DO YOU “TRUST” YOUR SPOUSE?

ESTATE PLANNING FOR ESTATES UNDER $5 MILLION

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Reasons to Prepare Estate Plan

- Transfer your property to persons you choose
- Plan for children (guardians, trusts)
- To reduce cost of probate
- Avoid multiple probates
- Asset protection for surviving spouse and children
- For estate tax planning
Meeting with the Clients

- Assets and family circumstances
- Revocable living trust or wills
- Probate v. non probate assets
- Possible estate tax planning
- Beneficiaries, guardians, executors, trustees
- Disability planning
Utilizing a revocable living trust

- To avoid costs of probate (in some cases)
- Privacy concerns
- Management in case of incompetence
- Frequent changes to plan
- Often accepted by third parties more easily than a power of attorney
Planning for Disability

- Statutory Durable Power of Attorney
- Medical Power of Attorney
- Directives to Physicians
- Patient Authorization
- Appointment of Agent to Control Disposition of Remains
- Declaration of Guardian
- Willed Body Programs / Organ Donation
Background

Prior to the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (the “2010 Tax Act”) a surviving spouse would lose the benefits of the first spouse’s estate tax exemption amount unless a bypass trust structure was set up at the first spouse’s death.

The 2010 Act, now made permanent by American Taxpayer Relief Act of 2012 (“ATRA”), allows the surviving spouse to utilize the deceased spouse’s unused estate tax exemption at the death of the surviving spouse and for gifts during the lifetime of the surviving spouse if certain requirements are met.
Definitions

The federal estate tax exemption is now called the “applicable exclusion amount” or “AEA” (under ATRA).

The amount of exclusion that may carry over to the surviving spouse is called the “deceased spousal unused exclusion amount” or “DSUE amount”.
Rules for Portability Election

- Election must be made on a timely filed return 9 months after date of death or the extended due date (if a timely extension request is filed).
- The act of filing an estate tax return is deemed to make the portability election unless the executor elects out of the election.
- If no estate tax return would otherwise be required (i.e. estate <$5.34 million), there are some simplified reporting procedures.
- Surviving spouse can only use the DSUE amount from his or her “last deceased spouse”.
Reasons in Favor of Portability

- Simplicity (no trust required)
- Step-up in basis for 100% of the couple’s assets
- Retirement plans are a big part of estate and harder to use to fund a bypass trust
- Administrative and income tax costs of a trust outweigh the reasons for using a trust
Reasons Portability Might not be Best Choice

- Surviving spouse may not be good asset manager
- There is no portability of the GST exemption
- No creditor protection for assets left outright to spouse
- Difficult to protect/leave assets to children of a prior marriage without using the bypass trust structure
Bypass Trust

- Bequeath property to traditional bypass trust.

**Advantages**

- Decedent can control ultimate disposition of property
- Can provide asset management for surviving spouse if needed
- Can provide protection from creditors of surviving spouse
- Can have other trust beneficiaries during surviving spouse’s lifetime
- Guaranteed use of Decedent’s AEA
- Can use Decedent’s GST exemption
Bypass Trust, cont’d

Disadvantages

- More expensive than outright to surviving spouse, including document preparation and administration expenses
- Some assets may be unsuitable for trust (qualified retirement benefits, etc.)
- May result in worst of all worlds: more complex and expensive plan, no federal estate tax savings upon survivor’s death, and no basis step-up for decedent’s assets at spouse’s death
QTIP Trust

- Bequeath property to QTIP Trust for surviving spouse.

**Advantages**

- Decedent controls disposition, and trust can provide for protection from spouse’s creditors and management of property

- If executor makes QTIP election, trust assets are included in spouse’s estate and receive step-up in basis

- Executor can make reverse QTIP election to fully utilize Decedent’s GST exemption
Disadvantages

- More expensive than outright to surviving spouse, including document preparation and administration expenses
- Cannot benefit others during surviving spouse’s lifetime, unless provision is made for partial QTIP election and *Clayton* trust.
- Asset appreciation before surviving spouse’s death may result in estate taxes
Disclaimer Plan

- Bequeath property to surviving spouse, but provide that if he/she disclaims, it passes to a bypass trust.
- **Pro**: Allows portability decision to be deferred until first spouse’s death.
- **Con**: Requires portability decision to be made at first spouse’s death.
- Narrow 9-month window to act (and how often do surviving spouses disclaim?).
Disclaimer Plan, cont’d

- Might use if estate currently consists of assets not well-suited for bypass-trust funding. (Restricted stock? Certain business interests?)
- Might use if projected estate size highly uncertain. (Start-up? Stock options? Life insurance?)
- Might use for trust-averse clients. (But if you can’t convince them now, can you later?)
Bypass Trust with Formula GPOA

- Bequeath property to bypass trust, but give surviving spouse a testamentary general power of appointment over a portion of the trust.

- The GPOA would apply to that portion of the bypass trust that is equal in value to any excess estate tax exemption of the surviving spouse. This achieves a step-up in basis (for that portion of the trust) without incurring additional estate tax.

- Example: Bypass trust is $5 million, survivor’s estate is $4 million, survivor’s estate tax exemption is $7 million. Survivor’s GPOA applies to $3 million of bypass trust assets (i.e., $7 million minus $4 million).
Bypass Trust with Formula GPOA: Funding

- Formula GPOA could apply on a fractional basis (e.g., a formula percentage of each asset would be subject to the power). This is “simple” (compared to . . .).

- Alternatively, formula GPOA could apply to more highly appreciated assets first (to maximize the step-up in basis and avoid any step-down). E.g., GPOA over those assets of the bypass trust equal in value to the surviving spouse’s excess estate tax exemption which, collectively, have the lowest basis. This is more tax-efficient, but harder to apply in practice.
Bypass Trust with Formula GPOA: Risk

- Estate tax risk: Does surviving spouse have the ability to drive the formula percentage to 100%? If so, is the surviving spouse deemed to have GPOA over the entire trust, regardless of the actual facts?
- Probably not; the power is hard to manipulate, and acts of independent significance shouldn’t matter.
- Could avoid this risk by giving independent trustee the power to grant GPOA. That would seem to solve the problem (if any), but at the cost of making the plan less automatic.
Bypass Trust with Formula GPOA: Pro/Con

- **Pro**: “Best of Both Worlds” – Achieves step-up in basis of appreciation up to survivor’s estate tax exemption, and probable estate tax exclusion of appreciation greater than survivor’s estate tax exemption. Since estate tax rates are greater than capital gains tax rates, this is a good result.

- **Con**: Bypass trust is subject to trust income tax rates (but may mitigate by making distributions).
Diagnostic Questions

**Family Circumstances**

1. Is this the first marriage for both spouses, or is it a blended family?
2. Is it likely that the surviving spouse will remarry?
3. Are there concerns about possible future undue influence?
4. Will the surviving spouse need assistance in managing assets?
5. Would the surviving spouse benefit from asset protection planning?
Diagnostic Questions, cont’d

Financial Questions

6. Will the surviving spouse need all of the income from the decedent’s property? What about principal?

7. Will other beneficiaries need income or principal from the decedent’s property?

8. Any assets which are likely to significantly appreciate in value? Depreciate in value?

9. Any assets difficult to administer as trust property?
10. How sensitive are the clients to implementation and maintenance expenses?

11. Are the clients willing to consider trusts?

12. If planning decisions are to be made after death of first spouse, should those be made by the surviving spouse or by a third party?
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