ESTATE PLANNING FOR THE 99%
IDEAS FOR THE 1%

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Gary V. Post is a Partner at The Blum Firm, P.C. in Fort Worth, Texas. He is Board Certified in Estate Planning and Probate Law and is a Fellow of the American College of Trust and Estate Counsel. Gary is a highly sought-after speaker and author. Gary earned his B.B.A. *magna cum laude* at Texas A&M University and his J.D. at Southern Methodist University School of Law.

Gary specializes in estate planning, probate, and trust matters for families and family-owned businesses, including: planning and implementing estate plans to accomplish estate, gift, and generation-skipping transfer tax and charitable planning objectives; cutting-edge qualitative estate planning for high net worth families; business succession planning; asset protection planning, including premarital/marital agreements, family limited partnerships, and irrevocable trusts; gift and generation-skipping transfer tax planning, including maximizing/leveraging use of tax exclusions and exemptions, planning and drafting trusts to accomplish tax and non-tax objectives, and preparation of gift tax returns; administration and planning with respect to existing trusts, including exercise of trust protector powers, judicial modification, and beneficiary waiver and release; and administration of estates and continuing living trusts, including funding trusts, IRA and retirement plan elections, and preparation of federal estate tax returns.

PROFESSIONAL ACTIVITIES

President, Tarrant County Probate Bar Association (2011 – 2012)

Chairman, Texas Board of Legal Specialization, Estate Planning and Probate Law Exam Commission (2010 – 2012)

Chairman, Tarrant County Probate Bar Association, Nuts and Bolts Seminar Committee (2009)

Chairman, Tarrant County Probate Bar Association, Probate Litigation Seminar Committee (2008)

SELECT PUBLICATIONS AND SPEECHES

"A FAST Solution to Legacy Planning" (co-authored by Gary V. Post, Marvin E. Blum and Thomas Rogerson), *Trusts & Estates* magazine, December 2017.

"678 Trusts," State Bar of Texas Estate Planning and Drafting Course, October 2016.

"The Form 709: Gift and Generation-Skipping Transfer Tax Reporting in Today's World," Texas Society of CPAs Advanced Estate Planning Conference, August 2016.

"Applied Generation-Skipping Transfer Tax II," Texas Society of CPAs Advanced Estate Planning Conference, August 2015.

"Applied Generation-Skipping Transfer Tax," Texas Society of CPAs Advanced Estate Planning Conference, August 2014.

"Planning for the Blended Family" (co-authored by Gary V. Post and Anna K. Selby), *Trusts & Estates* magazine, April 2014.

"Trust and Trustees: A New and Expanding World of Trust Fiduciaries, Flexibility and Situs" (moderator/panelist), State Bar of Texas Advanced Estate Planning Strategies Course, April 2013.

"Knowing When and How to Use, and When and How to Unwind, A Family Limited Partnership in Today's Estate Planning Environment," Texas Society of CPAs Advanced Estate Planning Conference, August 2012.

"Estate Planning for Divorce," State Bar of Texas Estate Planning and Probate Drafting Course, October 2011.

"The Gift Tax Return: Gift and GST Reporting in the Twilight Zone," Texas Society of CPAs Advanced Estate Planning Conference, August 2011.

"Income Tax Issues in Estate Administration" (co-authored by Gary V. Post, Laurel Stephenson and Amy E. Ott), State Bar of Texas Advanced Estate Planning and Probate Course, June 2011.

"Navigating the Mines and Potholes in Unwinding a Family Limited Partnership," University of Texas School of Law Estate Planning Workshop, December 2010.

"Unwinding Estate Plans: What to Do When Planning Has Worked Too Well or Has Not Worked At All" (panelist), State Bar of Texas Advanced Estate Planning Strategies Course, April 2010.

"Estate Planning for the Blended Family," Tarrant County Probate Bar Association, April 2010.

"Understanding Life Insurance Policies and Trustee Liability," Texas Society of CPAs Advanced Estate Planning Conference, August 2009.

SELECT COMMUNITY SERVICE

Lone Star Film Society (Board Member, 2017 – present)

American Cancer Society, Fort Worth (Volunteer of the Year, 2004; Chairman of the Board, 2000 – 2002)

Grand Prairie Rotary Club (President, 1999)

ESTATE PLANNING FOR THE 99%
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Gary V. Post

The enactment of the American Taxpayer Relief Act of 2012 (“ATRA”) significantly altered the landscape of estate planning. For clients with estates valued above the estate tax exemption amount, planning strategy, for the most part, evolved but remained on a similar course. However, for clients with a combined spousal estate valued in the $3–$11 million range, crafting the optimum estate plan became more complex and demanded more creativity from the planner. For example, the tax component of an effective estate plan had to be adjusted to account for the delicate balance between income tax savings and estate tax savings.

Since 2012, two primary developments that have impacted the estate planning environment are the passage of the Tax Cuts and Jobs Act of 2017 (the “2017 Tax Act”) and the evolving field of qualitative estate planning. The 2017 Tax Act continued the effects of ATRA by basically doubling the estate tax exemption. While the process of estate planning continues to focus on technical factors (tax, asset protection, etc.), there is an evolving call to add to that planning model a focus on clients’ qualitative goals and the need to not only prepare the estate for the heirs but to also prepare the heirs to responsibly receive, manage, maintain, and pass on the estate.

This outline provides an overview of the current landscape of estate planning, as well as important factors estate planners should consider in order to structure the best plan for each client.

I. THE NEW LANDSCAPE: INCOME & ESTATE TAX RATES AND EXEMPTIONS

A. Income Tax Rates

The highest marginal income tax rate is now 37%. The threshold amounts for those in the highest tax bracket are as follows: (i) $500,000 for single taxpayers; (ii) $600,000 for married taxpayers filing jointly; and (iii) $300,000 for married taxpayers filing separately. For trusts and estates, the threshold for the highest tax bracket is $12,500. The long-term capital gains rate for those in the highest tax bracket is 20%. Please note that income may also be subject to the Net Investment Income Tax (discussed below).

B. Estate Tax Rates and Exemption Amounts

Under the 2017 Tax Act, the estate tax, gift tax, and generation-skipping transfer (“GST”) tax exemptions are set at $11,180,000 per person (the “basic exclusion amount”) for 2018 and are scheduled to be adjusted annually for inflation. This exemption is reduced by the amount used during life. The annual exclusion amount is $15,000 per donee ($30,000 for a couple). Additionally, the 2017 Tax Act retains the provision that if gift tax or estate tax applies, the tax rate is 40%.

It is important to note that like other selected provisions of the 2017 Tax Act, the increased exemption amount is set to expire on December 31, 2025. For example, if the exemption amount (as adjusted for inflation) for 2025 is $13,500,000 and the inflation adjusted exemption under prior law would be $6,750,000, then on January 1, 2026, the exemption would be $6,750,000.

C. Net Investment Income Tax Rates

Beginning with ATRA, Section 1411 of the Internal Revenue Code imposes a 3.8% tax on the net investment income ("NII") of individuals, estates and trusts. NII is a broad category of investment income and other unearned income. In fact, most of what we used to think of as portfolio income is now taxable as NII. Types of NII include interest, dividends, annuity distributions, rents, royalties, income derived from passive activities, and the net capital gain derived from the disposition of property.

For individuals, the tax is imposed on the lesser of: (i) the individual's modified adjusted gross income ("MAGI") in excess of the threshold amount; or (ii) the individual's NII for the year. The threshold amounts for the NII tax are as follows: (i) $200,000 for single taxpayers; (ii) $250,000 for married taxpayers filing jointly; and (iii) $125,000 for married taxpayers filing separately. For estates and trusts, the NII tax is imposed on the lesser of: (i) the estate's or trust's adjusted gross income in excess of the highest income tax bracket threshold ($12,500); or (ii) the estate's or trust's undistributed net investment income. Note that, although the threshold amounts for individuals are not indexed for inflation, the threshold for estates and trusts is tied to the highest income tax bracket threshold, which is indexed.

D. Paradigm Shift: Importance of Basis Planning

With the implementation of ATRA came the reality that income tax planning now has a heightened significance within the realm of estate planning. As the differentials between income tax rates and estate tax rates have been significantly reduced, estate planners must remain keenly aware of the importance of basis planning. This is particularly true for estates that are valued below the exemption amount. Whereas in previous years the benefit of avoiding estate tax almost guaranteed the wisdom of removing appreciating assets from a client's estate, those same "estate freeze" techniques that formerly proved so effective could today cause a client's estate to miss out on a basis step-up at death for appreciated assets—which may have costly consequences. Thus, for many clients, estate tax planning can include a balancing act between avoiding estate tax and preserving basis adjustments for appreciated assets.

E. Planning in New Landscape: Factors to Consider

There are myriad of factors to consider when creating estate plans under the new landscape.

1. *Total net worth.* Does the clients' estate fall well below the exemption amounts or could they potentially be subject to federal estate tax?
2. *Age and life expectancy of client(s).* Is one spouse in significantly better health than the other? Or, much younger than the other?
3. *Out of state property.* Do the clients own property in another state?
4. *Occupation of client(s).* Do the occupations of the clients subject them to increased creditor exposure?
5. *Spending habits.* What standard of living are the clients accustomed to? How much income will they need for living expenses? What is the likelihood or to what extent will their estate be exhausted during their lifetimes?
6. *Preservation of GST tax exemption.* Will both spouses' GST tax exemptions be required to cover the amount of wealth being transferred to their descendants?
7. *Client tolerance for complexity.* Will the clients resist any complicated planning measures?
8. *Family structure.* Is the family a blended or unitary family? What is the likelihood of family discord?
9. *Client's desire for control.* How important is it to the client that he or she knows exactly how the estate will ultimately be distributed?
10. *Asset classification.* What types of assets are in the estate? Will they benefit from a basis adjustment? Or, will a basis adjustment likely result in a step-down? Is it likely that the clients will sell assets during their lifetimes?
11. *Expectation of appreciation.* Is it likely that the estate will appreciate? Could appreciation cause the estate to become subject to federal estate tax?
12. *Divorce protection.* Do the clients want to protect the estate from former spouses in the event of a child's divorce?
13. *Incapacity protection.* How important is it to the clients that their assets be protected from the potential incapacity of one or both spouses?
14. *Loss of DSUE amount.* Are the clients relying on the availability of portability to avoid the federal estate tax? If so, is it possible that the surviving spouse could put the deceased spouse's DSUE amount at risk by remarrying?

The above list demonstrates a few of the many factors that affect which tools will most effectively serve the client.

II. PORTABILITY

The introduction of portability under ATRA has opened new doors for estate planning opportunities. Prior to 2011, to the extent an individual did not use his basic exclusion amount, such amount would be lost. This changed with the introduction of portability in 2011. Portability first became available with the enactment of the Tax Relief, Unemployment Insurance Reauthorization and Jobs Creation Act of 2010 (the "2010 Tax Act") and was made permanent under ATRA. In essence, portability allows a surviving spouse to "port" or use his or her last deceased spouse's unused federal gift and estate tax exemption.[1]

With the increased estate tax exemption provided by the 2017 Tax Act, many estates will find that relying on portability to take advantage of the first spouse's basic exclusion amount is increasingly helpful. But, even with the increased exemption, traditional bypass trust planning can provide many benefits. As planners, we need to take a new look at the benefits and the drawbacks of using portability in lieu of traditional bypass trust planning as we develop the plan that is right for each client.

Before we move on to planning points, it is important to gain a clear understanding as to how portability works and how to ensure its availability.

A. Basics of Portability

If portability applies, the surviving spouse's "applicable exclusion amount" (the amount excluded from the estate tax) will be the *sum* of the surviving spouse's own basic exclusion amount and the deceased spousal unused exclusion amount.[2] The term "deceased spousal unused exclusion amount" (or "DSUE amount") of a decedent with a surviving spouse means the lesser of: (i) the basic exclusion amount in effect for the year in which the decedent died; and (ii) the excess of the decedent spouse's applicable exclusion amount, over the sum of the decedent's taxable estate and the decedent's adjusted taxable gifts (which is the amount with respect to which the tentative tax is determined on the estate of such deceased spouse).[3]

Because of the increase of the basic exclusion amount (and expiration of the increased basic exclusion amount) provided by the 2017 Tax Act, do adjustments have to be made to the DSUE amount available to a surviving spouses that dies after 2025 with an unused DSUE amount from a spouse who died when there was the increased basic exclusion amount? For example, if the first spouse dies when the estate tax exclusion amount is about $11 million, the

[1] I.R.C. § 2010(c)(2)(B).
[2] I.R.C. § 2010(c)(2); Treas. Reg. § 20.2010-1(d)(2).
[3] I.R.C. § 2010(c)(4).

DSUE amount will be calculated using this larger exclusion amount. If the surviving spouse dies after the exclusion amount has reverted back to $5 million, will the DSUE amount from the first spouse remain at the higher level, or is it limited to the exclusion amount in existence at the death of the second spouse? This clawback issue can be addressed by relying on the existing portability regulations that provide that the DSUE amount is based on the exclusion amount available at the time of the first spouse's death.

B. Election

1. Timely-Filed Estate Tax Return. In order to take advantage of portability, Section 2010(c) requires an "election" by the executor on a timely-filed Form 706 estate tax return (including extensions), even if an estate tax return would not otherwise be required.[4] The portability election is available for decedents whose death occurred after December 31, 2010. Upon the timely filing of a "complete and properly prepared" estate tax return, the estate of a decedent survived by a spouse will have elected portability *unless* the executor states affirmatively on the estate tax return that the estate is not electing portability.[5]

In 2017, the IRS issued new guidance which provided a simplified method for certain taxpayers to obtain an automatic extension of time to make the portability election. Revenue Procedure 2017-34 provides that certain estates may elect portability up to two years after the decedent's date of death. This relief is only available for estates that are not normally required to file an estate tax return because the value of the gross estate and adjusted taxable gifts is under the filing threshold in Section 6018(a). For executors filing an estate tax return for decedents dying after December 31, 2010, if they file a complete and properly prepared return by the later of (i) January 2, 2018 or (ii) two years after the decedent's date of death, the return will be considered to be timely-filed (as to portability). Such a return should state "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER §2010(c)(5)(A)." Filing in accordance with this revenue procedure is the equivalent of a grant of 9100 Relief.[6] It is important to note that this is only available for estates that have not already filed an estate tax return. If an estate does not qualify for relief under this revenue procedure, the estate may still seek 9100 Relief. However, if an estate *does* qualify for relief under Revenue Procedure 2017-34, 9100 Relief will not otherwise be granted for such estates.

2. Relaxed Rules in Certain Cases. As a general rule, the return will be deemed "complete and properly prepared" if it is prepared in accordance with Form 706 instructions and the regulations under Section 6018.[7] However, some relaxed reporting requirements are provided under the Regulations if the return is not otherwise required to be filed, but is being filed to elect

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[4] I.R.C. § 2010(c)(5)(A).

[5] Treas. Reg. § 20.2010–2(a)(2).

[6] "9100 Relief" refers to letter rulings that can be issued pursuant to Treas. Reg. § 301.9100-3, granting an extension of the time to make an election.

[7] Treas. Reg. § 20.2010-2(a)(7); Treas. Reg. § 20.6018-2 (relating to persons required to file a return); Treas. Reg. § 20.6018-3 (relating to required contents of the return); Treas. Reg. § 20.6018-4 (relating to documents to accompany a filed return).

portability.[8] In these cases, there are special rules for valuing assets that qualify for the estate tax marital or charitable deduction. In those cases, the executor is not required to report a value for such property and will only need to report the following information with respect to such assets:

- Description, ownership and/or beneficiary of the qualifying property;
- Information necessary to establish that the property qualifies for the marital or charitable deduction; and
- An estimate of the fair market value of the gross estate, including a best estimate of the value of the qualifying property.[9]

However, the relaxed reporting rules do not apply to marital or charitable deduction property if one of the following applies:

- The value of the property relates to the value of property passing to another beneficiary of the estate;
- The value of the property is needed to determine the estate's eligibility for special treatment such as alternate valuation, special use valuation or estate tax deferral;
- Only a portion of the property interest includable in the estate qualifies for the marital or charitable deduction; or
- A partial qualifying terminable interest property election or a partial disclaimer is made with respect to the property.[10]

3. Computation Required. The Regulations require a computation of the DSUE amount to be made by the executor on the filed estate tax return.[11] The current Form 706 includes portability provisions including this computation requirement.

4. Who Makes Election? If there is a court-appointed executor, that is the person with the authority to elect portability. If, however, there is no court-appointed executor, then any person in actual or constructive possession of property (a non-appointed executor) may file the estate tax return electing portability. A portability election by a non-appointed executor cannot be superseded by a subsequent election to opt out of the election by this non-appointed executor.[12] It is easy to imagine situations in which the family is not in agreement with respect to whether the portability election should be made. Therefore, if the decision with respect to portability will be an issue, provisions should be included in a Will or marital property

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[8] Treas. Reg. § 20.2010-2(a)(7)(ii).
[9] Treas. Reg. § 20.2010-2(a)(7)(ii).
[10] Treas. Reg. § 20.2010-2(a)(7)(ii)(A).
[11] Treas. Reg. § 20.2010-2(b).
[12] Treas. Reg. § 20.2010- 2(a)(6).

agreement specifying (i) whether portability should be elected or (ii) who will have ultimate authority to make such decision.

5. Opting Out of Portability. Most of the emphasis in the regulations has to do with an affirmative election to take advantage of portability. However, the regulations also clarify how to avoid the election. The simplest way to avoid a portability election is to not file an estate tax return, provided that a return is not otherwise required to be filed. If a return must be filed for other reasons, the executor must state affirmatively on the return, or on a statement attached to the return, that the estate is not electing portability under Section 2010(c)(5).[13] Part 6, Section A of Form 706 provides a check box for the executor to elect out of portability.

C. Use of DSUE Amount – Ordering

1. Last Deceased Spouse. A surviving spouse may only use the DSUE amount from his or her "last deceased spouse," determined as of the time of the gift. The "last deceased spouse" means "the most recently deceased individual who, at that individual's death after December 31, 2010, was married to the surviving spouse."[14]

> *Example*: Husband-1 dies in 2018 with a $4 million DSUE amount, survived by Wife. Husband-1's executor elects portability. In 2018, Wife has available to her a $15.18 million gift and estate tax exemption (a $4 million DSUE amount plus her own $11.18 million basic exemption amount).
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> If Wife later remarries, Husband-1 is still considered to be the "last deceased spouse" and the DSUE amount from Husband-1 is still available to Wife. If Husband-2 predeceases Wife, Husband-2 will be Wife's "last deceased spouse" meaning that the DSUE amount then remaining from Husband-1can no longer be used by Wife.[15]

If a surviving spouse plans to remarry, he or she should consider making lifetime gifts to utilize the DSUE amount from the last deceased spouse rather than risk losing it. The "last deceased spouse" is determined as of the date of the gift. In the preceding example, Wife would be able to use the DSUE amount from Husband-1 even after her remarriage to Husband-2 (until such time that Husband-1 is no longer Wife's "last deceased spouse").

2. Availability. A portability election is effective as of the date of the decedent spouse's death.[16] Thus, the DSUE amount will apply to gifts made by the surviving spouse after the date

[13] Treas. Reg. § 20.2010-2(a)(3).
[14] Treas. Reg. § 20.2010-1(d)(5).
[15] Treas. Reg. § 20.2010-3.
[16] Treas. Reg. § 20.2010-3(c).

of the decedent spouse's death even if the gift is made before the estate tax return electing portability is filed.

3. Ordering. The deceased spouse's DSUE amount is applied to gifts of the surviving spouse before his or her own remaining exemption is used.[17] A surviving spouse can take advantage of the DSUE amounts of multiple predeceased spouses during the surviving spouse's lifetime.[18] That is, to the extent a surviving spouse can use the full amount of each predeceased spouse's DSUE amount through lifetime gifting before the next spouse's death, he or she can make gifts far in excess of the exemption amount.

D. Portability Versus Bypass Trusts

Many practitioners believe that portability is a good safety net for those who have not done any estate planning, but is not something they would recommend to their clients. Instead, bypass trusts have traditionally served as the preferred planning tool for avoiding estate tax. The purpose of the bypass trust is to capture the estate tax exemption of the first spouse to die, while allowing the surviving spouse to maintain access to the assets during his or her life, as a beneficiary of the bypass trust. Bypass trusts are a well-established planning tool and have many benefits, including the following.

- Appreciation on assets transferred to the bypass trust escape estate tax at the surviving spouse's death.
- Assets left in trust remain protected from the surviving spouse's creditors and from claims of future spouses.
- The spouse who died first can control how his or her portion of the assets will be distributed at the surviving spouse's death, insuring that his or her assets ultimately pass to the children when the surviving spouse dies. (This aspect can be especially important in blended family situations due to concerns of inequities between children following the death of the first spouse.)
- Assets held in trust are more easily managed in the event of the incapacity of the surviving spouse.

Portability, however, has really opened up the landscape of estate planning options for couples at all wealth levels. First, let's take a look at some of the pros and cons of recommending or relying on portability versus the use of traditional bypass or credit shelter trust planning.

Pros: The main benefit of portability is its relative simplicity.

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[17] Treas. Reg. § 25.2505-2(b).
[18] Treas. Reg. § 25.2505-2(c).

- Married couples who are not interested in spending money on comprehensive estate plans that include bypass trust planning may opt to rely on portability to shelter their combined estate from estate tax. Although the estate tax return filing requirement may create some additional complexity, the relaxed reporting requirements of the regulations mitigate this burden to a certain degree.
- For married couples with one or more large qualified retirement accounts, relying on portability may be particularly desirable. Although a bypass trust that is drafted as a see-through trust can be named as the beneficiary of a retirement account without accelerating the minimum required distributions (and consequently the income tax thereon), drafting the provisions necessary to meet the see-through trust requirements is not consistent with the traditional purposes of the bypass trust.
- Married couples with disparate wealth may prefer to rely on portability rather than on lifetime equalization planning between the spouses. If one spouse's estate is nontaxable and the other spouse's estate exceeds the taxable limits, traditional bypass trust planning is not effective for the "poorer" spouse. If the non-monied spouse dies first, his or her estate tax exemption would be lost without portability, even with traditional bypass trust planning because he or she simply does not have enough money to fund the bypass trust.
- If the marital assets consist of low basis assets, portability may be a better option than traditional bypass planning in order to take advantage of the step-up in basis in assets at death. With the increase in income tax rates on capital gains and the relatively low estate tax rate, this is a good alternative in the right circumstances.

Cons: The most commonly discussed drawbacks include the following.

- Portability does not extend to GST tax. Any amount of the GST tax exemption amount that was not used during the deceased spouse's life or through other planning at his or her death will be lost.
- Portability has limited availability to non-US citizens, depending on residency and citizenship. If the deceased spouse is a nonresident, non-US citizen at the time of his or her death, a portability election is not available.[19] If the deceased spouse is a non-US citizen but is a resident at the time of his or her death, a portability election is available. However, the surviving spouse's use of that exemption may be limited or disallowed, depending on the surviving spouse's status.

[19] Treas. Reg. § 20.2010-2(a)(5).

- Assets of the deceased spouse that pass outright to the surviving spouse are subject to creditors of surviving spouse, whereas if those same assets are transferred to a bypass trust they are more likely to be protected from creditors.
- Appreciation of the deceased spouse's estate will be included in surviving spouse's estate. If proper bypass trust planning is implemented on the death of the first spouse, all of the appreciation on the assets transferred to the bypass trust (to the extent such assets are not distributed to the surviving spouse during his or her lifetime) will not be subject to estate tax at the subsequent death of the surviving spouse. The relevance of this factor is heightened with the temporary life of the increased estate tax exemption.
- There is a possibility that the DSUE amount could be lost entirely if the surviving spouse later remarries a new spouse and survives that spouse.
- Portability has not been adopted at the state level. Use of bypass planning may help mitigate state estate taxes that would be imposed on the presumably larger estate of the second spouse to die.

The choice between utilizing a traditional bypass trust (thereby foregoing a basis step-up at the surviving spouse's death) and relying solely on portability (which secures a basis step-up but leaves the client without many of the typical non-tax advantages of using a trust) is complex and depends largely on the circumstances of each client.

Portability, however, is not always a trust versus non-trust issue, as there are other planning techniques that can take advantage of portability without sacrificing the benefits of a trust. Accordingly, advisors need to consider the broad planning opportunities and options available, taking into account the changes in the tax laws and each client's particular situation. There are a variety of options available in designing estate plans now that portability is a permanent feature in estate planning. The best course will depend on a variety of factors that vary from client to client. Some of the factors to consider include asset composition, anticipated growth of assets, client age and health issues, blended family issues, desire for control, creditor issues, desire for simplicity/tolerance for complexity, and income tax rates, among others. There will not be a "one-size-fits-all" solution for all clients. The one thing that does appear certain is that nearly all clients will benefit from a review of their estate plan.

III. PLANNING TOOLS

A. Outright Gift to Surviving Spouse (Portability)

An outright gift to the surviving spouse is an option clients may prefer to take (often because of its apparent simplicity), and although this option does not include a lot of planning on the front end, there are several issues estate planners must ensure clients consider before utilizing this "simple" option. Even if portability would completely shield the clients from federal estate tax liability if an outright gift is used, the fact that the GST tax exemption is not portable may leave future generations with an unnecessary tax burden.

> *Example*: Husband dies in 2018 and leaves an $8 million estate. Husband's Will provides that $4 million passes to Wife outright, and the remaining $4 million passes to his children in trust. Because Husband's estate is less than $11.18 million, there is no federal estate tax liability.
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> The executor of Husband's estate files an estate tax return allocating $4 million of Husband's estate tax exemption and $4 million of Husband's GST tax exemption to the gift to the children's trust. The executor also elects portability to pass Husband's remaining $3.18 million unused exemption amount to Wife.
>
> Wife now has a gift and estate tax exemption of $14.36 million ($3.18 million DSUE amount from Husband plus $11.18 million of her own). Her GST tax exemption, however, remains at $11.18 million.

Passing assets outright to the surviving spouse does allow for the assets to receive a new basis at the surviving spouse's death. This technique, however, foregoes the many benefits of using a trust, including protection from creditors, the ability to allocate the deceased spouse's GST tax exemption, and the ability of the deceased spouse to control the ultimate disposition of his estate upon the death of the surviving spouse.

B. Outright Gift to Surviving Spouse with Disclaimer Planning

In the same scenario as the example above, Husband could have included a provision in his Will directing that if Wife disclaims the bequest, the $4 million should instead pass to a bypass trust. This technique gives the surviving spouse the flexibility of deciding whether to rely solely on portability.

Returning to the example above, if Wife also had a substantial estate (such that a lack of GST tax exemption might be an issue) or if Wife might eventually remarry (thereby risking a loss of deceased Husband's DSUE amount), it would be wise to suggest that Wife disclaim the bequest. Husband's GST tax exemption could be allocated to the bypass trust, and there would be no risk that the assets passing to the trust would be subject to the estate tax (as would be the case in the event that the DSUE amount from Husband would be lost or insufficient to cover Wife's estate). Disclaiming to the bypass trust would provide all of the non-tax benefits of a trust discussed above. A potential disadvantage would be Wife's inability to retain a special power of appointment over the disclaimed assets in the bypass trust, which would prevent her from making adjustments to account for changing conditions among beneficiaries.

There are other potential disadvantages to this approach that should also be considered. For example, Wife could inadvertently accept the bequest or die prior to disclaiming, which would negate her ability to disclaim. Wife could also refuse to disclaim regardless of whether it is the most advantageous tax planning option. In this way, the disclaimer technique prevents the deceased spouse from having control over the ultimate disposition of the estate, which is why this option is generally not recommended for blended families where unfair treatment among beneficiaries is a possibility.

C. QTIP Trust

Another planning option involves utilizing portability in conjunction with a standard QTIP trust. This option involves the following steps. The Will of the deceased spouse provides that all of his or her assets shall be transferred to a QTIP trust for the benefit of the surviving spouse, and, once the QTIP election is made, the estate of the deceased spouse receives a marital deduction equal to the value of the property passing to the trust. The executor of the deceased spouse's estate then makes a portability election, allowing the DSUE amount to pass to the surviving spouse. The executor can also make a "reverse QTIP election," which allows the deceased spouse's GST tax exemption to be allocated to the trust. Moreover, any assets in the surviving spouse's estate (including the assets in the QTIP trust) receive a step-up in basis at the surviving spouse's death.

Through a QTIP trust, the deceased spouse can ensure his estate will ultimately pass to his children by naming them as remainder beneficiaries of the trust, which is particularly useful in blended family situations. To qualify for QTIP treatment, however, the trust must meet certain terms. Two such requirements are that the surviving spouse must be the only beneficiary of the trust and must be entitled to receive all income from the trust.

> *Example*: Husband's Will provides that his entire $8 million estate passes to a QTIP trust for the benefit of Wife. The Will also provides that upon the death of Wife, Husband's two children (one from a prior marriage) are to become beneficiaries of the trust.
>
> When Husband dies in 2018, the executor of his estate makes a QTIP election for his estate, which qualifies the $8 million to be treated as a marital deduction. Husband's estate is therefore not subject to any federal estate tax liability, and Husband has preserved all of his estate tax exemption, which will be available for Wife's use. The executor also makes a portability election and a reverse QTIP election. The portability election transfers all of Husband's DSUE to Wife for her use. The reverse QTIP election allows the executor to allocate Husband's GST tax exemption to the trust, which allows the trust assets to pass to his descendants free of generation-skipping transfer tax.

Wife is entitled to all income earned by the trust. Assuming Wife does not use any of the DSUE amount during her lifetime (and assuming she is not predeceased by a second spouse), she will have Husband's full $11.18 million exemption to cover her estate, in addition to her own exemption, and all assets held by Wife at her death will receive a step-up in basis.

D. QTIPable Trust

Another possible planning option is the use of a "QTIP***able***" Trust, which is simply a trust that meets all terms required for it to receive QTIP treatment. To utilize this technique in the preceding example, Husband's Will would provide for his estate to pass to a QTIPable trust and would also give the executor of his estate the ability to refine Husband's estate plan as necessary after his death if circumstances warrant. Specifically, his executor can make either a full QTIP election, no QTIP election, or a partial QTIP election. Granting the executor this authority allows him or her to have the flexibility necessary to determine, at the time of Husband's death, which option would be most advantageous for Husband's estate as well as for all parties involved. It also ensures that regardless of what type of election the executor makes, the Husband retains control of who shall benefit from his estate.

If the executor chooses to make a full QTIP election, then the entire trust receives QTIP treatment with the same result as discussed above regarding standard QTIP trusts. If the executor makes a partial QTIP election, that portion of the assets in the QTIPable trust not subject to a QTIP election would be carved out and held in a separate trust designed to pass at Wife's death free of estate taxes to the remainder beneficiaries. Because the two trusts would have identical terms, Wife would retain the entire income interest from the trusts. The assets held in the non-elective trust would not be subject to the estate tax in Wife's estate and thus would not receive a step-up in basis at Wife's death.

E. QTIP with Clayton Provision

Alternatively, the Will could provide for any portion of assets in the QTIP trust for which a QTIP election is not made to pass to a bypass trust so that the mandatory income distributions required of a QTIP trust can be avoided. Accordingly, the executor could choose to not make a QTIP election for that portion of the QTIP trust equal to the remaining estate tax exemption amount. This type of provision is referred to as a "Clayton election."

Both the surviving spouse and descendants could be beneficiaries of the Clayton Bypass Trust and could receive income based on a HEMS standard (health, education, maintenance and support). The deceased spouse's GST tax exemption can be allocated to the Clayton Bypass Trust. The assets held in that trust, however, would not receive a step-up in basis at the death of the surviving spouse.

IV. NON-TAX CONSIDERATIONS

In planning for very large estates, the focus is often on minimizing the clients' exposure to estate tax and GST tax. However, every estate planner should also explore the various non-tax considerations as part of a complete estate plan.

A. Asset Protection Planning

Asset protection is a very important benefit of trusts and business entities, but is often seen as a "bonus" rather than the motivating factor in estate planning for large estates. Trusts, limited liability companies, and limited partnerships are three planning tools commonly used in limiting one's exposure to potential creditors. These tools can be used individually or in conjunction with each other.

1. Business Entity. A limited liability company or limited partnership can protect assets within the entity from the creditors of an individual owner (i.e., the member or partner). The individual owns a membership interest or limited partnership interest instead of the underlying assets. Under Texas law, the rights of a creditor of an individual owner are limited with respect to the individual's membership interest or limited partnership interest: the creditor can only obtain a charging order against the owner's interest in the entity. The charging order entitles the creditor to receive the individual owner's share of distributions from the entity if and when distributions are made. The creditor cannot force a distribution nor can it exercise voting rights with respect to such interest. Further, creditors whose claim stems from the operations or assets within the business entity have no claim against the individual owners.

2. Trust. The assets held in a spendthrift trust are protected from creditors of beneficiaries of the trust, provided the beneficiary is not the grantor. Further, trust assets are protected from a beneficiary's spouse in the event of a divorce. In some states (such as Texas), the beneficiary can even serve as sole trustee without forfeiting the asset protection qualities of the trust. While a limited liability company or limited partnership does provide asset protection in that a creditor can only seize assets actually distributed from the entity, this has practical limitations when an entity has multiple owners. Those other owners may want to make distributions from the entity despite the creditor problems of one owner. If a membership interest or limited partnership interest is owned by a trust for the benefit of an individual, rather than the individual himself, a distribution can be made from the business entity without exposing that distribution to the creditor. In such event, the distribution will go to a trust rather than the individual. The trustee of the trust can then use the distribution to provide for the health, education, maintenance, and support of the individual beneficiary.

B. Planning for Disability or Incompetency

Planning for disability or incompetency is another important component of estate planning that can be easily overlooked. Planning for disability or incompetency often includes preparing a statutory durable power of attorney, directive to physicians (living will), medical power of attorney, declaration of guardian of the person and estate, and, in many cases, a revocable living trust. These documents should be updated regularly and kept in an accessible location. The revocable living trust, if funded during life, provides for a smooth transition of management authority over the assets in the event of incapacity.

C. Beneficiary Designations

A carefully drafted Will or revocable Living Trust is meaningless if beneficiary designations are not properly coordinated to the plan. Bank accounts, retirement accounts, and life insurance can pass according to beneficiary designations, which can have unintended consequences to an estate plan, particularly when those assets make up a large percentage of the overall estate. Guiding the clients through these designations is vital to the success of their estate plan.

D. Retirement Planning

Due to the minimum required distribution rules applicable to retirement accounts, it often makes more sense, economically, to designate a surviving spouse or descendants as beneficiaries of a retirement account rather than a trust. If an individual is designated as the beneficiary of a retirement account, it will be included in the decedent’s estate for estate tax purposes and, when distributions are made to the individual beneficiary, such distributions will be included in the beneficiary’s income and subject to income taxes. An individual beneficiary may only receive 39% of the value of the retirement account after a 40% cut for estate taxes and another 35% for income taxes.

If the client is charitably inclined, a retirement account can be used very effectively in charitable planning. If a charity is designated as the beneficiary of a retirement plan, the charity will get 100% of the value of the retirement plan because (i) no estate tax will be due on such assets and (ii) the charity does not pay income taxes. Public charities, donor-advised funds, and private foundations are all eligible beneficiaries of a retirement plan. Designating a public charity is straightforward and a good option for clients who feel strongly about certain charities. The donor-advised fund provides greater flexibility in that it allows for disbursements to charities based on the donor’s guidelines and philosophies. The private foundation is appropriate for larger charitable gifts where the clients feel strongly about creating a charitable legacy that will endure for a long period of time. The private foundation does carry with it significant administrative burdens, which is why most practitioners do not recommended a foundation where the funding is under $10,000,000.

E. Business Succession

For a client who owns a closely held business, particularly if the client would be considered a "key man" in the operations of the business, it is important to consider what happens if this individual passes away unexpectedly. The following issues should be addressed:

- Who is capable of keeping the business going without the key man?
- Should the business be sold? If so, who should be in charge of this process? Is there sufficient liquidity for the family in the meantime?
- Would the value of the business fall drastically without the key man? Is there sufficient key man insurance?

F. Life Insurance

Life insurance is traditionally used to pay estate taxes and/or provide liquidity in the event of the untimely death of the family breadwinner. A new use of life insurance arises when basis step-up planning is in play, as life insurance is one of a few assets that receives an automatic basis step-up at death. It is important to review the life insurance regularly as the clients' needs may change over time and to monitor the performance and economic health of the policy. If a client decides a policy is no longer needed, they may want to consider a sale of the policy on the secondary market rather than simply letting it lapse or taking the cash value.

It is also important to ensure that beneficiary designations are updated appropriately. Life insurance proceeds pass according to the beneficiary designation rather than pursuant to the Will or Living Trust. If one fails to update his beneficiary designation and assets pass to an ex-wife, for example, it can difficult to retrieve those funds.

G. Qualitative Goals

Studies show that most wealthy families squander away their fortune—70% by the second generation and 90% by the time it's passing to the fourth generation. This gives rise to the "Shirtsleeves to shirtsleeves in three generations" proverb.

- The first generation **creates it**: starts with nothing, works hard, and amasses wealth—without making significant changes to their values, customs, or lifestyle.
- The second generation **saves it**: gets an education, lives well, and saves well.
- The third generation **spends it**: has no work experience or business acumen and spends all the family's wealth.
- The fourth generation is **back to manual work**.

The most common reason for wealth transfer efforts to fail is lack of communication and trust. The second most common reason is unprepared heirs. More and more, clients are beginning to understand that even the most well-crafted estate plan will be useless if it fails to address their qualitative goals and/or if their heirs are unprepared to receive the inheritance.

1. <u>Best Practices for Success</u>. By studying what families who have successfully avoided the "shirtsleeves to shirtsleeves in three generations" phenomenon are doing differently than others, common best practices can be identified.

- Hold Family Meetings/Retreats to Foster Family Relations/Cohesiveness
  - Identifying shared values; creating family mission statement
  - Preserving family's history and heritage
  - Family philanthropy
  - Encourage family member well-being and wellness
  - Teaching and enhancing communication skills
  - Communicating/sharing intensions for wealth transfer

- Develop Education Curriculum and Process to Prepare Heirs
  - Financial education
  - Money management
  - Mentoring
  - Support for entrepreneurship
  - Mentor future heirs on impact of an inheritance

- Develop a System of Family Governance
  - Family Mission: Serves as guidepost for all decisions/actions
  - Family Constitution/Bylaws
  - Family Council: Determine which family members vote; establish procedure for making decisions; establish procedure for resolving conflicts
  - Family Advisory Board: Includes the family's "go to" outside advisors (attorney, CPA, Financial Advisor, etc.)
  - Adopt Family Governance Policies: Procedure for when to tell young about wealth and when they get to vote; procedure for orientation to family history and values when people enter the family

2. <u>Family Advancement Sustainability Trusts</u>. A practical tool to help families engage in these best practices is a new type of trust called a Family Advancement Sustainability Trust (a "FAST"). Often Generation 1 (the generation that creates the wealth, or "G-1") begins these best practices and pays for them during G-1's lifetime, but after G-1 is gone, the second generation ("G-2") doesn't take the time to continue the best practices or doesn't want to pay for them. A FAST does two things. First, it provides the funds to pay for the infrastructure (advisors, meetings, etc.) to implement the best practices. Second, it creates a leadership structure to make sure the best practices happen, using a system of trustees and committees who are paid to run the

FAST and are charged with the responsibility of carrying out these tasks. It isn't enough for G-1 to implement best practices and just hope that the family will continue them after their deaths. In order to beat the odds and overcome the "shirtsleeves" adage, G-1 needs to put a structure in place. G-1 creates a FAST during their lifetimes and begins funding it, and then may pour more assets into the FAST at death. The FAST is an add-on to a traditional estate plan. The traditional plan is still needed to provide for the beneficiaries' health, education, maintenance, and support needs; investment management; tax savings; and asset protection.

Structurally, a FAST is a dynasty trust created in a state with Directed Trust laws. With a Directed Trust, decision-making authority is not concentrated solely in the trustee, but instead can be split among one or more advisors to the trust. Specifically, decisions regarding administrative matters, trust investments, and trust distributions may be assigned to separate co-trustees, advisors, or trust protectors. Thus, the significance of the Directed Trust is that it allows family members and trusted advisors of the family to directly participate in the governance of the trust.

A FAST contains four separate decision-making bodies, described below. Individuals may serve on more than one committee, and non-family committee members receive compensation for serving on a committee. The grantors, G-1, would likely desire to be a member of each committee.

- *Administrative Trustee*. Typically, a corporate trustee serves as the Administrative Trustee. The Administrative Trustee has no control over investment or distribution decisions but rather deals strictly with generic trust-related tasks such as recordkeeping, tax filings, and maintaining custody of trust assets.
- *Investment Committee.* The Investment Committee is commonly comprised of three members: two family members and one professional advisor. The professional advisor could be a peer (such as a family investment advisor or some other type of fiduciary) or could be a hired investment advisor. The Investment Committee is charged with making all decisions relating to the investment of trust assets and coordinates with the Distribution Committee to make sure the FAST generates the cash needed to pay for best practices activities.
- *Distribution Committee.* The Distribution Committee is comprised of several members, such as: two family members, a family legacy planning consultant, an individual that is a like-minded peer to the grantor(s), and a professional advisor who brings knowledge of the family. Whereas in other trusts a Distribution Committee makes decisions regarding the disbursement of trust assets, in a FAST the Distribution Committee is charged with spending trust assets to preserve and strengthen the family institution.

- *Trust Protector Committee*. The Trust Protector Committee may be comprised of three professional members such as the family's attorney, CPA, financial advisor, and/or a trusted fiduciary. Family members could serve as consulates to the Trust protector Committee. (One should avoid family members serving on this committee to prevent the trust assets from being subject to a general power of appointment.) The Trust Protectors are individuals charged with playing the role of the grantor once the grantor is no longer able to do so. Some typical Trust Protector duties include removing or appointing the trustees, committee members, or other advisors, and amending the governing instrument of the trust to efficiently administer the trust or to address unforeseen circumstances that adversely affect accomplishment of the trust's purpose.

A FAST should be created during the patriarch's and matriarch's lifetimes to allow G-1 to mold the trust to reflect the ideals and values of the family, guide family members and advisors, and establish the direction of the FAST for future generations. The FAST may be minimally funded during the lifetimes of G-1, with additional funds to be contributed to the trust upon their deaths. The amount of funding can be either a fixed amount or a percentage of the estate. During the patriarch's and matriarch's lifetimes, FAST-related activities such as family retreats and educational programs can be paid for either out of the eldest generation's pocket or from the FAST.

In addition to funding a FAST with liquid assets, a FAST can also be the ideal owner of a family's legacy real estate, such as a family ranch or lake house. The FAST would provide the funds necessary to maintain the property and would establish rules for shared use. It's recommended to segregate the real estate in a separate entity (such as an LLC owned by the FAST) to insulate other FAST assets from liability exposure related to the real estate.

Of the many ways to fund a FAST, two available techniques are a special purpose irrevocable life insurance trust ("ILIT") and a 678 Trust (also known as a Beneficiary Defective Irrevocable Trust). Both of these techniques would allow the FAST to be exempt from GST tax. With a special purpose ILIT, a stand-alone trust holds a life insurance policy on the patriarch or matriarch and funnels additional funds into the FAST at G-1's death. With a 678 Trust, at G-1's death (the primary beneficiaries of the 678 trust), GST tax-exempt assets from the 678 Trust "pour over" to the FAST. This pour-over can be achieved by G-1 exercising a special power of appointment directing assets into the FAST, which also allows them to periodically adjust the amount of the pour-over.

For a FAST that is not allocated GST tax exemption, additional factors must be considered. When the last G-2 member passes away, there would be a "taxable termination" for GST purposes, triggering a GST tax, because there would be no beneficiaries remaining at that time other than "skip persons." To avoid a taxable termination, one could include a charity as a beneficiary. The charity would receive an annual payment (such as 5% of the trust's assets), beginning on the date that the last surviving G-2 passes away. Because the charity is a "non-skip person," a taxable termination would be avoided. To the extent that the FAST makes distributions, directly or indirectly, to a third generation or more remote descendant, the distribution will be treated as a "taxable distribution" for GST purposes and a GST tax will be owed by the recipient. The FAST could be drafted to provide for the distribution to be grossed-up to provide the recipient with sufficient cash to pay the GST tax. (This is similar to a Health and Education Exclusion Trust. Note that distributions for educational and medical expenses that would qualify for the exclusion pursuant to Section 2503(e) would not be subject to GST tax.)

There may be income tax implications if the FAST pays for expenses such as family retreats. In the event a FAST expenditure is considered to be a distribution to a beneficiary, and if such distribution carries out distributable net income causing the beneficiary to owe income tax, the FAST should be drafted so as to allow it to make additional "tax" distributions to cover any income tax imposed on the beneficiary. It is unclear what expenditures would be categorized as trust administration expenses and, therefore, deductible on the FAST's Form 1041 income tax return. To the extent that expenditures are not tax deductible, the FAST needs to reserve cash to cover its income tax liability.

V. CONCLUSION

With the recent changes in the law and the increased focus on qualitative—not just quantitative—estate planning, we have entered a new era of estate planning with many exciting possibilities. Each client presents a unique set of circumstances and requires a thoughtful and unique estate plan to satisfy their needs and wishes. Fortunately, there are a multitude of options available, only some of which are mentioned in this outline.