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**ESTATE PLANNING, PROBATE, TRUSTS
AND
RELATED ESTATE AND GIFT TAX ISSUES
FOR SOUTH CAROLINA RESIDENTS
AFTER DECEMBER 31, 2010**

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--OR HOW DO YOU INHERIT ASSETS?

- **From your Spouse.**
- **From your mother.**
- **From your father.**
- **From your grandparents.**
- **From your aunts and uncles.**
- **From others.**
- **OR HOW DO THEY KEEP IT AWAY FROM YOU!!!**

AND HOW MUCH DOES IT COST TO INHERIT ASSETS?

You mean that it's not already mine?

- **Nope.**
- **Basic Advice - Be Nice to your mother, your father, your grandmother, grandfather, your aunts, your uncles and others.**
- **Although, I will admit that it never ceases to amaze me how often parents leave assets to kids that they have problems with.**

**AND MY INHERITANCE MIGHT
COST SOMETHING? YEP.**

AND IT MIGHT GET TAXED? YEP.

**IS THERE ANYTHING THAT CAN
HELP? YEP.**

WHAT IS IT?

ESTATE PLANNING

OK, So I May Need Estate Planning. What is Estate Planning?

- **Well, it is the process of planning:**
 - **To protect assets during life.**
 - **To transfer assets at death, in an efficient manner.**
 - **To manage financial and non-financial matters, in the event of a disability.**
 - **To protect those you care about in the event of your death or disability.**

**Now Let's Talk About Some Basic
Estate Planning Documents, such**

as:

Health Care Powers of Attorney

Living Wills

Durable General Powers of Attorney

HIPAA Releases

Wills

Trusts

Others.

What is a health care power of attorney?

- It's a *statutory* document.
- It designates an *agent* to make healthcare decisions on your behalf, if you are unable to.
- It is a *springing power*.
- It also has *living will* type provisions in it.

What is a living will?

- **There is not really such a document in South Carolina.**
- **The term was more or less created for marketing purposes at a time when there were no specific laws concerning the right to die.**
- **Then along came Quinlan and Cruzan and the right to die.**
- **Basically, the document allows someone to make decisions that can end your life.**
- **In South Carolina, we have a Declaration of a Desire for a Natural Death.**
- **It is probably not necessary if you have a *health care power of attorney*.**

What is a durable general power of attorney?

- **Allows someone to transact business on your behalf.**
- **Virtually unlimited *powers* are granted.**
- ***Durable* means that it survives incapacity or incompetence.**
- **Must be recorded to be durable.**
- **Can be recorded after the onset of a disability.**
- **Commonly abused and litigated.**

What is a HIPAA Release?

- **HIPAA is an abbreviation for the Health Insurance Portability and Accountability Act.**
- **A HIPAA Release is designed to allow someone to have access to your medical records; also, now included in the latest South Carolina Statutory Health Care Power of Attorney.**
- **Often *trustees* and *agents* need access to such records.**
- **Many documents provide that in the event of incapacity a successor takes over, but they need to show and know that you are incapacitated.**
- **Under HIPAA, medical providers, such as physicians, may not want to discuss incapacity unless there is a HIPAA Release.**
- **They may or may not honor provisions in trusts, *health care powers of attorney* or *durable general powers of attorney* authorizing them to give out medical information.**

What about a *Will* and why do you need one?

- **To control who receives your *Probate Property*.**
- **If married, to make sure your surviving spouse does not share with your children.**
- **If not married, then it depends upon who is alive.**
- **To appoint *guardians and trustees* for minors or disabled individuals.**

Why do you need a *Will*?-Continued

- **To choose your personal representative.**
- **To use simplified probate procedures:**
 - **Probate assets of \$10,000 or less and no Real Estate, with some adjustments.**
 - **Sole devisee is the sole personal representative.**
- **To save Estate Taxes.**

Does My Spouse Have Any Special Rights?

- **Certain limited homestead and related exemptions in small amounts, but only really applies if there are more debts than assets.**
- **Main entitlement is *Spouse's Elective Share Right* to one-third of probate assets, even if there is a will leaving no assets to the spouse, but the right can be waived by a special waiver or a prenuptial agreement.**
- **Under certain circumstances a surviving spouse may receive up to one-half or all probate assets – usually because of a will omitting the spouse or no will at all - usually happens when people marry and forget to update their wills.**

So what is a *Probate Asset*?

- **Any property or interest in property which is disposed of by *will* or by *intestacy*, if there is no will.**
- **OK, so what does that mean?**
- **Well, it's easier to define what non-probate property or interests are and then the rest are probate assets.**

Ok, so what is a *Non-Probate Asset*?

- **Any property or interest in property which is NOT disposed of by *will* or by *intestacy*, if there is no *will*.**
- **Alright, I give up, what does that mean?**

Well, being more specific-

- ***Joint Tenancy with Right of Survivorship (JTROS) property.***
- ***Tenancy by the Entirety* property, (also provides *asset protection*) but not available in SC, but is in states like NC, FL, VA, NJ and others.**
- **Assets controlled by beneficiary designation.**
- ***Transfer on Death (TOD) securities.***

Well, being more specific -continued

- **Payable on Death (*POD*) bank accounts.**
- **TOD and POD are similar to the old *Totten Trusts*.**
- **Life insurance, not payable to your estate.**
- **Annuities and pension benefits, not payable to your estate.**
- **Assets in trust, not payable to your estate.**

What is *Probate*?

- **The process of transferring probate assets at death through the *Probate Court* to those persons entitled to the assets by will or intestate succession.**
- **Normally takes *12-18-24 months*.**
- **Labor intensive and can be expensive.**
- **Also protects *creditors* including the IRS and the South Carolina Department of Revenue.**

What is *Probate*? - continued

➤ *Probate administration* is often confused with *tax administration*:

706 - Estate and (Generation-Skipping Transfer) Tax Return.

709 - Gift Tax Return.

1040 - Individual Income Tax Return.

1041 - Fiduciary Income Tax Return.

How do you Avoid a Full Probate?

- **Own less than \$10,000, with certain adjustments, in probate assets other than real estate.**
- **Own all property as JTROS, tenants by the entirety, payable or death (POD) accounts, or transfer on death (TOD) accounts.**
- **Make beneficiary designations for Life Insurance, Annuities, IRA, etc. to someone other than your estate.**
- **Own property in trust.**
- **However, all the above can create estate tax issues, if you are not careful.**

Are there any other costs if you avoid *Probate*?

- **Yes, even without probate there are costs:**
 - **Debts, Taxes, Legal fees, Accounting fees**
 - **and Other Administration Expenses**

- **Someone has to pay them if there are assets.**

- **The South Carolina Trust Code, which is a version of the Uniform Trust Code (UTC) now makes Revocable Trust assets liable for debts for up to one year after the date of death of the Settlor, if there are insufficient probate assets.**

Why do people create trusts?

- **Asset management**
- **Disability management**
- **Tax management**
- **Probate management**
- **Long term postmortem control of assets**
- **Protection of beneficiaries**
- **Asset Protection from creditors in some States and foreign countries under certain circumstances, but not in South Carolina.**

What are the basic types of trusts?

- *Trust under agreement:*
Life-----> Death-----> Beyond
- *Trust under will:*
Death-----> Beyond
- *Revocable Trust:*
Can be altered, amended and/or revoked.
- *Irrevocable Trust* - usually for estate and gift tax planning:
Can not normally be altered, amended or revoked and only terminates upon happening of certain events such as the death of a beneficiary or a beneficiary turning a certain age.

What is a Revocable Living Trust Agreement?

Five Basic Elements

- **Settlor/Grantor/Donor/Trustor** - The person who creates the trust.
- **Trustee** - The person who is responsible for managing the trust property and who is also the legal owner of the trust property.
- **Beneficiary** - The person who benefits from the trust income and/or principal.
- **Corpus** - The property transferred to the trustee.
- **Created while the Settlor is alive and not by a Will.**

What is a *Revocable Living Trust Agreement?* - continued

- Normally the trust is for the benefit of the *Settlor* during life.
- Then it splits into a *Credit Shelter Trust* usually for the benefit of the surviving spouse, if any, and also can save estate taxes upon death of the surviving spouse.

and

- A *Marital Deduction Trust* for the surviving spouse, which can save estate taxes during the surviving spouse's lifetime.

What is a *Revocable Living Trust Agreement*? – continued

- **Alternatively, the couple can use QTIP Trusts or a Disclaimer Trusts to gain the similar benefits.**

and

Then assets go to children or others, including charities, after the death of the surviving spouse.

- **If the *Settlor* is not married, then the assets go to children or others, including charities, after the death of the *Settlor*.**

What are the other benefits of a *Revocable Living Trust Agreement*?

- **Can be used to manage your assets, if you become disabled.**
- **May avoid a probate court competency proceeding, if you become incompetent.**
- **Can be used to avoid probate on assets owned by the Trustee.**
- **Very flexible and somewhat easy to create, fund and use.**
- **Widely used by Hilton Head Island Retirees.**

What are the basic requirements for a *Will*?

- **The maker (Testator or Testatrix) Must be Age 18 and have testamentary capacity.**
- **Basically you must know who the objects of your bounty are and roughly what you own - a low standard and less than that for a signing a contract.**
- **Revocable trusts now have the same capacity requirement under the South Carolina Trust Code.**
- **Will must be in writing, signed by the maker and two witnesses in South Carolina.**
- **It must at least name a *personal representative*.**

What are the basic requirements for a *Will*? – continued

- **Note there is no requirement that you leave property to anyone to have a valid will.**
- **It becomes effective only at death.**
- **It can also have amendments called codicils.**
- **It can be revoked by destruction or by a subsequent will.**
- **There can be serious problems if you can't find the original will at death because it is presumed to have been destroyed with the intent to revoke.**
- **It is dangerous to try drafting a will by yourself and a trust is even more so.**

What are some of those odd terms used in a *Will*?

- **What is a bequest, a gift and a devise?**
- **In the olden days there were differences between gifts in a will of real estate (a devise) and gifts of personal property (a bequest), but now we just call them all devises.**
- **All are basically the same thing under modern law - they are all leaving something to somebody.**

What is *Per Stirpes* and *Per Capita*?

- Normally used in a gift or devise, to “my issue, per stirpes,” which means that the gift is to all children equally, but if a child is not living at the time, then that child's children split the share that the child would have received.
- If you have two children and one has 3 children and the other child has 1 child and both of your children are deceased when the gift becomes effective, then a per stirpes distribution like SC gives $\frac{1}{6}$, $\frac{1}{6}$ and $\frac{1}{6}$ to the first child's children and $\frac{1}{2}$ to the other child's children whereas a strict per capita distribution would be $\frac{1}{4}$, $\frac{1}{4}$, $\frac{1}{4}$ and $\frac{1}{4}$ to the grandchildren. In Florida where a strict per stirpes is used, it would produce the same result as per stirpes in our example, but not in all examples.
- Which would you prefer and who benefits from each?

What are *Estate Taxes*?



A tax at death on the right to transfer assets:

- **Over \$1,000,000, if death occurs in 2002 - 2003.**
- **Over \$1,500,000, if death occurs in 2004 - 2005.**
- **Over \$2,000,000, if death occurs in 2006 - 2008.**
- **Over \$3,500,000, if death occurs in 2009.**
- **Estate tax was repealed for 2010, but retroactively reinstated on December 17, 2010 with a \$5,000,000 exemption and a 35% tax rate.**
- **Over \$5,000,000 if death occurs in 2011-2012 with “portability” under certain circumstances.**
- **Back to over \$1,000,000 in 2013, if Congress takes no further action or if either the House, the Senate or the President can not agree.**

What are the Duties and Responsibilities of a Trustee?

- **They are virtually the same as for a Personal Representative.**
- **However, a Personal Representative is for the management of a probate estate and usually only lasts about 12 - 24 months.**
- **The duties of a trustee can last for years, possibly for the trustee's lifetime and beyond, if the trustee is an individual.**

A Trustee Must Carry Out the Terms of the Trust Agreement

- **Trust agreement usually controls, but the South Carolina Trust Code, which is a version of the Uniform Trust Code (UTC), added new requirements in 2006.**
- **Duties may last longer than the life of the beneficiary.**
- **Income or life beneficiary usually receives the benefit of the trust assets during their lifetime.**
- **Remainder beneficiary receives the assets at the termination of the trust.**

Trustee's Duty of Loyalty

- **A Trustee must administer the trust assets for the sole benefit of the beneficiaries.**
- **A Trustee is entitled only to reasonable compensation for services rendered.**
- **However, a Trustee can be a beneficiary.**
- **A Trustee-Beneficiary has a built in conflict of interest.**
- **A Trustee-Beneficiary must be careful not to violate the duty of loyalty to other beneficiaries.**
- **A Trustee-Beneficiary normally has a much higher risk of being sued by another beneficiary than an independent Trustee**
- **The Settlor of his or her own Revocable Living Trust does not owe any duties to the other beneficiaries.**

Trustee Must Keep Trust Assets Separate

- **Should be in the name of the trustee.**
- **Sometime the trustee has to find the assets, if they are the successor trustee.**
- **The trustee should not commingle trust assets with the trustee's own assets.**

Trustee Must Keep an Accurate Accounting

- **A Trustee must *Account* and *Disclose* to the beneficiaries all transactions.**
- **All receipts, disbursements, investments, etc.**
- **Sometime the surviving spouse does not want the children or others to know that there is a trust or what is in it.**
- **This may be a breach of fiduciary duty, meaning there may be liability, especially if the children are from a previous marriage or relationship.**

Trustee Must Use Trust Assets Only for the Benefit of the Beneficiaries

- **Trustee is normally only entitled to a fee or commission plus reimbursement of out of pocket costs.**
- **Can normally hire professional advisors:**
 - **Attorneys, Accountants, Investment advisors and others as needed.**
- **Can also pay normal debts, taxes and expenses of administration.**
- **Often to save costs a family member who is a beneficiary is also the trustee, but can create a significant conflict of interest that must be carefully monitored.**

Delegation

- **Trustee is generally responsible for those he or she hires to do work.**
- **Document may excuse liability, if the advisors are chosen with reasonable care.**
- **State law (UTC) may also excuse liability, if the advisors are chosen with reasonable care.**

Trustee Must Be Fair and Impartial

- **The trustee must keep the beneficiaries reasonably informed.**
- **The trustee must treat all beneficiaries fairly and impartially.**
- **The trustee must be mature, even if the beneficiary is not.**
- **Inexperienced or immature trustees may over react to beneficiary complaints and criticisms.**
 - May give the beneficiary grounds to allege or sue for breach of fiduciary duty.**

Trustee Must Be Fair and Impartial

– continued

- **Becomes an issue with discretionary distributions to the income or life beneficiaries.**
- **There is basically a built in conflict of interest.**
- **Amounts paid to the income or life beneficiary reduces the amount ultimately going to the remainder beneficiary.**
- **Can be a problem between surviving spouses and children.**
- **Becomes even more serious in second marriage situations with children from previous marriages.**

Trustee Conflicts of Interest

- **A trustee who is also a beneficiary can not or should not normally make discretionary distributions to themselves.**
 - ***Cisa* case to this effect in South Carolina.**
 - **In the terms of many trust agreements.**
 - **There are also IRS estate tax issues.**
- **Trustee can not engage in self-dealing.**
- **Note these rules and duties do not generally apply to the trustee who is also the Settlor and beneficiary of a revocable trust.**

Prudent Investor Rule

- **Trustee must invest trust assets as a prudent investor would invest for someone else, and not for himself or herself.**
- **Involves more conservative investments.**
- **Was formally a subjective test, but is now objective.**
- **May be more complex than it appears.**
- **Often hard to define and can be ripe for litigation.**
- ***UPIA - Uniform Prudent Investor Act.***
- **Also UPIA stands for *Uniform Principal and Income Act.***

Investments and Beneficiaries

- **Trustee needs an investment plan based upon the terms of the trusts and needs of the income and remainder beneficiaries.**
- **Fiduciary must balance potentially conflicting interests.**
- **How does the income beneficiary want the funds invested?**
 - **Current income v. future appreciation.**
- **How does the remainder beneficiary want the funds invested.**
 - **Current income v. future appreciation.**
- **How does the trustee invest?**
 - **Current income v. future appreciation.**

Trustee May Need to Follow the Principal and Income Act (UPIA)

- **Maybe, but also depends on trust agreement instructions.**
- **Must keep income separate from principal.**
- **Hopefully trust agreement gives flexibility.**
- **Income plus 5x5 versus total return trust.**
- **Total return trust gained momentum during the roaring 90s and the DOT.COM Boom.**
- **What has happened in the last 10 years may demonstrate the fallacy of the total return trust and the wisdom of the ancients.**

What is *Principal* and *Income*?

- **Our Act is a version of the Uniform Principal and Income Act (UPIA).**
- **Subject to many adjustments, *Principal* is the fund or pool of assets that you start with such as cash, stocks, bonds, real estate, etc.**
- **Also subject to many adjustments, *Income* is the return from the principal usually consisting of income, dividends, rents, etc.**
- **Care must be taken with royalties and annuities.**
- **The Rules Can be quite complex.**

Trustee Must File Tax Returns

- **Must file Estate Tax Returns as a "person in possession of property," assuming they are holding assets that are included in the decedent's taxable estate.**
- **Income tax returns.**
- **Employment tax returns.**
- **Maybe other tax and information returns.**

Management Ability

- **Can the trustee make good investment and/or management decisions?**
- **Can the trustee work with professional advisors?**
- **Can the trustee treat the beneficiaries fairly and impartially?**
- **Can the trustee pick good people to advise or assist them?**

What is the Best Choice for a Trustee?

- **Probably a corporate trustee serving with a family member.**
- **Most people do not want to pay the cost of corporate trustees.**
- **Most people use family members.**
- **Family members may also charge.**
- **However, the fee or commission remains within the family.**
- **Those they hire will also charge.**
- **The family member must be a competent manager.**

Risk/Benefit Analysis

- **What is the probability of mistakes and their cost of an individual trustee versus the cost of a corporate fiduciary.**
- **Corporate fiduciaries do not become physically ill, die or become incompetent.**
- **Trust Department assets are separate from the corporate fiduciary's assets in the event the corporation goes bankrupt (Theoretical?)**
- **Corporate fiduciaries have many experienced people and many layers of backup personnel.**

Risk/Benefit Analysis – Continued

- **Corporate fiduciaries may not be as stable as they once were.**
- **Corporate fiduciaries have deep pockets, if they make serious mistakes.**
- **In addition to their normal yearly trustee fees, some corporate trustees are also charge the equivalent of a probate settlement fee, for settling a trust even if there is a fully funded revocable living trust, at death and no probate assets.**

Risk/Benefit Analysis – Continued

- **Often family members will not sue other family members who are trustees if they make a serious mistake.**
- **There are more and more problems, with individual beneficiaries improperly administering trusts.**
- **Might be minimal risk.**
- **Might be large risk.**
- ***Choose your trustee wisely!!***

What Assets are Subject to *Estate Tax?*

- **Assets subject to the estate tax at death include:**
- **Assets in your name alone.**
 - **All or a portion of JTROS, tenancy by the entirety, POD and TOD assets.**
 - **Assets in trust, if you have certain powers or interests in the trust.**
 - **Assets you give away but retain an interest in, such as a life estate.**
 - **Life Insurance, if you have incidents of ownership.**
 - **Your pension benefits, if payments continue after your death.**
 - **Certain lifetime gifts are added back.**

Note: Includes probate and non-probate assets.

How can you have *Estate Tax* savings and still have the benefit of the assets for both yourself and your spouse?

- **Set up a *Credit Shelter Trust at death* with assets of up to \$5,000,000, if death occurs in 2010 - 2012.**
- **However, estate tax might be back for estates over \$1,000,000 in 2013 in which case the credit shelter trust would be up to \$1,000,000.**
- **Much depends upon Congress and your year of death.**

**How can you have *Estate Tax* savings and still have the benefit of the assets for both yourself and your spouse?
-continued**

- **From the Credit Shelter Trust, the surviving spouse can receive:**
- **All income for life.**
 - **Greater of \$5,000 or 5% of principal on a non-cumulative annual basis.**
 - **Discretionary principal invasion by the trustee, other than the surviving spouse, for health, education, maintenance, support, etc.**

How can you have *Estate Tax* savings and still have the benefit of the assets for both yourself and your spouse? -continued

- **The surviving spouse can also have a special power to:**
 - **Change the ultimate disposition to children and certain other beneficiaries.**
 - **But not with a Disclaimer Trust.**
- **All assets over the exemption amounts can go to your spouse either outright or in marital deduction trust.**
- **May need caps on credit shelter amount under 2010 Tax Act.**
 - **Otherwise all assets may end up in a trust, which restricts surviving spouse's control.**
 - **Note: This can be and has been a significant problem for relatively modest estates, especially those planned prior to 2002 and in some cases, later.**

How can you have *Estate Tax* savings and still have the benefit of the assets for both yourself and your spouse? -continued

➤ *“PORTABILITY” UNDER THE 2010 TAX ACT*

- **For surviving spouses dying after 2010 and prior to 2013, unless Congress extends the new law.**
- **Surviving spouse can use their own \$5,000,000 estate tax exemption and the unused amount of predeceased spouse’s \$5,000,000 exemption.**
- **Possibly creates a \$10,000,000 exemption.**
- **Requires a special election by the estate of the estate of the first spouse to die.**
- **Requires a timely filed and complete estate tax return by the estate of the first spouse to die.**

How can you have *Estate Tax* savings and still have the benefit of the assets for both yourself and your spouse? -continued

- **Historical Note: In 2010 there were numerous interpretative difficulties, when there was no estate tax.**
 - **Old document with formula funding clauses no longer worked because they were based upon the existence of an estate tax, which did not exist, until Congress reinstated the estate tax.**
 - **South Carolina passed legislation to try to help solve the problem but didn't do a very good job – more or less required litigation.**
 - **It is always best not to let the State define matters for you.**
- **All assets over the exemption amounts can go to your spouse either outright or in marital deduction trust.**

Consider a *Disclaimer Trust* **(also discussed later)**

- **All assets go into a very liberal trust for the surviving spouse.**
- **The surviving spouse can keep the assets, if his or her estate will be non-taxable at death.**
- **The surviving spouse can disclaim assets so that they go into a *credit shelter trust* to save estate taxes upon their death.**
 - ***Credit shelter trust* can be for the surviving spouse's benefit.**
 - **However, the surviving spouse can not have a Special Power of Appointment (SPOA) as with a normal credit shelter trust with respect to the disclaimed amount.**

Consider a *Disclaimer Trust* **(also discussed later)**

- **Must make disclaimer decision within 9 months of first spouse's death.**
- **Surviving spouse must not accept any of the benefits of the assets prior to disclaiming.**
- **Places some pressure on surviving spouse to make decision before the end of the 9 month period.**
- **Need to make sure the surviving spouse has sufficient funds to last at least 9 months.**

Consider a *Disclaimer Trust* (also discussed later)

- However, it provides more flexibility and places more control in the hands of the surviving spouse since we don't know, at the time the documents are signed, if there will actually be an estate tax to pay at the death of the surviving spouse.
- Defers the decision for up to 9 months after the death of the first spouse.
- Affected by The 2010 Tax Act:
 - “Portability”
 - What happens if death occurs after 2012?
 - Too much uncertainty.
 - Too many choices.
 - Estate planning has become less efficient.

How do you protect children from a previous marriage or relationship and your new spouse?

- **Place assets into a *qualified terminable interest property trust (QTIP)* at your death.**
- **Surviving spouse must receive all income.**
- **A good choice for the children, but not necessarily the married couple.**
- **Fewer couples take advantage of this planning technique than you might expect.**

How do you protect children from a previous marriage or relationship and your new spouse? – continued

- **Optionally:**
 - **Surviving spouse can have a *5 x 5 power under the QTIP Trust*.**
 - **Can be turned off upon remarriage.**
 - **Discretionary principal invasion by trustee.**
 - **Can be turned off upon remarriage.**

- ***Executor (P/R) or "person in possession of property" must make QTIP election on estate tax return.***

How do you protect children from a previous marriage or relationship and your new spouse? – continued

- **What about the Impact of The 2010 Tax Act**
- **\$5,000,000 estate tax exemption until December 31, 2012**
 - **“Portability” Considerations.**
 - **May or may not be a tax on the surviving spouse, depending upon value of assets and year of death.**
 - ***QTIP Trust* may become the trust of choice for married couples with children from previous marriages or relationships.**
 - **It is almost the reverse of *Disclaimer Trust* Planning, which may not protect children from previous marriages or relationships.**

How do you protect children from a previous marriage or relationship and your new spouse? – continued

- **Do people in second and subsequent marriages use trusts just for estate tax planning or also to protect children from previous marriages or relationships?**
 - **The answer affects how the trust is drafted and which type of trust is used.**
- **Same question in a first marriage - what happens to children if surviving spouse remarries?**
- ***Has become more of a focus of discussion after EGTRRA in 2001 and now The 2010 Tax Act.***

Disclaimer Trust Versus a QTIP Trust

- **If the planning is designed to protect the surviving spouse, yet guarantee that the children are also protected, then a QTIP Trust is more likely.**
- **If the planning is designed to provide flexibility and complete control to the surviving spouse with the children being a secondary consideration, then a disclaimer trust is more likely.**
- **Note that since the disclaimer trust gives more control to the surviving spouse, it has a much higher likelihood of disinheriting children and caution is warranted especially when there are children from previous marriages or relationships.**

Can you save *Estate Taxes* without a trust?

➤ **YES:**

- Give up to \$5,000,000 by gift during life or exemption amount at death (amount depends upon the year of death), to someone other than your surviving spouse.
- However, not clear what happens after 2012, if the estate tax exemption is decreased below the amount of previous gifts lifetime gifts;
- Give enough to charity during life (but possibly subject to income tax limitations) or at death of surviving spouse to bring assets down to the exempt amount.
- Maybe consider entity or other more complex planning, which is beyond the scope of this seminar.

Can you save *Estate Taxes* without a trust? – continued

2001 Tax Act (EGTRRA):

- 2002-2003 \$1,000,000 exemption or \$2,000,000 with basic trust planning.
- 2004-2005 \$1,500,000 exemption or \$3,000,000 with basic trust planning.
- 2006-2008 \$2,000,000 exemption or \$4,000,000 with basic trust planning.
- 2009 \$3,500,000 exemption or \$7,000,000 with basic trust planning.

The 2010 Tax Act.

- 2010-2012 \$5,000,000 exemption or maybe \$10,000,000 with basic trust planning
- 2013 Currently scheduled to go back to a \$1,000,000 exemption, so you could exempt 2,000,000 with proper planning.

Note: Gift, Estate and Generation Skipping Transfer Tax Exemptions are \$5,000,000 beginning January 1, 2010 –December 31, 2012 and will be adjusted for inflation beginning in 2012. Each also has a 35% tax rate.

What is the A/B Trust Option to Save Estate Taxes?

- **A/B Trust sometimes called a Marital Deduction Trust and a Credit Shelter Trust (discussed earlier) comes into existence either under the decedent's will or revocable trust at death by virtue of a formula clause.**
- **The exemption amount that is not subject to estate tax is left to Trust B or the Credit Shelter Trust with the following provisions:**
 - **The Surviving Spouse normally receives the income.**
 - **The Surviving Spouse is often given the right to receive the greater of \$5,000 or 5% of the value of the Trust principal on a non-cumulative annual basis.**
 - **If the above is not sufficient, the Trustee is often given the power to invade principal for the surviving spouse's health, education and support, which is often referred to as a ascertainable standard.**
- **None of the above is required for the Credit Shelter Trust and the surviving spouse can be left out entirely, but subject to state spousal rights such as the *elective share*, or the Trustee can sprinkle income and principal among a group of people that could, but does not have to, include the surviving spouse and children.**

What is the A/B Trust Option to Save Estate Taxes? – Continued

- **The amount over the exemption that is subject to estate tax is then left to Trust A or the Marital Deduction Trust so that this excess will qualify for the marital deduction from estate taxes and cause the tax upon the first death to be zero.**
- **The Trust A or Marital Deduction Trust often has the following provisions:**
 - **The surviving spouse is normally entitled to both income and principal.**
 - **In some cases, the assets are distributed outright to the surviving spouse or the surviving spouse can be given the power to withdraw the assets.**
 - **The trust is very liberal for the surviving spouse.**

What is another common option if I am not sure I will need an Estate Tax saving trust, at my death?

➤ *Again, the Qualified Disclaimer* by surviving spouse (also see the above discussion):

- **All or a portion of assets received by surviving spouse.**
- **Surviving spouse can disclaim to the credit shelter trust, if properly drafted.**
- **Strict time and formal requirements.**
- **Highly technical but effective.**
- **Can be used for current law and for new tax act and for most reasonable alternatives.**
- **However, it may create disinheritance issues.**

What is another common option if I am not sure I will need an Estate Tax saving trust, at my death? – continued

- ***Disclaimer Trust* planning may become much more popular.**
- **May become the trust of choice for married couples without previous marriages and only one set of children.**
- **May also be used with second marriages, depending upon goals and objectives.**
- **However, the possible disinheritance of children or other beneficiaries needs to be discussed and considered.**

What is a Gift Tax and what are the safe harbor rules?

- **A *gift* is any lifetime transfer of assets for less than full and adequate consideration in money or money's worth.**
- **We have a unified estate and gift tax exemption after 2010 and prior to 2013 under The 2010 Tax Act.**
 - **Was unified prior to EGTRRA.**
 - **Was not a unified system beginning in 2002 with full separation in 2004 with EGTRRA.**
- **Congress made it easy to reunify them if needed in 2011, but then passed 2010 Tax Act.**

What is a Gift Tax and what are the safe harbor rules? – continued

- ***\$5,000,000 Lifetime Gift Tax Exemption, beginning January 1, 2010 until December 31, 2012.***
- **Subject to inflation adjustment beginning in 2012, as is the Estate and Generation Skipping Transfer (GST) Tax Exemptions.**
- **However the Estate Tax Exemption is unified with the Gift Tax Exemption, i.e. one and the same exemption.**

What is a Gift Tax and what are the safe harbor rules? – continued



Safe Harbors:

- **Outright transfer to spouse in any amount.**
- **Outright gifts of \$13,000 (beginning in 2009) or less per year, per donee.**
- **Outright gifts to charity, subject to income tax limitations, but no gift tax limitations.**
- **\$13,000 is also subject to inflation adjustments.**
- **Under The 2010 Tax Act, it is not clear what happens after 2012, if gifts in excess of previously gifted amounts are more than the estate tax exemption at death.**

Why Was the Gift Tax Not the Same as Estate Taxes under EGTRRA?

- **Congress was concerned that people would simply transfer assets from a high bracket income taxpayer to a low bracket family member who would then sell the asset and pay a lower capital gain tax.**
- **Then later the high bracket taxpayer would get the money back from the low bracket taxpayer.**
- **Congress wants the tax revenue from the high bracket taxpayer.**
- **Congress took all the fun out of planning.**
- **But now we have The 2010 Tax Act.**

What is a Gift Tax and what are the safe harbor rules? – continued

- **The *Gift Tax rate* is the same 35% tax rate beginning in 2010 as the Estate and Generation Skipping Transfer tax rates.**
- **May revert back to 2006 Law in 2013, which is the pre-EGTRRA law.**
- **Depends upon what Congress does.**

Why and when do I need to worry about *Generation Skipping Transfer (GST) Taxes?*

- **The GST tax is in addition to Estate and Gift Taxes.**
- **A flat tax of 35%, beginning January 1, 2011 through December 31, 2012, but it has been 55% in the past and may be in the future.**
- **Special 0% rate in 2010, only.**
- **Anytime you transfer either directly or indirectly assets by gift, will or trust to someone in a generation below your children.**

Why and when do I need to worry about *Generation Skipping Transfer (GST) Taxes?* – continued

- **Special generation determination rules for beneficiaries who are not related.**
- **Requires very technical planning.**
- **Safe Harbors:**
 - **Lifetime *outright gifts* of \$13,000 per year, per donee, or less, but problems with minors and incompetents.**
 - **Total combined assets of clearly less than \$5,000,000 for 2010 – 2012, which is inflation adjusted the same as the estate tax exemption.**
 - **Special Rules for 2010.**
 - **Must be cautious.**

Why and when do I need to worry about *Generation Skipping Transfer (GST) Taxes?* – continued

Tax 2001 Act (EGTRRA) Exemption Increases

2002-2003	\$1,000,000 exemption or \$2,000,000 with proper planning.
2004-2005	\$1,500,000 exemption or \$3,000,000 with proper planning.
2006-2008	\$2,000,000 exemption or \$4,000,000 with proper planning.
2009	\$3,500,000 exemption or \$7,000,000 with proper planning.

The 2010 Tax Act

2010	\$5,000,000 exemption with a 0% tax rate.
2011-2012	\$5,000,000 exemption or \$10,000 with proper planning.
2013	May be back to a \$1,000,000 exemption.

Are there any special problems if my spouse is not a United States citizen?

(Assuming Both Spouse are Residents of the United States)

- Yes, big problems for larger estates.
- Estate Tax
 - *No unlimited marital deduction without a QDOT Trust.*
 - Very strict technical requirements for QDOTs.
 - Not really a marital deduction.
 - *QDOT Tax* at surviving spouse's death is calculated on the first spouse's estate tax rate, which places the estate in a higher bracket.
 - Also, a *QDOT Tax* on most principal distributions.
- No unlimited marital deduction for gifts - only \$134,000 per year (for 2010), indexed for inflation.

Are there any special problems if my spouse is not a United States citizen? – continued

- **Problems with retirement benefits.**
- **2001 Tax Act (EGTRRA) Safe Harbors:**
 - **2002 - \$1,000,000 exemption.**
 - **2004 - \$1,500,000 exemption.**
 - **2006 - \$2,000,000 exemption.**
 - **2009 - \$3,500,000 exemption.**
 - **2010 – 2012 \$5,000,000 exemption (*The 2010 Tax Act*)**
- **Gift tax exemptions are very different.**
- **Traditionally one of the most complex and expensive estates to administer.**

Why so Harsh on Non-Citizen Spouses?

- **Back in the late 1980's Congress was concerned the non-citizen surviving spouse would take the assets estate tax free by using the marital deduction when the first spouse died.**
- **Then take all the money and go back to the Old Country and not pay any estate taxes.**
- **Not sure that there is any credible evidence that this is true on any mass scale.**
- **Also, our estate taxes are less than most industrialized countries.**
- **Most wealthy people are reasonable and logical and prefer not to live in third world countries.**
- **The QDOT Tax also deters wealthy foreigners from taking up residence in the United States, unless they want to become citizens.**
- **Don't we want wealthy individuals to live and spend money here?**

Step-up in basis (EGTRRA and The 2010 Tax Act)

- **Tax basis of assets are increased to date of death Fair Market Value (FMV).
 - **Does not include IRD items:**
 - **IRAs, Annuities, E Bonds, etc.****
- **Has the tendency to reduce capital gains tax upon the postmortem sale of assets.**
- **Was gone, beginning in 2010 under EGTRRA.**
- **The 2010 Tax Act brought it back.**
- **However, for 2010, only, a decedent's estate can elect out of the estate tax system and into the modified carry over basis regime.**

Modified Carryover Basis in 2010 (EGTRRA and The 2010 Tax Act)

- **Provided for a basic \$1,300,000 *step-up* in tax cost basis**
- **Provided for a \$3,000,000 *step-up* for certain marital deduction assets**
- **With planning can be *step-up* basis by as much as \$4,300,000, but not in excess of fair market value at the date of death.**
- **Adjustments for carry over losses and exemption on sale of home**
- **Above amounts take care of most South Carolina Estates**

Modified Carryover basis in 2010 (EGTRRA and The 2010 Tax Act) – Continued

- **However the rules are so complex that the American Institute of Certified Public Accountants (AICPA) sent a 6 page letter, voicing their concerns, to the IRS National Office in December of 2010, asking for clarification of the rules.**
- **Under the 2010 Tax Act an election out of the estate tax system and into Modified Carryover Basis is required.**

The Big Problem

We do not know what Congress or the Administration intends to do with Estate, Gift and Generation Skipping Transfer Taxes in 2013 and beyond. Until, we know more, planning will be even more complex and much less efficient than it has been in the past.

Any Questions?

**Thanks for
Coming!**