American Dream:
Estate Planning For This Election Cycle

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Mr. Blum founded The Blum Firm, P.C., now in its 40th year. The Blum Firm is one of the premier estate planning firms in the nation, known for creating customized, cutting-edge estate plans for high-net-worth individuals. The firm specializes in estate and tax planning and the related specialties of asset protection, business planning, business succession planning, charitable planning, family legacy planning, fiduciary litigation, and guardianship.

Mr. Blum serves on the Editorial Advisory Committee for *Trusts & Estates* magazine. He is Treasurer for the Fort Worth Symphony and the Texas Cultural Trust. He is Secretary/Treasurer of the Pat & Emmitt Smith Charities and a member of the Boards of Directors of the Multicultural Alliance and B Sharp Youth Music Program.

Mr. Blum earned both his BBA in Accounting (Highest Honors) and his law degree (High Honors) from the University of Texas.

The "Golden Age" of Estate Planning

- Conditions for estate planning have never been better.
- The stars are perfectly aligned:
  - Lower asset valuations
  - Higher valuation discounts
  - Historically low interest rates
  - Doubled estate tax exemption ($11,580,000 per person; $23,160,000 for a couple)
  - Wide array of "Squeeze and Freeze" planning tools
- Congress has not closed an estate planning loophole in 30 years.
- **We're in the lowest tax regime since 1930.**
  - In addition to estate tax planning, consider converting a regular IRA to a Roth IRA.

The Golden Age Won't Last

› The federal deficit is going through the roof. We will have to pay for all this stimulus help. A "Day of Reckoning" is coming.

› The political landscape will inevitably shift. (Note: A net win of 3 senate seats gets Democrats to 50 senators. Republicans need to pick up 19 seats to control the House.)

› The Byrd Rule requiring 60 senators to approve of a tax decrease doesn't apply to a tax increase. It would only take 50 senators plus a democratic VP to pass a tax increase in the senate.

› The doubled estate tax exemption sunsets in half on December 31, 2025, if not sooner.

› Section 2704 Regulations (shutting down intrafamily valuation discounts) could reemerge with a Democratic White House.

› Other conditions will change:
- Interest rates will rise
- Asset values will recover
- Planning tools (such as Grantor Trusts and GRATs) are easy targets.

› Public sentiment (See "Tax the Rich and Their Heirs," New York Times, June 24, 2020)

Biden Tax Positions

- Eliminate step-up in basis at death. It’s unclear if there would be a carryover basis or a capital gain tax imposed at death on assets not passing to a spouse or charity.
- As a candidate, called for a return to 2009 levels when the estate tax exemption was $3.5 million, lifetime gift exemption was $1 million, and top rate was 45% (versus 40% today).
- Raise top individual bracket to 39.6% from 37%.
- Raise corporate tax rate to 28% from 21%.
- Tax capital gains and dividends at 43.4% (39.6% + 3.8% Obamacare tax) if income above $1 million.
- Wages above $400,000 exposed to full 12.4% social security taxes, plus Medicare tax of 2.9% + 0.9% surcharge, for total payroll tax of 16.2%.
- Phase out 20% pass-through deduction if taxable income above $400,000.
- Cut back itemized deductions and cap benefit at 28%.

Why Are So Many Frozen?

› Logically, now is the time to plan.

› Those who planned during the 2008 credit crisis were rewarded greatly. The time to plan, like the time to invest, is during the crisis, not after the recovery.

› Psychological behaviors:

- Facing our mortality
- Dealing with family dynamics
- Feeling “poor” and reluctant to spend money
- Going through 5 stages of grief (Denial, Anger, Bargaining, Depression, Acceptance)

› Estate planning is an emotionally-charged activity; it involves both “head” and “heart.”

Combatting "Planning Paralysis"

- Cost is minimal compared to benefit.
- Planning now will generate dramatically higher tax savings.
- Waiting is risky.
  - Death isn't always preceded by a warning.
  - If life insurance is part of the solution, consider impact of aging/health decline.
  - Some techniques require time to fully work (such as taking a month pause between the squeeze step or the freeze step, the "burn down" of an estate following a "freeze" sale of discounted appreciating assets, or outliving a GRAT term).
  - Estate planning lawyers will likely be very busy this fall.
- Disease strikes even young people. Our children age 18+ need estate planning too, especially health care documents.
- People need a push, ideally from multiple advisors.

Dispel Planning Myths

› Some are hesitant to engage in estate planning for fear of losing control of the assets, losing access to the assets, or losing the flexibility to change their mind later.

› There are estate "freeze" planning techniques which allow the client to retain all these things.

- First, the client transfers the assets to a Family Limited Partnership ("FLP") to "squeeze" down the value of the FLP units by qualifying for valuation discounts.
- Next, "freeze" the value and lock in the discount by transferring FLP units to a trust that is outside of the estate, e.g., sales to a Beneficiary Defective Trust ("678 Trust"), gifts/sales to a Spousal Lifetime Access Trust ("SLAT"), or gifts/sales to an Intentionally Defective Grantor Trust ("DGT") for the benefit of your children.
- *Control* – Client is president of the general partner of the FLP; also, can serve as trustee of the 678 Trust.
- *Access* – Notes receivable from sales; client is also the beneficiary of the 678 Trust or SLATs.
- *Flexibility* – Special trustee or trust protector provisions; special power of appointment in 678 Trust or SLATs.

“Squeeze & Freeze” Planning

- Now is the ideal time. Down the road, you will likely look back and realize that now was the time to pull the trigger and do it.
  - Step 1 (the “Squeeze”) – Transfer assets to an FLP and squeeze down the value of the FLP units through discounts for lack of control and lack of marketability.
  - Step 2 (the “Freeze”) – “Freeze” the value and lock in the discount by selling FLP units to a trust that is outside of your estate, e.g., a 678 Trust, a SLAT, or a DGT for the benefit of your children in exchange for a promissory note at the applicable federal rate. You can also freeze by making gifts (rather than sales) to a SLAT or DGT.
- Note the transfer to a 678 Trust or a SLAT can be structured to not only remove assets from your estate, but you can **retain access** to the assets and **retain the flexibility** to alter the trust disposition if you wish to do so later. With a 678 Trust, you can also **retain control** over the assets.

Low Interest Rates Create Planning Opportunities

- Consider making loans to kids and locking in the historically low IRS Applicable Federal Rate ("AFR"). October AFR rates are short-term (0-3 years) 0.14%, mid-term (3-9 years) 0.38%, and long-term (> 9 years) 1.12%, near all-time lows. Given how little difference there is, it may be a good time to go with long-term notes and lock in the low rate.
- Also consider renegotiating existing intra-family notes to lock in the low AFR.
- Now is an ideal time for freeze sales to grantor trusts.
- Also explore the benefits of a Charitable Lead Trust ("CLT") which works best when interest rates are low.

“Use It or Lose It” Planning for Expanded Exemption

- The Tax Cuts and Jobs Act of 2017 doubled the estate and gift tax exemption amount. For 2020, it is $11.58 for an individual and $23.16 million for a married couple. But, the increased exemption sunsets December 31, 2025. We have a window of opportunity to take advantage of the higher amount.

- To lock in the benefit of the doubled exemption before it sunsets, a couple has to transfer $23.16 million out of their estate ($11.58 million per spouse). **“Use it or lose it.”**

- Note that if a couple only transfers a total of $11.58 million (50/50 from each spouse) in an effort to lock in the extra exemption, they’ve actually only used the original/old exemption amount. After 2025, that couple would have zero exemption remaining. To lock in the extra exemption amount, each spouse has to transfer $11.58 million.

- *Anti-Claw Back Regulation* – The IRS issued final regulations on November 22, 2019 providing that the benefit of the temporary increase in the gift and estate tax basic exclusion amount would not be clawed back on the taxpayer’s subsequent death after 2025.

Spousal Lifetime Access Trust ("SLAT")

- The most popular way for married couples to use each spouse's gift/estate tax exemption is for each spouse to create a trust for the benefit of the other because doing so **preserves the resources for the spouses' benefit.** This type of trust is often referred to as a Spousal Lifetime Access Trust (or SLAT).
- Each spouse's gift would use part or all of their lifetime exemption amount, depending on the amount of assets transferred. Assets held in the SLAT would not be included in either spouse's estate at death. Think of it as a "Lifetime Bypass Trust" for the benefit of a spouse.
- Example:
  - Husband and Wife enter into a marital property agreement in which they agree to convert a portion of their community property into two separate property halves.
  - Husband creates a trust for the benefit of Wife and funds it with $11 million of his separate property. Wife has access to Wife's SLAT for her needs during her lifetime. After her death, the remaining assets are split into separate trusts for the children.

- At a later date (the more time, the better), Wife creates a separate trust for the benefit of Husband and funds it with $11 million of her separate property. Husband has access to Husband's SLAT for his needs during his lifetime. After his death, the remaining assets are split into separate trusts for the children.
- While Husband and Wife are both alive, the married couple retains access to the full $22 million. However, after the first death, the survivor only has access to $11 million. To replace the lost assets, each SLAT could buy an $11 million life insurance policy on the life of the other spouse.
- If Husband dies first, at Husband's death, Wife continues to benefit from her SLAT, plus her SLAT collects $11 million on Husband's life, so her access to the full $22 million isn't diminished when Husband dies. If Wife dies first, at Wife's death, Husband continues to benefit from his SLAT, plus his SLAT collects $11 million on Wife's life, so his access to the full $22 million isn't diminished when Wife dies.

› Note that the two SLATs must be substantially different or will violate the reciprocal trust doctrine.

"Use It or Lose It" for a Single Person

- Whereas SLATS are the most popular technique for a married couple to lock in the extra exemption before it sunsets, a single person must consider other options.
- If the single person can part with access, the easiest approach is a **gift of $11 million to an Intentionally Defective Grantor Trust ("DGT")** for the benefit of children or others.
  - If the donor needs access, consider having the donor borrow from the DGT on arms' length terms.
  - Donor can retain a swap power to reacquire trust assets for assets of an equivalent value.
  - Independent Trustee could have ability to reimburse the donor for income taxes on trust income.
- Alternatively, to retain access, consider creating a Special Power of Appointment Trust. The donor makes a gift to a trust for others but gives an independent party a special power of appointment ("SPOA") to make distributions to a class of donees that includes the donor. For example, the class of donees could be "the descendants of the donor's mother."

Build Optionality into the Plan

- Waiting to plan until after the election results may be too late to get it done by December 31, 2020.
- If reluctant to make a gift now, consider an installment sale to a Grantor Trust, and then you can forgive the note later as a gift.
- If transferring low-basis assets to a Grantor Trust and step-up doesn't go away, retain a swap power to reacquire the low-basis assets for assets of equivalent value in order to achieve a basis step-up at death.
- Make a quick gift of cash to the Grantor Trust now, and then have the trust acquire discounted assets from you later.
- If reluctant to transfer low-basis assets in case the exemption doesn't sunset and step-up remains, gift the assets in 2020 to a QTIP-able SLAT. If you determine by the 2021 gift tax deadline that you prefer to retain the assets in the estate for a step-up, make the QTIP election.

If Only Willing to Gift $11.58 Instead of $23.16 Million

- If a couple decided it is only willing to give $11.58 million, make the gift entirely from one spouse and don't gift-split.
- Compare the outcomes:
- If each spouse gives a gift of half the $11.58 million, after sunset they will have each used all of their old exemption and none of the extra, so their remaining exemption is zero.
- Instead, if the husband gives the entire $11.58 million, after sunset, the wife will still have her old $5.79 million exemption.

Disclose Planning on a Gift Tax Return

- In order to get the three-year statute of limitations running, disclose all planning on a Form 709 Gift Tax Return.
- Be fully transparent. Attach copies of all trusts, transaction documents, and appraisals.

SECURE Act

- The Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act") was signed into law on December 20, 2019.
- *Repeal of Maximum Age for Traditional IRA Contributions* – The rule that prohibited contributions to a traditional IRA by taxpayers aged 70 ½ or older was repealed. Any individual who has earned income from wages or self-employment may now continue to contribute to a traditional IRA.
- *Increase in Age for Required Beginning Date for Mandatory Distributions* – Individuals who attain age 70 ½ after December 31, 2019, are not required to begin taking distributions from their retirement plan or IRA until attaining age 72.
- The provision that will have the largest impact from an estate planning perspective is a new 10-year payout rule for inherited IRAs. The rule eliminates the availability of what was known as the "stretch IRA" for most beneficiaries.

IRAs with Individual Beneficiaries

- Under prior law, when a child or spouse was named as beneficiary of an IRA, the Required Minimum Distributions ("RMDs") could be calculated based on the beneficiary's life expectancy, up to 58 years, thus "stretching out" the payout period. The SECURE Act changed this for most children, imposing a 10-year payout rule, requiring that IRA amounts must be paid out within 10 years of the account owner's death. (A surviving spouse may still withdraw retirement benefits based on his or her life expectancy.)
- In addition to a surviving spouse, the 10-year payout rule does not apply to the following individual beneficiaries:
  - Disabled individuals
  - Chronically ill individuals
  - Individuals who are not more than 10 years younger than the IRA owner
  - A minor child of an IRA owner (the 10-year period for a minor beneficiary begins when the beneficiary reaches the age of majority)

IRAs with a Trust as Beneficiary

- If a trust is named as the beneficiary of an IRA, unless the trust meets certain requirements, the payout is subject to a "5-year rule." This rule requires the balance of the IRA to be distributed (and taxed) to the trust beneficiaries within 5 years of the death of the IRA owner. Special trusts called Conduit Trusts and Accumulation Trusts (sometimes called "see through" trusts) could be named as beneficiary to gain the asset protection qualities inherent to trusts as well as qualify for a 10-year payout instead of a 5-year payout.
- With a **Conduit Trust**, payouts received by the trust are immediately distributed to the beneficiary. Under the SECURE Act's 10-year payout rule, IRA amounts will be paid to the Conduit Trust within 10 years and then distributed immediately to the beneficiary.
- With an **Accumulation Trust**, IRA amounts received can be held in the trust rather than paid out immediately. So, although IRA amounts must be paid out from the IRA to the Accumulation Trust within 10 years, they can be held in the Accumulation Trust and dribbled out to the beneficiary over a longer period of time. Accumulation Trusts will now be the "go to" technique to gain the asset protection qualities inherent to trusts and be able to "stretch out" the payout period.

CARES Act

- The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was signed into law on March 27, 2020.
- In addition to providing stimulus relief, the CARES Act also includes some tax-related provisions.
- *Waiver of Required Minimum Distributions ("RMDs")* – No need to take an RMD from your IRA or 401(k) in 2020.
- *Cash Contributions to Public Charities* – The limitation for itemized deductions of cash contributions is increased for 2020 from 60% to 100% of Adjusted Gross Income ("AGI"). The charity must be a public charity and cannot be a donor advised fund or a private foundation. For non-itemizers, up to $300 of cash contributions to public charities can be deducted.

Structuring Charitable Gifts

- How would you like to be remembered when you are gone? Most answer that they hope they lived a life with meaning—that their life made a difference. Charitable planning is one of the key ways to achieve that kind of fulfillment. By planning charitable gifts, either during life or at death, a legacy can be created that will last for generations after death.
- Charitable giving is not just an option for the wealthy. Every person, regardless of the size of their estate, can benefit a charity through charitable giving. There are many techniques available, from simple to complex, providing varying degrees of tax benefits and often benefitting the family of the donor at the same time.
- Families joining together for charitable activities creates powerful family "glue."

Charitable Lead Trust

- A charitable lead trust ("CLT") is a trust that makes an annual payout, either a fixed amount (a "CLAT") or a variable amount (a "CLUT"), to a charity for a fixed term such as 10, 15, or 20 years. At the end of the term, the trust assets pass to the donor's family (typically to the donor's children) free of estate or gift tax.
- The CLT removes assets from the donor's estate so that **the donor avoids the estate tax on the assets,** but when the term ends, **the assets pass to the donor's children.** With careful planning, a CLT can be structured so there is no estate or gift tax on the portion of the assets passing to the children.
- The best time to create a CLT is when interest rates are low. Low interest rates serve to reduce the present value of the remainder interest that passes to the children, making it easier to avoid paying gift tax on this amount.
- You can select the interest rate for the month of the transfer, or for either of the two prior months. For example, if you fund a CLT in September, you can use the AFR interest rates for either July, August, or September.

Charitable Remainder Trust

- When an individual creates and funds a charitable remainder trust ("CRT"), the trust makes an annual payout back to the donor and/or other humans for life (or a term of years up to 20 years), and at the end of the term, the remaining principal passes to the named charity. For example, the CRT can be structured to make an annual payout to the donor for life, and then continue after the donor's death for the life of the donor's child, and at the death of the child, the remaining principal passes to the named charity. When a CRT is established, **the grantor receives an income tax deduction for the value of the remainder interest.**
- CRTs can be structured as "annuity trusts" or "unitrusts." In an annuity trust, the annual payout is a fixed dollar amount. In a unitrust, the annual payout is equal to a fixed percentage (minimum of 5%; maximum of 50%) of the value of the trust's assets, determined annually. In order to qualify as a CRT, at the CRT's inception, the actuarial present value of the remainder interest must be at least 10% of the value of the original gift.

- **The CRT is exempt from tax, so it does not pay capital gains tax or income tax as a result of its transactions.** If appreciated assets are contributed to a CRT, the CRT can sell them with no tax due at the time of the sale. This provides an excellent opportunity to convert assets to cash without an immediate capital gains tax, which is even more appealing now that the long-term capital gain tax rate rose in recent years from 15% to 23.8%.
- When the donor (or other beneficiary) receives annual distributions from the CRT, the distributions are subject to income tax based on a WIFO (worst in, first out) tiering system.
- Distributions first carry out any ordinary income accumulated in the CRT, then capital gain, then tax exempt income, then return of principal. The tiering system tax treatment is determined by the original character of the income when it was generated inside the trust. For example, if the CRT distributed income to the donor that was generated when the CRT sold stock owned for more than one year, and assuming there was no other income earned by the CRT, the donor would pay tax on the distribution at long-term capital gain rates.

Family Advancement Sustainability Trust ("FAST")

- Only 10% of families enjoy multi-generation success. 90% fall victim to the proverb "Shirtsleeves to shirtsleeves in three generations." The successful 10% engage in activities like regular family meetings, preparing their heirs to be responsible inheritors. Typically, the patriarch and matriarch pay for these activities and make sure they happen. The problem is that after the patriarch and matriarch are gone, the children drop the ball and don't want to pay for these activities or take the time to do them. It takes more than G-1's hopes and dreams for future generations to succeed. Hope is not a strategy. G-1 needs to be intentional and implement a practical solution.
- G-1 should create a Family Advancement Sustainability Trust ("FAST") to endow the cost of conducting regular family meetings, travel, and enrichment activities.
- A FAST is the best way to pay for best practices of successful families, such as:
  - Holdings family meetings and retreats;
  - Creating a curriculum and educating future heirs to become responsible inheritors;
  - Establishing a system of family governance; and
  - Working to preserve the family's history and heritage.

- **A FAST provides FUNDS:**
  - Funds for future generations to use to prepare heirs to be able to successfully manage an inheritance.
  - Fund family endeavors to keep the family together after the elder generation dies, such as family retreats and family meetings.
  - Funds to train future generations on concepts like philanthropy and being responsible stewards.
- **A FAST provides LEADERSHIP:**
  - Creates a leadership structure to ensure these activities happen, using a system of trustees and committees who are paid to run the FAST and charged with the responsibility for carrying out these tasks.
- A FAST is structured as a Dynasty Trust created in a state with Directed Trust laws which allows decision-making authority to be split up among separate co-trustees, advisors, or trust protectors.
- A FAST is an add-on to a traditional estate plan, often funded with life insurance. A traditional plan is still needed to provide for: health, education, and support; investment management; tax savings; and asset protection (creditors/divorces).

Get Your Affairs In Order

› Getting your affairs in order is **more than having a will.**

› Having updated ancillary estate planning documents is equally important.

- Financial Power of Attorney
- Medical Power of Attorney
- Directive to Physicians/Living Will
- Declaration of Guardian
- HIPAA Waiver

› Now is also a good time to **create a "Red File"** for what estate planning documents don't cover.

"Red File"

- Centralized file of personal information, such as key contacts, location of assets, passwords, etc.
- A detailed plan for how you want to be cared for during incapacity.
- A continuity plan for any businesses owned.
    - Business succession planning is the number 1 most neglected area of estate planning.
- The family's legacy plan.
    - The recent increase in the use of video-conferencing services (such as Zoom) has shown us there is no need to put off having the first family meeting until everyone can be in the same room.
    - Locked up with family during this pandemic has made us acutely aware of any communication or family harmony issues.
    - Now is the ideal time to write an "ethical will" or "love letter" to future generations.

What Will You Be Most Proud Of?

- Author Michael Hyatt has written several books on planning and leadership and expressed the following thought.
  - Ten years from now when you look back on what you did during this episode, what will you be most proud of?
  - Wouldn’t it be great if you could say that you took advantage of this time to **set up your family for success**?

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