,449	$1,655,000	$2,565,449	($738,849)	$2,779,212	($1,072,358)	$2,445,704
29	2049	$4,347,063	$1,655,000	$2,692,063	($775,314)	$2,942,236	($1,125,282)	$2,592,268
30	2050	$4,477,474	$1,655,000	$2,822,474	($812,873)	$3,110,151	($1,179,794)	$2,743,230
31	2051	$4,611,799	$1,655,000	$2,956,799	($851,558)	$3,283,104	($1,235,942)	$2,898,720
32	2052	$4,750,153	$1,655,000	$3,095,153	($891,404)	$3,461,245	($1,293,774)	$3,058,875
33	2053	$4,892,657	$1,655,000	$3,237,657	($932,445)	$3,644,730	($1,353,341)	$3,223,834
34	2054	$5,039,437	$1,655,000	$3,384,437	($974,718)	$3,833,719	($1,414,695)	$3,393,742
35	2055	$5,190,620	$1,655,000	$3,535,620	($1,018,259)	$4,028,379	($1,477,889)	$3,568,748
36	2056	$5,346,339	$1,655,000	$3,691,339	($1,063,106)	$4,228,878	($1,542,980)	$3,749,004
37	2057	$5,506,729	$1,655,000	$3,851,729	($1,109,298)	$4,435,392	($1,610,023)	$3,934,667
38	2058	$5,671,931	$1,655,000	$4,016,931	($1,156,876)	$4,648,101	($1,679,077)	$4,125,900
39	2059	$5,842,089	$1,655,000	$4,187,089	($1,205,882)	$4,867,192	($1,750,203)	$4,322,871
40	2060	$6,017,351	$1,655,000	$4,362,351	($1,256,357)	$5,092,856	($1,823,463)	$4,525,750

QPRT TRUST PLANNING DEMONSTRATION

INITIAL VALUE OF HOME $1,000,000

	GIFT COMPONENT		VALUE OF RESIDENCE AT END OF TERM ASSUMING 7% GROWTH	ESTATE TAX ON VALUE AT END OF TERM ASSUMING 40% ESTATE TAX RATE	ESTATE TAX SAVINGS ON RESIDENCE AT END OF QPRT	ESTATE TAX SAVINGS AFTER 14 YEARS ASSUMING 7% GROWTH ON RESIDENCE	TOTAL AMOUNT OF RENT PAID (8% OF VALUE OF RESIDENCE PER YEAR) FROM END OF QPRT THROUGH END OF YEAR 14	ESTATE TAX SAVINGS ON RENT PAID	TOTAL ESTATE TAX SAVINGS AFTER 14 YEARS
7 YEAR QPRT	GIFT %	72.146%	$1,605,781	$642,313	$353,729	$742,830	$1,189,538	$475,815	$1,218,645
	VALUE OF GIFT	$721,460							
10 YEAR QPRT	GIFT %	59.126%	$1,967,151	$786,861	$550,357	$794,910	$747,634	$299,054	$1,094,964
	VALUE OF GIFT	$591,260							

Probability of Death Before Certain Age
Current Age: 70

7 years (77)	20.48%
10 years (80)	32.05%

Explanation of 10 year QPRT numbers -

A gift of a $1,000,000 home to the QPRT is reported to be a $591,260 gift. The home grows to $1,967,151 in value over ten years. The estate tax on a $1,967,151 asset would be $786,861. The gift tax exemption used on a $591,260 gift at 40% is equal to $236,504. Assuming no further growth in the house the estate tax savings at that point would be $550,357 ($786,861 - $236,504 = $550,357). If the value of the home continues to grow at 7% a year for another 4 years, the total estate tax savings will be $794,910.

If rent is paid for Years 11 through 14 equal to 8% of the value of the residence, then $747,634 of rent will be paid. The rent paid will not be subject to estate tax. The estate tax saved on this amount is equal to $299,054 ($747,634 x 40% = $299,054).

The total estate tax savings including the rent paid would be equal to $1,093,964 ($794,910 + $299,054 = $1,093,964).



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Floridians Should Use Annuity Trust Option

- Require that the QPRT will convert to an Annuity Trust, if the homestead is sold, or no longer resided upon by the term beneficiary. Annuities are creditor proof in Florida, and the Annuity Trust is one of the two required options under Internal Revenue Code Section 2702.



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The Stepped-Up Basis Conversation

	No Planning	JEST or Special Power of Appointment Trust Arrangements	Community Property Trust
Drafting and Design Time to Implement	None.	Requires sophisticated drafting and implementation.	Can be simple to install.
Creditor Protection Attributes	No effect.	Will typically expose assets to creditors to each owner spouse unless further planning is effectuated.	Alaska creditor protection law applies.
Annual Maintenance Costs	None beyond what client is already paying.	None but best to review assets and allocation within JEST periodically.	$3,000 per year payment to Alaska trust company and requiring that the clients follow appropriate formalities if they want to have creditor protection attributes. (But not necessarily required in Florida!)
Administration After Death of First Spouse	No special provisions needed.	Must meet with qualified planner to decide how to allocate assets between one or two credit shelter trusts and administration issues.	Can simply dissolve trust or maintain trust and step up has occurred.
Degree of Tax Certainty	Nonapplicable.	The Service may challenge the stepped-up basis and funding of a credit shelter trust from the assets of the first dying spouse.	Statutory support and over decades of community property case law eliminates stepped-up basis and full credit shelter trust funding issues.



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Married Couples Trust Decision Chart

	JEST (Joint Exempt Step-Up Trust)	Tenants by the Entireties Trust	Joint Trust – Not TBE, JEST, or CPT	Florida Community Property Trust	Tennessee Community Property Trust	South Dakota Community Property Trust	Alaska Community Property Trust	Kentucky Community Property Trust
Step-Up in Basis After First Death	Probably Yes	Only Half of a Step-Up	Depends Upon Drafting and Logistics	Probably Yes	Probably Yes	Probably Yes	Probably Yes	Probably Yes
Creditors of One Spouse Can Reach Trust Assets	Yes – the Debtor Spouse's Share	Protected from Either Spouse's Creditors	Depends Upon Trust Drafting	One-Half of Trust Assets Exposed to One Spouse's Creditors	One-Half of Trust Assets Exposed to One Spouse's Creditors	All of Trust Assets Exposed to One Spouse's Creditors	All of Trust Assets Exposed to One Spouse's Creditors	One-Half of Trust Assets Exposed to One Spouse's Creditors
Can Create Credit Shelter Trust With More Than Half of the Trust Assets	Yes, All Trust Assets May Go Into Credit Shelter Trusts	Up to Half, But Only by Disclaimer or Surviving Spouse Will Not Have a Power of Appointment	Depends Upon Drafting – Be Careful!	Only as to One-Half	Only as to One-Half	Only as to One-Half	Only as to One-Half	Only as to One-Half
May Share Upon Divorce as Set Forth in Pre- or Post- Nuptial Agreement	Yes	Probably Not	Yes	Yes – Spouses can agree on the dissolution of property Fla Stat. 736.1508	Yes – Spouses can agree on the dissolution of property	Yes – Spouses can agree on the dissolution of property	Yes – Spouses can agree on the dissolution of property	Yes – Spouses can agree on the dissolution of property

*Chart continued on next slide



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Married Couples Trust Decision Chart, Cont'd

	JEST (Joint Exempt Step-Up Trust)	Tenants by the Entireties Trust	Joint Trust – Not TBE, JEST, or CPT	Florida Community Property Trust	Tennessee Community Property Trust	South Dakota Community Property Trust	Alaska Community Property Trust	Kentucky Community Property Trust
May Be Converted from Former Joint or Individual Trust	Yes	Yes	N/A	No – Must Be Created On or After July 1, 2021 as a new Florida Community Property Trust	N/A	Yes	Yes	Yes
Complicated to Draft?	Yes	Simpler than JEST	Will Depend Upon Specifics	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed	Simple to Draft if the Statute is Followed
Requires a "Qualified" Trustee	No	No	No	Yes	Requires a Tennessee Trustee	Requires a South Dakota Trustee	Requires an Alaska Trustee	Requires a Kentucky Trustee



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THE JEST

Articles of Interest:

It's Just a JEST, the Joint Exempt Step-Up Trust, Leimberg Information Services Estate Planning Newsletter #2086

JEST Offers Serious Estate Planning Plus for Spouses – Part 1 Estate Planning Magazine, October 2013

JEST Offers Serious Estate Planning Plus for Spouses – Part 2 Estate Planning Magazine, November 2013

Understanding Section 1041(e) & Tax Basis Planning, by Jeff Scroggin, Leimberg Informtion Services Estate Planning Newsletter #2192



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From Howard Zaritsky – Lester Law January 2017 Heckerling Institute Fundamentals presentation (pgs 1-134 & 1-135):

GETTING A FULL STEP-UP USING POWERS OF APPOINTMENT ON FIRST DEATH – THE JEST TRUST

Consider the JEST Trust to fully fund a Credit Shelter Trust while receiving a stepped up basis for all joint and separate assets.

The Joint Estate Step-Up Trust (JEST)

A recently variation on the tax-basis revocable trust is the joint estate step-up trust, or JEST. See Gassman, ' Denicolo, & Hohnadell, *JEST Offers Serious Estate Planning Plus for Spouses - Parts I and 2,* 40 Est. Plan. 3, 14 (Oct., Nov. 2013).

1. Structure of the JEST

a) Joint Revocable Trust

A JEST is a joint revocable trust created by a married couple who reside in a non community property state. The JEST becomes irrevocable when the first spouse dies; both powers to revoke then terminate.

b) Separate Shares for Each Spouse

Each spouse owns a separate share of the trust.

c) Each Spouse Can Terminate Trust During Joint Lives

Each spouse has the power to terminate the trust during their joint lives, when each spouse's share will be distributed to him or her individually.



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Note. The step-transaction doctrine is particularly a problem if the estate planner has documented in the planning memoranda that the surviving spouse can be added later.

2. Analysis of the JEST

The JEST has one noteworthy advantage over the tax-basis revocable trust, in that the assets contributed by the surviving spouse do not pass back to the surviving spouse at the first spouse's death. The assets passing subject to the power of appointment will, except to the extent appointed otherwise, pass to a trust for other family members. This should make application of Code § 1014(e) extremely difficult.

3. Analysis of the JEST

The IRS analysis of the tax-basis revocable trust turned on the application of Section I014(e), which denies a basis adjustment to assets transferred to the decedent within one year of the date of his or her death, that pass to the original transferor upon the decedent's death. The JEST gets around Section 1014(e) by not having the assets transferred to the decedent return to the original transferor, to the extent that the original transferor has unused applicable exclusion amount. Thus, there is no reason why the JEST should not work.

4. Asset Protection and the JEST

The JEST offers only limited asset protection benefits.

a) Assets Contributed by the First Spouse to Die

(1) Creditors of the First Spouse to Die

The assets contributed to the JEST by the first spouse to die should be as available to the first spouse to die as any other assets of that spouse's revocable trust.

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(2) Creditors of the Surviving Spouse

The surviving spouse should be able to obtain the benefits of the spendthrift clause applicable to the assets contributed by the first spouse to die and then held either as Non-marital Trust A or as a QTIP.

(3) Creditors of the Descendants

The beneficiaries of Non-marital Trust B should be able to do the same

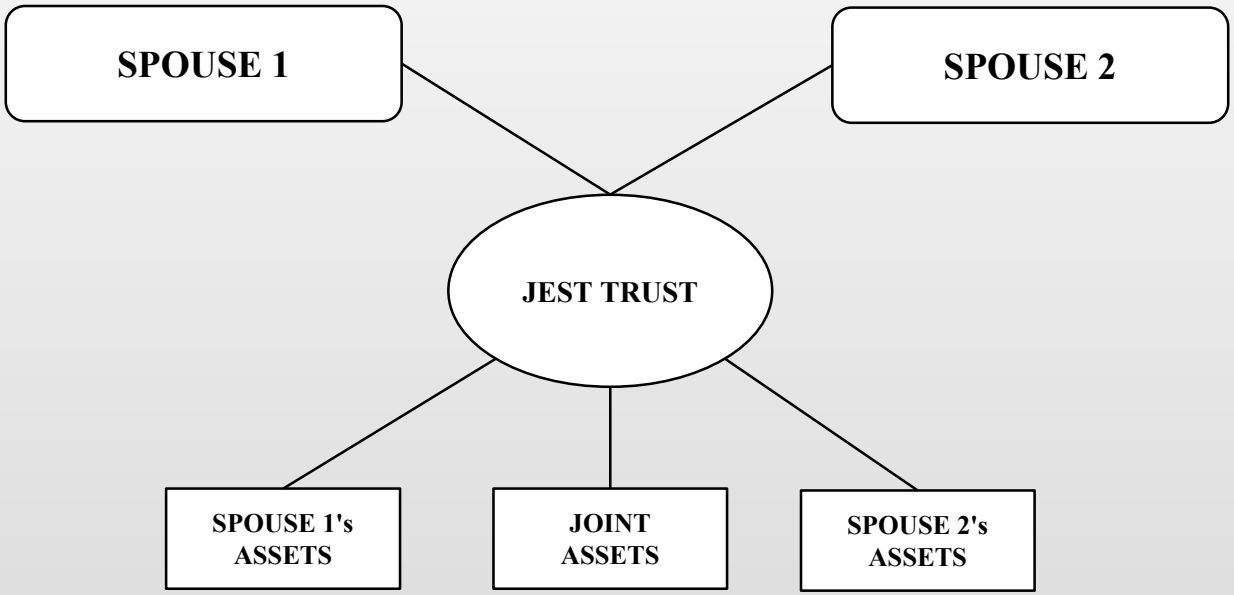
b**) Assets Contributed by the Surviving Spouse**

The assets contributed by the surviving spouse are also subject to a general testamentary power of appointment held by the first spouse to die. As noted above, these assets may be subjected to the claims of the creditors of the first spouse to die, even though they were originally assets of the surviving spouse.



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JEST Trust



On first death, up to exemption amount of first dying spouse (as much as $12,920,000), may pass to Credit Shelter Trust or Trusts to benefit surviving spouse and descendants, with a possible full step-up of all assets - excess assets going into QTIP Trusts, which may also qualify for full step-up.

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JEST Credit Shelter Trust B Planning



Formed from assets of the share of the surviving spouse.

Expected to be considered as being transferred to Credit Shelter Trust B by the first dying spouse for federal estate tax purposes pursuant to Private Letter Ruling 200101021 and Private Letter Ruling 200210051.

The IRS could claim that Credit Shelter Trust B was funded by the surviving spouse.

ALTERNATIVE A

Accepted as funded by first dying spouse.

Will not be subject to estate tax at the level of the surviving spouse.

Will not be subject to creditor claims of the surviving spouse.

<u>This is the optimum result</u>.

ALTERNATIVE B

Considered as funded by surviving spouse.

Might be subject to estate tax at the level of the surviving spouse.

Might be subject to creditor claims of the surviving spouse, unless local law of the Trust provides otherwise.

Strategy 1 - Incomplete Gift Treatment

The surviving spouse maintains a Power of Appointment over the Trust assets, which causes the Trust to be considered as an incomplete gift for federal gift tax purposes, and the Trust assets will be considered as owned by the surviving spouse for estate tax purposes on his or her death.

In light of the IRS' position in CCA 201208026, it is best to give the surviving spouse a lifetime Power of Appointment over the assets in Credit Shelter Trust B to assure that an incomplete gift results for federal gift tax purposes.

If there are separate children for each spouse or a concern that the surviving spouse might not appropriately exercise a Power of Appointment, then it could be limited to being exercisable only with a consent of non-adverse parties, or limited to the extent needed to avoid imposition of federal gift tax by funding under a formula clause.

Strategy 2 - Complete Gift Treatment

If the surviving spouse disclaims all Powers of Appointment over the Trust, then the transfer to Credit Shelter Trust B is considered to be a complete gift by the surviving spouse, and the Trust will not be subject to federal estate tax of the surviving spouse's estate.

The value of the assets passing to Credit Shelter Trust B would reduce the surviving spouse's $12,920,000 exemption.

Give the surviving spouse the power to replace Trust assets with assets of equal value, so then it can be considered a Defective Grantor Trust if this occurs.

Note (applicable to both Strategy 1 and Strategy 2): Situs Credit Shelter Trust B in an "asset protection trust jurisdiction" to avoid having creditors be able to reach into the Trust, and also to avoid the Trust being included in the surviving spouse's estate if the surviving spouse was considered as a contributor to the Trust for federal estate and gift tax purposes.



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Joint Exempt Step-Up Trust (JEST) Chronology – The 4 Steps from Drafting to Implementing

Derived from articles that can be found on Leimberg Information Services (Estate Planning Newsletter #2086) and Estate Planning Magazine October and November 2013 Editions

Before Funding

Spouse 1's Assets

Joint Assets: Joint Tenants w/ Right of Survivorship

½ to each Spouse's share

Joint Assets: Tenancy by the Entireties

½ to each Spouse's share or actuarial value

Spouse 2's Assets

The IRS could find a gift upon contribution of TBE assets to the joint revocable trust, but this gift will qualify for the marital deduction if recipient spouse can withdraw what is added to Spouse 1 or Spouse 2's share. Also see PLR 200201021.

Step 2

Funding of Joint Revocable Trusts; each spouse has the right to revoke his/her share until first death

Spouse 1's Share

Spouse 1's Assets

½ of former JTWROS Assets

½ of former TBE Assets (or by other percentage)

Spouse 2's Share

Spouse 2's Assets

½ of former JTWROS Assets

½ of former TBE Assets (or by other percentage)

Step 3 Note:

CST A and CST B can be merged if there is no concern with estate tax, stepped-up basis, creditor protection, or credit shelter trust effectiveness. Q-TIP Trust A and Q-TIP Trust B can be merged if there is no concern with respect to stepped-up basis or creditor protection effectiveness.

Step 3

Division upon First Dying Spouse's Death Assume Spouse 1 dies first

Credit Shelter Trust A
Funded from Spouse 1's Share in the amount of Spouse 1's available Estate Tax Exemption (ETE)

Q-TIP Trust A
If Spouse 1's Share exceeds Spouse 1's available ETE, the excess will fund this trust

Credit Shelter Trust B
If Spouse 1's Share is less than his available ETE, Spouse 2's Share will fund this trust in the amount of Spouse 1's remaining ETE (But not in excess of Spouse 2's available ETE)

Q-TIP Trust B
If Spouse 2's Share has any remaining assets, they will be used to fund this trust

Step 4

Results of JEST Technique

-For Spouse 2 & Descendants benefit (limited by ascertainable standard)
- Assets will receive a stepped-up basis
-Assets are protected from Spouse 2's creditors
- Assets escape estate tax on Spouse 2's death

- Spouse 2 can be beneficiary of income and principal
-Assets will receive a stepped-up basis on Spouse 1's death, and then again on Spouse 2's death
-Assets included in Spouse 2's taxable estate
-Will be protected from Spouse 2's creditors

-Assets may receive a stepped-up basis, but this is more likely if Spouse 2 is not a beneficiary
-May escape estate tax liability on Spouse 2's death
-For creditor protection and estate tax exclusion purposes, CST B may be moved to an APT jurisdiction
Special Consideration: If Spouse 2 is found to have made a gift of trust assets to Spouse 1 upon Spouse 1's death, this gift may qualify for the marital deduction
If IRS argues that Spouse 2 has gifted to trust the gift will be incomplete because of Spouse 2's power of appointment

-Spouse 2 will be income beneficiary
-Assets may receive a stepped-up basis on Spouse 1's death & again on Spouse 2's death
-Assets included in Spouse 2's estate
-May not be protected from Spouse 2's creditors unless moved to APT trust jurisdiction
-If IRS argues that Spouse 2 has gifted to trust the gift will be incomplete because of Spouse 2's power of appointment

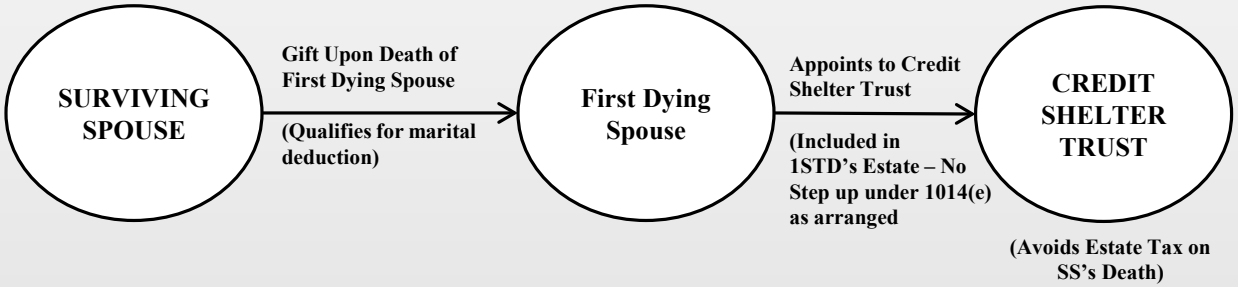


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Basic JEST Anatomy

1993 Technical Advice & 2001 and 2002 Private Letter Rulings



Blattmachr Article

Credit Shelter Trust could be found to be funded by surviving spouse under step transaction doctrine so creditor may invade the trust in most states.

Mulligan

If first dying spouse needs approval of surviving spouse to appoint then 2041 may not apply, could be considered as a gift of ½ by the surviving spouse – but 1933 Johnston case held otherwise in a similar situation.

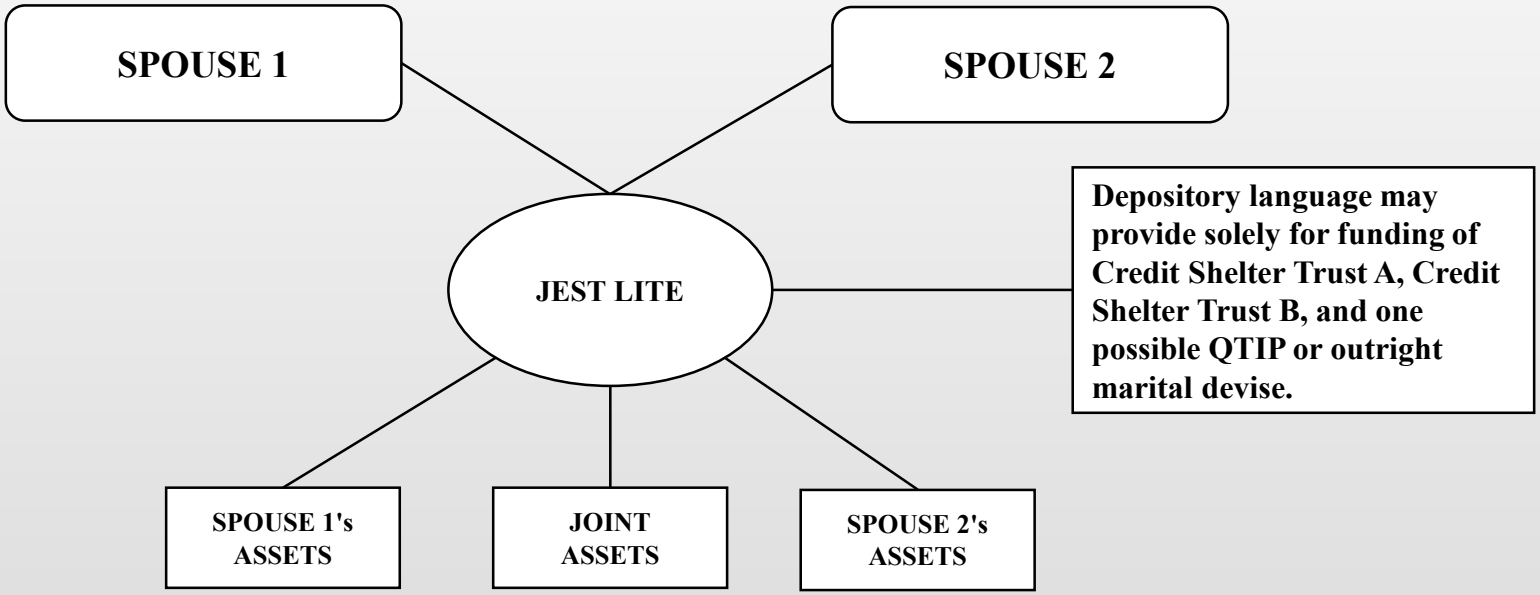
Zaritsky
2015 Heckerling Presentation.

Will the service consider the surviving spouse to have funded the credit shelter trust or trusts by reason of the step transaction doctrine?



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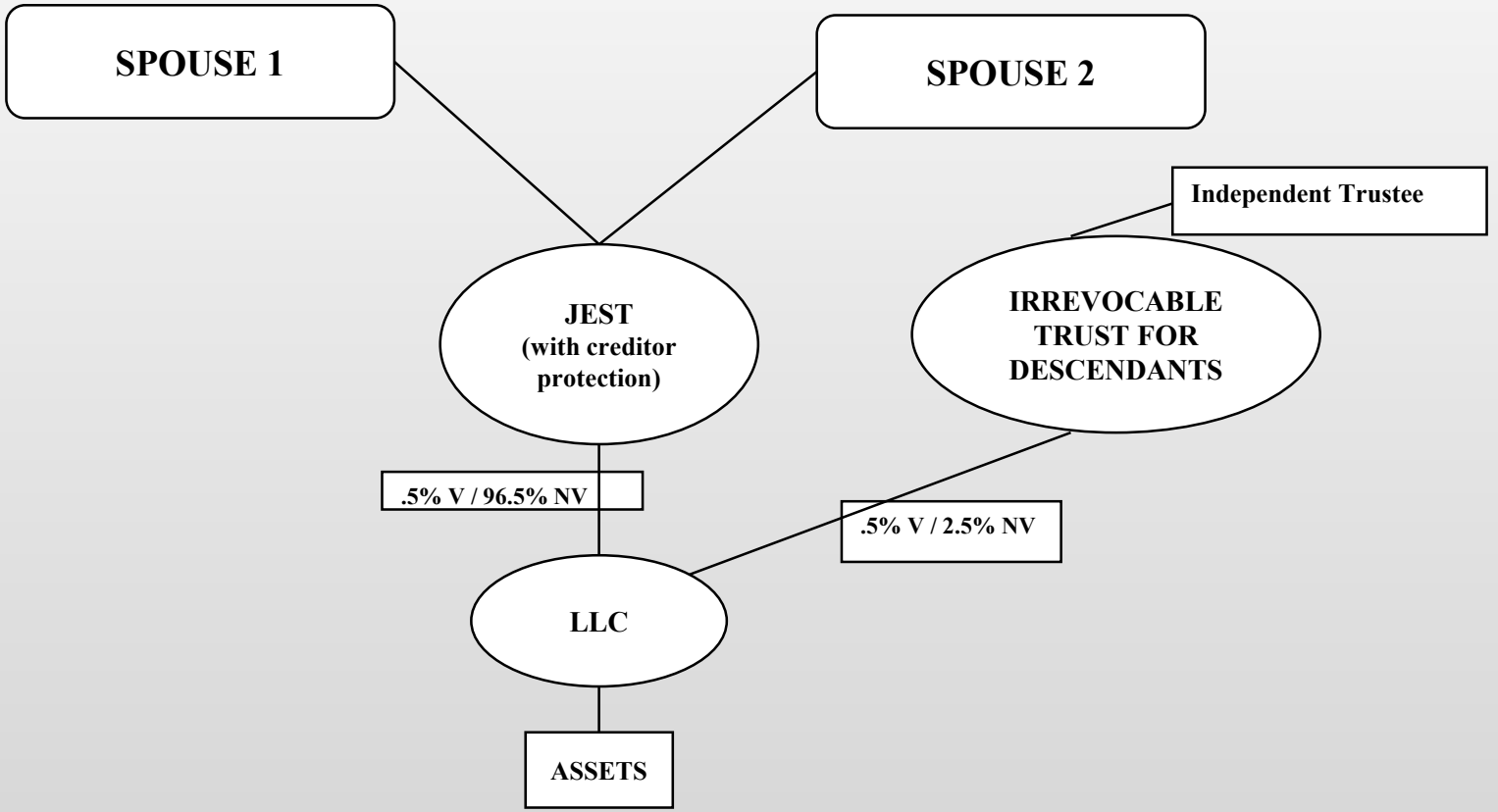
JEST Lite



Same as JEST, but will only break into Credit Shelter Trust A, Credit Shelter Trust B, and at most one QTIP Trust for simpler drafting

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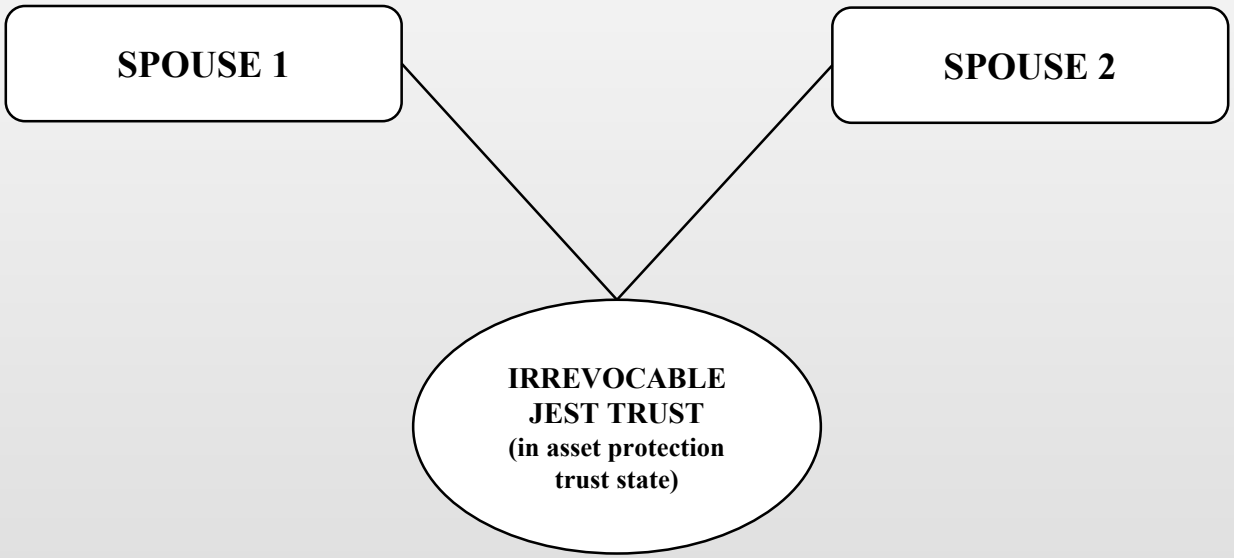
JEST with Some Creditor Protection



Provides charging order protection and discounting.

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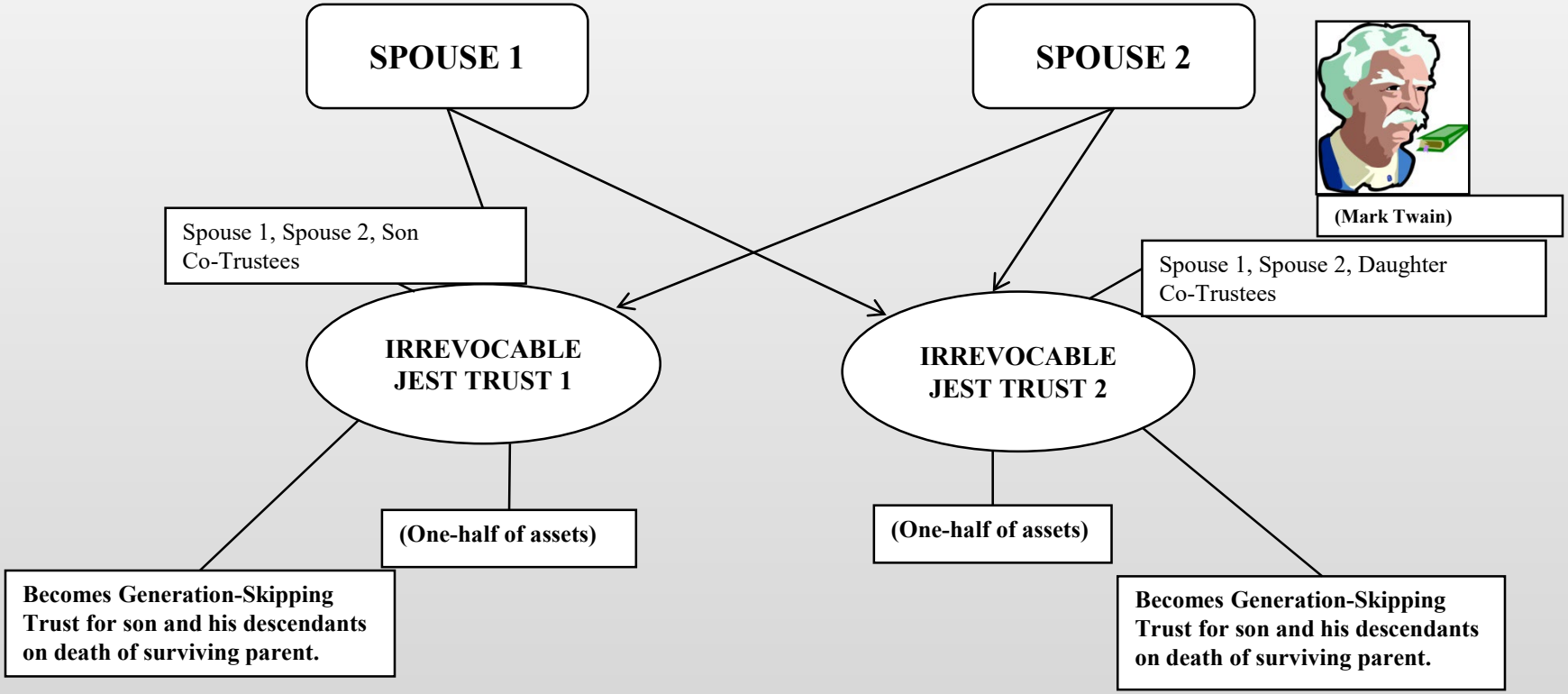
Irrevocable JEST Trust



Where a couple has concerns that they may be subject to undue influence, distortion or loss of assets and direction from dementia, or otherwise, why not make the Trust irrevocable, and to also possibly provide that transfers are "incomplete gifts" by having each spouse reserve the right to veto distributions and to appoint the Trust assets (with the Power of Appointment being subject to the consent of a non-adverse party) in addition to having other JEST Trust terms to obtain a stepped-up basis on each spouse's death.

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Irrevocable Multiple JESTs – Possession is 90% of the Law

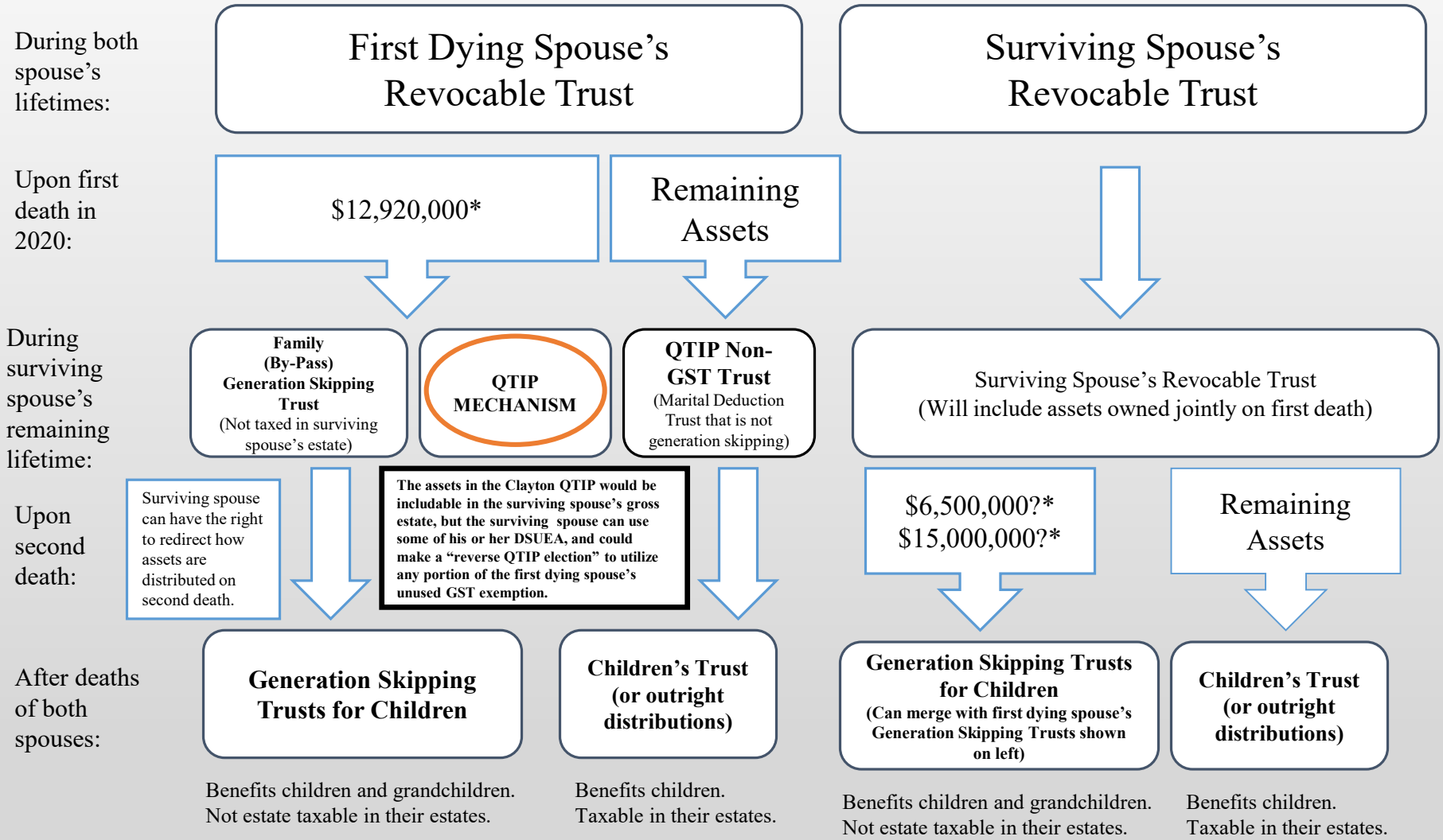


This trust has been funded for the primary purpose of benefitting the Grantor's during our lifetime, and then having a protective trust or trusts established for our daughter, Molly Hatchett, to the extent of assets then remaining. Our son, Leonard Skin-Us is the Trustee of another trust that will be held for his benefit. Distributions to my said child and his/her descendants shall therefore reduce his/her subsequent inheritance. Either child may require that a licensed trust company serve as additional Co-Trustee of each trust, and both of our children will receive annual accountings prepared by our certified public accountant of each trust. We, as Grantors, may further exercise our power to reappoint trust assets, but only after a four hour neurological examination and verification that we are not known to be subject to undue influence, and have received approval from any two of the following five trusted non-related individuals ...



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Revised Protective Trust Logistical Chart with Clayton QTIP



***Assumes first spouse dies in 2023 when the exemption is $12,920,000, and that the surviving spouse dies in a later year when the estate tax exemption has changed. The estate tax exemption is $12,920,000, less any prior reportable gifts, for those that die in 2023, and increases with the CPI in $10,000 increments. If the first spouse does not use the entire exemption amount, what remains may be added to the surviving spouse's allowance under the "portability rules" but will not grow with inflation, and will be lost if the surviving spouse remarries and the new spouse dies first, leaving no exemption.**



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“Special Rule,” “Bad Exceptions,” and “Good Exceptions” to the Exceptions.



Special Rule

Allows an estate to calculate its estate tax credit using the higher of the exclusion applicable as of the date of the gift or the exemption amount applicable upon death



Exceptions

- Gifts that are includible in the gross estate pursuant to § 2035, 2036. 2037. 2038, or 2042, of the Code
- Unsatisfied enforceable promises to pay
- Gifts subject to the special valuation rules of § 2701 (preferred partnership freezes and similar arrangements)
- § 2702 (related to GRATs (Grantor Retained Annuity Trusts) and QPRTs (Qualified Personal Residence Trusts))
- The relinquishment or elimination of an interest in any one of the aforementioned situations that occurs within eighteen (18) months of the date of the decedent’s death.



Exceptions to the Exceptions

<u>The Five Percent Or Less Exception</u>.

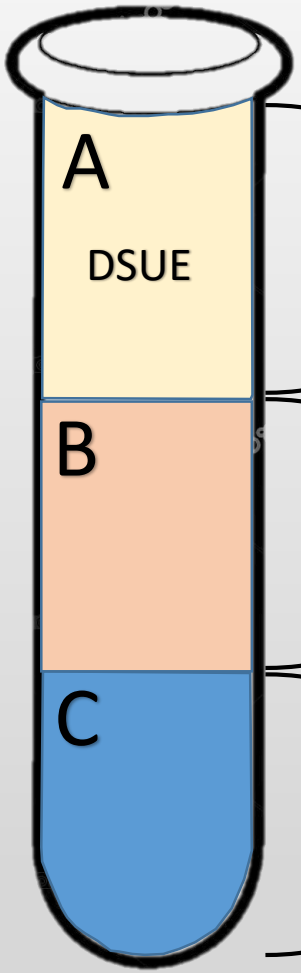
Transfers where the value of the taxable portion of the transfer has not exceeded five percent of the total transfer, such as if the taxable component of a GRAT does not exceed 5% of the amounts transferred to the GRAT, then the gift component can be used to lock in use of the estate tax exemption in effect in the year of the gift, if the gift is large enough to exceed the smaller exclusion that will otherwise apply on death

<u>Termination or Lapse by Death</u>.

Transfers where the retained interests were relinquished or terminated by the termination of a durational period described in the original instrument of transfer which is either (a) the death of any person, or (b) the passage of time.

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BEA Order of Use



$2,000,000

$6,920,000 in 2023

$6,920,000 in 2026

Must use 1st

Must use 2nd

Only usable until 1/1/2026 - after A and B have been used.

EXAMPLE:

If DSUE is $2,000,000, must give over $8,460,000 to use part of the exemption that will be lost in 2026.

NOTE:

A & B could be poured into a GST exempt GRIT.

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Insure the Risk of Anti-Clawback

Buy Term or Low Initial Premium Second-to-die life insurance policies before 2026 to lock-in insurability and death benefit.

Convert to permanent or begin paying larger premiums if and when the exemption amount is reduced.



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THE FLORIDA COMMUNITY PROPERTY TRUST

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The Florida Community Property Trust Act

- Effective July 1, 2021, Florida has enacted a Community Property Trust Act that was written to allow for married couples to “opt-in” to community property treatment for assets held in a trust that meets certain requirements.
- Community property can have considerable income tax planning benefit on the death of the first spouse to die due to Internal Revenue Code Section 1014(b)(6), which provides for all community property assets (including the surviving spouse’s interest in community property) to receive a full step-up in basis upon the death of the first dying spouse.
- The language of Section 1014(b)(6) is as follows:
  - “…property which represents the **surviving spouse’s one-half share** of community property held by the decedent and the surviving spouse under **the community property laws of any State**, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent’s gross estate.”



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What is Community Property?

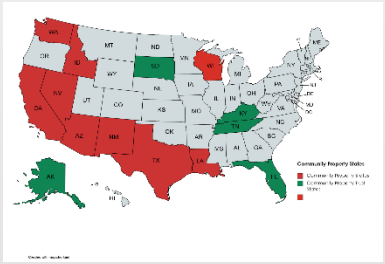
- There are two primary types of legal regimes concerning the ownership of property by legally married couples – community property law states and common law states (also known as separate property states).
- Under a community property system, all property of the spouses is considered to be either “community” or “separate” property.
- All property acquired during the marriage is generally presumed to be community property unless clear and convincing evidence demonstrates that the property is the separate property of one spouse only.
    - For example, property received by one spouse as a gift or inheritance as his or her “sole and separate property” generally becomes the sole and separate property of that spouse.



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Which States are Community Property States?

- In the United States, there have historically been eight community property states and two territories that have applied community property law:



- **Arizona**
- **California**
- **Idaho**
- **New Mexico**
- **Louisiana**
- **Texas**

- **Nevada**
- **Washington (state)**
- **Wisconsin**
- **Alaska**
- **Guam**
- **Puerto Rico**

- The laws in these states generally evolved from Spanish law, except that Louisiana's community property law came from France.
- Note that in Louisiana, married couples who have assets characterized as community property can modify or terminate community property characterization only upon joint petition and a finding by a court that this serves their best interests.
- In other community property state, married couples can simply enter into marital agreements during marriage (without petitioning a court) that modify or terminate ("transmute") their community property characterization of assets, and may be required to record such agreements to transmute real estate.



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Community Property Trust Features- Florida

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
Florida	**(1)** Expressly declares that the trust is a community property trust within the meaning of this part **(2)** Has at least one trustee who is a qualified trustee, provided that both spouses or either spouse also may be a trustee **(3)** Is signed by both settlor spouses consistent with the formalities required for the execution of a trust under this chapter. **(4)** Contains substantially the following language in capital letters at the beginning of the community property trust agreement: THE CONSEQUENCES OF THIS COMMUNITY PROPERTY TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND UPON THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD BE SIGNED ONLY AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK COMPETENT AND INDEPENDENT LEGAL ADVICE.	(1)An obligation incurred by only one spouse before or during the marriage may be satisfied from that spouse's one-half share of a community property trust. (2) An obligation incurred by both spouses during the marriage may be satisfied from a community property trust of the settlor spouses.	All property owned by a community property trust is community property under the laws of the state during the marriage of the settlor spouses.	**36.1511 Application of Internal Revenue Code; community property classified by another jurisdiction.**--For purposes of the application of s. 1014(b)(6) of the Internal Revenue Code of 1986, 26 U.S.C. s. 1014(b)(6), as of January 1, 2021, a community property trust is considered a trust established under the community property laws of the state. Community property, as classified by a jurisdiction other than this state, which is transferred to a community property trust retains its character as community property while in the trust. If the trust is revoked and property is transferred on revocation of the trust, the community property as classified by a jurisdiction other than the state retains its character as community property to the extent otherwise provided by ss. 732.216-732.228.

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736.1503 – 4 Requirements for a Community Property Trust

- An arrangement is a Community Property Trust if one or both settlor spouses transfer property to a trust that:
  - (1) Expressly declares that the trust is a community property trust within the meaning of this part.
  - (2) Has at least one trustee who is a qualified trustee, provided that both spouses or either spouse also may be a trustee.
  - (3) Is signed by both settlor spouses consistent with the formalities required for the execution of a trust under this chapter.
  - (4) Contains substantially the following language in capital letters at the beginning of the community property trust agreement:

  - THE CONSEQUENCES OF THIS COMMUNITY PROPERTY TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND UPON THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD BE SIGNED ONLY AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK COMPETENT AND INDEPENDENT LEGAL ADVICE.



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Creating a Florida Community Property Trust

- A “qualified trustee: is defined under Florida Statute Section 736.1502 to be either (a) a natural person who is a resident of [Florida], or (b) a company authorized to act as a trustee in [Florida].
- “Settlor spouses” is defined as a married couple who establish a Community Property Trust pursuant to the statute.



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Is a 50/50 Split on Termination Mandatory or Modifiable?

- Florida Statute Section 736.1508 appears to intend to provide that the married couple can contractually agree to share the assets of the community property trust other than equally in the event of the dissolution of marriage.
- However, the statute does not seem to permit the spouses to modify the division of the community property assets upon the death of one spouse, which means that the surviving spouse must be entitled to his or her community property interest on the death of the first dying spouse.
- Will an agreement between the spouse for reallocation weaken the argument that the trust assets should receive a step-up in value on the first death because other than equal division is not a common characteristic of community property.



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Will a Community Property Trust Work?

- The question still stands as to whether an elective community property arrangement like the Florida Community Property Trust will be recognized by the IRS as a legitimate community property arrangement to qualify all trust assets for a fair market value date of death basis step-up under IRC Section 1014(b)(6).
- Commentators who urge caution point to the 1944 U.S. Supreme Court decision of *Commissioner v. Harmon,* which involved a married couple who opted into community property treatment under an Oklahoma law that was passed to allow married couples living there to elect whether to have community property characterization apply to their assets.



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Will a Community Property Trust Work?

- The U.S. Supreme Court held in *Harmon* that the act of electing into the community property regime constituted an “assignment of income” and quoted the 1930 United States Supreme Court case of *Lucas v. Earl.*
- Nevertheless, the 1958 United States District Court decision of *McCollum v. United States* seems to support the proposition that the 1014(b)(6) step-up in basis will apply to community property created as a result of an election made by the spouses.
- In *McCollum*, a married couple elected under the then applicable Oklahoma law to treat their assets as community property under Oklahoma law in 1943, and in 1945 Oklahoma changed its law to require that all of a married couple's assets had to be considered to be community property. Mr. McCollum died after the community property status became mandatory and Mrs. McCollum took a full step-up in basis for the full value of the community property that existed on Mr. McCollum's date of death. The court allowed the full step-up in basis.
    - Although Oklahoma had a mandatory community property system by the time the decision was reached because the property at issue was acquired before the change of law in 1945, the property would not have been community property under the 1945 Oklahoma community property law, except by reason of the fact that the McCollum's had previously designated it as community property under the elective system.



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Will a Community Property Trust Work?

- IRC Section 1014 was enacted in 1948, only four years after the Supreme Court decision in Harmon, and it is therefore possible that Congress recognized the issue by enacting Section 1014(b)(6).
  - This is evidenced by the fact that Congress made no mention in the statutory language and provided no legislative history that would distinguish between elective and mandatory versions of community property law.
- Further, Section 1014(b)(6) is clear that the step-up in basis applies to the surviving spouse's share of community property "held by the decedent and the surviving spouse under the community property laws of ***any*** State, or possession of the United States or any foreign country…" (emphasis added), without distinction for elective community property laws or without regard to unique characteristics that a State might have with respect to its community property laws (such as creditor protection features).
- There are no known cases or audits of elective Community Property Trusts, so the risk of this being an issue as a practical matter may be quite small.



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Moving With Community Property

- Case law dating as far back as 1826 supports the proposition that a change of domicile by a husband and wife from a community property state to a non-community property state has no effect on the character of the property as community.

- Therefore, community property retains its character as community property after a couple moves from a community property state to Florida, unless the imported community property assets are then used to purchase, or are otherwise converted, into a different asset in Florida, in which case the new asset would have its property characteristics determined by Florida law.



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Moving with Community Property – **Example 1** (Community Property Retains Character)

- Assume a married couple lives in California. While the couple is domiciled in California, the husband acquires a LLC membership interest in his own name. Under the community property laws of California, each spouse has a separate 50% interest in the other spouse's property acquired during the marriage, therefore the wife acquired a community property right in her husband's LLC investment.
- The couple has now moved to Florida and a California court has entered a money judgement against the wife only, and the creditor has moved the judgement to Florida. The judgement creditor seeks to levy upon the debtor wife's community property interest in the LLC.
- In such a case, the wife's creditor can use California community property law to get a charging lien upon her 50% community property interest in the LLC.
- The wife's rights in her husband's LLC interest vested while the couple resided in California, the couple's move to Florida did not destroy the wife's community property interest in the LLC.



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Moving With Community Property – **Example 2** (Community Property Loses Character)

- Assume a married couple lives in Texas and maintains a community property bank account in Texas. The couple then moves to Florida and subsequently opens a tenants by the entireties bank account in Florida, and deposits the funds from the community property bank account in Texas to the new Florida account.

- The funds deposited into the new Florida account would be considered tenants by entireties property because the transfer of money to the new Florida account would be a conversion of funds to a new form of property.



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Advantages of the Florida Community Property Trust

- The two primary reasons why Florida's Community Property Trust Act may be preferred over other "opt-in" community property jurisdictions are:
  - (1) The creditors of one spouse can only reach such spouse's one-half of the assets held in a Florida Community Property Trust.
    - In all other states with Community Property Trust laws (except Tennessee and Kentucky), creditors of one spouse can reach all assets held in a Community Property Trust.
  - (2) More individuals will know a lawyer or potential trustee in Florida because Florida has a significantly larger population than Alaska, South Dakota, and Tennessee.
- An additional advantage of the Act is that any person residing in the State of Florida can serve as the trustee or a co-trustee under a Florida Community Property Trust.



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Advantages of the Florida Community Property Trust

- Prior to the enactment of the Florida Community Property Trust Act married couples who wished to enter into a Community Property Trust had to have a trust company duly registered with Alaska, South Dakota, Kentucky, or Tennessee, or an individual residing in one of those states, serve as the trustee of the trust.
- Florida's Community Property Trust Act works the same way by permitting any Floridian or a qualified company to act as a trustee of a Florida Community Property Trust, which broadens the universe of potential trustees of a Community Property Trust established by Floridians.



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Advantages of the Florida Community Property Trust - Example

- Harry and Sally Katz-Deli live in New York and are in their 70's. They have $3,000,000 worth of publicly traded stock for which they paid approximately $500,000. Neither of them has a "Billy" Crystal ball with respect to who will survive the other.
- If they sell the stock now, they will have a $2,500,000 capital gain and may have to pay a 23.8% combined federal income tax and net investment income tax, not to mention a 9.65% New York state tax and 3.876% New York City tax.
- The federal income and net investment income tax would be $595,000, and the New York state and local capital gains tax would be $338,150, if they are in the highest brackets.



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Advantages of the Florida Community Property Trust – Example continued

- If the stock is held in joint names (such as tenants by the entireties or joint tenants with rights of survivorship), and one of them dies while the stock is worth $3,000,000, then, immediately after the death of the first dying spouse, the surviving spouse will have the ability to sell the one-half of the stock inherited on the death of the first dying spouse for $1,500,000, and would pay no state or federal tax. However, if the surviving spouse sells his or her one-half of the stock that was held in joint names, such spouse would pay $297,500 in federal income and net investment income tax and $169,075 in New York state and local income tax (one-half of the tax described above, if all of the stock was sold before the death of the first dying spouse).
- Instead of holding the stock jointly or placing it into the name of the spouse who may be expected to die first, Harry and Sally can establish a Florida Community Property Trust and have it drafted by the estate planning lawyer for their daughter, who lives in Boca Raton, Florida, and their daughter can serve as trustee.
- On the first death, the surviving spouse can have a $3,000,000 basis in the stock and pay no state, federal, or Medicare tax on the sale.



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Advantages of the Florida Community Property Trust

- Despite the advantages of a Florida Community Property Trust, a married couple transferring assets to a community property trust will cause assets that would otherwise be protected from creditors to be accessible to them.
- Some couples may have the community property trust own the majority interest in an LLC that will have other members.
  - The statutes are silent as to whether a charging order will be the sole remedy of a judgment creditor who has the right to receive one-half of the community property trust assets by reason of being owed by one spouse.
- The safest approach would be to have voting-member interests owned by the minority member so that the creditor can only reach an LLC member interest that would not be able to vote to authorize or require a liquidation or distribution from the LLC.
- However, a community property trust that does not control the voting rights of an entity that it owns part of may result in less than a full fair market value basis if the IRS argues that there should be a significant discount in value.



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Final Thoughts on the Community Property Trust

- In conclusion, the Florida Community Property Trust Act should be well understood by estate and tax planning professionals based in Florida, or who have Floridian clients or clients with Florida ties, as a potential tool that will benefit married couples who have substantially appreciated assets and would like to avoid federal income tax by being able to sell the assets after the death of the first dying spouse. In addition, estate and tax planners throughout the United States should be somewhat familiar with the various Community Property Trust acts in order to determine which state will be most appropriate for clients for whom the Community Property Trust would be a good fit.
- Given that all five states have statutes which are probably effective to provide a full step-up in basis upon the first dying spouse's death, the main criteria may be what family members or advisors or trust companies would be preferable trustees. A secondary consideration might be whether all assets held under a Community Property Trust are accessible to creditors, such as using a state (Florida, Kentucky, or Tennessee) that does not expose 100% of the Community Property Trust assets to creditors, versus using a state (Alaska or South Dakota) that exposes all of the Community Property Trust assets to creditors.



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Final Thoughts on the Community Property Trust

- Perhaps more importantly, the new Act will cause advisors to discuss basis step-up and logistical planning with clients. A great many Florida lawyers suggest that their clients use predominantly one type of arrangement, such as where each spouse has a separate revocable trust, or the spouses share a joint trust that does not provide a full step-up on the first death. Many lawyers still favor joint ownership of assets without using revocable trusts. Well informed clients with similar circumstances will commonly choose different systems based upon their orientation, appreciation of tax planning strategies, and their perception of cost considerations and complexity.
- Perhaps most importantly, The Florida Community Property Trust Act is a reminder that "one size will not fit all" and that married Floridians and other clients should have tailor-made estate plans to better protect and benefit themselves and their families while effectuating their wishes.



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Spousal Limited Access Trusts (SLATs)

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The Stepped Up Basis Conversation
By: Jonathan Blattmachr and Alan S. Gassman
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"Step Right Up. Everyone's a winner, bargains galore."
- Tom Waits - Step Right Up from the 1976 album Small Change.

The largest tax facing the great majority of American families on death will be the capital gains tax. The increase in this tax from 15% to 20%, with the additional 3.8% Medicare tax for high income earners makes this a very important topic to cover with clients and their families.

The primary estate planning goal of most married couples is to provide as well as possible for the surviving spouse, but most of them do not recognize that 23.8% of the lifetime appreciation of family investments including in many cases on a large residence will have to be paid to the government in order to produce money for the surviving spouse.

For some survivors, this will be a devastating reality that must be faced when the cost of an adult congregate living facility and proper care is compared to the net proceeds that can be derived from the liquidation of assets.

Even a modest investment portfolio owned by a retired married couple can be significantly impacted by these taxes.

Assume that a married couple in their late sixties has $500,000 of investments with a cost basis of $100,000, and their home's worth is $100,000.

If one spouse dies owning one-half (1/2) of the assets or the assets are jointly owned in a non-community property state and one of them dies, his or her half of the assets will receive an automatic change in income tax basis to its estate tax value (even if no estate tax is due) and the inherent gain in those assets are forgiven. That result is known as the income tax free "step up in basis" at death. But the inherent gain in the survivor's half of their wealth will not be stepped up. That means then that there is $200,000 worth of untaxed gain that will cost, depending upon several factors including whether the couple lives in a jurisdiction with state and local taxes of, perhaps, over $50,000 in capital gains tax in order to liquidate their wealth to provide cash to support the surviving spouse or to buy into a retirement center unit. And if most of the couple's wealth was owned by the surviving spouse, then the amount of the remaining gain (and, therefore, tax resulting from liquidation) will be even greater.



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Contrast that couple's situation with one if they live in a community property state, such as Texas or California. For that couple, all of the inherent gain is "forgiven" when the first spouse dies. Therefore, the survivor would face no capital gains tax in liquidating the couple's wealth.

A couple with $2,000,000 of assets and a $500,000 home with the same ratios of growth face a much larger tax which could be $450,000 or more.

The above assumes that tax rates will not rise and that there will be no state income tax to be paid.

Why do so many planners fail to discuss this with clients, much less put mechanisms in place to assure a complete step-up in basis of all of a couple's assets on the first death? One reason is that the full impact of the large capital gains tax increase has not yet been felt by many clients. Another is that the complexity of the recent estate tax changes, and especially the attention given to wealthy clients during 2012 to use their large gift and generation-skipping transfer tax exemptions have taken the typical estate planner's eyes "off the ball" where they should be for many couples.

There are three primary ways that the typical non-community property state couple can attain a full step-up in basis for assets on the first death (understanding that some assets, such as those in pension plans or IRAs never receive a step up when the owner dies):

1. Have the assets owned by the first dying spouse more than one (1) year before he or she dies, or if the one (1) year period cannot be met, have the spouse leave the assets to a trust that may benefit the surviving spouse and not violate the one (1) year rule under Internal Revenue Code Section 1014(e).

Trying to guess who dies first and even having to talk about this can be a difficult and risky proposition.



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2. The couple can amend their estate planning documents to either provide that each of them will have a testamentary power of appointment over assets held in one another's separate revocable trusts or form one joint JEST trust, in which event Private Letter Rulings 200101021, 200210051, and 200403094 and TAM 9308002 support the proposition that assets owned jointly under a JEST Trust or under the revocable trust of a surviving spouse may be considered to have passed through the "taxable estate" of the first dying spouse, although there are Section 1014(e) one (1) year rule and fundamental issues associated with this that are discussed at length in LISI Newsletter No. 2086 and the October and November issues of Estate Planning Magazine that were co-written by Alan S. Gassman, Tom Ellwanger, Christopher J. Denicolo, and Kacie Hohnadell.

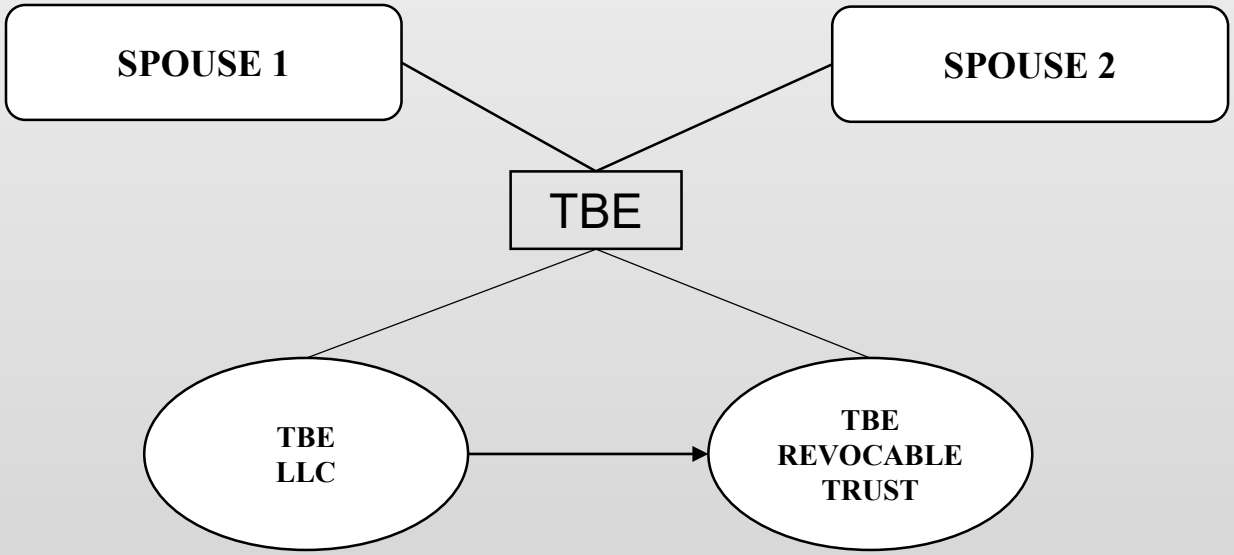
This technique has its downsides, as described in the chart below but the JEST Trust itself has no annual cost associated with it unless there are changes in the client's estate plan. Many clients prefer to have their assets under a single trust, and preexisting separate trusts can be amended and restated to be considered a part of the single JEST Trust so that re-titling of assets is not required. It will take the planner a few hours to draft and thoroughly review their initial trust draft, or a number of JEST Trust versions and client letters and explanations drafted by Gassman Law Associates, PA can be purchased through the website of Phil's Ultimate Estate Planner.

3. The most reliable way to achieve a full step up on the first death, with very effective incidental asset protection features is to establish a conventional Alaska Community Property Trust with an Alaskan Co-Trustee. The Alaskan community property statute was enacted in 1998 to allow non-Alaskan couples to form trusts there to comply with Internal Revenue Code Section 1014(b)(6), which provides that community property will receive a full step up on the death of one spouse. This technique has been endorsed by not only Jonathan Blattmachr, who originated the concept, but also by Howard Zartisky and a number of other well respected experts. The Alaska Trust Company provides the trust form to professionals who use these, and an Alaskan lawyer is available to review and approve the trust document for only about $1000.

A chart of considerations and factors is as follows:

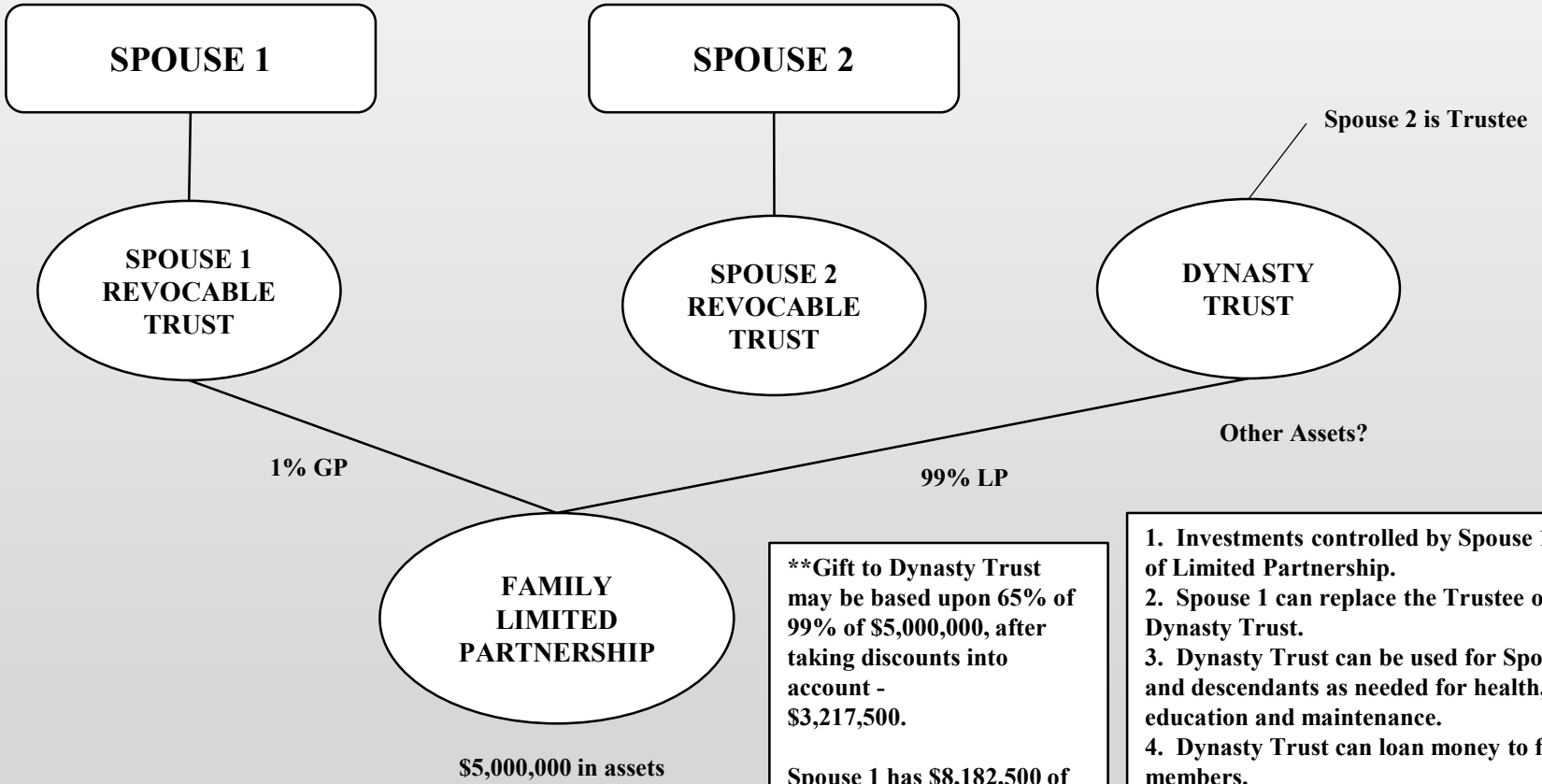
TBE Revocable Trust/ LLC Combo – Hold the Fries!

TBE LLC ownership will pass to Revocable Trust by pay-on-death clause on death of surviving spouse.



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Example of Spouse 1/Spouse 2 Dynasty Trust Arrangement



**Gift to Dynasty Trust may be based upon 65% of 99% of $5,000,000, after taking discounts into account - $3,217,500.

Spouse 1 has $8,182,500 of his $11,400,000 exemption remaining.

1. Investments controlled by Spouse 1 as GP of Limited Partnership.
2. Spouse 1 can replace the Trustee of the Dynasty Trust.
3. Dynasty Trust can be used for Spouse 2 and descendants as needed for health, education and maintenance.
4. Dynasty Trust can loan money to family members.
5. Dynasty Trust should be exempt from estate tax, creditor claims, and divorce claims of both spouses and descendants.

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Planning for a Dynasty Trust Where the Spouse of the Settlor/Contributor is a Beneficiary – Special Considerations

1. The settlor's spouse may be a trustee of the trust. As with all irrevocable trusts, administration should be well documented and according to the trust document.

2. The settlor's spouse can have the right to receive amounts as reasonably needed for health, education, maintenance, and support. It is best to provide that any such distributions for the spouse will be made only after taking into account the spouse's other assets and resources.

   Otherwise, consider whether the spouse might be considered to be gifting to the trust if he or she had the right to receive distributions and did not take them.

   Alternatively, limit distributions to the spouse by requiring an independent fiduciary to approve them.

3. Marital Deduction Savings Clause - The settlor's spouse may be the beneficiary of an outright disposition or General Power of Appointment Marital Trust provision to be funded if total contributions to the trust would otherwise cause gift tax responsibility. Do not use a QTIP trust for this because of the harsh regulations requiring a marital deduction election to be filed for a lifetime QTIP trust gift.

4. Typically the trust will be disregarded for income tax purposes, so that the settlor can pay the income tax attributable to the trust's income.

   In case the settlor may want to "toggle off" defective grantor trust status (such as by reserving the right to replace trust assets with assets of equal value, and then releasing that right) an adverse party (another substantive beneficiary under the trust) must have the right to approve any distributions to the spouse.

   Otherwise the trust will be a defective grantor trust under Internal Revenue Code Section 677, and the settlor will not be able to toggle that off (except by getting divorced!).

5. The settlor's spouse may choose to "split the gift" on a gift tax return, which is permitted notwithstanding that the spouse is a beneficiary, so long as it is very unlikely that the spouse will need to receive benefits for health, education, maintenance and support when taking into account the spouse's other assets and resources. See Private Letter Ruling 200345038, *William H. Robertson vs. Commissioner, 26 TC 246 (1956), and BNA Portfolios 822-2nd: Estate, Gift and Generation-Skipping Tax Returns and Audits, Section IX.M, and 826-2nd: Life Insurance, Section II.F.*

6. What if the assets used to fund the trust had recently been owned jointly by the settlor and the spouse, or were owned by the spouse and transferred to the settlor, who then transferred them to the trust? Under the Step Transaction Doctrine, the assets and the economic risk associated therewith should be owned and held exclusively by the settlor for a reasonable period of time. In case the IRS argues that the contribution to the trust was really made by the settlor's spouse (in which event the settlor's spouse may be subject to federal estate tax under Internal Revenue Code Section 2036(a)(1) - retained life interests), it may be important to have trust language which provides that any trust assets considered as transferred to the trust by the spouse beneficiary will be considered to be held in a separate subtrust of which the spouse will not be a beneficiary.



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Planning for a Dynasty Trust Where the Spouse of the Settlor/Contributor is a Beneficiary – Special Considerations

7. Should the surviving spouse be given a limited power of appointment (or general power of appointment) to direct how trust assets will pass? The grantor cannot be given this power if a completed gift to the trust is desired, but the spouse can. However, the power should not be exercisable in favor of her personally, her creditors, her estate, or creditors of her estate.

   At what point should the power of appointment exist and/or be terminated?

   (a) Immediately upon inception of the trust until the death of the surviving spouse?; (b) Only after the death of the settlor until the death of the surviving spouse?; (c) Only unless or until the parties are divorced or either party has a child who is not a beneficiary under the trust; or (d) Granted by a committee of independent fiduciaries when deemed appropriate for tax reasons (such as to obtain a step-up in basis upon death)?

   What would prevent the beneficiary spouse from exercising his or her power of appointment to fund a trust for the donor spouse to allow the ability to receive amounts as needed for health, education, maintenance, and support – assuming that there is no pre-existing agreement or obligation for this to happen.

8. Should there be a divorce clause?

   Typically where the drafting lawyer is representing both spouses this can be discussed and a joint representation letter can be put into place. It is likely that the judge will consider the trust assets to be for the benefit of the beneficiary spouse, but this will vary from state to state and judge to judge.

   If the settlor's spouse is not a client then consider a clause that will provide that, upon divorce, the beneficiary spouse is no longer a beneficiary, trustee or otherwise entitled under the document.

   Also consider giving the surviving spouse or another beneficiary of the Trust a general power of appointment, or enabling a committee of Independent Fiduciaries the ability to bestow a general power of appointment upon a beneficiary in order to attain a step-up in basis on the assets held under the Trust.

9. If the trust also provides for health, education, maintenance and support or other payments to descendants, how will the trust be protected from a descendant's support claims or other items for which state law permits penetration of a trust?

   If the trust's primary beneficiary is your spouse, but your children can reach into it, do you have to worry that one of your children is going to have a nasty divorce and the ex-spouse of a child is going to be able to reach into this trust?

   Consider whether there should be a Flee (Cuba) Clause in the trust, or whether the trust should name an independent trust protector or trust protectors with the ability to remove descendant beneficiaries and/or the ability to move the situs of the trust to an appropriately protective jurisdiction.



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New Florida Spousal Limited Access Trust ("SLAT") Law

The Grantor will not be considered to be a contributor for creditor purposes after death of Spouse/Beneficiary.

Florida Statute 736.505, effective July 1, 2022 - If signed by Governor Ron DeSantis.

Applies to an irrevocable trust in which (1) the Grantor's spouse is a current beneficiary of income and principal, and (2) the Grantor will not be a beneficiary during the lifetime of the Grantor's spouse.

	Florida	Asset Protection Jurisdiction
While both spouses are alive:	Only spouse beneficiary can receive benefits.	Grantor may also receive benefits, if added.
Upon divorce:	Only Grantor's spouse can receive benefits.	Grantor may become beneficiary of Trust upon divorce.
Can a future spouse of Grantor benefit from Trust	Yes	Yes
After death of Grantor:	Spouse and descendants are beneficiaries.	SAME
If spouse beneficiary dies first:	Grantor can be beneficiary. (Can Grantor have a Power of Appointment?)	Grantor can be beneficiary. Grantor may have Power of Appointment.
Risk of 10-year lookback under Bankruptcy Code:	Yes, if funding is a "fraudulent transfer."	Not unless Grantor is a beneficiary.
Rule against Perpetuities:	1,000 years, if formed after July 1, 2022. (Has been 360 years.)	Alaska – 1,000 years Nevada – 365 years Tennessee – 360 years Delaware – 110 years – but exercise of Power of Appointment can extend for up to 110 years, and therefore being "infinite."



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THOUGHTS AND SUGGESTIONS FOR FUNDING AN IRREVOCABLE TRUST THAT WILL BENEFIT THE GRANTOR'S SPOUSE

1. The settlor's spouse may be a trustee of the trust.

2. The settlor's spouse can have the right to receive amounts as reasonably needed for health, education, maintenance and support.

3. The settlor's spouse may be the beneficiary of an outright disposition or General Power of Appointment Marital Trust provision to be funded if total contributions to the trust would otherwise cause gift tax responsibility.

4. Avoid the Reciprocal Trust Doctrine by not having the spouses form substantially equivalent trusts for one another.

5. Typically the trust will be disregarded for income tax purposes, so that the settlor can pay the income tax attributable to the trust's income.



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THOUGHTS AND SUGGESTIONS FOR FUNDING AN IRREVOCABLE TRUST THAT WILL BENEFIT THE GRANTOR'S SPOUSE

6. The settlor's spouse may choose to "split the gift" on a gift tax return, which is permitted in limited circumstances notwithstanding that the spouse is a beneficiary as discussed later in the slides.

7. What if the assets used to fund the trust had recently been owed jointly by the settlor and the spouse, or were owned by the spouse and transferred to the settlor, who then transferred them to the trust?

8. Should the surviving spouse be given a limited power of appointment to direct how trust assets will pass?

9. Should there be a divorce clause?

10. If the trust also provides for health, education, maintenance and support or other payments to descendants, how will the trust be protected from the spouse's or descendant's support claims or other items for which state law permits penetration of a trust?



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Estate Planning Advice / SLAT Introduction

Stepped-up basis planning can be impacted by the above decision.

Assets in a "credit shelter trust" will normally not get a new income tax basis on the beneficiary spouse's death, unless the beneficiary spouse is given a power to appoint the trust assets at least to creditors of his or her estate upon death.

This "general power of appointment" would cause the assets in the trust to be considered as owned by the surviving spouse for estate tax purposes.

"Credit shelter trusts" now benefitting surviving spouses who are well below the estate tax exemption amount can be modified to facilitate this "stepped-up basis planning."

JEST ("Joint Exempt Step-up Trusts") and community property trusts may be used to allow a step-up of all non-IRA/non-pension/non-annuity assets owned by a married couple on the first death.



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SLATs

On divorce, the SLAT can divide into two trusts: one trust that continues to be a SLAT, and another trust for descendants that the grantor can control by being able to control who the Trustees are.

The Trustees can make loans to the grantor at fair market value.

If the trust is based in an asset protection jurisdiction, then it should be possible for the grantor to be added as a beneficiary, if and when his or her own assets are no longer sufficient to provide support for the grantor.

The grantor can sell assets to a defective grantor trust at arm's-length, including discounted LLC or limited partnership interests, in exchange for long-term low interest notes.



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Estate Planning Advice / SLAT Introduction

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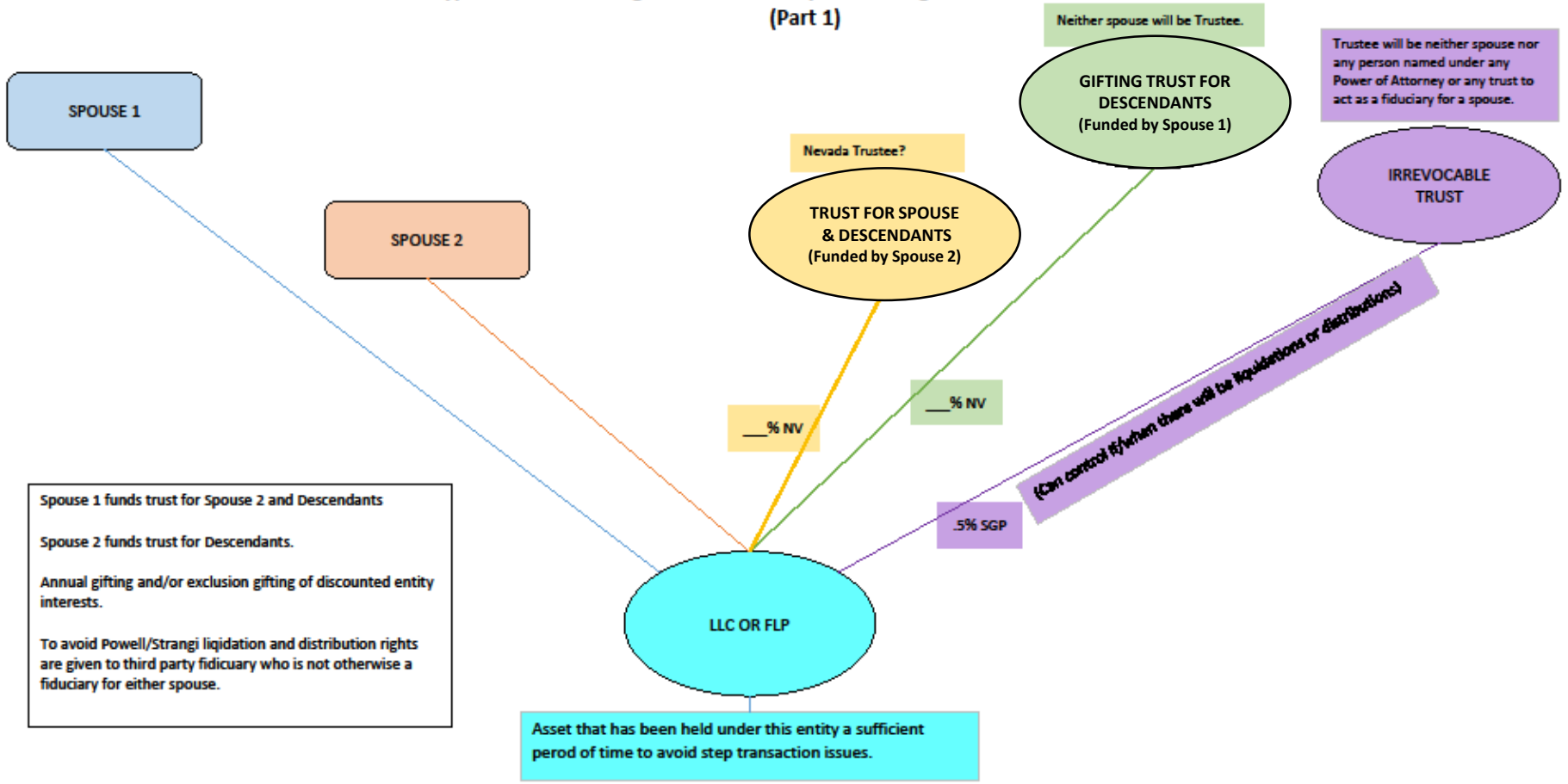
- The grantor can sell assets to a defective grantor trust at arm's-length, including discounted LLC or limited partnership interests, in exchange for long-term low interest notes.



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agassman@gassmanpa.com

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Typical Annual Gifting and Use of Exemption Gifting for Estate Taxable Clients (Part 1)

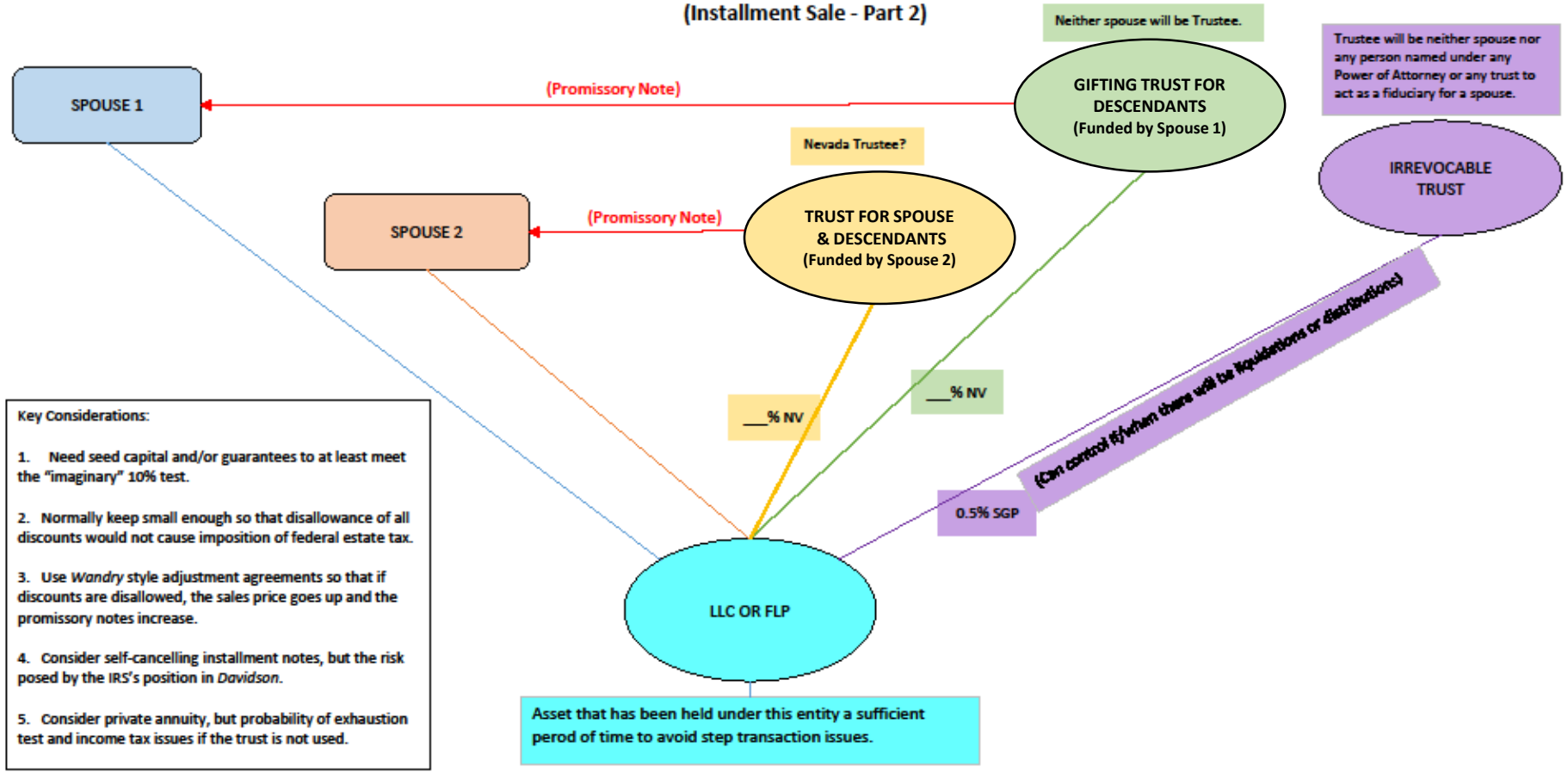


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TYPICAL ANNUAL GIFTING AND USE OF EXEMPTION GIFTING FOR ESTATE TAXABLE CLIENTS
(Installment Sale - Part 2)



Key Considerations:

1. Need seed capital and/or guarantees to at least meet the "imaginary" 10% test.
2. Normally keep small enough so that disallowance of all discounts would not cause imposition of federal estate tax.
3. Use *Wandry* style adjustment agreements so that if discounts are disallowed, the sales price goes up and the promissory notes increase.
4. Consider self-cancelling installment notes, but the risk posed by the IRS's position in *Davidson*.
5. Consider private annuity, but probability of exhaustion test and income tax issues if the trust is not used.

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SLAT CHECKLIST

1. Is client the Grantor, or both spouses?

   A. Will there be a "floating spouse" provision, so that the Grantor can benefit, if the beneficiary spouse dies by entering a new marriage with a spouse who can be a beneficiary?

   B. In such event, will the new spouse have a Power of Appointment? - Perhaps only exercisable with consent of a majority of the Grantor's descendants and only in favor of descendants of the Grantor's parents?

   C. Will a "floating spouse" only be eligible to benefit during the life of the Grantor, or thereafter?

   D. If the spouse/beneficiary remarries and is a beneficiary of the SLAT, should he or she be required to obtain a Marital Agreement with the new spouse so that the new spouse agrees to not attempt to reach into the trust or to consider the trust for purposes of setting alimony or support in the event of a divorce? - Limit benefits payable to remarried spouse, unless new spouse signs binding Marital Agreement.

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SLAT CHECKLIST

E. If Grantor and spouse divorce, does the trust divide into a SLAT as to one-half and a trust for the descendants of the Grantor as to the other half, with each spouse to control the trusteeship and do Trust Protectors change to "Spouse Protectors?"

F. Will an "adverse party" be named with the power to veto any distribution to the Grantor's spouse in order to be able to attempt to toggle off Grantor Trust status?

G. Will the spouse's Power of Appointment be:

   i. Exercisable during the life of the Grantor?

   ii. Exercisable during the life of the spouse or only upon death?

   iii. Subject to what limitations?



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SLAT CHECKLIST

2. Will the SLAT be placed in an asset protection jurisdiction ("APT"), so that the Grantor may be added as a beneficiary if certain events occur.

3. Will Trust Protectors be appointed and able to change the beneficiaries?

4. Will children be required to receive Marital Agreements with their spouses where the spouse agrees not to pursue the trust for support or as a possible source of alimony for purposes of measuring alimony, etc., in order to allow the child to receive more than a specified amount from the trust?



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SLAT CHECKLIST

5. Will distributions after the death of the Grantor be limited to not exceed a monthly or annual amount that may be adjusted with the Consumer Price Index to assure that the life journey of a beneficiary will not be unduly interfered with?

6. Does the Grantor want distributions to possibly be made to charity?

   If so, should it be limited to charities that the Grantor has supported during his lifetime, or charities named in the document?

   If so, should it be limited as to what percentage of each trust or what dollar amount may be transferred to charity each year, or upon what circumstances?



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS OVERVIEW

1. The settlor's spouse may be a trustee of the trust. As with all irrevocable trusts, administration should be well documented and according to the trust document.

2. The settlor's spouse can have the right to receive amounts as reasonably needed for health, education, maintenance, and support. It is best to provide that any such distributions for the spouse will be made only after taking into account the spouse's other assets and resources.

   Otherwise, consider whether the spouse might be considered to be gifting to the trust if he or she had the right to receive distributions and did not take them.

   Alternatively, limit distributions to the spouse by requiring an independent fiduciary to approve them.

3. Marital Deduction Savings Clause - The settlor's spouse may be the beneficiary of an outright disposition or General Power of Appointment Marital Trust provision to be funded if total contributions to the trust would otherwise cause gift tax responsibility. Do not use a QTIP trust for this because of the harsh regulations requiring a marital deduction election to be filed for a lifetime QTIP trust gift.

4. Typically the trust will be disregarded for income tax purposes, so that the settlor can pay the income tax attributable to the trust's income.

   In case the settlor may want to "toggle off" defective grantor trust status (such as by reserving the right to replace trust assets with assets of equal value, and then releasing that right) an adverse party (another substantive beneficiary under the trust) must have the right to approve any distributions to the spouse.

   Otherwise the trust will be a defective grantor trust under Internal Revenue Code Section 677, and the settlor will not be able to toggle that off (except by getting divorced!).

5. The settlor's spouse may choose to "split the gift" on a gift tax return, which is permitted notwithstanding that the spouse is a beneficiary, so long as it is very unlikely that the spouse will need to receive benefits for health, education, maintenance and support when taking into account the spouse's other assets and resources. See Private Letter Ruling 200345038, *William H. Robertson vs. Commissioner, 26 TC 246 (1956), and BNA Portfolios 822-2nd: Estate, Gift and Generation-Skipping Tax Returns and Audits, Section IX.M, and 826-2nd: Life Insurance, Section II.F.*

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7. Should the surviving spouse be given a limited power of appointment to direct how trust assets will pass? The grantor cannot be given this power if a completed gift to the trust is desired, but the spouse can. However, the power should not be exercisable in favor of her personally, her creditors, her estate, or creditors of her estate.

   At what point should the power of appointment exist and/or be terminated?

   (a) Immediately upon inception of the trust until the death of the surviving spouse?

   (b) Only after the death of the settlor until the death of the surviving spouse?

   (c) Only unless or until the parties are divorced or either party has a child who is not a beneficiary under the trust?

   What would prevent the beneficiary spouse from exercising his or her power of appointment to fund a trust for the donor spouse to allow the ability to receive amounts as needed for health education and maintenance – assuming that there is no pre-existing agreement or obligation for this to happen.

8. Should there be a divorce clause?

   Typically where the drafting lawyer is representing both spouses this can be discussed and a joint representation letter can be put into place. It is likely that the judge will consider the trust assets to be for the benefit of the beneficiary spouse, but this will vary from state to state and judge to judge.

   If the settlor's spouse is not a client then consider a clause that will provide that, upon divorce, the beneficiary spouse is no longer a beneficiary, trustee or otherwise entitled under the document.

9. If the trust also provides for health, education, maintenance and support or other payments to descendants, how will the trust be protected from a descendant's support claims or other items for which state law permits penetration of a trust?

   If the trust's primary beneficiary is your spouse, but your children can reach into it, do you have to worry that one of your children is going to have a nasty divorce and the ex-spouse of a child is going to be able to reach into this trust?

   Consider whether there should be a Flee (Cuba) Clause in the trust, or whether the trust should name an independent trust protector or trust protectors with the ability to remove descendant beneficiaries and/or the ability to move the situs of the trust to an appropriately protective jurisdiction.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

1. The settlor's spouse may be a trustee of the trust. As with all irrevocable trusts, administration should be well documented and according to the trust document.

SPECIAL LANGUAGE:

> Removal and Replacement of Trustee. Grantor may remove any Trustee of a Trust under this instrument who is then serving or who is designated as a successor or alternate Trustee and may additionally name any "Eligible Person," as defined herein, to serve as Trustee in the place of the removed or retiring Trustee, or to be designated as successor or alternate Trustee.
>
> An "Eligible Person" is a licensed trust company or an individual (other than Grantor) who is neither related nor subordinate to the Grantor. For this purpose, "related" and "subordinate" have the same meaning that they have under Code Section 672(c).

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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

SPECIAL LANGUAGE (Cont.):

The right to remove and replace a Trustee under this Section may be exercised by a writing delivered to the then-serving Trustee, signed by Grantor, and indicating the effective date of the removal, the identity of such next-serving Trustee, and the agreement of that next-serving Trustee. No cause or justification shall be required for any removal or appointment under this Section.

If the Grantor is unable to exercise the above removal and replacement power, then the Grantor's spouse, MARY SMITH, shall have this removal and replacement power if exercised with the consent of any adult child of the Grantor.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

2. The settlor's spouse can have the right to receive amounts as reasonably needed for health, education, maintenance, and support. It is best to provide that any such distributions for the spouse will be made only after taking into account the spouse's other assets and resources.

Otherwise, consider whether the spouse might be considered to be gifting to the trust if he or she had the right to receive distributions and did not take them.

Alternatively, limit distributions to the spouse by requiring an independent fiduciary to approve them.

SPECIAL LANGUAGE:

> Further, notwithstanding any provision herein to the contrary, no distribution shall be made for the Grantor's spouse from this Trust or any trust herein established unless clearly necessary whereby such spouse does not have sufficient income and/or investment resources to satisfy said spouse's reasonable needs for health, education, maintenance and support.

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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

3. The settlor's spouse may be the beneficiary of an outright disposition or General Power of Appointment Marital Trust provision to be funded if total contributions to the trust would otherwise cause gift tax responsibility. Do not use a QTIP trust for this because of the harsh regulations requiring a marital deduction election to be filed for a lifetime QTIP trust gift.

SPECIAL LANGUAGE:

Contingent Martial Deduction Provision. In the highly unlikely event that the Grantor's contributions to this Trust exceed the maximum amount that can be gifted by the Grantor without incurring Federal Gift Tax (based upon the assumption that the Grantor's spouse will sign a split gift Form 709 Gift Tax Return with respect to any contribution made while the Grantor is married), then the Trustee shall divide the Trust estate into two separate shares, hereinafter designated as the SMITH IRREVOCABLE BENEFICIARY TRUST SHARE and the SMITH MARITAL DEDUCTION TRUST SHARE. The SMITH IRREVOCABLE BENEFICIARY TRUST SHARE shall be a fraction of the Trust estate of which (a) the numerator shall be the largest amount that if allowed as a Federal Gift Tax Exemption would result in no Federal Estate Tax being payable by the Grantor or the Grantor's spouse by reason of the gift to this Trust by the Grantor which was split by the Grantor's spouse, and (b) the denominator shall be the value as finally determined for Federal Gift Tax purposes of the assets in the Trust estate. The SMITH MARITAL DEDUCTION TRUST shares shall be the remainder of the Trust estate. No property shall be allocated to the SMITH MARITAL DEDUCTION TRUST SHARE that would not qualify for the Estate Tax Marital Deduction. The SMITH IRREVOCABLE BENEFICIARY TRUST SHARE shall be held pursuant to the terms of Section _____ and Article _____ of this Trust. The SMITH MARITAL DEDUCTION SHARE shall be held for the benefit of the Grantor's spouse, pursuant to Section _____ below.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

SPECIAL LANGUAGE (Cont.):

Disposition of SMITH Marital Deduction Share. The SMITH Marital Deduction Share shall be held as a separate trust to be known as the SMITH MARITAL DEDUCTION TRUST, and shall be held, managed and distributed for the benefit of the Grantor's spouse as follows:

(1) Income. Commencing with the date of the funding of the SMITH MARITAL DEDUCTION TRUST, the Trustee shall pay to or for the benefit of the Grantor's spouse during such spouse's lifetime all the net income in convenient installments but no less frequently than annually.

(2) Principal. In addition, the Trustee may pay to or for the benefit of the Grantor's spouse at any time and from time to time such sums from principal as are reasonably necessary for the Grantor's spouse's health, education, maintenance and support. Furthermore, an Independent Trustee, if appointed, may pay to or for the benefit of the Grantor's spouse at any time and from time to time such amounts, up to and including the whole thereof, as such Independent Trustee deems appropriate in its sole and absolute discretion, provided that no non-Independent Trustee then serving shall have any ability whatsoever to participate in such decision.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

(3) IRAs and Qualified Plans. If this SMITH MARITAL DEDUCTION TRUST becomes the beneficiary of any individual retirement account (IRA), qualified retirement plan, or similar tax-deferred arrangement or annuity (the "Plan"), the Trustee shall withdraw from such Trust's share of the Plan, in each calendar year, and deposit in such Trust, at minimum the "minimum distribution amount" which is required to be withdrawn from such share under Section 401(a)(9) of the Code, the Regulations thereunder, or other applicable law, as then in force, provided that the Grantor's spouse may require, on an annual basis by signed writing delivered to the Trustee, that the Trustee so withdraw and deposit the greater of the minimum distribution amount or the net income on the Trust's share of such Plan for such year. The net income of this SMITH MARITAL DEDUCTION TRUST's share of the Plan shall be included in computation of the Trust's net income for the purpose of determining any required income distributions.

(4) Prohibited Distributions. Notwithstanding anything in this Trust Agreement to the contrary, no distribution of income or principal shall be made from the SMITH MARITAL DEDUCTION TRUST to or for the benefit of anyone but the Grantor's spouse during the Grantor's spouse's lifetime, unless the Grantor's spouse executes her inter vivos limited Power of Appointment as described below.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

(5) Power of Appointment. The Grantor's spouse shall have a testamentary general Power of Appointment (as defined in Section 1.09 of this Trust Agreement) with respect to the SMITH MARITAL DEDUCTION TRUST, and upon the death of the Grantor's spouse, the Trustee shall pay the remaining principal, or such portion thereof over which said Power is exercised, as the Grantor's spouse directs pursuant to the exercise of such Power.

Further, the Grantor's spouse shall have an inter vivos limited Power of Appointment (as defined in Section 1.09 of this Trust Agreement) with respect to the SMITH MARITAL DEDUCTION TRUST, provided that the Grantor's spouse must exercise such power, if at all, by making specific reference to such power in a written document signed in the presence of two witnesses and a notary and delivered to the Trustee. Upon receipt of such document, the Trustee shall pay such principal or a portion thereof over which said power is exercised, as the Grantor's spouse directs pursuant to the exercise of such power.

(6) Disposition in Lieu of Exercise of Powers of Appointment. Upon the death of the Grantor's spouse and to the extent not otherwise effectively appointed, any property remaining in the SMITH MARITAL DEDUCTION TRUST shall be held, managed and distributed pursuant to Section 5.01(b) of this Trust Agreement, which are the protective trust provisions for descendants.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

4. Typically the trust will be disregarded for income tax purposes, so that the settlor can pay the income tax attributable to the trust's income.

In case the settlor may want to "toggle off" defective grantor trust status (such as by reserving the right to replace trust assets with assets of equal value, and then releasing that right) an adverse party (another substantive beneficiary under the trust) must have the right to approve any distributions to the spouse.

Otherwise the trust will be a defective grantor trust under Internal Revenue Code Section 677, and the settlor will not be able to toggle that off (except by getting divorced!).



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

SPECIAL LANGUAGE:

(1) The Trustee may pay to or for the benefit of Grantor's spouse, so much of the income and/or principal of the Trust as the Trustee shall deem appropriate to provide said spouse with expenses of health, education, support or maintenance. This includes maintenance in health and reasonable comfort, support in said spouse's accustomed manner of living, education, including college and professional education, and medical, dental, hospital and nursing expenses and expenses of invalidism. The Trustee may also invade the principal of this Trust in such amounts as it may deem appropriate to provide for the maintenance, support, health and education of Grantor's descendants taking into consideration any other means of support they or any of them may have to the knowledge of the Trustee, provided that no such distribution shall satisfy any obligation of support of Grantor, or any legal obligation of Grantor or any Trustee hereof. The Trustee is encouraged to withhold payments that would otherwise be unwisely spent, would disqualify the beneficiary from receiving public assistance, or might be seized by creditors or any divorced spouse of such beneficiary. **Notwithstanding the above, no distribution shall be made to or for the benefit of the Grantor's spouse during the lifetime of the Grantor except as approved by an adverse party as defined in Section _____ of this Trust Agreement.**



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GASSMAN CROTTY & DENICOLO, P.A.
ATTORNEYS AT LAW

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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

5. The settlor's spouse may choose to "split the gift" on a gift tax return, which is permitted notwithstanding that the spouse is a beneficiary, so long as it is very unlikely that the spouse will need to receive benefits for health, education, maintenance and support when taking into account the spouse's other assets and resources. See Private Letter Ruling 200345038, *William H. Robertson vs. Commissioner, 26 TC 246 (1956), and BNA Portfolios 822-3rd: Estate, Gift and Generation-Skipping Tax Returns and Audits, Section X.M, and 826-2nd: Life Insurance, Section II.F.*

SPECIAL LANGUAGE:

Assets being transferred to make use of the $4,000,000 lifetime gifting exclusion increase may be owned by one spouse or the other, and desired use of exclusions may not match the ownership of assets being transferred.

For example, husband has an $8,000,000 asset and Husband and Wife wish to use each of their new $4,000,000 increases in gifting exclusion. Is it best for Husband to transfer $4,000,000 worth of the asset to Wife, who can in turn gift this portion of the asset, or is it preferable for Husband to make the entire gift and for Wife to sign a split gift return in order to consider the gift to have been made half by Wife?



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

SPECIAL LANGUAGE (Cont.):

The split gift return technique works even if wife is a beneficiary of a trust that receives the gifts from husband, unless (1) the Trustee's power to distribute property for the benefit of the spouse is not limited by an ascertainable standard; and (2) the spouse does not have sufficient financial assets outside of the Trust and therefore it is likely that the Trustee will distribute assets from the Trust for the benefit of the spouse. For an excellent discussion of this see Qualifying Trust Transfers for Split-gift Treatment by William R. Swindle, July/August 2007, Vol. 81, No. 7, FL Bar Journal

However, if Husband transfers half the assets outright to Wife, and Wife then transfers these assets, the step transaction doctrine may apply. The step transaction doctrine was developed under the common law to provide that the substance of a transfer or transaction will be considered to have occurred, notwithstanding intermediary steps for predetermined intermediary structuring. Under the step transaction doctrine, a transfer from party A to party B followed by a transfer from party B to party C may be considered as a transfer directly from party A to party C. "The 'step-transaction' doctrine collapses 'formally distinct steps in an integrated transaction' in order to assess federal tax liability on the basis of a 'realistic view of the entire transaction.'"



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

6. What if the assets used to fund the trust had recently been owed jointly by the settlor and the spouse, or were owned by the spouse and transferred to the settlor, who then transferred them to the trust? Under the Step Transaction Doctrine, the assets and the economic risk associated therewith should be owned and held exclusively by the settlor for a reasonable period of time. In case the IRS argues that the contribution to the trust was really made by the settlor's spouse (in which event the settlor's spouse may be subject to federal estate tax under Internal Revenue Code Section 2036(a)(1) - retained life interests), it may be important to have trust language which provides that any trust assets considered as transferred to the trust by the spouse beneficiary will be held in a separate subtrust that the spouse will not be a beneficiary of.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

SPECIAL LANGUAGE:

If the Grantor's Spouse is a Contributor to this Trust. To take into account that the Grantor's spouse may be considered to be the contributor of certain assets to this Trust, and should thereby not have any right to receive distributions or benefits from any Trust assets that the Grantor's spouse has funded, in the event that for any reason the Grantor's spouse is considered to be the contributor of assets to this Trust or any trust herein established, then such assets shall be set aside and held as a separate trust, in a manner identical to the provisions set forth in Section 5.01(a) hereof, provided that no distributions whatsoever shall be made to the Grantor's spouse from such separate subtrust, and that no power of appointment otherwise exercisable by the Grantor's spouse shall be considered to be exercisable or exercised, notwithstanding any provision herein to the contrary.

The purpose of this provision is to avoid having the Grantor's spouse be considered the owner of any Trust assets for purposes of Internal Revenue Code Section 2036(a)(1) and (2) or any Treasury Regulations set forth therein. Consistent therewith, the Grantor's spouse shall not be the Trustee of any such separate trust and any acting Co-Trustee shall have the power to act without joinder or consent of the Grantor's spouse as to any such trust.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

Some courts have noted that the step transaction doctrine should only apply if tax savings is the sole motivation behind the taxpayer's actions. If the transaction has an "independent purpose or effect" in addition to the goal of tax savings such purpose or effect may be sufficient to avoid the application of the step transaction doctrine.

Planners will therefore need to consider whether the step transaction doctrine will apply, how to avoid the step transaction doctrine, and whether to use split gift returns if one spouse makes a gift that they wish to consider having been made ½ by the other spouse.

Clients who have been involved with installment sales shortly after the funding of the entity as to which the interests were sold may wish to unwind those sales or have the note paid off as part of estate tax law planning in order to reduce the likelihood that the IRS would attempt to apply the step transaction doctrine to the transaction that occurred.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

7. Should the surviving spouse be given a limited power of appointment to direct how trust assets will pass? The grantor cannot be given this power if a completed gift to the trust is desired, but the spouse can. However, the power should not be exercisable in favor of her personally, her creditors, her estate, or creditors of her estate.

At what point should the power of appointment exist and/or be terminated?

(a) Immediately upon inception of the trust until the death of the surviving spouse?

(b) Only after the death of the settlor until the death of the surviving spouse?

(c) Only unless or until the parties are divorced or either party has a child who is not a beneficiary under the trust?

SPECIAL LANGUAGE:

If JANE C. JONES predeceases the Grantor and has left a Last Will and Testament or separate written document executed in the presence of two witnesses and a notary which changes the dispositive provisions of this Trust Agreement as would otherwise apply pursuant to Section 5.01(b) hereof, then the remaining Trust assets shall be held or distributed as set forth by the exercise of such testamentary "Power of Appointment," provided that the guidelines and limitations described in Section 1.09 of this Agreement shall apply with respect to such exercise.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

Power of Appointment. The term "Power of Appointment" means a power of appointment under which the holder of the power shall be able to appoint all or a portion of the property to which the power applies, outright or in trust or otherwise, to or for the benefit of any person or persons as the power holder may select from among the lineal descendants of the parents of the Grantor (other than the power holder) and/or one or more charities that are named under this Trust Agreement, provided that this restriction to the lineal descendants of the parents of the Grantor shall not apply if there are no such descendants then surviving. The holder of a Power of Appointment must exercise such power, if at all, by making specific reference to such power in his or her Last Will and Testament duly admitted to probate. In disposing of any property subject to a Power of Appointment, the Trustee may rely upon an instrument admitted to probate in any jurisdiction as the Last Will and Testament of the holder of such power. If the Trustee has no written notice of the existence of such Will with a period of three (3) months after the power holder's death, it may presume that the power holder died intestate, and the Trustee shall be protected in acting in accordance with this presumption. Unless otherwise expressly provided, no Power of Appointment shall be exercisable in favor of the Grantor individually, the power holder, his or her creditors, his or her estate, or the creditors of his or her estate, nor shall any such Power be exercisable in satisfaction of any legal obligation, including any support obligation of the power holder, and the term shall be construed to be a limited power of appointment as defined in Sections 2041 and 2514 of the Code.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

8. Should there be a divorce clause?

Typically where the drafting lawyer is representing both spouses this can be discussed and a joint representation letter can be put into place. It is likely that the judge will consider the trust assets to be for the benefit of the beneficiary spouse, but this will vary from state to state and judge to judge.

If the settlor's spouse is not a client then consider a clause that will provide that, upon divorce, the beneficiary spouse is no longer a beneficiary, trustee or otherwise entitled under the document.

ESTATE PLANNING JOINT REPRESENTATION DISCLOSURE

THE UNDERSIGNED, _____ and _____, being husband and wife, do hereby affirm that GASSMAN, CROTTY AND DENICOLO, P.A. has informed us of the following by providing this document:



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

The Florida Bar Ethics Rules encourage that we inform both spouses in a marriage of their ability to procure independent legal counsel, of the possibility of differing economic interests that might be pursued in estate planning and shifting asset ownership, and that information made available to us becomes jointly available as part of an estate planning file. For example, under Florida law, signing a declaration which states that all personal property held by each spouse will be owned as tenants by the entireties with the other spouse will cause all personal property of each spouse, including wedding rings and other gifts that have been previously received by each spouse, to be owned jointly with the other spouse as tenants by the entireties. This may restrict each spouse's rights with respect to the sale or subsequent transfer of such personal property. Also, under Florida law there is something called the Elective Share which allows a surviving spouse to elect to receive up to 30% of total available assets if the spouse is not made the beneficiary of direct or certain indirect devises. If at any time either of us wishes to have the advice of separate counsel, before or after executing this Agreement, we understand that we are each able to do so.

Each of us acknowledges the above and has on our own volition proceeded with this estate planning on a joint basis. We further have had the opportunity to review the attached correspondence that was sent with or before the initial estate planning document package that we received, and each of us has had the opportunity to review this letter and to consider its implications.

_____ _____

HUSBAND WIFE



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Possible Impact of Divorce-Control Over Trusteeship

In the highly unlikely event that either the Grantor or JANE SMITH has filed for a dissolution of marriage, then at the time such dissolution is finalized (or sooner if determined appropriate by the unanimous consent of all acting Trustees) the Trustee shall divide the assets of this Trust and any separate trusts herein established, into separate equal trusts which will have equivalent values. The Grantor shall have the authority to remove and replace the Trustee as described above only with respect to one such described Trust (or Trusts equaling 50% of the value of the assets of this Trust prior to division), and JANE SMITH shall have the authority to remove and replace the Trustee as described above only with respect to the other Trust (or Trusts equaling 50% of the value of the assets of this Trust prior to division). In such event, the Trust Protectors of the separate trust that JANE SMITH will have the right to replace the Trusteeship of shall be _____, _____ and _____, and the Trust Protectors for the separate trust that the Grantor shall have the power to replace the Trusteeship of shall be _____, _____ and _____. Further, in such event, the Trust Protectors may name alternate Trust Protectors to serve in lieu of one or more of the Trust Protectors then serving of each such separate trust, but only with the advanced written approval of JANE SMITH, as to the separate trust that she will have the power to replace the Trusteeship of, and only with the advanced written approval of the Grantor, with respect to the separate trust that he will have the power to replace the Trusteeship of.



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Possible Impact of Divorce- Elimination of Ex-Spouse as a Beneficiary

If and when a spouse of the Grantor, including CURRENT SPOUSE, is no longer married to the Grantor during the Grantor's lifetime, or on the one-year anniversary of the filing of a Petition for Dissolution of Marriage by either of the Grantor or a spouse of the Grantor to terminate the marriage of the Grantor that is not withdrawn or settled without a divorce occurring, then such spouse of the Grantor shall no longer be eligible to be a beneficiary under this Trust, or to have or exercise any power of appointment or any right with reference to this Trust Agreement or any trust herein established, unless or until such individual and the Grantor revoke any and all divorce proceedings and continue to be married or re-marry, it being the intention of the Grantor that this Trust should benefit the Grantor's spouse during such spouse's marriage with the Grantor.



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Possible Impact of Divorce- Elimination of Ex-Spouse as a Beneficiary, Continued

In the unlikely event that the Grantor and the Grantor's Spouse are no longer married during the Grantor's lifetime, or on the one-year anniversary of the filing of a Petition for Dissolution of Marriage by either of the Grantor or a spouse of the Grantor to terminate such marriage that is not withdrawn or settled without a divorce occurring within one year of such filing, then if this Trust has been funded solely from non-marital separate property of the Grantor the Grantor's spouse shall not be considered to be living or to have any power under this Trust Agreement, provided that if this Trust is funded with assets considered to be marital assets for marital law purposes, then an amount equal to one-half of the value of such assets that would be considered to be marital assets in the event of a divorce shall be set aside into a separate trust with terms equivalent to the terms of this Trust, provided that the Grantor's spouse shall have the right to determine the trusteeship of such trust, and shall be considered to continue to be married to the Grantor and thus eligible to receive benefits and otherwise have the beneficial rights set forth herein. In the event of such division the Grantor shall have the authority to remove and replace the Trustee(s) as described above only with respect to the trust that is not funded for the primary benefit of the Grantor's spouse as described above. By means of example, if this Trust is funded with $100,000 worth of marital assets and $900,000 worth of non-marital assets and by reason of income and growth in value is worth $2,000,000 at the time of a divorce, then $200,000 (10% of the Trust assets) would be considered to be marital assets, and the Grantor's spouse's share of such Marital Assets that would be set aside in a separate trust to be held for the primary benefit of such spouse would be one-half (½) of such Marital Assets or $100,000 ($200,000 / 2 = $100,000) in this example. In the unlikely event that the CLIENT MARITAL DEDUCTION TRUST SHARE is funded pursuant to Section 4.05 above, to the extent possible, such CLIENT MARITAL DEDUCTION TRUST SHARE shall be allocated to the Trust or Trusts over which ALICE CLIENT retains the authority to remove and replace the Trustee as described above.



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Possible Impact of Divorce- What if the Trust is Inadvertently Funded with Marital Assets?

(a) Spouse's Marital Property Trust. It is the intention of the Grantor to fund this Trust solely with the Grantor's separate non-marital property, but in the unlikely and unexpected event that marital property is contributed by the Grantor to this Trust, then, if the Grantor's spouse survives the Grantor, the Trustee shall hold, administer and distribute the Trust property which is considered to be marital property during such spouse's lifetime under a separate trust that will be held, managed and administered pursuant to the following terms and conditions:



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Possible Impact of Divorce- What if the Trust is Inadvertently Funded with Marital Assets?, Continued

Notwithstanding the paragraph above, it is the intention and expectation of the Grantor that this Trust is being funded solely with non-marital assets which constitute the separate property of the Grantor for marital law purposes, and that would not be considered to be marital assets, or assets that the Grantor's spouse would have access to in the event of a divorce or if the Grantor's spouse survived the Grantor. It is further the Grantor's intention and expectation that income produced by such separate property assets transferred to this Trust, appreciation in value, and assets subsequently purchased or acquired with such income and/or appreciation in value will also not be marital assets. It is further the intention of the Grantor to pay any and all income taxes attributable to the income of assets held under this Trust and any trust herein established from the Grantor's own separate non-marital assets, so that the Grantor's spouse is not disadvantaged by having such income taxes paid from assets that would be available to such spouse in the event of a divorce or upon the death of the Grantor. Therefore, with respect to the paragraph above (which would prevent the Grantor's spouse from receiving any benefit under this Trust in the event of a divorce or a divorce proceeding exceeding one year), to the extent that any assets held under this Trust or any trust herein established would be marital assets, the Grantor's spouse will not be excluded as a beneficiary with respect to a separate subtrust that would be established upon divorce and funded with an appropriate portion of the marital trust assets that would then be held for the benefit of the Grantor's spouse, consistent with Section 6.04 of this Agreement. The Grantor requests that the Trust Protectors would take such actions as are necessary and appropriate in such event, with the intention being that the Grantor's personal assets would not have to be transferred to the Grantor's spouse to make up for assets held under this Trust that may cause a change in how the assets held outside of this Trust would be allocated between the Grantor and the Grantor's spouse.



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“Floating Spouse” Provision

- Sample language to define the “Grantor’s spouse”:

  Wherever used in this Trust Agreement, the term "Grantor" shall mean JOHN CLIENT, and the term "Grantor's spouse" shall mean the individual to whom the Grantor is married at the applicable time. It is acknowledged that the Grantor is currently married to ALICE CLIENT.

- Sample language to add a potential new spouse if the Grantor and the Grantor’s spouse divorce, or if the Grantor’s spouse predeceases the Grantor:

  Further, in the unlikely event of a divorce, or if ALICE CLIENT predeceased JOHN CLIENT, then a subsequent spouse of JOHN CLIENT may receive benefits for said spouse’s health, education, maintenance and support during the lifetime of JOHN CLIENT, based upon a conservative standard, provided that no such distribution to or for the benefit of a subsequent spouse of JOHN CLIENT shall be made from any trust held for the primary benefit of ALICE CLIENT while she is living.

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Consider the Implications of the Repeal of IRC Section 682

- Under prior law, Internal Revenue Code Section 682 provided that, following the divorce of a Grantor and the Grantor's spouse, any income that the spouse "is entitled to receive" from a trust which would have otherwise been taxed to the Grantor will be taxed to the Grantor's (now ex-) spouse, and not to the Grantor. The phrase "is entitled to receive" has been interpreted to mean that the income of the trust can be paid or distributed to the ex-spouse, regardless of whether the spouse actually receives it.
- Thus, Section 682 generally had the effect of "turning off" grantor trust status of a Spousal Benefit Trust so that the Grantor would not be taxed on the income of the Trust after the Grantor and the Grantor's spouse divorce.
- However, Section 682 was repealed as part of the Tax Cuts and Jobs Act of 2017. As a result a Grantor will continue to be responsible for paying the income tax associated with a trust that benefits the Grantor's ex-spouse (such as a SLAT), even if the Grantor and the Grantor's spouse divorce.
- This is referred to by us as the "Section 682 issue."



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Consider the Implications of the Repeal of IRC Section 682- Possible Solutions

- Provide for the beneficiary spouse to be eliminated as a beneficiary upon divorce.
  - Likely effective to avoid the Section 682 issue, but it may not be practical if the assets used to fund the SLAT are marital assets.
- Require that an "Adverse Party" (i.e., a person other than the Grantor's spouse who has a substantial interest in the SLAT) to approve any distribution made to the Grantor's (ex-) spouse.
  - Probably effective to avoid the Section 682 issue, but it is not clear. Even still, it seems that any distributions made to the Grantor's (ex-) spouse could be subject to grantor trust treatment, causing the Grantor to be income tax on any income that is so distributed.
- The spouses enter into a marital agreement defining who pays the income tax associated with the Trust's income in the event of a divorce.



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Consider the Implications of the Repeal of IRC Section 682- Sample Language for a Marital Agreement

- Sample language for a marital agreement to cause the beneficiary spouse to be responsible for the income tax obligations associated with the Trust if a divorce occurs:

If a Dissolution of our Marriage occurs, then any income or other tax obligations resulting from the continuing existence of the CLIENT DESCENDANTS TRUST dated August 15, 2021 that has or will be executed and funded and/or the CLIENT SPOUSAL BENEFICIARY TRUST _____ which has been executed and is in the process of being funded, shall be considered to be marital expenses mutually paid from the marital income and/or assets of the parties, and after a divorce has occurred, any and all income or other taxes attributable to the continuing existence of the CLIENT SPOUSAL BENEFICIARY TRUST and/or any subtrust or subsequent successor Trust created under or from such Trust Agreement shall be the sole responsibility of WIFE, to the extent that under federal income tax laws HUSBAND would otherwise be responsible for such taxes. Further, after a divorce, one-half of any and all taxes attributable to the CLIENT DESCENDANTS TRUST and/or any subtrust or subsequent successor Trust created under or from such Trust Agreement shall be timely paid by WIFE or reimbursed by WIFE to HUSBAND, so that each party is responsible for one-half of the income tax relating to that Trust. The parties will reasonably cooperate with applicable tax advisors to reduce federal income taxes, when possible, or to cause the subject Trusts to pay income taxes from Trust income or principal if and when one party requests that this occur, and such action is a reasonable and conventional method of trust planning.



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PLANNING FOR A DYNASTY TRUST WHERE THE SPOUSE OF THE SETTLOR/CONTRIBUTOR IS A BENEFICIARY - SPECIAL CONSIDERATIONS IN DETAIL

9. If the trust also provides for health, education, maintenance and support or other payments to descendants, how will the trust be protected from a descendant's support claims or other items for which state law permits penetration of a trust?

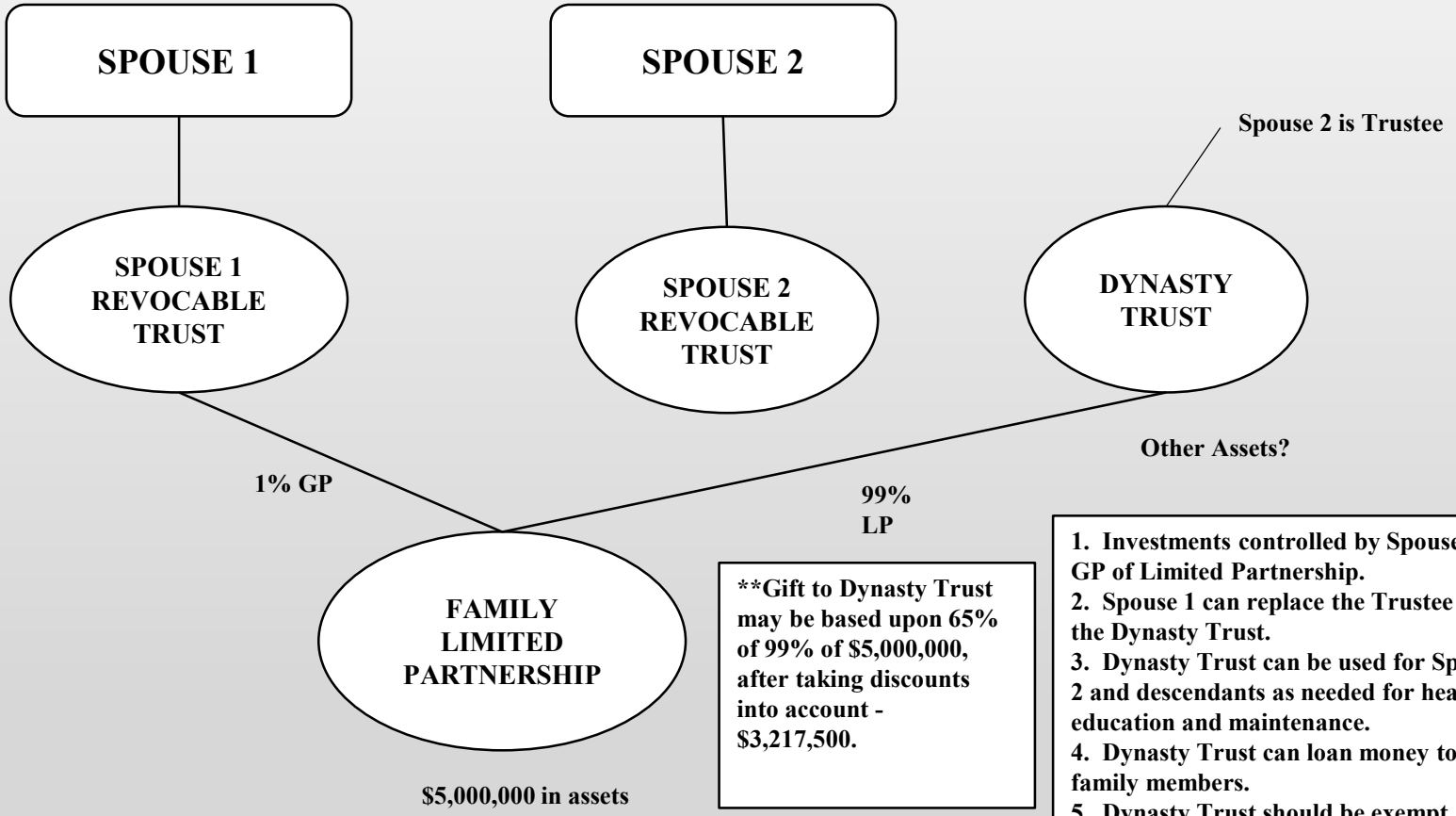
   If the trust's primary beneficiary is your spouse, but your children can reach into it, do you have to worry that one of your children is going to have a nasty divorce and the ex-spouse of a child is going to be able to reach into this trust?

   Consider whether there should be a Flee (Cuba) Clause in the trust, or whether the trust should name an independent trust protector or trust protectors with the ability to remove descendant beneficiaries and/or the ability to move the situs of the trust to an appropriately protective jurisdiction.



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The SLAT (Spousal Lifetime Access Trust) Example of Spouse 1/Spouse 2 Dynasty Trust Arrangement



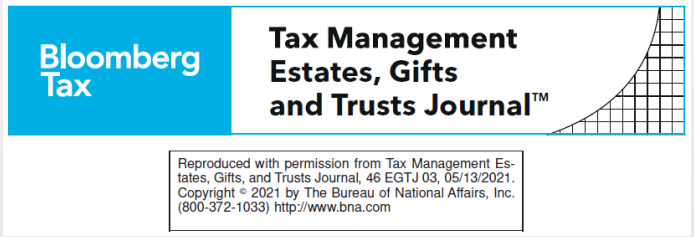


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SLAT-OPEDIA: Considering All Options And A Client-friendly Letter

By Alan S. Gassman, Christopher J. Denicolo and Brandon Ketron

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A Spousal Lifetime Access Trust (SLAT) is a trust established by one person that is held for the benefit of his or her spouse and others in a manner that will not be subject to the creditor claims of the spouse and other beneficiaries of the trust and also will not be subject to federal estate tax in the estates of such beneficiaries. The SLAT has its roots under the common law of all 50 states of the United States, and has been fine-tuned and augmented by creative planners over the years to comply with and take advantage of guidance set forth under applicable state statutes. Given the present uncertainty and possible changes with respect to the federal estate and gift tax laws, the SLAT offers clients flexibility while making use of what might be a vanishing lifetime gifting exclusion.

THE CURRENT STATUS OF THE FEDERAL ESTATE AND GIFT TAX SYSTEM

Under the federal estate and gift tax system, there is presently an 12 million dollar unified estate and gift tax exclusion amount.[1] This allows a person to make large gifts which reduce the exclusion amount for both estate and gift tax purposes without paying gift tax unless or until the entire exclusion amount is exhausted. Current law provides for the unified estate and gift tax exclusion amount to be reduced to $5 million, plus post 2011 increases for inflation as a result of the changes to the ''Chained Consumer Price Index'' since 2012 (which many estimate will be approximately $6.5 million) effective January 1, 2026.[2]

1 §2010(c)(3). All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), or the Treasury regulations promulgated thereunder, unless otherwise indicated.
2 §2010(c)(3)(C).



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THE SLAT: A USEFUL SOLUTION

For married couples, the SLAT is an excellent tool to help achieve the balance between gifting assets to make use of lifetime gifting exclusion and retaining the possibility of access to such assets because it involves the "grantor-spouse" establishing a trust for the "beneficiary-spouse" whereby the beneficiary-spouse can receive distributions as needed for his or her health, education, maintenance, or support (HEMS). The beneficiary-spouse also can be the sole trustee or a co-trustee of the SLAT, and the assets of the SLAT should not be subject to the beneficiary-spouse's creditors or subject to estate tax in the beneficiary-spouse's estate.

This is based upon the federal estate tax law in this area, which was enacted to run parallel to a fundamental tenet of the common law with respect to "third-party irrevocable trusts." If a "third-party irrevocable trust" is formed by one person for the benefit of another person who can only demand or effectuate withdrawals to the extent needed for HEMS, the assets of the trust will not be subject to federal estate tax in the estate of the beneficiary (which typically would not be subject to the creditors of the beneficiary), unless there are certain strings attached or arrangements in place.

It is very important that a beneficiary of a trust (such as the beneficiary-spouse) not have the right or power to demand payment or benefits that are more than what is needed for his or her HEMS (such as distributions determined to be for the "best interest" of the beneficiary). A trustee other than the beneficiary may have the power to distribute the assets of the trust to the beneficiary beyond what is needed for HEMS, and this will not cause the assets of the trust to be subject to federal estate tax in the beneficiary's estate or subject to the beneficiary's creditors, so long as there is not an understanding between the beneficiary and the trustee that the trustee will make such distributions in excess of what is needed for HEMS. Likewise, a SLAT can be an important planning technique for single wealthy individuals who may want to benefit a future spouse. The Trust can be drafted with a "floating spouse" provision whereby the definition of the "grantor's spouse" is defined as the individual to whom the grantor is married at any given time.

As with much of the tax law and estate planning techniques, it can be a challenge to explain complex topics such as the federal estate and gift tax law and the SLAT to the clients in an easily understandable format that allows them to make an informed decision in view of the salient benefits and limitations. It is the authors' experience that even sophisticated and business-savvy clients can have difficulty with abstract concepts if they are not explained in layman's terms in writing and in a format that can be referenced at a later time. Clients can be better educated and have many of their questions answered by a well-drafted letter explaining the mechanics of a SLAT, the planning opportunities associated therewith, and the implications and limitations of the technique. Such a letter can be invaluable in communicating the complex ideas associated with the federal estate and gift tax law and the SLAT in simple terms.

A Client Friendly Explanation Letter of the SLAT

The authors recently prepared such a letter to a sophisticated retired CPA client that was largely similar to the following, although without the authors' annotations in the footnotes, which provide considerations regarding the design of a SLAT to reader of this article:

Dear Client:

It was a pleasure to speak with you on Friday. I thought that it would be useful to reiterate much of what we discussed.

Under the federal estate and gift tax system, there is presently an $11.7 million dollar unified estate and gift tax exemption. Under this exemption, a person can make large gifts which reduce the exemption amount for both estate and gift tax purposes.

In addition, the first $15,000 of gifts per year given directly to any one person do not count against the exemption. For example, if you gave your brother-in-law and his wife $30,000 in a given year, this would not count against your exemption. If you gave them $1,030,000 in a particular year, then your exemption would go down from $11. 7 million to $10.7 million dollars.

POTENTIAL LEGISLATIVE CHANGES TO THE FEDERAL ESTATE AND GIFT TAX SYSTEM

Under the Bernie Sanders proposed Estate and Gift Tax Reform Bill, the gift tax exemption would come down to $1 million dollars.

If you make a taxable gift of $120,000 this year that does not qualify for the $15,000, then your lifetime exemption would be $880,000 after the Bernie Sanders Bill passes (if it passes). Therefore, if you thereafter gift over the $15,000 per person per year amount, then the reduction would be from $880,000, and the gift tax of at least 40% (and possibly up to 65%) would be owed to the extent that you give in excess of the $880,000 during your lifetime.

In addition, the Bernie Sanders Bill would reduce the federal estate tax exemption to $3.5 million per

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person, so your exemption would be $3.38 million if the reduction occurs before or after you make a $120,000 reportable gift.

Even though it seems to me that it is unlikely that these provisions of the Bernie Sanders Bill could pass, many clients are advancing their estate tax planning under the assumption that something will happen eventually.

For example, the estate tax exemption is scheduled to come down to half of its otherwise inflation-adjusted amount in 2026 (which is expected to be approximately $6.5 million), and Congress could be in gridlock from now until well after 2026 on this issue.

Alternatively, a Democratic sweep of the House and Senate in 2022 could yield drastic changes to the federal estate and gift tax law, similar to what has been proposed by Bernie Sanders.

USE OF A SLAT

As a result, many married clients are entering into an estate planning trust arrangement known as a "Spousal Lifetime Access Trust" (a "SLAT") where one spouse forms an irrevocable trust for the benefit of the other spouse and their descendants.

A combination of estate tax planning techniques that can be very effective for most individuals in your situation involves the creation of a SLAT for your spouse and descendants, and also a strategy called the "Installment Sale to a Defective Grantor Trust" and involves the following principles:

1. You can establish one or more irrevocable trusts for the benefit of your spouse and descendants that will pass estate tax-free but would be disregarded for income tax purposes.

2. As a result of this, you can pay the income tax on the income of the trust, without such payments being considered to be gifts for gift tax measurement purposes. This means that your exemptions would not be reduced and no gift tax would result from payments of income tax on the trust.

3. In addition, you can exchange or sell assets to the trust in exchange for other assets or a long-term low-interest note income tax-free, without this being considered to be a gift. Further, the interest on the note (which can be at a low rate) will not be considered as income to you for income tax purposes as long as the trust is disregarded for income tax purposes.

4. In addition, if you are selling or transferring minority or non-voting ownership interests in an LLC or other entity, then a discount may be taken in determining the value of what is sold or transferred. For example, if an LLC has $1 million in underlying assets, and you transfer a 70% non-voting interest to the trust, then the value of the 70% non-voting LLC interest is probably worth something like $490,000 after accounting for a 30% valuation discount.

Please keep in mind that the Bernie Sanders Bill would grandfather arrangements put into place using the above four advantages before the Bill passes, but would essentially take away the right to use these four features in the future, or to make substantial changes to arrangements in place on the day that the bill passes.

Example of Use of SLAT

An example of an appropriate SLAT arrangement might be as follows:

Howard has $1,500,000 worth of investments in an LLC that he has owned for three or four years.

He would like to have the investments available to benefit his wife, Wilma, for her lifetime, and then to pass to be held for the lifetime benefit of their children, and later their grandchildren, without being subject to federal estate tax.

Howard forms an irrevocable SLAT for Wilma and the children, and names Wilma and their friend, Frieda, as the co-trustees. Howard will have the right to replace the trustee of the trust at any time and for any reason with an individual who is not related to Howard or employed by him.

The trust provides that Wilma can make distributions to herself based upon what is reasonably needed for her health, education, maintenance, and support.[4] Frieda, as an independent trustee who is not a beneficiary of the trust, will have the power to distribute to Wilma any or all of the trust assets at any time and for any reason as Frieda determines

[4] One question is whether the beneficiary/spouse is considered to be making a gift by not withdrawing amounts as needed for health, education, maintenance, or support when he or she has the right to do so. This is a possible issue, although, to the authors' knowledge, it has not been successfully argued by the IRS. Nevertheless, the adverse effects of the spouse being considered as having made a gift to the trust could be catastrophic because if the spouse makes a contribution to the Trust that benefits him or her, then the value of the Trust attributable to such gifts will be subject to estate tax upon his or her death and may be subject to his or her creditor claims. The authors have a savings clause in the SLATs that they draft which provides that any portion of the trust that is considered to have been funded by the beneficiary-spouse may not be used for the benefit of the beneficiary-spouse.

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in her sole and absolute discretion, with no duty whatsoever to make any such distribution.[5]

The trust also gives Wilma the right to redirect how the trust assets will pass upon her death as long as they are used solely for their descendants. This is known as a "limited power of appointment."[6]

In the example, Howard retains the right to replace trust assets with assets of equal value, which makes the trust "disregarded" during Howard's lifetime for federal income tax purposes. Additionally, Wilma's status as the trustee of the trust and as a beneficiary of the trust also causes the trust to be "disregarded" for federal income tax purposes during Howard's lifetime.[7]

This results in all income and deductions of the trust being reported on the income tax return of the grantor, or the joint income tax return of the grantor and the beneficiary-spouse, if the spouses file a joint Form 1040, *U.S. Individual Income Tax Return*.

The trustee of the SLAT should file a blank Form 1041, *U.S. Income Tax Return for Estates and Trusts*, for the trust with the IRS, along with a statement indicating that the trust has been established and that all income and deductions will be reported on Howard's tax returns. It is also prudent to include a list of the income and deductions of the trust on the statement.

Additionally, the trust provides for Howard and Wilma's trusted accountant, Alex, and Howard's cousin, Charles, to serve as independent Trust Protectors who can amend the trust (but only with Wilma's consent, or the consent of Howard and Wilma's common adult children) under certain circumstances, such as to modify the trusteeship or

[5] It should be possible for the beneficiary-spouse to choose an independent trustee who can give the spouse unlimited amounts based upon the HEMS standard, but might be best to limit the scope of potential Trustees that the beneficiary-spouse can appoint to any one or more listed individuals or trust companies. In any event, it is advisable that no such independent trustee should be a relative or employee of the grantor or the grantor's spouse, and that there be no pre-existing understanding that the independent trustee would give the beneficiary-spouse "whatever he or she wants." By the same token, it is common not to have an independent trustee who could give the assets of the trust to the beneficiary-spouse in case some undue influence on both the beneficiary-spouse and the independent trustee were to apply. Notwithstanding the above, it is common to have "Trust Protectors" appointed to be able to amend a trust, and they may be given the power to direct the assets to the spouse.

[6] It is important to assure that the power of appointment be structured as a "limited" or "special" power of appointment, and not as a general power of appointment. A limited or special power of appointment is a power of appointment which is exercisable in any manner other than in favor of: (1) the powerholder herself; (2) the powerholder's creditors; (3) the powerholder's estate; or (4) creditors of the powerholder's estate. If a power of appointment allows the powerholder to exercise the power in favor of any one or more of the four above potential appointees, then the power will be considered to be a general power of appointment, and the assets subject to the power will be included in the powerholder's gross estate for federal estate tax purposes and probably would be subject to the powerholder's creditors under estate law.

Another consideration is whether the exercise of the limited power of appointment should be exercisable solely with the consent of one or more parties so as to prevent unwise or improper exercise. This approach is less common, as typically the class of appointees would be restricted so as to limit the possibility of undue influence or improper exercise of the power of appointment.

[7] An exception to grantor trust status applies if any and all distributions to the beneficiary-spouse must be approved by an "adverse party," (a party with a substantial economic interest in the trust that would be adversely affected distributions to the beneficiary-spouse) and the spouse is not a trustee of the Trust. If the beneficiary-spouse is the Trustee and beneficiary of a SLAT, then it generally will be considered to be a grantor trust with assets of the trust being considered to be owned by the grantor for income tax purposes, unless distributions to the beneficiary-spouse require the approval of an adverse party and the beneficiary-spouse resigns from being the Trustee. In that event, the trust may not be considered as owned by the grantor for income tax purposes unless the grantor has another "grantor trust power" over the Trust, such as the right to replace trust assets with assets of equal value. There are some exceptions to the rule that the beneficiary-spouse serving as Trustee would cause grantor trust status to apply, but this requires careful drafting and it is generally advisable to have the beneficiary-spouse resign as trustee if grantor trust status is not desired.

For this reason, most well-drafted SLATs provide that no distributions will be made to the beneficiary-spouse without the approval of at least one other beneficiary of the Trust.

Families having several children and grandchildren typically have no problem with this standard because if no child or grandchild will approve a distribution, they can simply be disinherited under the exercise of the beneficiary-spouse's power of appointment.

This is a good reason to let the spouse's power of appointment be exercisable to charity or other non-descendants in case there is family squabbles or the spouses wish to disinherit members of the family for actions taken after the grantor-spouse's death.

With the repeal of §682, it may difficult, if not impossible, to toggle off grantor trust status. Specifically, the repeal of §682 causes the determination of whether a beneficiary is the "grantor's spouse" to be made at the time of establishment of the trust, and does not change as a result of the later divorce of the grantor and the grantor's spouse. This therefore causes the rights and powers of such spouse to be imputed to the grantor for the purposes of determining whether the trust is a grantor trust, regardless of whether the parties later divorce. In essence, the repeal of §682 causes a trust established for the benefit of the grantor's spouse to continue to be a grantor trust for federal income tax purposes notwithstanding a divorce between the spouses. Most authorities believe that, if the power of the trustee to make distributions to the beneficiary-spouse must be approved by "an adverse party"', then grantor trust status may be toggled off even if the beneficiary-spouse remains as a beneficiary of the trust. However, this is not exactly clear following the repeal of §682.

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change the distribution standards applicable to the trust.[8]

Howard makes a gift of $100,000 to the trust and provides that his four children each have the right to withdraw up to $15,000 from the trust within 60 days of when he makes the contribution. This will cause $60,000 of the contribution not to count against Howard's $11.7 million estate and gift tax exemption if he makes no other gifts to the children during the year.

Howard also provides Wilma with a right to withdraw up to $5,000 from the trust within 60 days of his contribution. This allows for another $5,000 of the $100,000 contribution to not be considered to be a gift that will reduce Howard's lifetime exclusion. None of Wilma or the children exercise their withdrawal rights.

Howard will, therefore, file a gift tax return in the following calendar year showing use of only $35,000 of his $11.7 million dollar estate tax exemption, so it will be $11.665 million or will go to $965,000 if the Bernie Sanders Bill passes.[9]

Howard recapitalizes the ownership of his LLC so that he owns 1% of the LLC as the sole voting member and 99% as a non-voting member.

Howard then sells his 99% non-voting member interest to Wilma and Frieda, as co-trustees of the trust, in exchange for a long-term low-interest promissory note.[10]

---

[8] Another common strategy is to give the Trust Protectors the power to give the surviving spouse the right to direct trust assets to creditors of his or her estate, which should be a general power of appointment. This approach might be attractive where the estate tax is not as much as a consideration as the income tax because giving the beneficiary-spouse a general power of appointment will cause the assets to be considered as owned by him or her for federal estate and income tax purposes to allow for the assets of the trust to receive a new income tax basis equal to fair market value upon her death.

Trust Protectors may also be given the power to install a general power of appointment that can be exercised by an older or infirm relative in order to have the trust assets receive a new income tax basis on the death of the powerholder.

Under the present law, it does not appear that the powerholder needs to be a beneficiary of the trust in order to cause this to happen.

This result seems too good to be true and may, therefore, be eliminated in future tax law changes.

[9] It might be possible for the grantor/spouse and beneficiary-spouse to split the gift made to the SLAT under the "gift-splitting rule" notwithstanding that the beneficiary-spouse is a beneficiary of the trust. The effect of the split gift is that the gift is treated as having been made one-half by each spouse for federal estate and gift tax purposes, therefore reducing each spouse's exclusion amount by one-half of the value of the gift.

The IRS has taken the position that a spouse cannot split a gift to a trust of which he or she is a beneficiary where the beneficiary-spouse's interest was not terminable or severable from the other beneficiaries' interests, but the courts have limited this to situations where it is reasonably expected that the spouse will benefit from the trust, or that the amount that can be split will be reduced by whatever portion of the trust that would be expected to benefit the spouse. *See* Steiner, Bruce *Gift-Splitting Where the Spouse is a Beneficiary,* 37 Est., Gifts & Tr. J. No. 6, 320 (Nov. 8, 2012) (citing e.g. *Robertson v. Commissioner,* 26 T.C. 246 (1956).

If Mr. and Mrs. Smith have $100,000,000 in joint assets, and the trust provides that Mrs. Smith can only access the trust if and when needed for health, education, and maintenance after taking into account other sources of income and resources, then it appears the gift can be split.

If this is an issue and the trust indicates that Mrs. Smith's cumulative benefits from the trust cannot exceed $4 million then she should be able to split the gift to the extent of at least $5 million ($9 million minus $4 million) in the above example.

[10] The authors have found that the most effective use of a SLAT for a married couple with a high net worth is to facilitate an installment sale using discounts and low-interest rates that are presently available, especially after the Bernie Sanders "For the 99.5% Act" has indicated that the possibility that discounts for non-business entities and grantor trusts status (whereby the income of the trust can be reported and paid under the grantor's Form 1040 income tax return) may not be available once further tax legislation has occurred. The Bernie Sanders proposed legislation would grandfather those arrangements in place before it is passed.

Clients can be informed that most tax legislation becomes effective back to the date that it is proposed by the Ways and Means Committee of the House of Representatives, which is where tax legislation formally and technically comes into existence.

Getting defective grantor trusts and installment sales into place can take a number of weeks because of the step transaction doctrine, and it is difficult to predict when legislation may come out of the House Ways and Means Committee.

It is noteworthy that the installment sale to the SLAT should usually come only from the grantor for two primary reasons: (1) if the sale is considered to be a bargain sale by the IRS, then the grantor would be considered to be the contributor to the trust. If the beneficiary-spouse is considered to be a contributor to the trust, then a portion of the trust will be subject to federal estate tax upon such spouse's death, as discussed above; and (2) interest paid by one spouse to another spouse results in interest income, even if they file a joint Form 1040 income tax return.

The death of the grantor-spouse who has sold appreciated assets to a SLAT may cause an income tax event, according to some authorities. *See* Mulligan, Michael, *A "Reality of Sale" Analysis of Installment Sales to Grantor Trusts: Properly Structured, the Best Transfer Tax Strategy* , Lewis Rice (Aug. 2015) (citing *Mandorin v. Commissioner* 84 T.C. 667 (1985). Many authorities appear to agree that the promissory note held by grantor-spouse would receive a step-up in income tax basis upon the death of the grantor, therefore causing any payments of principal owed under the promissory note to be income tax free. Mulligan, Michael, (citing Blattmachr, Gans, and Jacobson, *Income Tax Effects of Termination of Grantor Trust Status by Reason of the Grantor's Death,* 97 J. Tax No. 3, 149 (2002) (citing *Crane v. Commissioner* 331 U.S. 1 (1947)).

On the other hand, toggling off grantor trust status during the

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If this occurs in May of 2021, then Howard and Wilma can use the lowest interest rate that applies under the "Applicable Federal Rates" that are issued by the IRS for March, April, and May of 2021. Howard's life expectancy is 20 years, so his lawyer recommends a 20-year promissory note so that if interest rates go up, the note will be locked into the low rate now available for 20 years, which requires a minimum interest rate of 1.61% per year based upon the March 2021 Applicable Federal Rate for "long-term" debt obligations (i.e., loans with a term of longer than 9 years).

Howard hires a valuation expert recommended by his certified public accountant who reviews the information about the LLC and its investments, and the valuation expert determines that a 30% valuation discount should apply to the value of a non-voting interest in the LLC.

Therefore, the promissory note will be for just under $1,039,500, and the annual interest payable will be approximately $16,735 per year based upon an annual interest rate of 1.61%. The trustee will also be able to prepay the note without penalty.

One variation to the above is for the promissory note to be "self-canceling," at least to some extent. This variation requires that the higher interest rate be used on the promissory note in exchange for the promissory note "canceling" if the "grantor" (i.e., Howard) dies during the promissory note term. The benefit of this technique is that the value of the note will not be included in Howard's estate if he were to die during the note term. The downside is that a higher interest rate must be used, which would require additional amounts of payments to be made annually and which would therefore increase Howard's gross estate for federal estate tax purposes.

The additional interest rate charged under a self-canceling installment note (SCIN) is known as a "risk premium" and generally is based upon the actuarial life expectancy if the grantor/spouse is of reasonable health when the note is entered into. It is usually appropriate that the grantor/spouse has at least a 50% chance of living to his or her actuarial life expectancy. Normally, the note will need to balloon based upon the life expectancy of the person when it is entered into.

For example, a 60-year-old has a life expectancy of 21.54 years under the current actuarial tables, and said actuarial tables provide that the applicable annual interest rate for a 21-year SCIN that would cancel if the grantor died during the 21-year term should be 3.578%. Therefore, if the 60-year-old dies before the end of the 21-year promissory note term, then the promissory note should not be considered as a taxable asset for federal estate tax purposes.

For a 50-year-old, the life expectancy under the actuarial tables is 29.88 years, and the interest rate for a 29-year interest only SCIN would be 2.63%.

For many younger clients, it therefore makes sense to use a SCIN rather than a conventional promissory note because the risk premium is low given the relatively small likelihood that the person would die during his or her actuarial life expectancy.

CREATION AND OPERATION OF THE SLAT

There are several guidelines that must be followed with respect to the creation and operation of the SLAT, in order to help assure that the trust functions as intended and that unintended adverse estate or gift tax consequences do not result. These guidelines laid out below are as follows.

First, The trust must be funded solely by the grantor-spouse, and not by the beneficiary-spouse.

If the spouse who is the beneficiary of the trust is shown to have made contributions to it and is a beneficiary of assets so contributed, then that portion of the trust that has been contributed by the beneficiary-spouse will be considered to be owned by the beneficiary-spouse upon his or her death. This can have adverse tax and creditor protection consequences because the portion of the trust that is considered to be owned by the beneficiary-spouse will be subject to estate tax upon his or her death, and also will be subject to any creditor claims against the beneficiary-spouse.

For this reason, we normally have the grantor-spouse as the sole seller and contributor of assets to the trust because if the IRS were to determine that a sale to the trust by the beneficiary-spouse was a "bargain sale/part gift," then the gift element would be considered to be a contribution in part by the beneficiary-spouse, causing the assets to be subject to estate tax to that extent.

As a protective measure, we have a provision in our trusts which provides that any contribution considered as having been made by the beneficiary's spouse will go into a separate sub-trust to benefit only descendants. Nevertheless, the IRS may not respect such a "safety clause," especially if the addition to the trust's

grantor's lifetime with an installment note in place may cause income tax to be incurred as if the sale occurred when the toggle off is completed. This may be avoided by swapping assets with the trust so that the trust does not own assets that have a fair market value exceeding the basis at the time that the trust is toggled off.

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net value by the beneficiary spouse is intended, or the result of highly aggressive conduct.

For example, if the grantor/spouse makes an $800,000 gift to the trust and the beneficiary-spouse sells an asset to the trust for $1.1 million (that is later determined to be worth $1.3 million) in exchange for a $1.1 million note, then the beneficiary-spouse may be considered to be the owner of 20% of the trust assets for estate tax purposes. The provision in our trust agreements should cause 20% of trust assets to be considered as held in a separate sub-trust for the sole benefit of the descendants of the spouses and not for the benefit of the beneficiary-spouse.

It is noteworthy that when a trust is considered to be created by one spouse for income tax purposes (for example, because that spouse funded the trust with a gift and retained the right to replace trust assets with assets of equal value), then monies owed by the trust to the other spouse will cause interest income to the other spouse and may cause an interest deduction to the grantor/spouse depending on the circumstances (such as whether the spouses itemize their deductions, and if the interest relates to a personal residence or business or investment assets).

Second, one potential issue is where assets contemplated for transfer are owned jointly or in part by the beneficiary/spouse. As described above, it is important that the beneficiary/spouse not be considered as a contributor to the trust because of the adverse estate tax and creditor protection consequences that could result.

When the beneficiary/spouse has an ownership interest in assets that the couple would like to have go into the SLAT, the grantor/spouse may purchase those assets from the beneficiary/spouse by trading assets of equal value or giving the beneficiary/spouse a bona fide promissory note that is enforceable under state law.

For example, Howard and Wilma would like for Howard to donate $ 100,000 to a trust for Wilma and descendants and sell an investment property that Howard and Wilma own jointly that is worth $400,000 to the trust.

Howard may give Wilma $200,000 from his checking account in exchange for Wilma transferring her 50% ownership in the property to Howard. Howard may then sell the property to the SLAT in exchange for a note.

As described above, if Wilma makes a sale or loans money to a trust considered as owned by Howard for income tax purposes, then Wilma will have taxable income that must be reported on her Form 1040 income tax return or the return that she and Howard file jointly, and Howard may or may not have a corresponding deduction, depending on the circumstances (such as whether Howard and Wilma itemized their deductions, and if the interest relates to a personal residence or business or investment assets).

Third, it is important to have a valuation report prepared by a qualified and reputable valuation expert to support the sale price of the asset being sold. This can help assure that the sale price is based upon the fair market value of the asset being sold and that such sale price might withstand IRS scrutiny. Nevertheless, the IRS may challenge the sale price and argue that the transaction was a "bargain sale" whereby the excess in the value of the asset over the sale price is considered to have been a gift made by the grantor/spouse.

One way to reduce the risk of a bargain sale characterization by the IRS would be to have the grantor/spouse who is selling the asset do so with "valuation adjustment clauses," which would cause a change in the sale amount if it turns out that the value of the assets transferred is more than the note received in exchange for it.

It is very important that precise language be used under these types of clauses which specifically refers to if and when a court would make a determination of a value other than what is used in a gift or sale transaction for federal gift tax purposes. A recent court case reached an unintended result when interpreting a valuation adjustment clause because the language did not contain the necessary wording.

There are three different kinds of valuation adjustment clauses:

1. A commonly used valuation adjustment clause is a "Wandry" clause, which is named after a recent court case in which a court upheld use of this type of provision.[11] The Wandry valuation adjustment clause involves stating the assets being transferred in terms of a specified dollar amount, rather than in terms of a percentage of ownership in an entity. The goal is that the percentage of ownership of an entity or asset transferred will be reduced if the IRS takes the taxpayer to court and proves that the interest was worth more than agreed. An example of the language used in this type of clause is as follows: "I hereby give to the Trustee of ABC Trust an amount of non-voting ownership interests in ABC, LLC worth $1 million in exchange for a $ 1 million promissory note."

We typically would have a valuation report showing that $1 million of non-voting LLC interests are equivalent to a specified percentage of ownership in the LLC (such as 65%). The result of the above

[11] *Wandry v. Commissioner*, T.C. Memo 2012-88.

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language is that, if it turns out that 65% of ABC, LLC is worth more than $1 million, then the percentage given will be reduced to whatever is worth $1 million.

2. A second type of valuation adjustment clause is known as a "King" clause, which also is named after a court case that approved this type of provision.[12] The King clause defines the assets transferred in terms of a percentage of ownership as is typically done under a conventional assignment document, but provides for the sale price and/or outstanding balance of the promissory note to be adjusted based upon whether the value of the assets transferred is determined to be greater than what is contemplated under the documents.

An example of the language used in a King valuation adjustment clause is as follows: "I accept a $1 million promissory note for 65% of ABC, LLC, but if it turns out that 65% of ABC, LLC is worth more than $1 million then the promissory note, with retroactive interest, will be for the appropriate greater amount."

3. The third type of adjustment clause, known as a "McCord/Petter" clause, or charitable overflow clause, involves transferring a specified number of shares, with shares equal to a defined dollar amount going to the trust with any excess passing to a charity. If the IRS takes the taxpayer to court and proves that the interest was worth more than agreed, then the number of shares exceeding the specified dollar amount would pass to charity and qualify for the charitable gift tax deduction so that no taxable gift would be made to the trust.

An overly simplified example of the language used in a McCord/Petter clause is as follows: I hereby sale transfer and assign $8 million worth of stock to the Trustee of the ABC Trust, and hereby gift $900,000 worth of stock to the Foundation, provided that if a court determines that the value of the amount of stock sold to the trust as finally determined for federal gift tax purposes exceeds $8 million, then the excess stock above the amount of $8 million will instead pass to the Foundation as a charitable gift.

Fourth, from an operational standpoint, the SLAT should be kept separate and apart from the assets of the couple, and have its own separate checking or brokerage account, and be considered a separate fiscal entity.

The SLAT does not need to file an income tax return or pay any income tax, but it is best for the SLAT to have a separate taxpayer identification number to help establish that it is a separate entity, and to facilitate it having its own bank or brokerage account. The SLAT does need to file a blank Form 1041 income tax return with a statement that basically lets the IRS know that the income and deductions of the SLAT are going onto the tax return of the donor, or the married couple if they file jointly.

As mentioned above, there is no income tax on the sale of assets to a trust that is disregarded for income tax purposes, and no interest considered to be received or paid for income tax purposes when the trust owes money and pays interest to the grantor.

It is important that the interest payments be made at least annually and that the terms of the documents are complied with to help assure that the trust and the installment sale will be respected by the IRS.

USE OF RECIPROCAL SLATS

Finally, a common question asked by clients is whether spouses can establish trusts for each other and descendants. There is something known as the "reciprocal trust doctrine" where the IRS has argued that each spouse would be considered as a beneficiary of the trust that they have established, which could lead to the assets in both trusts being included in the estate of the applicable grantor and subject to the creditor claims of the grantor/spouse.[13]

There are tax court cases and a few IRS rulings which have permitted "reciprocal SLATs,"[14] but our law firm does not recommend them or feel comfortable installing these in the way that some estate planners might.

Our concern is that the Tax Court and IRS pronouncements do not mention the creditor protection implications of reciprocal trusts. Specifically, if under state law, a creditor can reach into a reciprocal trust that spouses establish for each other (which would be based upon a "state law reciprocal trust doctrine"), then the IRS likely would take the position that the

[12] *King v. United States*, 545 F.2d 700 (10th Cir. 1976).

[13] One question is whether a trust formed in an APT jurisdiction will be considered to be "creditor proof" if the jurisdiction allows family support claims, such as alimony and child support, to be paid by the trust. For this reason, the authors prefer to use jurisdictions that do not allow for the payment of any family support obligations, such as Nevada and South Dakota. Delaware permits the claims of the spouse presently married to the grantor of the trust to be paid from the trust, but does not allow such claims of a "future spouse."

[14] *See, e.g., Estate of Levy v. Commissioner*, T.C. Memo 1983-453; *Lueders' Estate v. Commissioner*, 164 F.2d 128 (3d Cir. 1947); PLR 200426008, *but see also United States v. Grace*, 395 U.S. 316 (1969). For an excellent summary of the Reciprocal Trust Doctrine and planning to avoid its application see Bruce D. Steiner & Martin M. Shenkman, *Beware of the Reciprocal Trust Doctrine*, Trusts & Estates (Apr. 2012).

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assets in each trust are therefore subject to estate tax in the applicable grantor's state.

There is a "common law" reciprocal trust doctrine that goes back to England, which provides that if two people form trusts for each other at approximately the same time and the trusts benefit each other, then creditors of each person may reach into the trust established for them by their spouse as if they had established the trust for themselves. Florida, like many other states, has adopted the common law of England as it existed on July 4, 1776.

Therefore, our concern is that the trust would be subject to estate tax if creditors can reach into the trust as a matter of state law.

For this reason, clients who would like to consider "reciprocal trusts" should establish one or both trusts in an asset protection jurisdiction that does not allow creditors into a trust even if it is formed and funded by a beneficiary, such as Nevada, South Dakota, Alaska, and Delaware. Nevertheless, individuals residing in non-asset protection jurisdictions, such as Florida, Texas, and California, cannot be sure that the law of an asset protection jurisdiction where a trust is formed would be applicable if the debtor/grantor of the trust, the beneficiary, and the creditor are all in a state like Florida, Texas, or California that does not recognize the asset protection trust (APT) laws.

Therefore, the vast majority of our clients form one trust as a SLAT, with the beneficiary spouse forming a trust solely for descendants that may be situated in Nevada, South Dakota, Alaska, or Delaware but may allow one or both spouses to become beneficiaries only if unexpected circumstances arise, and individuals named as Trust Protectors have the discretion to add one or both spouses as a beneficiary if and when such unexpected circumstances may arise.

Nevertheless, it may be of interest that trusts that provide only for the health, education, maintenance and support of one or more beneficiaries may be moved to Nevada, South Dakota, Delaware, or another APT jurisdiction in order to provide for independent Trust Protectors to have the ability to add the grantor/spouse as a beneficiary of the trust if and when certain circumstances occur.[15] This approach can add additional flexibility, while likely avoiding any adverse estate tax or creditor issues based upon the laws of the above-referenced jurisdictions providing that the creditors of a grantor of an irrevocable trust cannot reach into a trust established for the grantor's benefit.[16]

Unexpected circumstances may include divorce and significant financial misfortune (such as the grantor's net worth dropping below a certain threshold which is far lower than the grantor's net worth as of creation of the trust).

Given that Trust Protectors may be neutral or may favor one spouse over another, the trust instrument may provide that there will be specific Trust Protectors of each separated trust in the event of divorce. Some clients are skeptical or concerned that Trust Protectors may not act in the way intended when the time comes for a potential Trust Protector action. The authors commonly give the beneficiary-spouse a right to veto actions taken by the Trust Protectors.

As a practical matter, most couples who have estate tax issues should be able to live comfortably on the assets not going into the SLAT, promissory notes that the SLAT may owe the grantor/spouse, and promis-

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[15] The vast majority of SLATs are prepared and implemented by individuals who reside in states that would allow creditors to reach into a trust where the grantor is a beneficiary. This follows the English common law and was the law of all 50 states until the 1997 when Alaska, with the assistance of Jonathan Blattmachr, passed a trust law which basically provides that a grantor's creditors cannot reach into an irrevocable trust where the Trustee has the discretion to make distributions to the grantor.

As the result of this, it appears that a SLAT formed by a couple who resides in an APT Trust jurisdiction may provide that the grantor will be a beneficiary of the trust, although the IRS has not heartily endorsed this.

Therefore, individuals who reside in APT jurisdictions may want to provide that Trust Protectors can add the grantor to the trust in their discretion so that the grantor is not considered to be a beneficiary of the trust. This assumes that the Trust Protectors are not "fiduciaries" and have full discretion as to whether to add the grantor or not.

Families residing outside of APT jurisdictions need to be even more careful because we do not yet have many court cases on the question of whether the law of a non-APT jurisdiction will apply to a trust where the grantor, beneficiaries, and creditors involved in the situation are in a state that does not recognize the APT rules.

As an additional safeguard, the authors commonly recommend that the grantor cannot be added as a beneficiary by the Trust Protectors unless an unexpected "event of independent significance" occurs, such as in the event of a divorce or if the grantor's assets and earnings become insufficient to support him, or his net worth drops below a certain level.

In addition, such trust agreements should specifically provide that the grantor is not a beneficiary that could become a discretionary beneficiary of a trust established in an APT jurisdiction.

[16] PLR 200944002 ruled that an irrevocable trust established by a grantor which he is the beneficiary would not be subject to estate tax in the grantor's estate if the grantor's creditors cannot reach into the trust under state law, so long as the grantor is not the trustee and there is not an understanding or pre-existing arrangement between the grantor and trustee that trustee's exercise his discretion to make distributions to or for the benefit of the grantor.

It is noteworthy that the laws of Nevada and South Dakota (and other states) permit a trust to be decanted or reformed to allow an independent trustee to have the power to make discretionary distributions to a beneficiary under a trust that only permitted distributions as needed for HEMS, notwithstanding whether this was consistent with the intentions of the grantor.

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sory notes that may be due from an irrevocable trust established solely from descendants (a "Descendants' Trust"), without ever having to worry about whether they might need to invade a Descendants' Trust.

As a worst-case scenario, the Descendants' Trust might make distributions to descendants who might then loan money or provide financial assistance for parents, although there cannot be an agreement or understanding that this would ever occur when a Descendants' Trust is formed and funded.

CONCLUSION

As described above, the SLAT is a versatile and flexible planning tool that can be a great fit for many clients' situations. The SLAT can provide both advantages and be subject to limitations or potential issues. It is therefore important to assure that the clients are aware of potential restrictions and implications of establishing and funding a SLAT and to program in as much flexibility as possible.

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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER

VIA EMAIL TRANSMISSION & U.S. MAIL

March 20, 2022

Under the federal estate and gift tax system, there is presently a 12,060,000) unified estate and gift tax exemption.

Under this exemption, a person can make large gifts which reduce the exemption amount for both estate and gift tax purposes.

In addition, the first $15,000 of gifts per year given directly to any one person do not count against the exemption.

For example, if you gave your brother-in-law and his wife $30,000 in a given year, this would not count against your exemption.

If you gave them $1,030,000 in a particular year, then your exemption would go down from $12,920,000 to $ $11,060,000.

You and your wife could give your brother-in-law and sister-in-law $60,000 a year without using any of your exemptions.

If you want to give your brother-in-law and sister-in-law a $600,000 house in exchange for them owing you $300,000 and giving you a mortgage on the house, you could do so this year and will be considered to have made a $300,000 gift, coming $150,000 from each of you. After accounting for each of you being considered to have used $120,000 of your $1 $12,920,000 exemptions fter accounting for $30,000 of the gifts from each of you not reducing your exemptions), which results in your exemptions being reduced to $ $11,940,000.

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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

Please keep in mind that under the "part sale part gift" income tax rules you will be considered to have sold one-half of the house for $300,000, and will therefore incur income tax if your income tax basis in the house is less than $300,000. It would be wise to get an appraisal on the home at the time of the sale so that you can support whatever your income tax reporting is on this.

Under the Bernie Sanders proposed Estate and Gift Tax Reform Bill, the gift tax exemption would come down to $1,000,000.

If you make the $120,000 exemption gift this year, as described above, then your lifetime exemption would be $880,000 after the Bernie Sanders Bill passes. Therefore, if you thereafter gift over the $15,000 per person per year amount, then the reduction would be from $880,000, and the gift tax of at least 40% (and possibly up to 65%) would be owed to the extent that you give in excess of the $880,000 during your lifetime.

In addition, the Bernie Sanders Bill would reduce the federal estate tax exemption to $3,500,000 per person, so your exemption would be $3,380,000 if the reduction occurs before or after you make a $120,000 reportable gift.

Even though it seems to me that it is unlikely that these provisions of the Bernie Sanders Bill could pass, many clients are advancing their estate tax planning under the assumption that something will happen eventually.

For example, the estate tax exemption is scheduled to come down to half of its otherwise inflation-adjusted amount in 2026 (which is expected to be approximately $6,250,000), and Congress could be in gridlock from now until well after 2026 on this issue.

Alternatively, a Democratic sweep of the House and Senate in 2022 could yield drastic changes to the federal estate and gift tax law, similar to what has been proposed by Bernie Sanders.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

The most effective combination of estate tax planning techniques for most individuals in your situation is called the "Installment Sale to a Defective Grantor Trust" and involves the following principles:

1. You can establish one or more irrevocable trusts that will pass estate tax-free but would be disregarded for income tax purposes.

2. As a result of this, you can pay the income tax on the income of the trust, without such payments being considered to be gifts for gift tax measurement purposes. This means that your exemptions would not be reduced and no gift tax would result from payments of income tax on the trust.

3. In addition, you can exchange or sell assets to the trust in exchange for other assets or a long-term low-interest note income tax-free, without this being considered to be a gift. Further, the interest on the note (which can be at a low rate) will not be considered as income to you for income tax purposes as long as the trust is disregarded for income tax purposes.

4. In addition, if you are selling or transferring minority or non-voting ownership interests in an LLC or other entity, then a discount may be taken in determining the value of what is sold or transferred. **For example**, if an LLC has $1,000,000 in underlying assets, and you transfer a 70% non-voting interest to the trust, then the value of the 70% non-voting LLC interest is probably worth something like $490,000 after accounting for a 30% valuation discount.

Please keep in mind that the Bernie Sanders Bill would grandfather arrangements put into place using the above four advantages before the Bill passes, but would essentially take away the right to use these four features in the future, or to make substantial changes to arrangements in place on the day that the Bill passes.

Please also note that the usual effective date for tax law changes is the day that a proposed bill is issued by the Ways and Means Committee of the House of Representatives, and that such releases are usually not announced in advance. Accordingly, many clients are moving forward with implementing planning to best utilize the advantages described above before they are no longer available.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

The above advantages might best be described by the following **example**:

John has $1,500,000 worth of investments in an LLC that he has owned for three or four years.

He would like to have the investments available to benefit his wife, Andrea, for her lifetime, and then to pass to be held for the lifetime benefit of their children, and later their grandchildren, without being subject to federal estate tax.

John forms an irrevocable trust for Andrea and the children, and names Andrea as the Trustee. This type of trust is sometimes known as a "Spousal Lifetime Access Trust" or a "SLAT". The Spousal Beneficiary Trust that was sent to you is a SLAT.

The Trust provides that Andrea can receive whatever she reasonably needs for her health, education, maintenance, and support, and also gives Andrea the right to redirect how the Trust assets will pass upon her death as long as they are used solely for descendants of John's parents (which may include John).

John retains the right to replace Trust assets with assets of equal value, which makes the Trust "disregarded" during John's lifetime for federal income tax purposes. Additionally, Andrea's status as the Trustee of the Trust and as a beneficiary of the Trust also causes the Trust to be "disregarded" for federal income tax purposes during John's lifetime.

John will have the right to replace the Trustee of the Trust at any time and for any reason with an individual who is not related to John or employed by him.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

John makes a gift of $100,000 to the Trust and provides that his four children each have the right to withdraw up to $15,000 from the Trust within 60 days of when he makes the contribution.

This will make $60,000 of the contribution not count against John's 12,060,000 estate and gift tax exemption if he makes no other gifts to the children during the year.

John also provides Andrea with a right to withdraw up to $5,000 from the Trust within 60 days of his contribution. This allows for another $5,000 of the $100,000 contribution to not be considered to be a gift that will reduce John's lifetime exclusion.

None of Andrea or the children exercise their withdrawal rights.

John will, therefore, file a gift tax return in the following calendar year showing use of only $35,000 of his $12,920,000 estate tax exemption, so it will be $12,025,000, or will go to $965,000 if the Bernie Sanders Bill passes.

John recapitalizes the ownership of his LLC so that he owns 1% of the LLC as the sole voting member and 99% as a non-voting member.

John then sells his 99% non-voting member interest to Andrea, as Trustee of the Trust, in exchange for a long-term low-interest promissory note.

If this occurs in March of 2022, then John and Andrea can use the lowest interest rate that applies under the "Applicable Federal Rates" that are issued by the IRS for January, February and March of 2022.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

A chart that describes the published rates that can be used for each month so far each year is as follows:

This means that if the note is for more than nine years, the interest rate can be 2.14%, with interest payable annually.

If the note is for more than three years and up to nine years, then the interest rate can be 1.74%, and if the note is for no more than three years or a demand note, then the interest rate can be .97%.

These rates are going up, and are tied to Treasury Bill interest rates.

The above rates are based upon the March 2022 rates.

If the rates stay stable or keep going up, then the best rates in May will be the March rates described above.

The interest rate differential between March and May 2022 is small, but could cause a material difference in values that have passed outside of the estate tax system over time. This is because the interest rate effectively is a "hurdle rate" whereby any appreciation above this rate will escape estate tax.

John hires a valuation expert recommended by his Certified Public Accountant who reviews the information about the LLC and its investments, and the valuation expert determines that a 30% valuation discount should apply to the value of a non-voting interest in the LLC.

Therefore, the promissory note will be for just under $1,039,500, and the annual interest payable will be approximately $18,919 per year based upon an annual interest rate of 1.82%. The Trustee will also be able to prepay the note without penalty.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

John's life expectancy is 20 years, so his lawyer recommends a 20-year promissory note so that if interest rates go up, the note will be locked into the low rate now available for 20 years.

If interest rates go down (but how much lower can they go?), then the note might be refinanced for a lower interest rate in the future.

One variation to the above is for the promissory note to be "self-canceling", at least to some extent. This variation requires that the higher interest rate be used on the promissory note in exchange for the promissory note "canceling" if the Grantor (i.e., John) dies during the promissory note term. The benefit of this technique is that the value of the note will not be included in John's estate if he were to die during the note term. The downside is that a higher interest rate must be used, which would require additional amounts of payments to be made annually and which would therefore increase John's gross estate for federal estate tax purposes.

The additional interest rate charged under a self-canceling installment note ("SCIN") is known as a "risk premium" and generally is based upon the actuarial life expectancy if the Grantor/spouse is of reasonable health when the note is entered into. It is usually appropriate that the Grantor/spouse has at least a 50% chance of living to his or her actuarial life expectancy. Normally, the note will need to balloon based upon the life expectancy of the person when it is entered into.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

For example, a 60-year-old has a life expectancy of 21.54 years under the current actuarial tables, and said actuarial tables provide that the applicable annual interest rate for a 21-year SCIN that would cancel if the Grantor died during the 21-year term should be 3.578%. Therefore, if the 60-year-old dies before the end of the 21-year promissory note term, then the promissory note should not be considered as a taxable asset for federal estate tax purposes.

For a 50-year-old, the life expectancy under the actuarial tables is 29.88 years, and the interest rate for a 29-year interest only SCIN would be 2.63%.

For many younger clients, it therefore makes sense to use a SCIN rather than a conventional promissory note because the risk premium is low given the relatively small likelihood that the person would die during his or her actuarial life expectancy.

There are several guidelines that must be followed with respect to the creation and operation of the SLAT, in order to help assure that the Trust functions as intended and that unintended adverse estate or gift tax consequences do not result. These guidelines are as follows:



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

There are several guidelines that must be followed with respect to the creation and operation of the SLAT, in order to help assure that the Trust functions as intended and that unintended adverse estate or gift tax consequences do not result. These guidelines are as follows:

1. The Trust must be funded solely by the donor/spouse, and not by the beneficiary/spouse.

If the spouse who is the beneficiary of the Trust is shown to have made contributions to it and is a beneficiary of assets so contributed, then that portion of the Trust that has been contributed by the beneficiary's spouse will be considered to be owned by the spouse/beneficiary upon his or her death. This can have adverse tax and creditor protection consequences because the portion of the Trust that is considered to be owned by the spouse/beneficiary will be subject to estate tax upon his or her death, and also will be subject to any creditor claims against the spouse/beneficiary.

For this reason, we normally have the donor/spouse as the sole seller and contributor of assets to the Trust because if the IRS were to determine that a sale to the Trust by the beneficiary/spouse was a "bargain sale/part gift," then the gift element would be considered to be a contribution in part by the beneficiary/spouse, causing the assets to be subject to estate tax to that extent.

As a protective measure, we have a provision in our Trusts which provides that any contribution considered as having been made by the beneficiary's spouse will go into a separate subtrust to benefit only descendants. Nevertheless, the IRS may not respect such a "safety clause," especially if the addition to the Trust's net value by the beneficiary spouse is intended, or the result of highly aggressive conduct.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

For example, if the donor/spouse makes an $800,000 gift to the Trust and the beneficiary/spouse sells an asset to the Trust for $1,100,000 (that is later determined to be worth $1,300,000) in exchange for a $1,100,000 note, then the beneficiary/spouse may be considered to be the owner of 20% of the trust assets for estate tax purposes. The provision in our Trust Agreements should cause 20% of trust assets to be considered as held in a separate subtrust for the sole benefit of the descendants of the spouses and not for the benefit of the beneficiary/spouse.

It is noteworthy that when a Trust is considered to be created by one spouse for income tax purposes (**for example**, because that spouse funded the Trust with a gift and retained the right to replace trust assets with assets of equal value), then monies owed by the Trust to the other spouse will cause interest income to the other spouse and may cause an interest deduction to the donor/spouse depending on the circumstances (such as whether the spouses itemize their deductions, and if the interest relates to a personal residence or business or investment assets).



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

2. One potential issue is where assets contemplated for transfer are owned jointly or in part by the beneficiary/spouse. As described above, it is important that the beneficiary/spouse not be considered as a contributor to the Trust because of the adverse estate tax and creditor protection consequences that could result.

When the beneficiary/spouse has an ownership interest in assets that the couple would like to have go into the SLAT, the donor/spouse may purchase those assets from the beneficiary/spouse by trading assets of equal value or giving the beneficiary/spouse a bona fide promissory note that is enforceable under state law.

For example, John and Mary Smith would like for John to donate $100,000 to a trust for Mary and descendants and sell an investment property that John and Mary own jointly that is worth $400,000 to the trust.

John may give Mary $200,000 from his checking account in exchange for Mary transferring her 50% ownership in the property to John. John may then sell the property to the SLAT in exchange for a note.

As described above, if Mary makes a sale or loans money to a trust considered as owned by John for income tax purposes, then Mary will have taxable income that must be reported on her Form 1040 Income Tax Return or the return that she and John file jointly, and John may or may not have a corresponding deduction, depending on the circumstances (such as whether John and Mary itemized their deductions, and if the interest relates to a personal residence or business or investment assets).



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

3. It is important to have a valuation report prepared by a qualified and reputable valuation expert to support the sale price of the asset being sold. This can help assure that the sale price is based upon the fair market value of the asset being sold and that such sale price might withstand IRS scrutiny. Nevertheless, the IRS may challenge the sale price and argue that the transaction was a "bargain sale" whereby the excess in the value of the asset over the sale price is considered to have been a gift made by the donor/spouse.

One way to reduce the risk of a bargain sale characterization by the IRS would be to have the donor/spouse who is selling the asset do so with "valuation adjustment clauses," which would cause a change in the sale amount if it turns out that the value of the assets transferred is more than the note received in exchange for it.

It is very important that precise language be used under these types of clauses which specifically refers to if and when a court would make a determination of a value other than what is used in a gift or sale transaction for federal gift tax purposes. A recent court case reached an unintended result when interpreting a valuation adjustment clause because the language did not contain the necessary wording.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

There are two different kinds of valuation adjustment clauses:

A. A commonly used valuation adjustment clause is a "Wandry" clause, which is named after a recent court case in which a court upheld use of this type of provision. The Wandry valuation adjustment clause involves stating the assets being transferred in terms of a specified dollar amount, rather than in terms of a percentage of ownership in an entity. The goal is that the percentage of ownership of an entity or asset transferred will be reduced if the IRS takes the taxpayer to court and proves that the interest was worth more than agreed. **An example** of the language used in this type of clause is as follows: "I hereby give to the Trustee of ABC Trust an amount of non-voting ownership interests in ABC, LLC worth $1,000,000 in exchange for a $1,000,000 promissory note."

We typically would have a valuation report showing that $1,000,000 of non-voting LLC interests are equivalent to a specified percentage of ownership in the LLC (such as 65%). The result of the above language is that, if it turns out that 65% of ABC, LLC is worth more than $1,000,000, then the percentage given will be reduced to whatever is worth $1,000,000.

B. A second type of valuation adjustment clause is known as a "King" clause, which also is named after a court case that approved this type of provision. The King clause defines the assets transferred in terms of a percentage of ownership as is typically done under a conventional assignment document, but provides for the sale price and/or outstanding balance of the promissory note to be adjusted based upon whether the value of the assets transferred is determined to be greater than what is contemplated under the documents.

An example of the language used in a King valuation adjustment cause is as follows: "I accept a $1,000,000 promissory note for 65% of ABC, LLC, but if it turns out that 65% of ABC, LLC is worth more than $1,000,000, then the promissory note, with retroactive interest, will be for the appropriate greater amount."



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

4. From an operational standpoint, the SLAT should be kept separate and apart from the assets of the couple, and have its own separate checking or brokerage account, and be considered a separate fiscal entity.

The SLAT does not need to file an income tax return or pay any income tax, but it is best for the SLAT to have a separate taxpayer identification number to help establish that it is a separate entity, and to facilitate it having its own bank or brokerage account. The SLAT does need to file a blank Form 1040 income tax return with a statement that basically lets the IRS know that the income and deductions of the SLAT are going onto the tax return of the donor, or the married couple if they file jointly.

As mentioned above, there is no income tax on the sale of assets to a trust that is disregarded for income tax purposes, and no interest considered to be received or paid for income tax purposes when the trust owes money and pays interest to the Grantor.

It is important that the interest payments be made at least annually and that the terms of the documents are complied with to help assure that the trust and the installment sale will be respected by the IRS.



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EXPLAINING THE SLAT TO CLIENTS- A SAMPLE COVER LETTER, CONTINUED

5. A common question asked by clients is whether spouses can establish trusts for each other and descendants. There is something known as the "reciprocal trust doctrine" where the IRS has argued that each spouse would be considered as a beneficiary of the Trust that they have established, which could lead to the assets in both Trusts being included in the estate of the applicable Grantor and subject to the creditor claims of the Grantor spouse.

There are two tax court cases and a few IRS rulings which have permitted "reciprocal SLATS," but our law firm does not recommend them or feel comfortable installing these in the way that some estate planners might.

Our concern is that the tax court and IRS pronouncements do not mention the creditor protection implications of reciprocal trusts. Specifically, if under state law, a creditor can reach into a reciprocal trust that spouses establish for each other (which would be based upon a "state law reciprocal trust doctrine"), then the IRS likely would take the position that the assets in each trust are therefore subject to estate tax in the applicable Grantor's state.

There is a "common law" reciprocal trust doctrine that goes back to England, which provides that if two people form trusts for each other at approximately the same time and the trusts benefit each other, then creditors of each person may reach into the trust established for them by their spouse as if they had established the trust for themselves. Florida, like many other states, has adopted the common law of England as it existed on July 4, 1776.



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Therefore, our concern is that the Trust would be subject to estate tax if creditors can reach into the Trust as a matter of state law.

For this reason, clients who would like to consider "reciprocal trusts" should establish one or both trusts in an asset protection jurisdiction that does not allow creditors into a trust even if it is formed and funded by a beneficiary, such as Nevada, South Dakota, Alaska, and Delaware. Nevertheless, individuals residing in non-asset protection jurisdictions, such as Florida, Texas, and California, cannot be sure that the law of an asset protection jurisdiction where a trust is formed would be applicable if the debtor/grantor of the trust, the beneficiary, and the creditor are all in a state like Florida, Texas or California that does not recognize the asset protection trust laws.

Therefore, the vast majority of our clients form one trust as a SLAT, with the beneficiary spouse forming a trust solely for descendants that may be situated in Nevada, South Dakota, Alaska, or Delaware but may allow one or both spouses to become beneficiaries only if unexpected circumstances arise, and individuals named as Trust Protectors have the discretion to add one or both spouses as a beneficiary if and when such unexpected circumstances may arise.

Unexpected circumstances may include divorce and significant financial misfortune (such as the Grantor's net worth dropping below a certain threshold which is far lower than the Grantor's net worth as of creation of the Trust).

As a practical matter, most couples who have estate tax issues should be able to live comfortably on the assets not going into the SLAT, promissory notes that the SLAT may owe the Grantor/spouse, and promissory notes that may be due from an irrevocable trust established solely from descendants (a "Descendants' Trust), without ever having to worry about whether they might need to invade a Descendants' Trust.

As a worst-case scenario, the Descendants' Trust might make distributions to descendants who might then loan money or provide financial assistance for parents, although there cannot be an agreement or understanding that this would ever occur when a Descendants' Trust is formed and funded.

Please do not hesitate to contact us if you have any questions or if you would like to discuss this further.

We appreciate the opportunity to be of service.

Best personal regards,

VIA EMAIL & U.S. MAIL



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Contingent Marital Devise Provision

In the highly unlikely event that the Grantor's contributions to this Trust exceed the maximum amount that can be gifted by the Grantor without incurring Federal Gift Tax, then the Trustee shall divide the Trust estate into two separate shares, hereinafter designated as the SMITH FAMILY TRUST SHARE and the SMITH MARITAL DEDUCTION TRUST SHARE. The SMITH FAMILY TRUST SHARE shall be a fraction of the Trust estate of which (a) the numerator shall be the largest amount that if allowed using the Grantor's Federal Gift Tax Exemption would result in no Federal Gift Tax being payable by the Grantor by reason of the gift to this Trust, and (b) the denominator shall be the value as finally determined for Federal Gift Tax purposes of the assets in the Trust estate immediately after such gift that would have otherwise caused gift tax to be imposed has been made. The SMITH MARITAL DEDUCTION TRUST SHARE shall be the remainder of the Trust estate. No property shall be allocated to the SMITH MARITAL DEDUCTION TRUST SHARE that would not qualify for the Federal Gift tax Marital Deduction and the Federal Estate Tax Marital Deduction. The SMITH FAMILY TRUST SHARE shall be held pursuant to the terms of Section ____ and Article ____ of this Trust. The SMITH MARITAL DEDUCTION SHARE shall be held for the benefit of the Grantor's spouse, pursuant to Section ____ below.

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If The Grantor's Spouse Is A Contributor To This Trust

To take into account that the Grantor's spouse may be considered to be the contributor of certain assets to this Trust, and should thereby not have any right to receive distributions or benefits from any such Trust that the Grantor's spouse has funded, in the event that for any reason the Grantor's spouse is considered to be the contributor or co-contributor of assets to this Trust or any trust herein established, then such assets shall be set aside and held as a separate trust, in a manner identical to the provisions set forth in Section 5.01(b) hereof, provided that no distributions whatsoever shall be made to the Grantor's spouse from such separate subtrust, and that no power of appointment otherwise exercisable by the Grantor's spouse shall be considered to be exercisable or exercised, notwithstanding any provision herein to the contrary.

The purpose of this provision is to avoid having the Grantor's spouse be considered the owner of any Trust assets for purposes of Internal Revenue Code Section 2036(a)(1) and (2) or any Treasury Regulations set forth therein. Consistent therewith, the Grantor's spouse shall not be the Trustee of any such separate trust and any acting Co-Trustee shall have the power to act without joinder or consent of the Grantor's spouse as to any such trust.



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ECT Trusts

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Exception Creditor Issues and the ECT Trust

- Exception creditors are classes of creditors, determined by state law, that are able to access the trust assets despite the existence of a domestic asset protection trust (DAPT) statute or a spendthrift provision within the trust.

- The jurisdictions that most lawyers who prepare and implement asset protection trusts to be the “best” are states that do not allow such “exception creditors.” Nevada and Utah are the only DAPT states that have no statutory exception creditors.



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Land Mines and Safe Havens for SLAT Planning — Part 1

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INTRODUCTION

Spousal Lifetime Access Trusts (SLATs), which traditionally are nonmarital deduction trusts that one spouse creates for the other, remain in vogue and the scheduled reduction in the bonus exemption amount in 2026 (from $10 million inflation adjusted down to $5 million inflation adjusted) will likely precipitate a surge of new SLAT plans before the end of 2025. This may happen earlier if legislation is enacted that causes the reduction to take effect before then. The recent wave of SLATs completed in 2020–2022, and the coming surge in SLAT plans make it imperative that practitioners remain cognizant of potential land mines in SLAT planning. This has been made more complex by recent changes in the law which have created new traps for the unwary. For example, Florida recently passed a new law which will make certain SLATs more attractive to Florida residents by permitting the settlor of a SLAT to be a beneficiary of the trust following the death of the settlor's spouse. In addition to Florida, 10 other states have "SLAT Friendly" legislation which provide that the contributing spouse of a SLAT will not be treated as the contributor spouse upon the death of the initial beneficiary spouse.[1] Moreover, in virtually all so-called DAPT (domestic asset protection trust) states, such as Alaska, Delaware, South Dakota, and Nevada, such a SLAT trust can be created without specific SLAT legislation.

Practitioners should also be well versed on:

- "Exception creditors" who may be able to reach into an otherwise creditor proof SLAT.
- The effect of the reciprocal trust doctrine when establishing two similar SLATS for both spouses in a marriage.
- The implications of §2036[2] and §2038 with regard to gross estate inclusion for estate tax purposes. Just as §2036(a)(2) came and snuck up on the estate planning community in the Family Limited Partnership and Limited Liability Company (LLC) arena, what might happen in the SLAT arena as well?

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Jonathan G. Blattmachr is the co-developer of Wealth Transfer Planning, a computerized system that is able to produce estate planning documents. Jonathan is the editor-in-chief of the Interactive Legal Systems and is the Director of Estate Planning for the Alaska Trust Company and a Director of Pioneer Wealth Partners, LLC in a boutique wealth advisory firm in Manhattan

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[1] The other 10 states are as follows: Mississippi (Miss. Code §91-8-504(d)); Virginia (Va. Code §64-2-747); Arizona (AZ. Rev. Stat. §14-10505(e)(3)); Arkansas (AR. Code §28-73-505(c)(1)); Georgia (O.C.G.A. §53-12-82); North Carolina (N.C. G.S. §36C-5-505(c)(2)); South Carolina (SC. Code §62-7-505); Oregon (OR. Rev. Stat. §130.315); Texas (Tex. Prop. Code Ann. §112.035(g)); Wisconsin (Wisc. Stat. §701.0505(2)(e)).

[2] All section references herein are to the Internal Revenue Code of 1986, as amended (the Code), or the Treasury regulations promulgated thereunder, unless otherwise indicated.



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The following points will be addressed in a later installment of this article:

- The recent *Smaldino v. Commissioner*[3] opinion, which highlighted not only step-transaction risks to SLAT planning, but a veritable checklist of other mistakes that might torpedo SLAT plans.
- Insurance and financial planning risks SLAT planning may create, and proactive steps that practitioners might suggest to clients to mitigate these risks.

EXCEPTION CREDITORS

In states that have both (a) a law which permits the donor/settlor spouse of a SLAT to become a beneficiary of the trust after the death of the initial beneficiary spouse, and (b) an "exception creditor" statute, exception creditors may be able to reach into the otherwise "creditor proof" SLAT immediately after formation. Exception creditors are a special category of creditors that may be permitted to access assets held under a trust that otherwise would be immune from claims of the creditors of the beneficiary.

The statutorily authorized exception creditors vary by state. Uniform Trust Code (UTC) §503(b) provides that even if a trust contains a spendthrift provision, (a) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, or (b) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, may obtain a court order attaching present and future distributions to or for the benefit of the beneficiary. This often can be done notwithstanding the presence of a spendthrift provision in the trust instrument (that is, a provision that prohibits the attachment of assets by a creditor of the trust beneficiary). Additionally, spendthrift provisions are generally unenforceable against a claim of the state in which the trust is administered or of the United States.[4] The exception creditor laws only apply to creditors of the beneficiary. However, the creditor exception laws can apply to the creditors of a settlor if the settlor will become a beneficiary after the death of his spouse. And if the trust can reimburse the settlor for income taxes on trust income attributed to the settlor, then the settlor may be characterized as a beneficiary because of that.

Additionally, so long as the settlor is alive, the IRS may claim that the settlor's ability to incur debt that could be enforced against the trust, thereby "relegating" his or her creditors to the trust assets, is the equivalent of the retention of economic access to the trust assets.[5] Such retention of economic access may result in the inclusion of the trust corpus in the gross estate of the settlor under §2036 and §2038.[6] A settlor may be deemed to be a beneficiary who can cause debt to be paid by exception creditors if the settlor would become a beneficiary after the spouse's death, or the settlor may receive a reimbursement of taxes.

It is worth noting with regard to the exception creditor concern that the doctrine of "acts of independent significance" is often overlooked. This doctrine provides that certain actions or circumstances which are taken or experienced by a settlor are generally beyond his or her control and should not be considered to be a retained right in violation §2036.[7] Although not specifically tested in this situation, the rise of certain exception creditor claims may be deemed to be independent acts of significance, such as having or adopting children, or divorcing one's spouse.[8]

THE EXCEPTION CREDITOR TRUST PLAN

The exception creditor concern may potentially be mitigated by having the SLAT actually be two separate trusts from inception. The two trusts could be identical, although one trust would provide that any distributions to satisfy the claims of exception creditors against either trust would come from that trust (this trust could be known as the "exception creditor trust" or the "ECT" trust). The second trust (the non-ECT trust) would provide that the settlor would be excluded as a beneficiary completely if and when the ECT trust has a net worth of less than a reasonable amount, such as $500,000, sufficient to pay the creditor's claim. Under such an arrangement, it would ap-

[3] T.C. Memo 2021-127.

[4] UTC §503.

[5] *See* Rev. Rul. 76-103.

[6] Notwithstanding the fact that "SLAT Friendly" legislation generally provides that the contributor spouse will not be considered to have contributed to the trust for creditor purposes if the settlor becomes a beneficiary after the death of the settlor's spouse.

[7] Rev. Rul. 80-255 indicates that "the act of bearing or adopting children is an act of independent significance, the incidental and collateral consequence of which is to add the child as beneficiary to the trust." Additionally, in *Estate of Tully v. United States*, 528 F.2d 1401 (Ct. Cl. 1976), the taxpayer successfully argued that the ability of the decedent to divorce her wife, thereby depriving her of a business-related death benefit that would have otherwise been owed to her by the decedent's business part upon his death, did not result in estate tax inclusion. *See also Ellis v. Commissioner*, 51 T.C. 182 (1968), *aff'd*, 437 F.2d 442 (9th Cir. 1971) (failure to support a spouse and thereby trigger payments to her from a trust was not sufficient to render the gift to the trust incomplete).

[8] See Note 7, above.

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pear unlikely, if not impossible, for the non-ECT trust to be exposed to the claims of exception creditors.

The concept is that if a creditor is paid the creditor cannot pursue the (second, non-ECT) SLAT until the first trust runs dry. The same trustee can handle both trusts. The objective is to safeguard the trust assets from §2036(a) inclusion in an exception creditor jurisdiction. Consider that a claim may arise at a later date, after the trust is formed and funded, such as when the issue occurs. If a client created a SLAT today and has no creditors but may marry and not pay alimony, then this right may be considered an §2036(a) retained interest.

As further discussed below, the arrangement described above should also not implicate the reciprocal trust doctrine (under which the identity of each grantor is "switched") due to the fact that the same settlor would establish trusts.

An alternative drafting strategy which may help to alleviate exception creditor concerns would be to have the SLAT divide into three separate trusts:

1. The ECT Trust;

2. A trust that would benefit the settlor after the death of the settlor's spouse, unless or until the ECT trust is invaded by an exception creditor or, in the sole judgment of the independent trustee, such invasion appears likely or imminent; and

3. A trust that would not benefit the settlor whatsoever.

As an illustration, a settlor intending to place $10 million into a SLAT may be comfortable only being able to benefit from $5 million worth of assets, and to whatever they may grow. If the settlor were to divide the SLAT into three separate trusts, the ECT trust could be funded with $500,000, the second trust for the benefit of the settlor after the death of the settlor's spouse could be funded with $4.5 million and the third trust that would not benefit the settlor whatsoever may be funded with $5 million. If possible, the amount to be allocated to each trust in the proposed structure might be estimated by a financial forecast, etc.

It may be safest to set these up from inception and administer these as three separate SLATs.[9]

A simpler and possibly effective alternative would be to simply provide in the trust agreement that any withdrawals from the trust passing to or for exception creditors exceeding a total of a relatively material amount, such as $500,000, would cause the beneficiary to no longer be a beneficiary of the trust whatsoever. This should limit the inclusion of the trust assets in the settlor's estate on the death of the beneficiary to $500,000 and would seem to insulate the rest of the trust assets from being subject to federal estate tax.

TAX REIMBURSEMENT CLAUSES

Rev. Rul. 2004-64 has been important authority on the question of whether a trustee's discretionary power to reimburse the settlor for income tax constituted a retained right such that the trust assets would be includible in the settlor's gross estate for estate tax purposes. Ultimately, the IRS ruled that the trustee's discretion to reimburse would not alone cause inclusion of the trust assets in the settlor's estate. But the IRS qualified its stance by stating that applicable local law subjecting the trust assets to the claims of creditors (or if there was an understanding the trustee would so reimburse the grantor) may cause inclusion of the assets in the grantor's gross estate.[10] In response, states began enacting laws that provide that creditors of the grantor cannot invade a trust simply because the trustee has the ability reimburse the grantor for taxes paid.

PLR 200944002 (not precedent) added context to Rev. Rul. 2004-64 by stating that "[i]f, pursuant to the trust's governing instrument or applicable state law, the grantor had to be reimbursed by the trust for the income tax payable by the grantor that was attributable to the trust's income, the full value of the trust's assets would be includible in the grantor's gross estate under §2036."[11]

PLR 200944002 then stated that "[i]f, however, the trust's governing instrument or applicable local law gave the trustee the *discretion* to reimburse the grantor for that portion of the grantor's income tax liability, the existence of that discretion, by itself, *whether or not exercised*, would *not* cause the value of the trust's assets to be includible in the grantor's gross estate."[12]

Nevertheless, a few commentators express some uncertainty that Rev. Rul. 2004-64 completely eliminates the possibility for inclusion under §2036. For

[9] Administration of the three SLATs separately should not be an inconvenience because the SLATs may not have to file income tax returns if all income deductions have been reported on the settlor's income tax return because it is a grantor trust (one from which the income of the trust is attributed directly to the grantor). Some practitioners recommend that a grantor trust return be filed. Other practitioners recommend just filing an informational letter with the IRS and not filing a return for such a disregarded trust.

[10] Shop Talk, *New Ruling on Consequences When Grantor Is Taxed on Trust's Income*, 101 J. of Tax'n 253 (Oct. 2004).

[11] The ruling did not differentiate between §2036(a)(1) and §2036(a)(2).

[12] (emphasis added). PLR 200944002 also added that "other facts" may cause inclusion of a trust's assets in the grantor's gross estate for federal estate tax purposes.

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example, Richard Nenno, Esq., of Delaware, advises[13] against the use of a discretionary tax reimbursement right in states[14] that do not statutorily authorize such a reimbursement right.

There are differing views on this. It appears that many practitioners routinely use tax reimbursement clauses. Some speakers/commentators have said that it is questionable not to. Yet other practitioners believe that there is danger in using tax reimbursement clauses and do not use them or provide a structure whereby trust protectors have discretion, but no fiduciary duty, to install them.

OTHER §2036 AND §2038 TRAPS WHICH MAY SPOIL THE PLAN

Actions or arrangements which cause the settlor to be considered a beneficiary of the SLAT before the death of the settlor's spouse, may risk inclusion of the trust assets in the estate of the settlor. This might include any action or arrangement whereby the settlor benefits from the SLAT, whether directly or indirectly. In a state, such as Florida, that permits the settlor spouse to be added back as a beneficiary without subjecting the trust to claims of the settlor's creditors after the death of the beneficiary spouse this issue would apply only before the death of the settlor's spouse.

For example, estate planning professionals should be aware that if the corpus or income of a trust can be used for the purpose of discharging the settlor's legal obligations to support a beneficiary of the trust and the settlor passes away, the trust property may be treated as reserved by the settlor and therefore included in the settlor's estate.[15]

For purposes of avoiding gross estate inclusion, provisions which give the trustee absolute discretion are a taxpayer's friend. The courts and the IRS (in at least one situation) have concluded that if the trustee of the trust has the absolute and uncontrolled discretion as to if and when to make to distributions to the settlor, and there is no preexisting understanding or arrangement that the distributions be made, the §2036 should not apply, because the settlor does not have the "right" to benefit from the trust, but only "a hope or passive expectancy."[16]

In addition, the use of provisions which require the consent of an adverse party in order for a power to be exercisable are favorable for purposes of avoiding inclusion in the gross estate of the settlor.[17] It is, therefore, recommended to provide under the SLAT that one or more beneficiaries other than the contributor would need to consent to any distribution being made to the settlor. It is noteworthy, however, that powers which are exercisable by the settlor only with the consent of a nonadverse party are treated as if there were a power held alone by the settlor under §2036(a).[18]

There are other practical precautions that practitioners might suggest to clients to address these issues. For example, it may be advisable to have each spouse maintain a separate bank account so that distributions from a SLAT to a beneficiary spouse are deposited in that beneficiary spouse's own bank account not a joint bank account. For example, assume husband creates a SLAT for wife and descendants. The trustee makes a distribution to wife which is deposited into a joint bank account. Husband uses the joint bank account to pay expenses that are his lifestyle or living expenses. Might this constitute an impermissible indirect benefit to husband causing estate tax inclusion in his gross estate?

Under applicable case law, it may be safe for the settlor spouse to make use of a residence owned by a SLAT but the beneficiary spouse also resides in because of the spousal relationship. Nevertheless, some practitioners recommend that fair market value rent be paid for any use of a property in a SLAT by the settlor.[19]

Another approach practitioners might consider is to include a mechanism in the SLAT to address possible

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[13] Richard W. Nenno, *Federal Income and Transfer-Tax Consequences of Domestic Asset Protection Trusts*, 45 Tax Mgmt. Ests., Gifts & Trs. J. No. 2, 75 (Mar. 12, 2020).

[14] The following states currently have express statutory authority permitting grantor reimbursement: Delaware (12 Del. C. §3344); New Hampshire (N.H. Rev. Stat. §564-B:8-816); Florida (Fla. Stat. Ann. §736.08145); Colorado (C.R.S. §15-5-818); Connecticut (C.G.S. §445A–499); New York (N.Y. EPTL §7-1.11).

[15] Reg. §20.2036-1(b)(2). If for any such period the use, possession, rents, or other income (in whole or in part) were to be disposed of in discharge of a legal obligation of the decedent or otherwise for his pecuniary benefit, then to that extent the use, possession, rents, or other income will be treated as having been reserved to or retained by the decedent.

[16] Rev. Rul. 77-378; *In re Uhl's Est.*, 241 F.2d 867 (7th Cir. 1957).

[17] In *Estate of German v. United States*, 7 Cl. Ct. 641 (1985), the IRS was not entitled to assess estate tax deficiency for value of property decedent transferred to six trusts with provision that trustees had power at any time in their absolute and uncontrolled discretion to pay to or apply for benefit of decedent all or part of net income and principal as trustees should determine, subject to condition that trustees receive written consent of respective beneficiary of particular trust and written consent of trust committee comprised of individuals who were not beneficiaries of the trust, notwithstanding contention that value of trusts was properly includable in gross estate because decedent had not disposed of the property, where the IRS did not establish that under Maryland law, which governed the trust, creditors of decedent could have reached income or principal of the trusts up to time of her death. §2036, §2038.

[18] *Cf.* Reg. §25.2511-2(c).

[19] *Estate of Guichess v. Commissioner*, 46 T.C. 554 (1966).

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errors in paying expenses of the settlor spouse inadvertently. Consider the following:

> ***Lifestyle Expense Distribution Reimbursement Provision.*** *Recognizing the difficulty of delineating which expenses of the spouse beneficiary are those of that spouse beneficiary versus those of the settlor spouse, the trustee and the spouse beneficiary agree to the following reimbursement provision. By accepting any distribution from this trust, the spouse beneficiary agrees to this reimbursement provision. If the trust makes a distribution to the spouse beneficiary under the terms of the trust believing that those expenses for which the distribution is being made are for the beneficiary spouse, and those expenses are later determined by the trustee or another beneficiary, a creditor, or a tax authority, to be expenses of the other spouse (who is the settlor of the trust), then the recipient beneficiary spouse agrees to reimburse the trust for such inadvertent disbursement with such interest from the date of each occurrence of such expense reimbursement distributions until the date of repayment to prevent such disbursement from constituting a retained interest in the trust for purposes of §2036 and §2038.*

THE RELATION BACK DOCTRINE

Much of the literature in this arena glosses over the issue of the relation back doctrine, which can cause the grantor of a "first trust" to be considered to also be the grantor of a subsequent trust resulting from the exercise of a power of appointment under the first trust. The doctrine minimizes the importance of the powerholder, treating the powerholder as a mere conduit or agent (with no property interest) for the donor of the power.

Attorneys Barry and Cassandra Nelson of Florida succinctly describe how the doctrine may apply in the SLAT context:

> Providing the initial donee of a SLAT a special power of appointment to direct the SLAT assets back to the initial settlor, as compared to retaining a reversion in a SLAT in favor of the settlor, may not change the estate tax consequences to the settlor due to the Relation Back Doctrine. . . . As a result, assets passing from a SLAT back to a credit shelter trust for the initial settlor may be considered to be held in a self-settled trust and therefore subject to estate tax inclusion for the settlor spouse.[20]

In "SLAT Friendly" jurisdictions, which have statutes providing that property contributed to a SLAT is not considered to have been contributed by the settlor in certain circumstances, negate the effect of the relation back doctrine. This is due to the fact that such statutes cause the settlor of the "first trust" to not be treated as a settlor for creditor protection purposes, and therefore a subsequent trust resulting from the exercise of a power of appointment provided under the first trust will not "relate back" to the original settlor.[21]

Alexander Bove, Esq., of Boston, observes the following about the relation back doctrine:

> Commentators have observed that the relation back doctrine is provided as a means of rendering the transaction legally "sound" from a property law standpoint, as without it, no one would be making the transfer. Thus, it is not clear that a court would actually hold that it was a transfer from the donor to a trust for his own benefit through a powerholder's discretionary exercise of a power of appointment, but it is a risk.[22]

WHAT ABOUT THE RECIPROCAL TRUST DOCTRINE?

An additional point of consideration is the situation where spouses may each attempt to establish a SLAT for the other in order to increase the amount transferred outside of their taxable estates, while preserving access to the assets involved. When considering such an arrangement, draftsmen should be particularly cautious of the effects of the reciprocal trust doctrine. The reciprocal trust doctrine provides that when two trusts are established which name the settlor of each trust as the beneficiary of the other, and the establishment of such trusts leaves the settlors in roughly the same economic position as if they had made themselves lifetime beneficiaries of the trusts they had created, each settlor may be deemed to be the settlor of the trust actually created by the other.[23] The primary concern with the reciprocal trust doctrine is that

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[20] Barry A. Nelson and Cassandra S. Nelson, *6 Question 2018 Gift Suitability Analysis*, Leimberg Information Services, Inc. (Mar. 22, 2018).

[21] *See* Steve R. Akers, *ACTEC 2020 Annual Meeting Musings*, 46 (Mar. 2020). Noting that "the spouse may decide to have all or some of the assets pass into a trust with the settlor as a discretionary beneficiary (depending on whether DAPT legislation or a statute reversing the "relation back doctrine" applies to the continuing trust for the settlor)."

[22] Alexander A. Bove, Jr., *Using the Power of Appointment to Protect Assets-More Power Than You Ever Imagined*, 36 ACTEC L.J. 333, 337 (2010).

[23] *United States. v. Estate of Grace*, 395 U.S. 316, 324 (1969),

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avoiding it may be difficult; there's no clearly defined line or safe harbor as to what constitutes a sufficient different between two trusts to avoid the reciprocal trust doctrine.[24] Therefore, it is commonly recommended to draft the trusts as different as practicable given the client's circumstances.

One problem that arises under the reciprocal trust doctrine is how the IRS will treat such trusts with respect to §2036. In short, if a court holds that the two trusts violate the reciprocal trust doctrine, the trusts will be treated as self-settled, and each settlor's estate will include the assets of the other's trust under §2036.

Estate planning professionals may consider drafting methods such as varying the funding structure of each trust, designating independent trustees for each trust, or differentiating the powers given to the trustee and beneficiaries of the two trusts to mitigate the potential for application of the reciprocal trust doctrine. The case of *Estate of Levy v. Commissioner*[25] is particularly favorable on this front. There, the Tax Court held that two otherwise identical trusts were not reciprocal because one of the trusts had an *inter vivos* special limited power of appointment. The Tax Court accepted the argument that the trusts were not interrelated because their terms were not identical and had different legal consequences.

One of the frequently cited cases about the reciprocal trust doctrine is *Grace*.[26] In *Grace*, the court said it did not have to delve into the subjective intent of the settlors of the trusts in question; rather, the court said it would apply the reciprocal trust doctrine if it found there to be a quid pro quo. In *Grace*, the trusts were created 15 days apart, which was close enough to determine that they were interrelated. The court held the following:

> [A]pplication of the [reciprocal trust] doctrine requires only that the trusts be interrelated, and that the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as they would have been had they created trusts naming themselves as life beneficiaries.[27]

It would be unwise to think that the reciprocal trust doctrine can be avoided by having the two grantors fund the trusts with assets of different value. That almost certainly will not avoid it.[28]

THE RECIPROCAL TRUST CREDITOR CONCERN

There is one item of concern with respect to reciprocal trusts that are formed and funded in non-asset protection trust (APT) jurisdictions—even if the trusts are different enough to survive the standards set forth in *Grace* and fall under *Levy*, and various authorities, if a creditor of the beneficiary of a trust can reach into the trust because a state court or bankruptcy court judge decides that the beneficiary is the substantive settlor, then §2036(a) may apply, regardless of whether the trusts are different enough that they would withstand the tests of *Grace* and *Levy*. The courts in *Grace* and *Levy* did not make mention of the question of whether creditors might reach into the respective trusts.

The only reciprocal trust court case on point known of by the authors is the 1950 Delaware Court of Chancery case of in *Security Trust Co. v. Sharp*,[29] which held that creditors may reach the settlor's interest in a reciprocal trust. This case was decided under Delaware law well before Delaware statutes were passed to protect trusts like the one that was the subject of this case from creditors. In a 2008 LISI commentary Mark Merric, Esq., observed that the *Sharp case* had been cited as the state of the law in a few leading treatises on asset protection and is also the position of the Restatement (Third) of Trusts.[30] He concluded that "[d]ue to the common acceptance of this Delaware case as the state of the law, I would strongly suggest that most courts will follow it."[31]

Some estate planners have commented that families wealthy enough to engage in SLAT planning may feel comfortable not having access to a trust formed and funded for descendants only by the spouse who is the beneficiary of the SLAT, or that any such access should be only possible through a trust for descendants that is formed in an APT jurisdiction, or to be even safer, also requires that the settlor thereof would be added as a beneficiary by persons acting in a non-fiduciary capacity, who have not duty to do so. Some go further and provide that this can be done only after events of independent significance such as a divorce or a large financial reversal have occurred.

CONCLUSION

SLATs have been and will likely remain a common planning tool. But their ubiquitous use should not lead planners to overlook the many issues and risks that the technique may entail.

where the Court held that application of the doctrine was not dependent on a "finding that each trust was created as a quid pro quo" for the other. Instead, in order for the doctrine to apply the trusts must be (1) "interrelated" and (2) that the arrangement leave the grantors in "approximately the same economic position" as if they had named themselves as beneficiaries of the trusts they created.

[24] *See* Bruce D. Steiner and Martin M. Shenkman, *Beware of the Reciprocal Trust Doctrine*, Trs. & Ests J. (Apr. 2020).

[25] *Est. of Levy v. Commissioner*, T.C. Memo 1983-453.

[26] *Estate of Grace*, 395 U.S. 316.

[27] *Id.* at 317.

[28] *See* Rev. Rul. 74-533, Rev. Rul. 57-422.

[29] 32 Del. Ch. 3 (1950).

[30] Mark Merric, *Estate Inclusion Issues of Reciprocal Trusts and Self Settled Estate Planning Trusts*, Leimberg Estate Planning Newsletter (Sept. 5, 2008).

[31] *Id.* at 2.

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Florida's Exception Creditors

- Under Florida Statutes Section 736.0503 (which corresponds to the Uniform Trust Code section 503), the following classes of creditors can reach into an otherwise "creditor-proof" spendthrift trust established by a third party for a beneficiary:

- 1. A creditor having a claim for child, spousal, or other family support that is not able to satisfy the claim from the personal assets of the settlor.

- 2. A law firm and other professionals who provide representation of a beneficiary with respect to terms, conditions, and rights that the beneficiary has with respect to such trust.

- 3. A claim by the state in which the trust is established or by the United States to the extent a law of the state or a federal law so provides.



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Exception Creditor Issues

- A possible solution to these concerns would be to provide for the SLAT to actually be two separate trusts from inception.

- These trusts could be identical, except that one trust could provide that any distributions to satisfy exception creditors as to both trusts could come from that trust (which could be known as the exception creditor trust or "ECT Trust") and the other trust could provide that the Grantor Spouse would be excluded as a beneficiary completely if and when the ECT Trust would have a net worth of less than a reasonable amount, such as $400,000.

- It would therefore seem unlikely, if not impossible, for the non-ECT Trust to have exposure to exception creditor claims.

- The SLAT could also divide into three separate trusts upon the death of the Beneficiary Spouse:
- 1. The ECT Trust
- 2. A trust that would benefit the Grantor Spouse until such time that the ECT trust reaches a relatively low level, and
- 3. A separate trust that would not benefit the settlor whatsoever.



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Exception Creditor Issues

- For example, a settlor placing $10,000,000 into a SLAT may be perfectly comfortable only being able to benefit from $5,000,000 worth of assets, and whatever they grow to.

- The ECT trust may be $500,000, the second trust for the benefit of the Grantor Spouse after the death of the Beneficiary Spouse may be $4,500,000 (assuming the Grantor Spouse has held back enough to live on), and the third trust that benefits descendants only may be $5,000,000.

- It would be safest to administer these as three separate stand alone SLATs, and that would not be inconvenient, since the SLATs will not have to file income tax returns if all income deductions are reported on the grantor's income tax return, and the primary asset of the SLAT consists of an LLC owned 10% by the ECT trust, 40% by the non-ECT trust that may benefit the settlor, and 50% by a trust that will not benefit the settlor.

- The draftsmen and client can determine whether the second trust should have the Grantor Spouse as the automatic beneficiary on the death of Beneficiary Spouse, or allow trust protectors to add the Grantor Spouse, and then perhaps only if the settlor's net worth is below a certain level.



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The Doctrine of Acts of Independent Significance

- While it is recognized in the estate tax law that the contributor to a trust will be subject to federal estate tax where he or she has retained the right to benefit from the trust or to direct how the trust assets will pass, the courts have provided that certain actions or circumstances that a grantor may take or experience are generally beyond his or her control, and should not be considered to be a power or lever that would cause a violation of section 2036 or section 2038.

- The doctrine of Acts of Independent Significance is generally grounded in two court cases, *Estate of Tully*, 208 Ct.Cl. 596 (1976) and *Ellis v. Commissioner*, 51 T.C. 182 (1968), as well as Revenue Ruling 80-255, which is still binding upon the IRS.



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The Doctrine of Acts of Independent Significance.

- Revenue Ruling 80-255

- In Revenue Ruling 80-255 the taxpayer created an irrevocable trust which indicated that children born or adopted after creation of the trust would become beneficiaries.
- The concern was that the power/ability to have natural children or to adopt children could be considered to be a retained right to change the beneficial interests of the trust.
- The revenue ruling indicates that "the act of bearing or adopting children is an act of independent significance, the incidental and collateral consequence of which is to add the child as beneficiary to the trust. Although [the settlor's] acts of bearing or adopting children will automatically result in adding the child as beneficiary to the trust, such result is merely a collateral consequence of the bearing or adopting of children."
- Therefore, a trust provision providing for the automatic inclusion of children born or adopted to the settlor after the formation of the trust is not equivalent to the settlor's retention of a power to designate or change beneficial interests under the meaning of section 2036(a).



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GOOD REASONS TO USE FLORIDA AS THE JURISDICTION OF AN IRREVOCABLE TRUST

1. No income taxes or state reporting with respect to trust income.
2. No estate, inheritance or gift taxes.
3. A well-developed trust law and experienced probate court judiciary.
4. A 360-year Rule Against Perpetuities.
5. Ability to appoint a Designated Representative.
6. We need the business!



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GOOD REASONS NOT TO USE FLORIDA AS THE JURISDICTION OF AN IRREVOCABLE TRUST

1. The power of invasion by a beneficiary's ex-spouse or unintended / undeserving descendants.

2. Trustee's obligation to make extensive disclosures to beneficiaries who the settlor may not want to have annual reminders, plus related expenses.

3. Issues relating to clauses in trusts requiring beneficiaries to have certain religious orientation, sexual orientation, or to be married, which may be viewed as repugnant to Florida public policy but be upheld by a foreign jurisdiction.

4. Creditor access to non-lapsed withdrawal powers, child support, and alimony.

5. Concern as to "court of equity" interpretations.

6. Potential concern that federal legislation could cause domestic trusts to be subject to governmental agency liability, which would not apply to international trusts.



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Current and Recent Applicable Federal Rates (2022-2023)

MONTH4.02	SHORT TERM	MID-TERM	LONG-TERM
Jan. 2022	0.44%	1.30%	1.82%
Feb. 2022	0.59%	1.40%	1.92%
Mar. 2022	0.97%	1.74%	2.14%
Apr. 2022	1.26%	1.87%	2.25%
May 2022	1.85%	2.51%	2.66%
June 2022	2.21%	2.93%	3.11%
July 2022	2.37%	2.99%	3.22%
August 2022	2.88%	3.15%	3.35%
September 2022	3.05%	2.93%	3.14%
October 2022	3.40%	3.28%	3.43%
November 2022	4.10%	3.97%	3.92%
December 2022	4.55%	4.27%	4.34%
January 2023	4.50%	3.85%	3.84%
February 2023	4.47%	3.82%	3.86%
March 2023	4.50%	3.70%	3.74%
April 2023	4.86%	4.15%	4.02%

Can use lowest of last three months on a "sale or exchange" under IRC Section 1274(d)(2). See IRC Section 7872(f)(2)



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Section 7520 Interest Rates

Valuation Month	120% of Applicable Federal Midterm Rate	Section 7520 Interest Rate	Revenue Ruling
May 2022	3.01	3.0	Rev. Rul. 2022-9
June 2022	3.52	3.6	Rev. Rul. 2022-10
July 2022	3.59	3.6	Rev. Rul. 2022-12
August 2022	3.80	3.80	Rev. Rul. 2022-14
September 2022	3.52	3.60	Rev. Rul. 2022-17
October 2022	3.94	4.0	Rev. Rul. 2022-18
November 2022	4.78	4.8	Rev. Rul. 2022-20
December 2022	5.14	5.2	Rev. Rul. 2022-22
January 2023	4.45	4.40	Rev. Rul. 2023-1
February 2023	4.59	4.60	Rev. Rul. 2023-3
March 2023	4.45	4.40	Rev. Rul. 2023-3
April 2023	4.99	5.0	Rev. Rul. 2023-6



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$1,000,000 PROMISSORY NOTE/SCIN/PRIVATE ANNUITY/GRAT ALTERNATIVES

January 2023 / CLIENT AGE 70

Alternatives: (Using January 2023 Applicable Federal Rates and January 2023 7520 Rate of 4.6%)

CLIENT (AGE 70)

<3 Year Interest Only Installment Note @ 4.50% - **Payment = $45,000 per year***

9 Year Interest Only Installment Note @ 3.85% - **Payment = $38,500 per year***

>9 Year Interest Only Installment Note @ 3.84% - **Payment = $38,400 per year***

14 Year Interest Only SCIN @ 8.923% - **Payment = $89,226 per year***

Private Annuity Level Annual Payment - **Payment = $104,134.12 per year**

3 Year Level Payment GRAT @ 4.6% - **Payment = $364,458.05 per year**
(Note: would have been $340,000 one year ago)

3 Year GRAT @ 4.6% - **Initial Payment = $302,014.44 and Increases Annually by 20%****
(Note: would have been $280,000 one year ago)

TRUST (PURCHASER)

* Notes would have no penalty for prepayment – minimum payments are shown above.

Self-Cancelling Installment Note ("SCIN") based upon balloon before life expectancy as measured at time of Note being made. Client's life expectancy is 14.27 years under IRS table. It is not required that the Note balloon at life expectancy – but standard calculation software does not calculate for a longer term, and the interest rate will be higher.

** This GRAT assumes that each annuity payment will increase by 20% each year. **Assumes no taxable gift on funding**

If interest rates increase in the future, consider the use of a 20-year interest only note at the 3.84% long-term AFR, locking in a 3.84% rate for the next 20 years.

Note: November 2022 rates for annual compounding are:
Short-Term – 4.10%
Mid-Term – 3.97%
Long-Term – 3.92%

Usable through January 31, 2023 for a "sale or exchange"



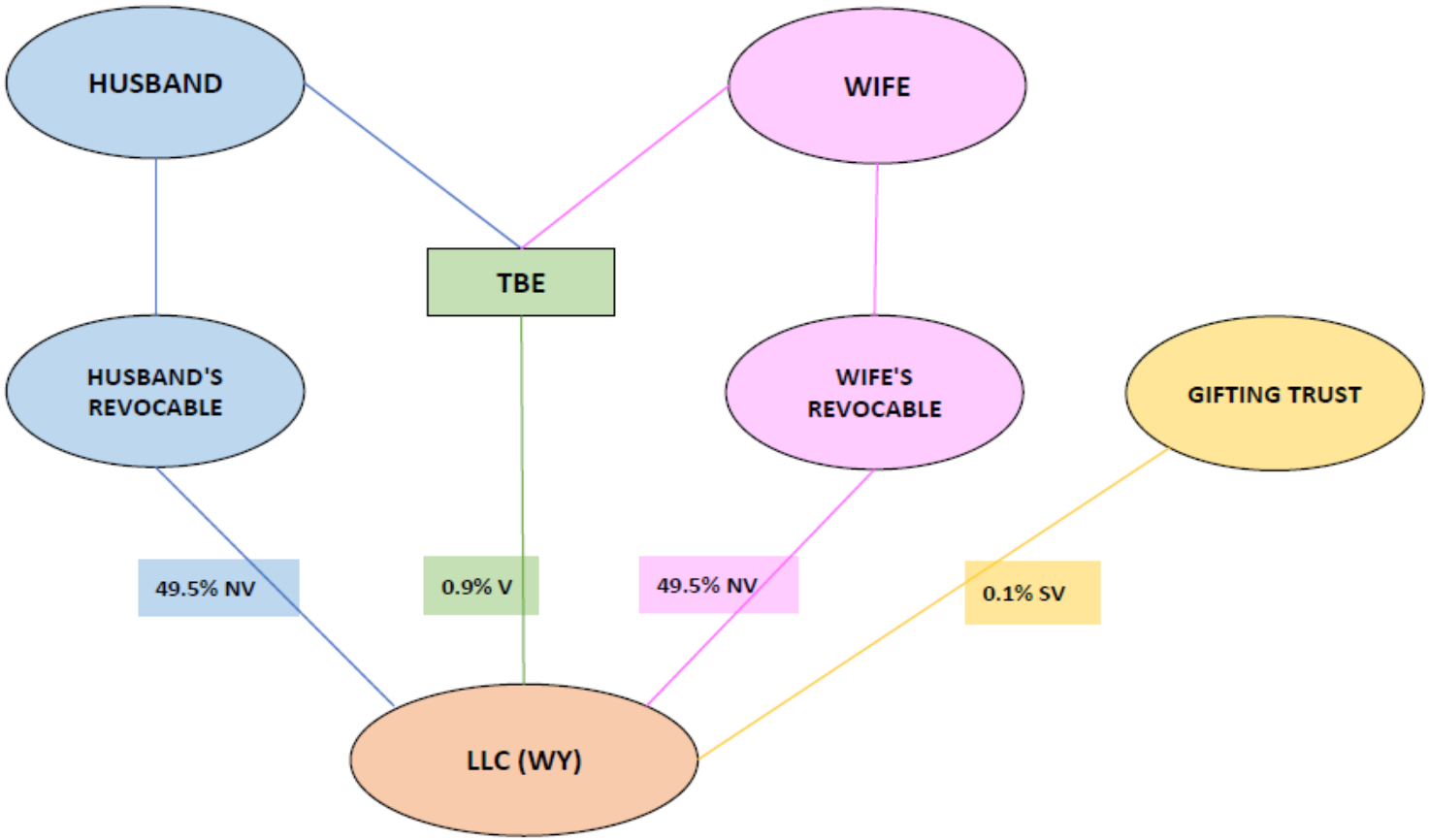
Alan Gassman, JD, LL.M. (Taxation)
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GASSMAN CROTTY & DENICOLO, P.A.
ATTORNEYS AT LAW

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Chart 1

Initial Setup for LLC to Receive Annuities and Cash



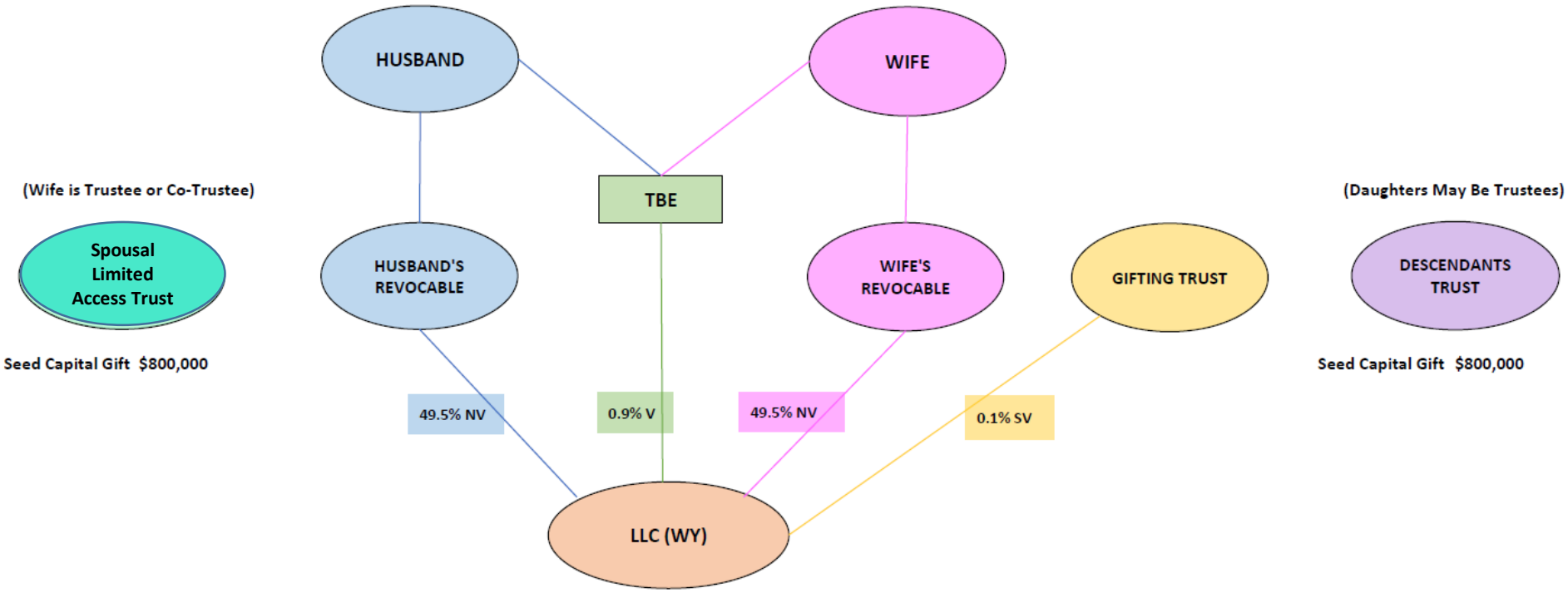
Annuity Value	$15,000,000
Stocks and Bonds	$4,500,000
TOTAL	$19,500,000

Owns annuities and receives annuity payments of $975,000 a year.

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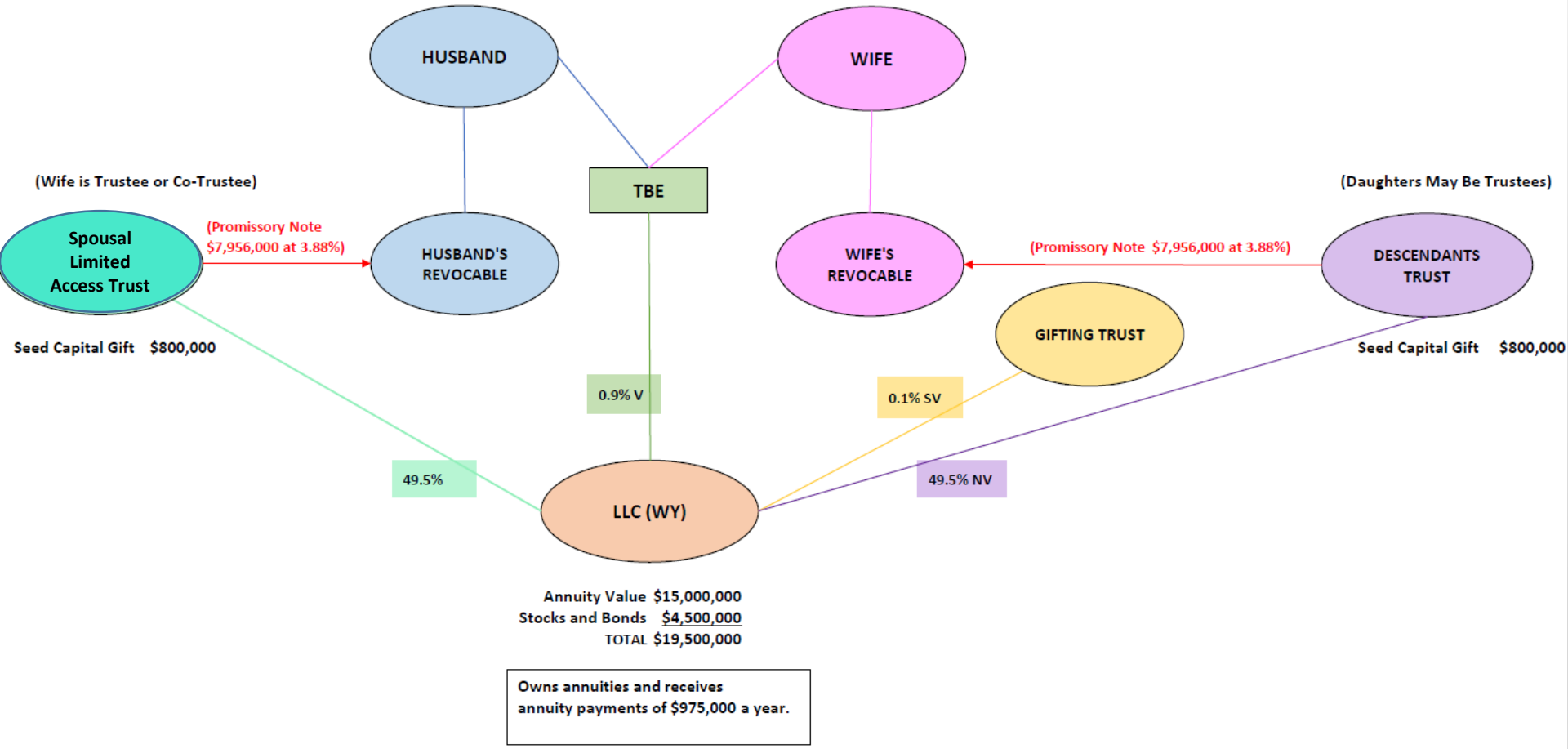
Chart 2

Establish Irrevocable Trusts and Make Seed Capital Gifts



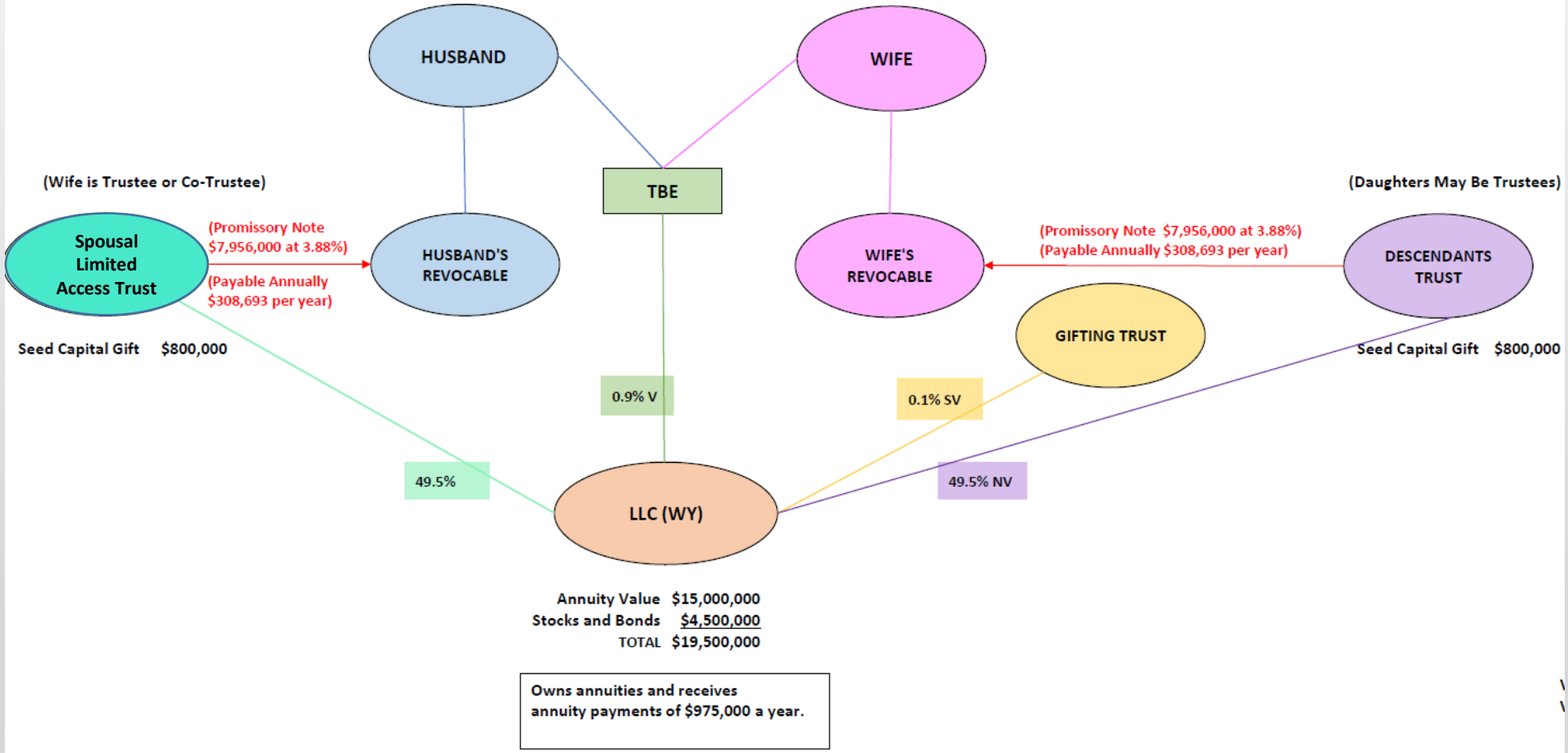
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Chart 3 SLAT and Descendant's Trust Purchase 49.5% Each Non-Voting LLC Interests In Exchange For Promissory Notes



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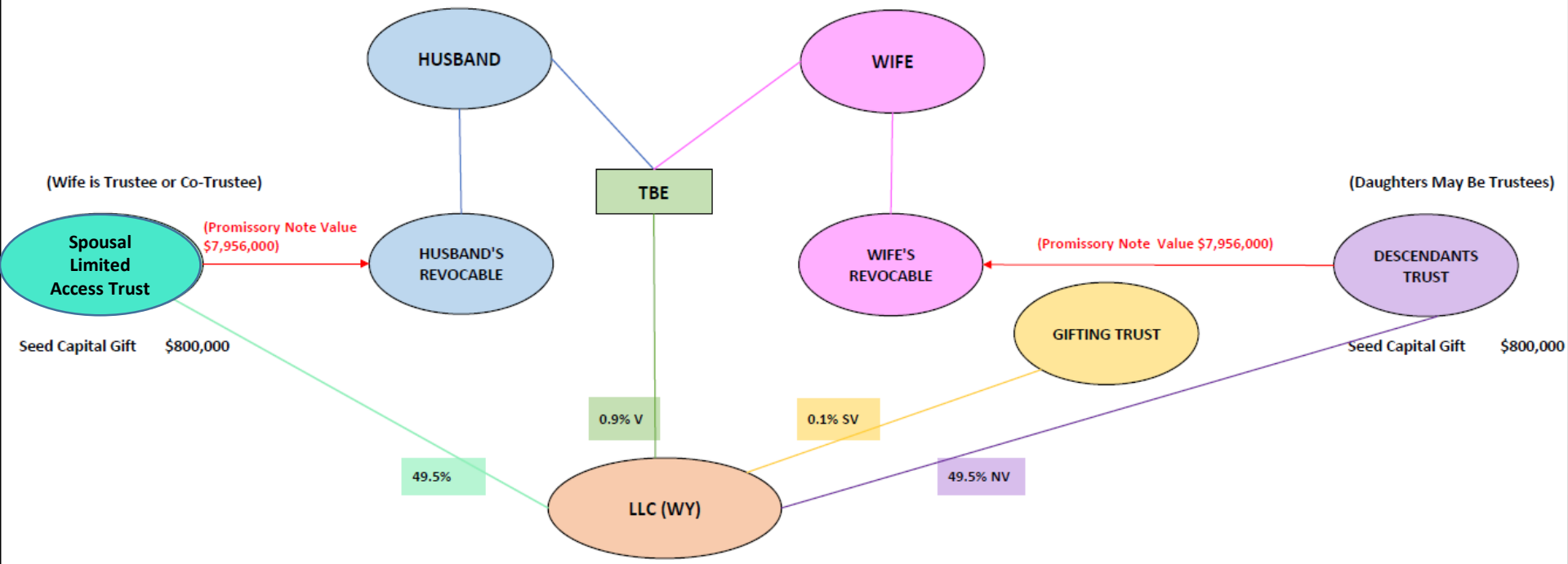
Chart 4 Annual Maintenance - Trusts Make Annual Payments / LLC Makes Distributions to Trusts, If and When Necessary



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Chart 5

After 10 Year / 20 Years



Annuity Value Initial Value	$15,000,000
Stocks and Bonds Initial Value	$4,500,000
Total Initial Value	$19,500,000
Value after 10 years (Assuming 5% Growth and $308,693 Interest Only Pym'ts on each Note)	$23,998,030
Value after 20 years (Assuming 5% Growth and $308,693 Interest Only Pym'ts on each Note)	$31,324,848

Promissory notes held by the Revocable Trusts will still be $7,956,000 each.

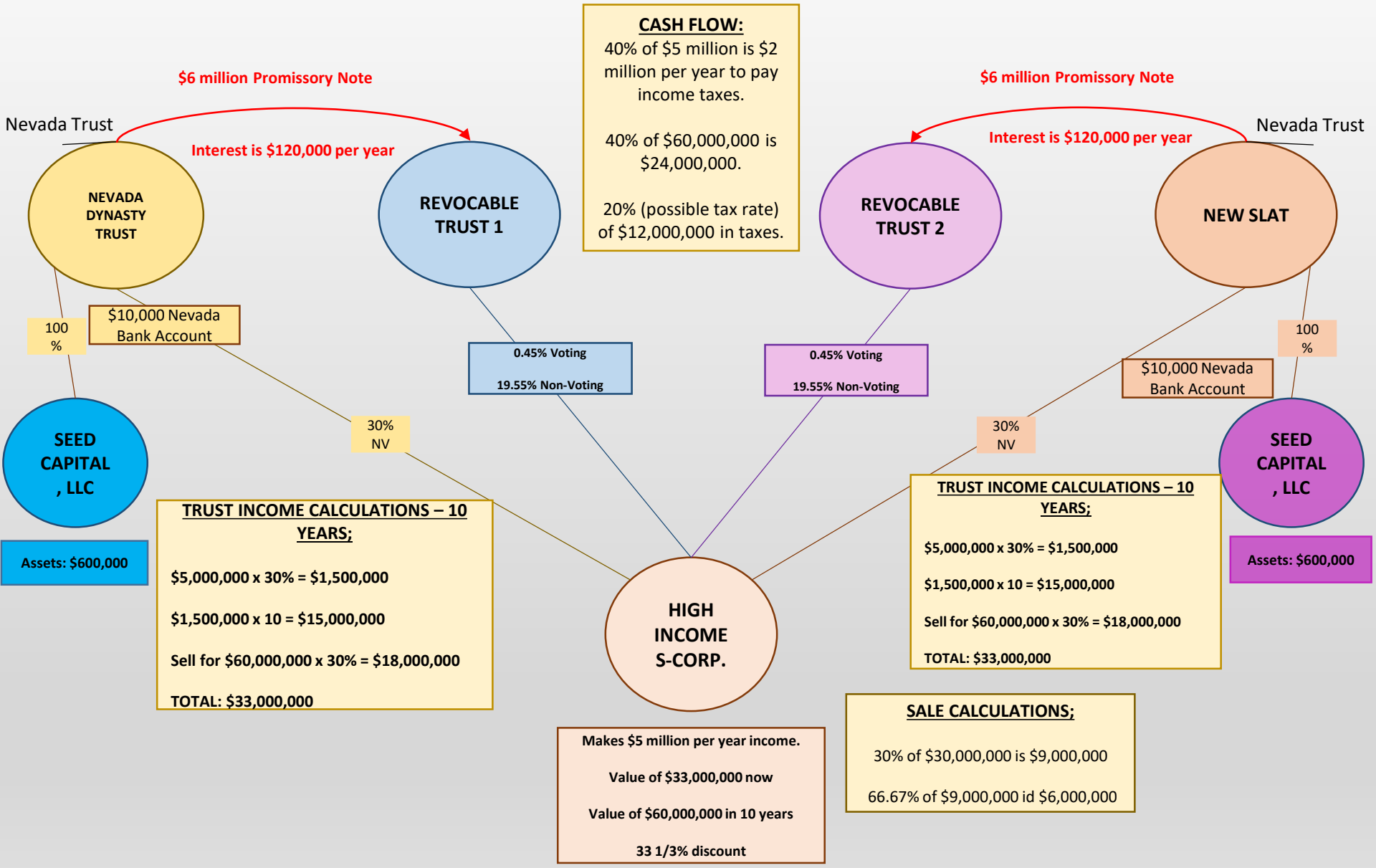
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Year	19,500,000	5% Growth	Sub-Total	Annual Combined Note Payments	Net Total
1	$19,500,000	$975,000	$20,475,000	$617,386	$19,857,614
2	$19,857,614	$992,881	$20,850,495	$617,386	$20,233,109
3	$20,233,109	$1,011,655	$21,244,764	$617,386	$20,627,378
4	$20,627,378	$1,031,369	$21,658,747	$617,386	$21,041,361
5	$21,041,361	$1,052,068	$22,093,429	$617,386	$21,476,043
6	$21,476,043	$1,073,802	$22,549,845	$617,386	$21,932,459
7	$21,932,459	$1,096,623	$23,029,082	$617,386	$22,411,696
8	$22,411,696	$1,120,585	$23,532,281	$617,386	$22,914,895
9	$22,914,895	$1,145,745	$24,060,640	$617,386	$23,443,254
10	$23,443,254	$1,172,163	$24,615,416	$617,386	**$23,998,030**
11	$23,998,030	$1,199,902	$25,197,932	$617,386	$24,580,546
12	$24,580,546	$1,229,027	$25,809,573	$617,386	$25,192,187
13	$25,192,187	$1,259,609	$26,451,797	$617,386	$25,834,411
14	$25,834,411	$1,291,721	$27,126,131	$617,386	$26,508,745
15	$26,508,745	$1,325,437	$27,834,182	$617,386	$27,216,796
16	$27,216,796	$1,360,840	$28,577,636	$617,386	$27,960,250
17	$27,960,250	$1,398,013	$29,358,263	$617,386	$28,740,877
18	$28,740,877	$1,437,044	$30,177,921	$617,386	$29,560,535
19	$29,560,535	$1,478,027	$31,038,561	$617,386	$30,421,175
20	$30,421,175	$1,521,059	$31,942,234	$617,386	**$31,324,848**
		$24,172,568		**$12,347,720**	



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HIGH INCOME S CORPORATION



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REALLY HIGH INCOME S CORP

Can you split the gift? Seems unlikely that spouse/beneficiary would benefit from SLAT?

$9 million per year for __years.

$36 million Promissory Note

Interest is $720,000 per year

GRANTOR RETAINED ANNUITY TRUST (NON-GST)

SPOUSE 1

Age: 65

IRREVOCABLE CONTROL TRUST

SPOUSE 2

Age: 60

REVOCABLE TRUST 2

NEW SLAT

Revocable Trust 1 and Revocable Trust 2 are each getting $12,000,000 (40% of $30,000,000) to pay taxes.

100 %

$10,000 Nevada Bank Account

CALCULATIONS:

30% of $120,000,000 is $36,000,000.

A zeroed-out GRAT making payments of $__ per year for __ years or first payment at $__ and increasing by 20% per year for 10 years.

Final payment of $___.

30% NV

30% NV

.1% Special Voting

SEED CAPITAL , LLC

Assets: $3,600,000

CALCULATIONS:

$9,000,000 per year income x 10 years = $90,000,000

30% of $360,000,000 = $108,000,000

$90,000,000 + $108,000,000 = $198,000,000

REALLY HIGH INCOME S-CORP.

Makes $30 million per year income.

Value of $180,000,000 now

After discounts = $120,000,000 for 99%

Sell in 10 years for $360,000,000

SALE PRICE:
30% of $120,000,000 is $36,000,000

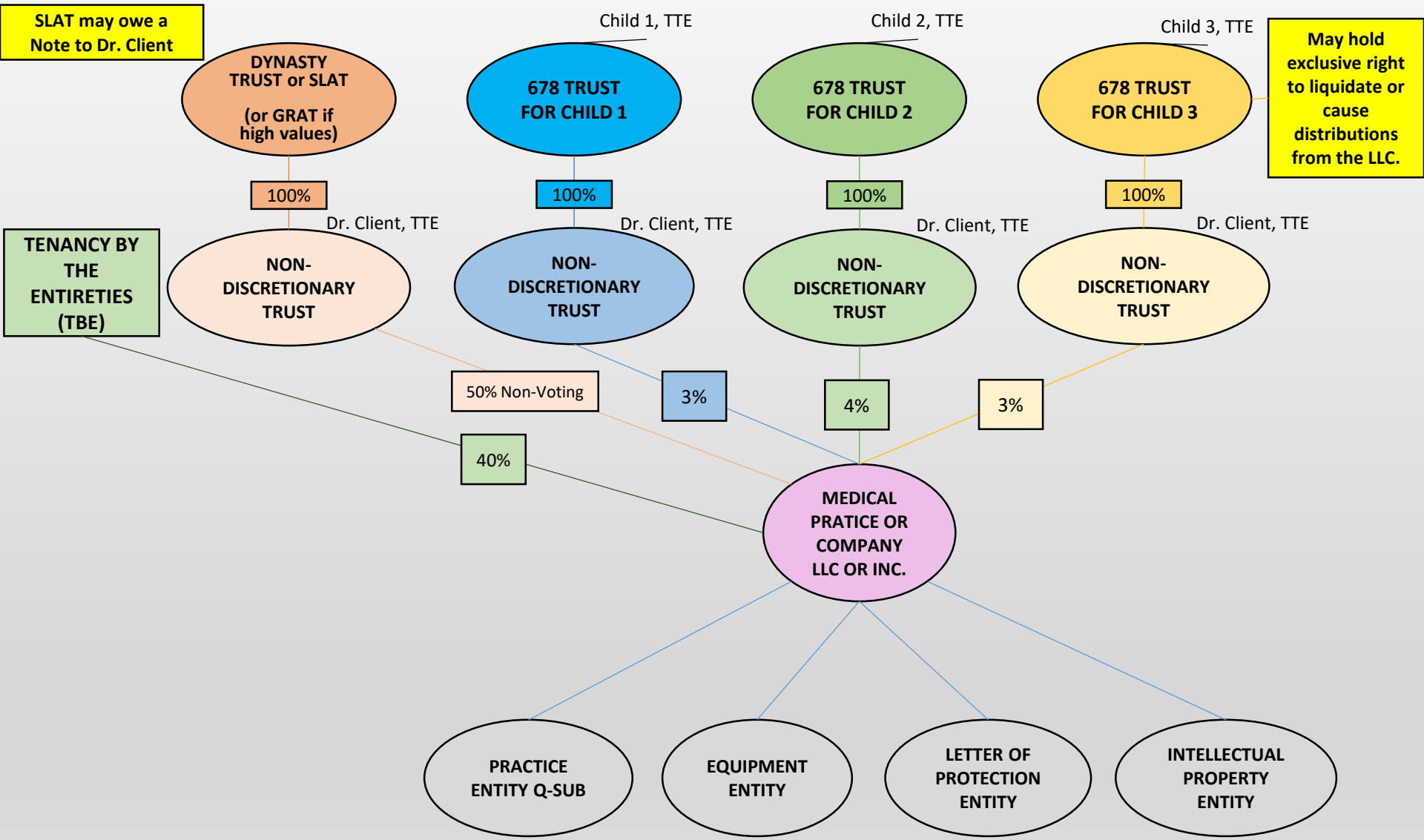


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ATTORNEYS AT LAW

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MEDICAL PRACTICE PLANNING



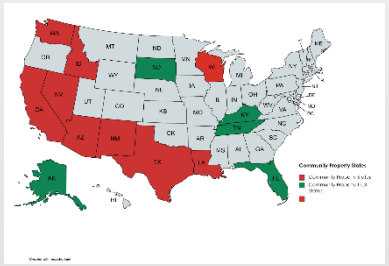
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Community Property & Trusts

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Which States are Community Property States?

- In the United States, there have historically been eight community property states and two territories that have applied community property law:



- **Arizona**
- **California**
- **Idaho**
- **New Mexico**
- **Louisiana**
- **Texas**

- **Nevada**
- **Washington (state)**
- **Wisconsin**
- **Alaska**
- **Guam**
- **Puerto Rico**

- The laws in these states generally evolved from Spanish law, except that Louisiana's community property law came from France.
- Note that in Louisiana, married couples who have assets characterized as community property can modify or terminate community property characterization only upon joint petition and a finding by a court that this serves their best interests.
- In other community property state, married couples can simply enter into marital agreements during marriage (without petitioning a court) that modify or terminate ("transmute") their community property characterization of assets, and may be required to record such agreements to transmute real estate.



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Community Property Trust Features- Florida

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
Florida	**(1)** Expressly declares that the trust is a community property trust within the meaning of this part **(2)** Has at least one trustee who is a qualified trustee, provided that both spouses or either spouse also may be a trustee **(3)** Is signed by both settlor spouses consistent with the formalities required for the execution of a trust under this chapter. **(4)** Contains substantially the following language in capital letters at the beginning of the community property trust agreement: THE CONSEQUENCES OF THIS COMMUNITY PROPERTY TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND UPON THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD BE SIGNED ONLY AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK COMPETENT AND INDEPENDENT LEGAL ADVICE.	(1)An obligation incurred by only one spouse before or during the marriage may be satisfied from that spouse's one-half share of a community property trust. (2) An obligation incurred by both spouses during the marriage may be satisfied from a community property trust of the settlor spouses.	All property owned by a community property trust is community property under the laws of the state during the marriage of the settlor spouses.	**36.1511 Application of Internal Revenue Code; community property classified by another jurisdiction.**--For purposes of the application of s. 1014(b)(6) of the Internal Revenue Code of 1986, 26 U.S.C. s. 1014(b)(6), as of January 1, 2021, a community property trust is considered a trust established under the community property laws of the state. Community property, as classified by a jurisdiction other than this state, which is transferred to a community property trust retains its character as community property while in the trust. If the trust is revoked and property is transferred on revocation of the trust, the community property as classified by a jurisdiction other than the state retains its character as community property to the extent otherwise provided by ss. 732.216-732.228.

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Community Property Trust Features- Alaska

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
Alaska	(a) A community property agreement must be contained in a written document signed by both spouses and classify some or all of the property of the spouses as community property. It is enforceable without consideration. (b) A community property agreement must contain the following language in capital letters at the beginning of the agreement: THE CONSEQUENCES OF THIS AGREEMENT MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE. (c) A community property agreement may not adversely affect the right of a child to support.	(j) An obligation incurred by only one spouse before or during marriage may be satisfied only from the property of that spouse that is not community property and from that spouse's interest in community property. This subsection does not apply to an obligation described in (b) of this section. (k) An obligation incurred during marriage by both spouses may be satisfied from property of each spouse that is not community property and from the community property.	(h) The trustee of a community property trust shall maintain records that identify which property held by the trust is community property and which property held by the trust is not community property.	N/A



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Community Property Trust Features- South Dakota

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
South Dakota	An arrangement is a South Dakota special spousal trust if 1) one or both spouses in a marriage transfer property to a trust, 2) the trust expressly declares that some or all the property transferred is South Dakota special spousal property as provided in this chapter, 3) and at least one trustee is a qualified person. A South Dakota special spousal trust is enforceable without consideration. Both spouses, or either spouse, may be a trustee. The trust must be signed by both spouses. The trust may be revocable or irrevocable. For purposes of this section, a qualified person is any person who meets the requirements of §§ 55-3-41 and 55-3-39, but without regard to whether that person is the transferor. 4) A South Dakota special spousal trust shall contain the following language in capital letters at the beginning of the trust: THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING YOUR RIGHTS WITH RESPECT TO CREDITORS AND OTHER THIRD PARTIES, AND YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE, AT THE TIME OF A DIVORCE, AND AT THE DEATH OF YOU OR YOUR SPOUSE. ACCORDINGLY, THIS TRUST AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS TRUST AGREEMENT, YOU SHOULD SEEK INDEPENDENT LEGAL ADVICE.	Notwithstanding anything contained in § 55-17-9 to the contrary: (1) A provision of a revocable South Dakota special spousal property trust does not adversely affect the interest of a creditor unless the creditor has actual knowledge of the trust when the obligation to the creditor is incurred. The interest of a creditor in an irrevocable South Dakota special spousal property trust may be subject to the rights and liabilities of a creditor with respect to transfers under chapter 55-16 as provided in § 55-17-6; (2) A spouse shall act in good faith with respect to the other spouse in matters involving South Dakota special spousal property. The obligation under and effect of this section may not be varied by a South Dakota special spousal property trust.	The trustee of a South Dakota special spousal trust shall maintain records that identify which property held by the trust is South Dakota special spousal property and which property held by the trust is not South Dakota special spousal property.	For purposes of the application of § 1014(b)(6) of the Internal Revenue Code of 1986, 26 U.S.C. § 1014(b)(6), as of January 1, 2016, a South Dakota special spousal trust is considered a trust established under the community property laws of South Dakota. For purposes of this chapter, the term, special spousal property, means community property for those purposes. Community property as classified by a jurisdiction other than South Dakota transferred to a South Dakota special spousal trust retains its character as community property while in the trust. If the trust is revoked and property is transferred on revocation of the trust, the community property as classified by a jurisdiction other than South Dakota retains its character as community property to the extent otherwise provided by South Dakota law.

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Community Property Trust Features- Tennessee

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
Tennessee	An arrangement is a community property trust if one or both spouses transfer property to a trust, that: (1) Expressly declares that the trust is a Tennessee community property trust; (2) Has at least one (1) trustee who is a qualified trustee whose powers include, or are limited to, maintaining records for the trust on an exclusive or a nonexclusive basis and preparing or arranging for the preparation of, on an exclusive or a nonexclusive basis, any income tax returns that must be filed by the trust. Both spouses or either spouse may be a trustee; (3) Is signed by both spouses; and (4) Contains the following language in capital letters at the beginning of the trust: THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.	(a) An obligation incurred by only one spouse before or during marriage may be satisfied from that spouse's one-half (1/2) share of a community property trust. (b) An obligation incurred by both spouses during marriage may be satisfied from a community property trust of the spouses.	(c) All property owned by a community property trust will be community property during marriage.	N/A



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Community Property Trust Features- Kentucky

State	Requirements	Creditor Protection	Property Included	U.S.C. s. 1014(b)(6)
Kentucky	Any arrangement between spouses involving community property shall be considered a community property trust if one (1) or both spouses transfer property to a trust that: (a) Expressly declares that the trust is a Kentucky community property trust that meets the requirements of Sections 1 to 3 of this Act; (b) Has at least one (1) trustee who is a qualified trustee whose powers include or are limited to maintaining records for the trust, on an exclusive or a nonexclusive basis, and preparing or arranging for the preparation of, on an exclusive or a nonexclusive basis, any income tax returns that must be filed by the trust. Both spouses or either spouse may be a trustee; (c) Is signed by both spouses; and (d) Contains the following language in capital letters at the beginning of the trust: THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING BUT NOT LIMITED TO YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.	(1) An obligation incurred by only one (1) spouse before or during marriage may be satisfied from that spouse's one-half (1/2) share of a community property trust. (2) An obligation incurred by both spouses during marriage may be satisfied from a community property trust of the spouses	All property owned by a community property trust shall be considered community property during marriage and the right to manage and control property that is transferred to a community property trust shall be determined by the terms of the trust.	N/A

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Will a Community Property Trust Work?

- The question still stands as to whether an elective community property arrangement like the Florida Community Property Trust will be recognized by the IRS as a legitimate community property arrangement to qualify all trust assets for a fair market value date of death basis step-up under IRC Section 1014(b)(6).
- Commentators who urge caution point to the 1944 U.S. Supreme Court decision of *Commissioner v. Harmon,* which involved a married couple who opted into community property treatment under an Oklahoma law that was passed to allow married couples living there to elect whether to have community property characterization apply to their assets.



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Will a Community Property Trust Work?

- The U.S. Supreme Court held in *Harmon* that the act of electing into the community property regime constituted an “assignment of income” and quoted the 1930 United States Supreme Court case of *Lucas v. Earl.*
- Nevertheless, the 1958 United States District Court decision of *McCollum v. United States* seems to support the proposition that the 1014(b)(6) step-up in basis will apply to community property created as a result of an election made by the spouses.
- In *McCollum*, a married couple elected under the then applicable Oklahoma law to treat their assets as community property under Oklahoma law in 1943, and in 1945 Oklahoma changed its law to require that all of a married couple's assets had to be considered to be community property. Mr. McCollum died after the community property status became mandatory and Mrs. McCollum took a full step-up in basis for the full value of the community property that existed on Mr. McCollum's date of death. The court allowed the full step-up in basis

    - Although Oklahoma had a mandatory community property system by the time the decision was reached because the property at issue was acquired before the change of law in 1945, the property would not have been community property under the 1945 Oklahoma community property law, except by reason of the fact that the McCollum's had previously designated it as community property under the elective system.



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Will a Community Property Trust Work?

- IRC Section 1014 was enacted in 1948, only four years after the Supreme Court decision in Harmon, and it is therefore possible that Congress recognized the issue by enacting Section 1014(b)(6).
  - This is evidenced by the fact that Congress made no mention in the statutory language and provided no legislative history that would distinguish between elective and mandatory versions of community property law.
- Further, Section 1014(b)(6) is clear that the step-up in basis applies to the surviving spouse's share of community property "held by the decedent and the surviving spouse under the community property laws of ***any*** State, or possession of the United States or any foreign country…" (emphasis added), without distinction for elective community property laws or without regard to unique characteristics that a State might have with respect to its community property laws (such as creditor protection features).
- There are no known cases or audits of elective Community Property Trusts, so the risk of this being an issue as a practical matter may be quite small.

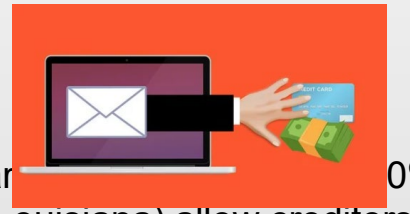


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Creditor Rights in Community Property

- Creditor rights vary based on the state where the community property is located. Most of the community property states allow a creditor of one spouse to reach all community property.

- **“Creditors Can Take It All” States**



  - All states, except Texas, allow collection of some post-mar 0% of community property. Some states (California, Idaho, and Louisiana) allow creditors to collect all debts of either spouse from 100% of community property. Other states (New Mexico and Nevada) only allow this with respect to post-marital obligations.

  - In California, Idaho, and Louisiana, creditors of the debtor spouse can reach all community property if the debt is incurred during the marriage. Idaho and Louisiana courts have held similarly that community property can be reached to satisfy separate debts.

  - New Mexico law requires the creditor to first seek payment from the separate property of the debtor spouse before being able to attempt to attach the debtor spouse's one-half ownership in the community property.

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Creditor Rights in Community Property

"Community Debt" States

- Some states (Arizona, Washington, and Wisconsin) characterize post-marital debts as either community debt or separate debt. Community debt is debt that has been incurred to benefit the marriage or family. Community debts may be satisfied from all community property. Separate ("non-community") debt may only be satisfied from the debtor spouse's half of community property or from the debtor spouse's contribution to community property. In these states, the presumption is that debts are community debts

- In Arizona, all debts incurred during the marriage are presumed to be community debt unless clear evidence is presented to show that the debt is separate. Thus, Arizona law allows creditors to reach the debtor spouse's interest in community property for payment for debt incurred prior to the marriage
- Washington statutes permit community debt to be satisfied from the community property of both spouses, and the separate property of the debtor spouse.

- Wisconsin courts divide the debts incurred after the marriage into (1) family purpose obligations; or (2) non-family purpose obligations. Debt incurred for family purpose obligations can be satisfied through the debtor spouse's separate property and all marital property, including community property. Non-family purpose obligations can be repaid by the debtor spouse's separate property and the debtor spouse's one-half interest in the couple's community property



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Creditor Rights in Community Property

“Community Debt” States (continued)

- Texas law provides for different rules as to a creditor’s ability to access community property, depending on whether the debt results from a contract or tort claim, and whether the debt was incurred before or during the marriage.

- Under the Tennessee Community Property Act, the obligation of one spouse incurred before or during the marriage can be satisfied only from that spouse's one-half of the trust. On a spouse's death, half of the value of the trust reflects the deceased spouse's share and the other half reflects the surviving spouse's share.

- Similarly, Florida's Community Property Trust Act provides that the debts and obligations of one spouse may be satisfied from that spouse's one-half share of the trust, regardless of whether the debt or obligation is incurred before or during the marriage. As such, the Florida Community Property Trust may not be attractive to spouses who prioritize creditor protection planning due to assets owned as tenants by the entireties generally being protected from the debts and obligations of only one spouse. A joint debt or obligation of both spouses may be satisfied from the assets of the trust, which is similar to the treatment of joint debts and obligations vis-à-vis tenants by the entireties assets.



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ESTATE AND ESTATE TAX PLANNING FOR FLORIDIANS

Tuesday, April 18, 2023

From 6:50 PM to 7:40 PM EST

(50 minutes)

Presented By:

Alan Gassman, JD, LL.M. (Taxation), AEP® (Distinguished)



Alan Gassman, Esquire
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