

Caplin & Drysdale

Estate Planning for Wealthy Widows and Widowers

Presented By:
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Beth Shapiro Kaufman – Bio



Beth Shapiro Kaufman is a member in Caplin & Drysdale's Washington, D.C. office. She rejoined the firm's private client group in 2001 after working for over six years in the Treasury Department's Office of Tax Policy. Serving first as Attorney Advisor and then as Associate Tax Legislative Counsel, Ms. Kaufman had principal responsibility for all tax policy matters affecting trusts and estates, including estate, gift, and generation-skipping transfer taxes, as well as income taxation of trusts and estates. She has continued her focus in these areas in private practice.

At Caplin & Drysdale, Ms. Kaufman assists wealthy individuals with their estate planning. She also advises lawyers and other professionals on complex issues regarding estate, gift, and generation-skipping transfer taxes. Ms. Kaufman is a frequent lecturer on estate and gift tax topics. She is a graduate of Harvard Law School, where she was an editor of the Harvard Law Review.

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Estate Planning for Wealthy Widows and Widowers

- I. Planning to avoid probate
- II. Planning for incompetency
- III. Planning to minimize taxes
- IV. Ways to Use Gift, Estate and GST Exemptions
- V. Strategies for charitable giving

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I. Planning to Avoid Probate



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Planning to Avoid Probate

Revocable Trusts

- CREATE** trust during life
- GRANTOR** is sole beneficiary
- SERVES** as will substitute
- OPERATES** under state law
- MUST** fund during life

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Planning to Avoid Probate

Revocable Trusts – Pros and Cons

| Pros | Cons |
|---------------------------|-----------------------------------------|
| Avoids probate | More costly than a will to draft |
| Provides for incompetency | Accelerates the work of probate |
| Provides privacy at death | Requires client to hold assets in trust |
| Avoids ancillary probate | Unfunded trust does not give benefits |

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Planning to Avoid Probate

Simpler Solutions to Avoid Probate

Beneficiary Designations

- Retirement accounts
- Life insurance

Payable on Death Accounts

- Bank accounts
- Brokerage accounts

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II. Planning for Incompetency

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Planning for Incompetency

Funded Revocable Trust

- Upon incompetency, successor trustee takes over
- Only works to the extent assets are held in trust

Alternative: Durable General Power of Attorney

- Meaning of "durable"
- Springing or not springing
- Naming successors

Advance Directive for Health Care

- Created under state law
- Defaults if no one named
- Can be held jointly

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III. Planning to Minimize Taxes

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Planning to Minimize Taxes

Use Gift Tax Exclusions

- Annual Exclusion of \$13,000 (indexed)
 - Per donor, per donee
 - Outright (cash or property)
 - Crummey Trusts
 - 529 Plans
- Exclusion for Tuition and Medical Expenses
 - Unlimited in amount
 - Must be paid directly to provider

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Using the \$5 Million Exemption

Law in 2011 and 2012

- Estate, Gift and GST
- \$5 million exemption
 - Indexing increases exemption to \$5,120,000 for 2012
 - 35% flat rate

Presumptive Law in 2013 and beyond

- Estate, Gift and GST
- \$1 million exemption (GST indexed)
 - 55% top marginal rate, plus surtax
 - Return of state death tax credit

But

- President's budget proposal calls for \$3.5 million and 45% rate
- Others are still pushing for repeal

If client can afford it, better to use the exemption this year

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Advantages of Gifts over Bequests



- Locks in the \$5 million credit (but see clawback discussion)
- Gift tax is a better deal than the estate tax (tax exclusive tax)
- Gets future appreciation out of the estate
- Avoids state estate tax (in states that have one, e.g. MD, DC)
- Can allocate GST exemption (which will then grow with the assets)

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Disadvantages of Gifts

- Carryover basis
- Loss of use by the donor



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Who Should Make Gifts?

Prediction as to the future exemption amount

- If exemption \geq \$5 million in the future → no pressing need to make gifts
- If exemption = \$3.5 million in the future → need to use the last \$1.5 million now to get benefit
- If exemption = \$1 million in the future → any gifts over \$1 million help

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Outright Gifts and Gifts in Trust

Outright Gifts

- Simple and direct

Gifts in Trust

- Can allocate GST exemption to trust
- Trust can be grantor trust, with tax advantages
- Protection from claims of creditors of next generation

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Leveraged Gifts

- If \$5 million is good, leveraging the \$5 million is better

- Traditional (pre-2011) estate planning techniques all work
 - GRAT
 - QPRT
 - FLP or LLC
 - Sale/gift to grantor trust
 - Life insurance



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GRATs and QPRTs

Both are techniques that provide a discount for a retained interest

- Low 7520 rates are an advantage for GRATs
 - Current rate (January 2012) is 1.4%
 - If GRAT assets return more than 1.4%, GRAT is successful
- Different payout rate determines amount of gift
 - At one extreme, can zero out the gift ("heads I win, tails I don't lose")
 - Even a modest payout rate reduces the amount of the gift
- Term is generally short, but legislative proposal to limit to 10 years
- Low appreciation environment is a disadvantage for real estate
 - QPRT offers same tax treatment without the annuity
 - Grantor can occupy residence for term of QPRT

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Valuation Discounts

Key Aspects

- Minority and lack of marketability discounts leverage the exemption
- Example: A 30% combined discount would reduce a \$7 million interest to \$4.9 million (covered by an individual's exemption)
- Discounts carry through for GST purposes
- Excellent technique if client has a closely-held business, but also can work with investment assets if rules are carefully followed

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Gift/Sale to Grantor Trust

- Gift is "seed money," trust then buys assets from the grantor
- Seed money is typically 10% (or more)
- Highly leveraged use of exemption
- Can produce better results than a GRAT because
 - AFR is often lower than the 7520 rate
 - No annuity is required (but interest payments are required)
- Riskier than a GRAT because
 - GRATs are authorized by statute and sale to grantor trust is not
 - Hard to protect against valuation issues
- Less risky because mortality risk is eliminated
- Another excellent technique for closely-held business assets

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Life Insurance

- Income tax free growth
- Must give up "incidents of ownership" (either to another person or to a Trustee)
- Has all advantages of gifts in trust plus
 - Can make gifts to the life insurance trust to provide a fund for future premiums
 - Can provide liquidity at death if client holds illiquid assets
- Weigh against cash gift to trust
 - Mortality risk vs
 - Cost of insurance

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Dynastic Trusts

- Look for ways to use GST exemption
- Using GST exemption is like doing your child's estate planning for him (why not, you did everything else for him)
- Very wealthy might leave assets directly to grandchildren
- If children might need assets, a discretionary trust would be better
- Take advantage of repeal of rule against perpetual trusts

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The Risk of Clawback

Some people think that use of the gift tax exemption in 2011 or 2012 could be "clawed back" at death

- Only an issue if the exemption amount actually goes down in the future
- Statutory language is unclear, no evidence of legislative intent for clawback
- Concern stems from worksheets and instructions of return from prior years
- Clawback seems unlikely

No downside

- Even if there is a clawback, client is no worse off than if gifts not made
- Gifts are advantaged anyway

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V. Strategies for Charitable Giving

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Charitable Giving

- Outright gifts compared to bequests
 - Lifetime charitable gifts have income tax advantages
 - Percentage limitations apply to income tax deduction
- Charitable gifts in trust
 - Charitable remainder trusts
 - Charitable lead trusts
- Donor advised funds
- Private foundations
- Gifts directly from IRAs (expired end of 2011)
 - At present limit it to amount of required distribution

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Thank You

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