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Anna K. Selby Kelsey A. Brock Kent H. McMahan,* Senior Counsel

# ESTATE PLANNING FOR 2014

## The Stayton at Museum Way
## May 20, 2014

***Materials prepared by Marvin E. Blum and Julie A. Plemons***

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**Marvin E. Blum, Esq.**
**Attorney and Founder**
**The Blum Firm, P.C., Fort Worth, Texas**

The Blum Firm, P.C., established by Marvin Blum over 30-years ago, has law offices in Fort Worth, Dallas, Austin, and Houston and specializes in the areas of estate planning and probate, asset protection planning, planning for closely-held businesses, tax planning, tax controversy, and charitable planning. The company has grown to be the largest group of estate planning attorneys in the State of Texas.

Mr. Blum is known for creating customized, cutting-edge estate plans, now serving hundreds of high net worth families, several with a net worth exceeding $1 billion. Mr. Blum was chosen as one of the "Nation's Top 100 Attorneys" by New York's *Worth* magazine, and was also named one of the Top 100 *Super Lawyers* in Texas by *Texas Monthly Magazine*. He is a highly sought-after speaker and lecturer among his peers, having made numerous presentations to legal and tax professionals, and has recently been named to the Editorial Advisory Committee for *Trusts & Estates Magazine*.

Mr. Blum is highly dedicated to his community and currently serves as Secretary/Treasurer and one of three Board members (along with Emmitt and Pat Smith) of the Pat & Emmitt Smith Charities, a public charity devoted to creating opportunities for disadvantaged children. Mr. Blum is in his 35th year as Treasurer of the Fort Worth Symphony and served as Presiding Chair for numerous terms of The Multicultural Alliance, formerly The National Conference of Christians and Jews, a service organization fighting bias, bigotry and racism. Mr. Blum has recently joined the Texas Cultural Trust Board of Directors to help raise public and legislative awareness of the importance of the arts in Texas.

Mr. Blum, an attorney and Certified Public Accountant, is Board Certified in Estate Planning & Probate Law and is a Fellow of the American College of Trust and Estate Counsel. He earned his BBA (Highest Honors) in Accounting from the University of Texas in 1974, where he graduated first in his class and was named Ernst & Ernst Outstanding Student in Accounting. Mr. Blum received his law degree (High Honors) from the University of Texas School of Law in 1978, where he graduated second in his class and was named the Prentice-Hall Outstanding Student in Taxation. Mr. Blum and his wife, Laurie, reside in Fort Worth, Texas.

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## I. BASIC ESTATE PLANNING

Every individual needs some form of a basic estate plan. Typically, this includes a Will, a Living Trust, and ancillary documents such as a Power of Attorney, a Medical Power of Attorney, a Directive to Physicians, a Declaration of Guardian, and a HIPAA Waiver. These documents not only ensure that your assets pass upon death according to your wishes and in the most tax efficient manner possible, they also help to provide a smooth transition of management authority if you become incapacitated.

A. Will. The Will directs how your assets pass at death. The Will also names an executor, who is responsible for gathering the property and retitling it. When coupled with a Living Trust, a Will simply pours over all your assets into a Living Trust. This type of Will is commonly known as a "Pourover Will."

B. Living Trust. A Living Trust is a revocable trust that exists during your lifetime and provides a comprehensive plan for disposition of your estate to accomplish both tax and non-tax objectives including tax efficiency and asset protection for your beneficiaries.

We recommend that you fund the Living Trust during your lifetime. This will allow for a seamless transition of management authority if you become incapacitated or pass away. Typically, you are named as the initial trustee of the Living Trust. When you become unable to serve (whether from death or disability), successor trustees that you have named can immediately begin managing your assets without the delay of a court proceeding.

Another advantage of titling your assets in the name of the Living Trust is privacy. Any assets held in the Living Trust will not need to be listed on a probate inventory, which is a public document. Further, titling out-of-state real estate in the name of the Living Trust allows you to avoid ancillary probates in other states.

Any assets that are not already held in your Living Trust when you pass away will pour over to your Living Trust under your Will. The Living Trust is designed to take full advantage of all tax benefits that are available to your estate.

For a married couple, upon the first death, all of your property will be divided into two shares (1) the surviving spouse's one-half of the community property and his or her separate property and (2) the deceased spouse's one-half of the community property and his or her separate property. The surviving spouse's property will be distributed to the Survivor's Trust. The Survivor's Trust is essentially a revocable living trust for the surviving spouse. The surviving spouse, provided that he or she is not incapacitated, will have unlimited access to and control of the assets held in the Survivor's Trust.

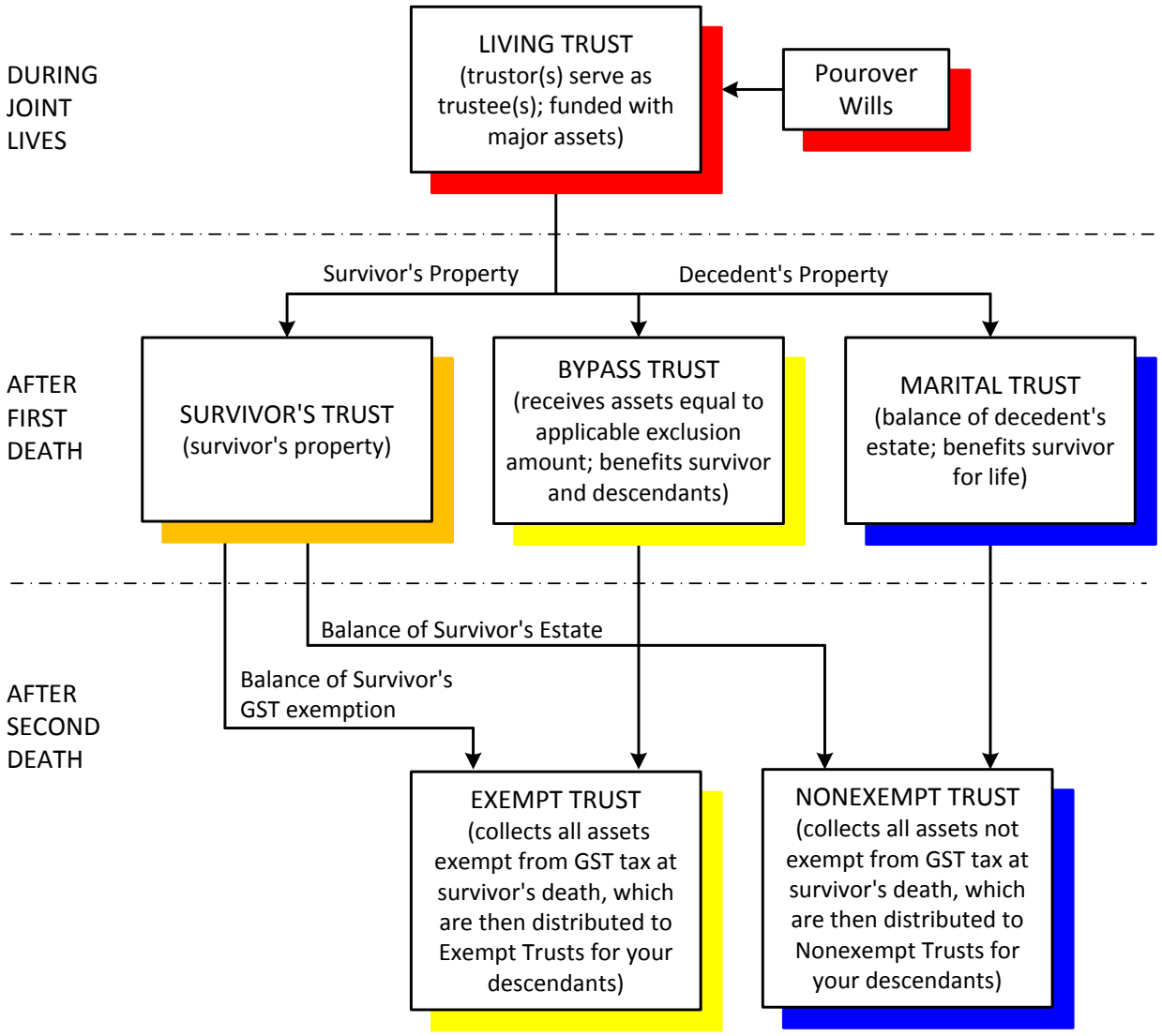
The deceased spouse's property will be divided between two trusts: the Bypass Trust and the Marital Trust. The Bypass Trust will first be funded with an amount of assets equal to the deceased spouse's remaining estate tax exemption amount (up to $5,340,000 in 2014). Often, the surviving spouse will be the primary beneficiary of the Bypass Trust, and your descendants will be secondary beneficiaries. After funding the Bypass Trust, the remainder of the deceased spouse's property will be distributed to the Marital Trust, which will be solely for the benefit of the surviving spouse and which will qualify for the unlimited marital deduction. This structure will ensure that no estate taxes will be triggered at the first death regardless of the size of your estate at that time.

At the second death for a married couple or at the death of an unmarried person, the assets remaining after payment of all expenses and estate taxes, if applicable, will be divided between two trusts (1) an Exempt Trust to hold all assets exempt from generation-skipping transfer ("GST") tax and (2) a Nonexempt Trust to hold all assets not exempt from GST tax.

The Exempt Trust and the Nonexempt Trust will each be divided into equal shares for your children, to be held in trust during their lifetimes and passed on from generation to generation.

There are many advantages to having assets you leave to your children remain in trust, including asset protection and potential tax savings benefits. The Exempt Trusts for your children will not be subject to estate tax at their deaths. Also, while property remains in trust for your children, it cannot be reached by their creditors and is not subject to claims by a child's spouse in the event of divorce. By leaving assets to your descendants in trust, they may be able to avoid the need for a prenuptial agreement when they marry, as the trust assets will not be your descendants' marital property.

**BASIC ESTATE PLAN**




NOTE: With the new "portability" law enacted in 2013 allowing a deceased spouse's unused exemption to port over to the surviving spouse, some suggest there is no need for the Bypass Trust. However, eliminating the Bypass Trust has certain disadvantages which should be considered carefully.

C. Power of Attorney. A Power of Attorney authorizes the attorney-in-fact to handle your financial matters, including the power to make gifts and to transfer property (that has not been previously so transferred) to the Living Trust. These powers can be effective immediately upon signing the document or effective only upon your disability.

D. Directive to Physicians. A Directive to Physicians, also known as a Living Will, gives you the opportunity to direct whether artificial life support systems should be continued or discontinued in case of terminal illness or an irreversible condition where death is imminent.

E. Medical Power of Attorney. A Medical Power of Attorney authorizes the named agent to make health care decisions for you if you are incapacitated and not able to do so. This document deals with health care decisions other than life support issues covered by the Directive to Physicians.

F. Authorization to Release Medical Information. The Authorization to Release Medical Information (also called a "HIPAA Waiver") enables those persons you name to receive information from your health care providers, which is particularly useful when questions arise about your capacity to continue to exercise authority over your financial affairs. The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") limits disclosure of any "Individually Identifiable Health Information," regardless of your state of health.

Because successor trustee designations and other fiduciary designations may hinge on your successor being able to show you have been declared incapacitated by your health care provider, this authorization allows such provider to disclose your health care information to the persons you name and to openly discuss that information with them.

G. Declaration of Guardian. The Declaration of Guardian gives you the ability to designate those persons who you specifically want to serve as your guardian should you need one. You may also designate specific persons who you do not want to serve as your guardian. Although the Power of Attorney and the Medical Power of Attorney are both designed to prevent guardianships, a guardianship may still be necessary. The "guardian of the person" handles personal care matters while the "guardian of the estate" takes care of financial matters.

H. Assets Not Subject to Provisions of a Will. It is important to note that several types of assets pass by contract and are not subject to the provisions of your Will. Assets with a beneficiary designation (such as life insurance and retirement plans) are examples of assets that pass by contract because such assets will be distributed directly to the person named on the beneficiary designation. Therefore, it is important to coordinate beneficiary designations with your overall plan.

Another type of asset that passes outside of your Will is bank or brokerage accounts which are designated as "pay on death" (POD) or "joint tenants with right of survivorship" (JTWROS). Assets such as these that pass outside of your Will can create problems for your estate, such as not having enough assets available to fund the Bypass Trust (thus wasting a part of the estate tax exemption).

## II. ADVANCED ESTATE TAX PLANNING

Under current law, each person has a $5,340,000 lifetime gift and estate tax exemption and a $5,340,000 GST tax exemption. Gifts made during your lifetime, other than $14,000 annual exclusion gifts, reduce the gift and estate tax exemption that will be available upon death. Assets in excess of the estate tax exemption are subject to a 40% estate tax.

> *For example, George, who is unmarried, gifts $100,000 outright to his daughter in 2014. A portion of the gift ($14,000) qualifies for the annual exclusion, but George must use $86,000 of his lifetime gift and estate tax exemption to avoid paying gift tax. If, upon George's death, the lifetime gift and estate tax exemption is $5,000,000, then the amount of assets that can pass tax-free under George's estate will be $4,914,000 ($5,000,000 - $86,000).*

Similarly, gifts made during your lifetime to a "skip person" utilize a portion of your GST tax exemption. Generally speaking, a skip person is a person who is two or more generations below the donor (e.g., a grandchild or a trust for a grandchild). To the extent that the GST tax exemption is used during your lifetime, it is not available to apply to assets passing upon your death.

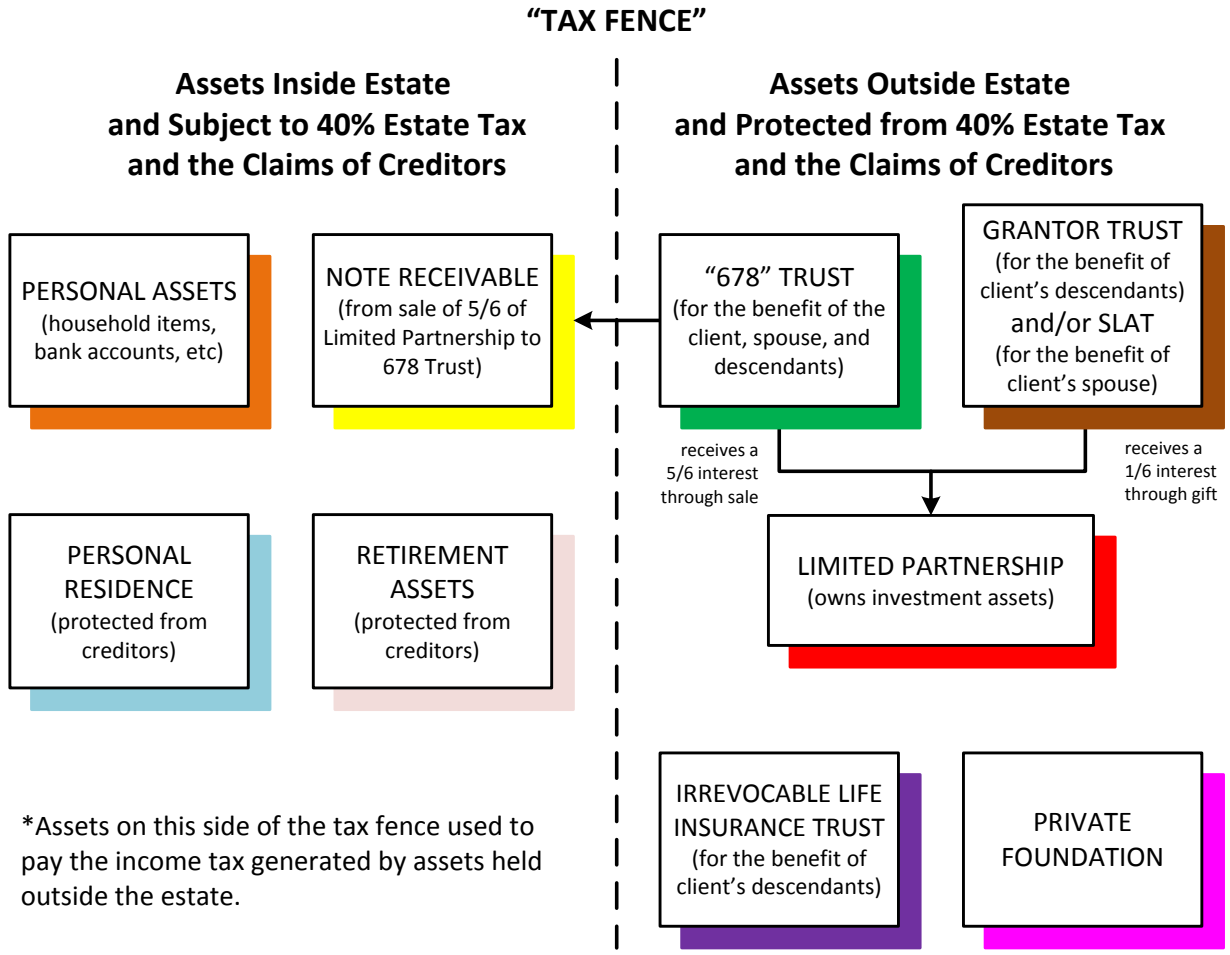
> *Here's an example of how the estate tax is calculated. Billy and Samantha have worked their entire lives to build an estate worth $50,000,000. If they have a basic estate plan in place, then upon their deaths, over 30% of their assets will pass to the IRS and the remainder will pass to their children.*

| | |
|---|---|
| *$50,000,000* | *Gross Estate* |
| *($10,680,000)* | *Total Estate Tax Exemptions* |
| *$39,320,000* | *Taxable Estate* |
| *x40%* | *Estate Tax Rate* |
| *$15,728,000* | *Estate Tax* |
| *$34,272,000* | *Amount Passing to Family* |

Thus, if your estate exceeds the exemption, you need to consider more advanced estate planning techniques. There are a variety of very effective techniques available that will allow you, over time, to eliminate the estate tax no matter the size of your estate. Generally speaking, these techniques take the form of either "Estate Freeze" gifts and sales and/or charitable techniques.

In order to visualize these techniques, consider the following illustration. The assets on the left side of the "Tax Fence" are included in your taxable estate at death and are generally

subject to your creditors. In contrast, the assets on the right side of the Tax Fence are not subject to estate tax and cannot be reached by your creditors.




A. Gifts to Irrevocable Trusts. You can move assets to the right side of the Tax Fence by gifting them to an Irrevocable Trust for your descendants and/or spouse. Some of the best assets to gift are minority interests in limited liability companies or limited partnerships, life insurance policies, and assets with high growth potential.

Any income generated by assets owned by the Irrevocable Trust stays on the right side of the Tax Fence until the beneficiary is ready to spend it. Likewise, the growth and appreciation of trust assets stays on the right side of the Tax Fence where it is protected from creditors and sheltered from estate tax liability. Accordingly, this planning is most effective if the asset is gifted at a time when the value is relatively low so that the appreciation occurs outside of your taxable estate.

If the Irrevocable Trust is structured as a grantor trust, you can further drain your estate by having the income tax burden on your personal estate (the left side of the Tax Fence).

B. Sales to Grantor Trusts and Grantor Retained Annuity Trusts. Sales can be used to transfer assets to the right side of the Tax Fence without using any of your lifetime gift and estate tax exemption or GST tax exemption. With interest rates at historically low levels, this is an optimal time to sell assets to Grantor Trusts or Grantor Retained Annuity Trusts ("GRATs") in exchange for a promissory note or annuity. This sale technique is most effective when used with income-producing assets and assets with growth potential because the income or growth will occur on the right side of the Tax Fence. You give up the asset, but retain an income stream that can be used for your needs until the note or annuity is paid in full.

C. Sales to 678 Trusts. 678 Trusts are ideal for individuals who need to reduce their estate tax exposure but who are not ready to part with their assets. The 678 Trust is established with a $5,000 gift from a friend or relative who is not a beneficiary of the trust. The 678 Trust can be for the benefit of you, your spouse, and your descendants. You and your spouse can serve as trustees of the 678 Trust.

You can shift additional assets to the right side of the Tax Fence by selling them to the 678 Trust in exchange for a promissory note. Again, because interest rates are at historically low levels, this is an ideal time to sell income-producing and appreciating assets to the 678 Trust. The promissory note grows at a mere 1-2%, while the assets sold to the 678 Trust grow outside of your taxable estate. As a beneficiary of the 678 Trust, the assets are all still available for your needs. As a trustee of the 678 Trust, you retain control of the assets. Further, the 678 Trust is always structured so that income taxes are paid out of your personal estate, which helps to drain the left side of the Tax Fence while allowing the right side to grow tax-free.

Upon your death, the assets are held in trust for your spouse or divided among trusts for your descendants. Assets held in trusts for your descendants are protected from creditors and not subject to division upon divorce.

D. Optimal Estate Plan. For estates above the exemption level, the earlier described "Basic Estate Plan" expands to include "Estate Freeze" and charitable techniques. Regardless of the size of the estate, it is possible to reduce the estate tax to zero. For that reason, the estate tax is sometimes referred to as a "voluntary tax." See the attached Optimal Estate Plan chart.

## III. ESTATE PLANNING CHECKLIST

☐ Ensure your family is well-informed of the location of your Will, of the names of your executors and other fiduciaries, and of the nature and extent of your assets. Because serving as an executor or trustee is burdensome and time-consuming, you want make the process is as easy as possible for your family.

☐ Ensure beneficiary designations on life insurance, retirement plans, bank accounts, and the like have been updated to coordinate with your estate plan.

☐ Consider preparing a handwritten ("holographic") Will to dispose of your personal effects. Under Texas law, a handwritten or "holographic" Will can effectively dispose of your assets. The holographic Will must be wholly in your handwriting, signed, and dated. We recommend that a holographic Will or Codicil be used only to dispose of your personal effects such as art, jewelry, and family heirlooms. More valuable assets should be governed by estate planning documents prepared by an attorney so that they pass in a tax-efficient manner.

☐ Under the "basis adjustment" rules, an asset passing as part of your estate upon death is given a new basis equal to the fair market value of the asset at that time. In contrast, assets that pass by gift receive a carryover basis, i.e., the asset in the donee's hands has the same basis as in the donor's hands. Accordingly, it is most advantageous for low-basis assets to pass upon death. If there are low-basis assets held in irrevocable grantor trusts, consider trading them for high basis assets held in your individual name so that the low basis assets receive a "step up" in basis. When your heirs later decide to sell the asset, they will avoid capital gains tax.

☐ If you are charitably inclined, consider making charitable gifts during your lifetime rather than at death. Charitable contributions at death qualify for an estate tax deduction. Charitable contributions during your lifetime, however, both reduce your taxable estate and allow you to receive an income tax deduction (subject to certain limitations).

☐ Consider converting your traditional IRA to a Roth IRA. You will pay income tax at the time of conversion, but it avoids the risk of being subject to higher tax rates in the future. Under current law, a Roth IRA (unlike the traditional IRA) has no required minimum distributions so you can defer income tax on the growth of the Roth IRA until you withdraw it. Furthermore, converting to a Roth IRA saves the estate tax on the dollars used to pay the income tax.

☐ If you are charitably inclined, consider making charitable donations using your IRA or retirement plan, which allows you to avoid both estate tax and income tax on the retirement assets. For example, you can name a charity as a beneficiary on the beneficiary designation form. Whereas heirs may end up with only 20 cents of each dollar from an IRA, a charity will receive the full 100 cents of each dollar.

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# OPTIMAL ESTATE PLAN