

Adaptable Wealth Planning Strategies

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Together we'll go far



Who said?

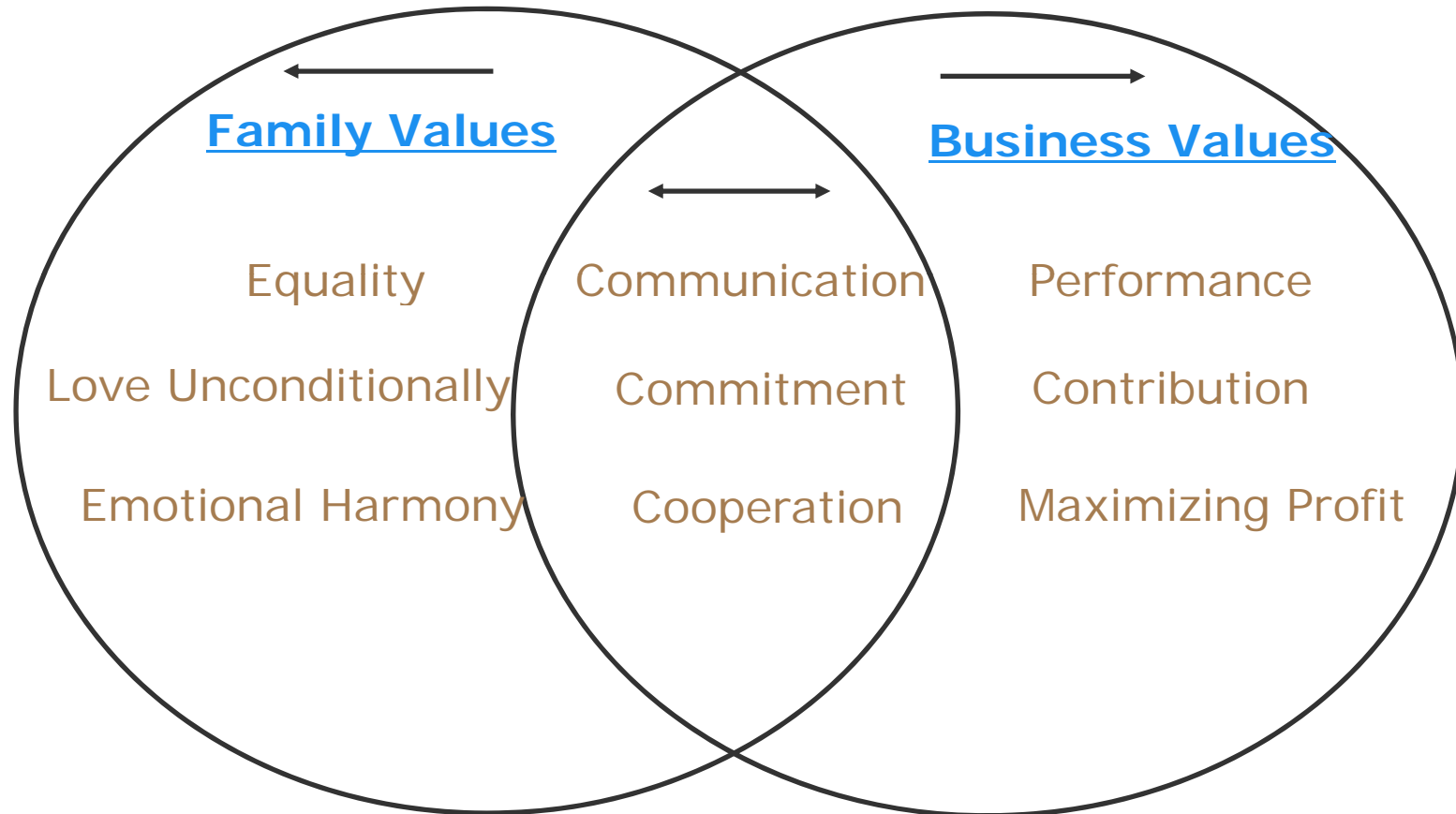
“It is not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is the most adaptable to change.”

**-Leon C. Megginson (1963)
Professor of Management and Marketing at Louisiana State**

Challenges Facing Family Businesses

- According to the SBA roughly 90% of America's businesses are family owned, yet only 30% are successfully transferred to the second generation, only 12% survive into the third, generation, and only a mere 3% reach the fourth generation.
- The primary reason that businesses fail to continue in successive generations is that they do not have properly structured succession plans.
- Experts estimate that 85% of the crises faced by the family business focus around the issues of succession.

Family Values & Business Values Impact Succession Planning



When Competing Values Pull in Different Directions Conflict Arises

Business Succession Planning vs. Trust & Estate Planning

- **Business Succession Planning** deals with ensuring that the family business continues to thrive with successive owners and managers.
- **Trust & Estate Planning** deals primarily with whom your assets will be held, administered and distributed to when you die. Trust & Estate Planning are only a critical part of succession planning but never the succession plan.

Disclaimer Trust

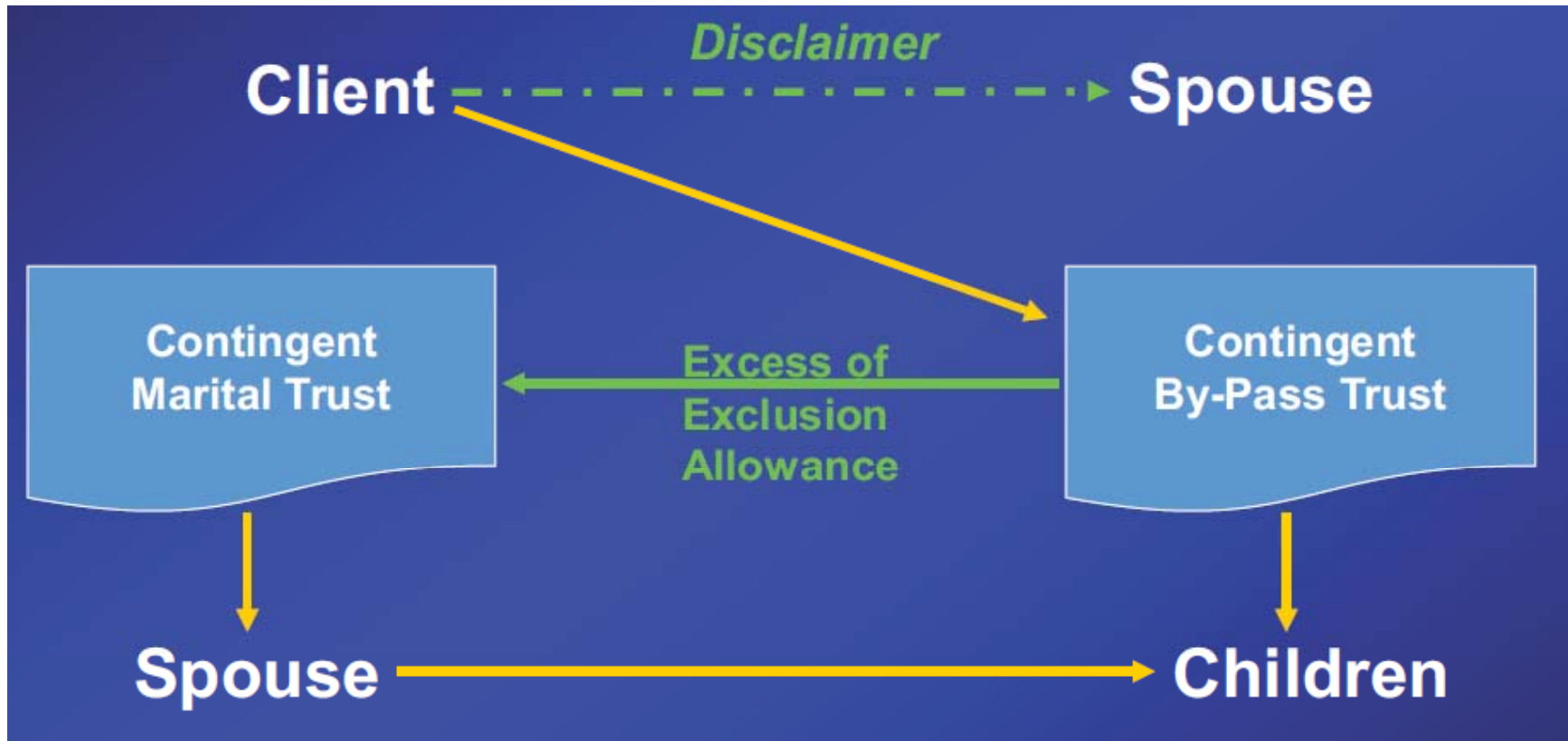
Elements of a Qualified Disclaimer are:

1. The disclaimer must be irrevocable and unqualified;
2. Made in writing;
3. Delivered to the transferor within nine months;
4. No acceptance of the interest or property being disclaimed;
5. Interest disclaimed must pass to either the decedent's spouse or to a person other than the disclaimant.

Planning Pointer:

- Surviving spouse may not even make a disclaimer;
- Surviving spouse cannot retain a limited power over assets in disclaimed trust;
- No step-up in basis for assets in disclaimed trust.

Contingent Disclaimer Trust



One-Lung & Clayton Marital Trusts

One-Lung Marital Trust ("OLMT")

- Entire estate left to a marital trust ; executor makes a partial QTIP election;
- Two identical trusts: one qualifying for the marital deduction and the other not;
- Surviving spouse must be the sole beneficiary to the exclusion of the children.

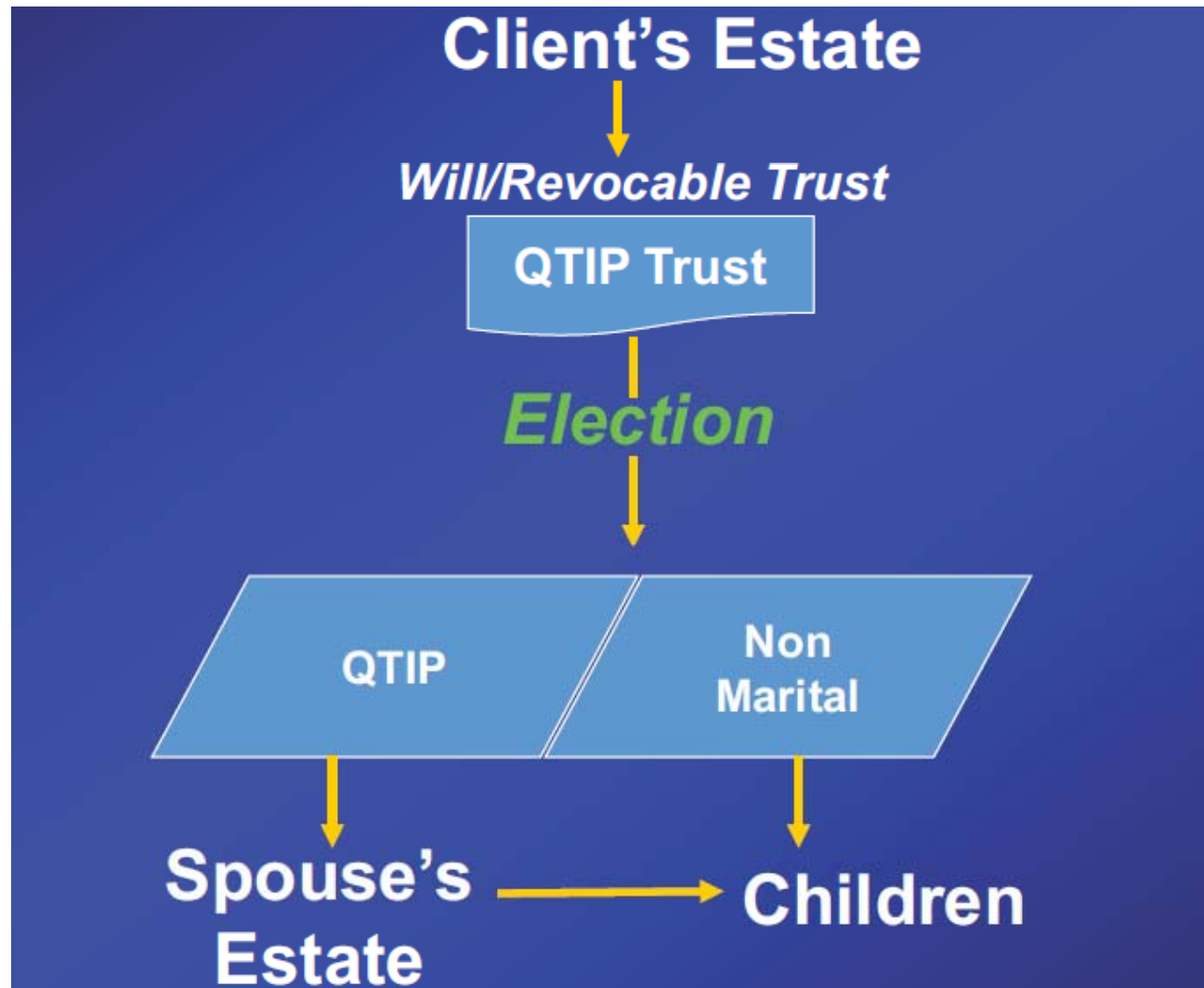
Clayton Contingent Marital Trust ("CCMT")

- Entire estate left to a marital trust; executor makes a partial QTIP election;
- Surviving Spouse's income interest in QTIP is contingent on QTIP election;
- Two trusts: one qualifying for the marital deduction and the other a bypass trust;
- Terms and beneficiaries of bypass trust can be different from the QTIP trust.

Planning Pointer:

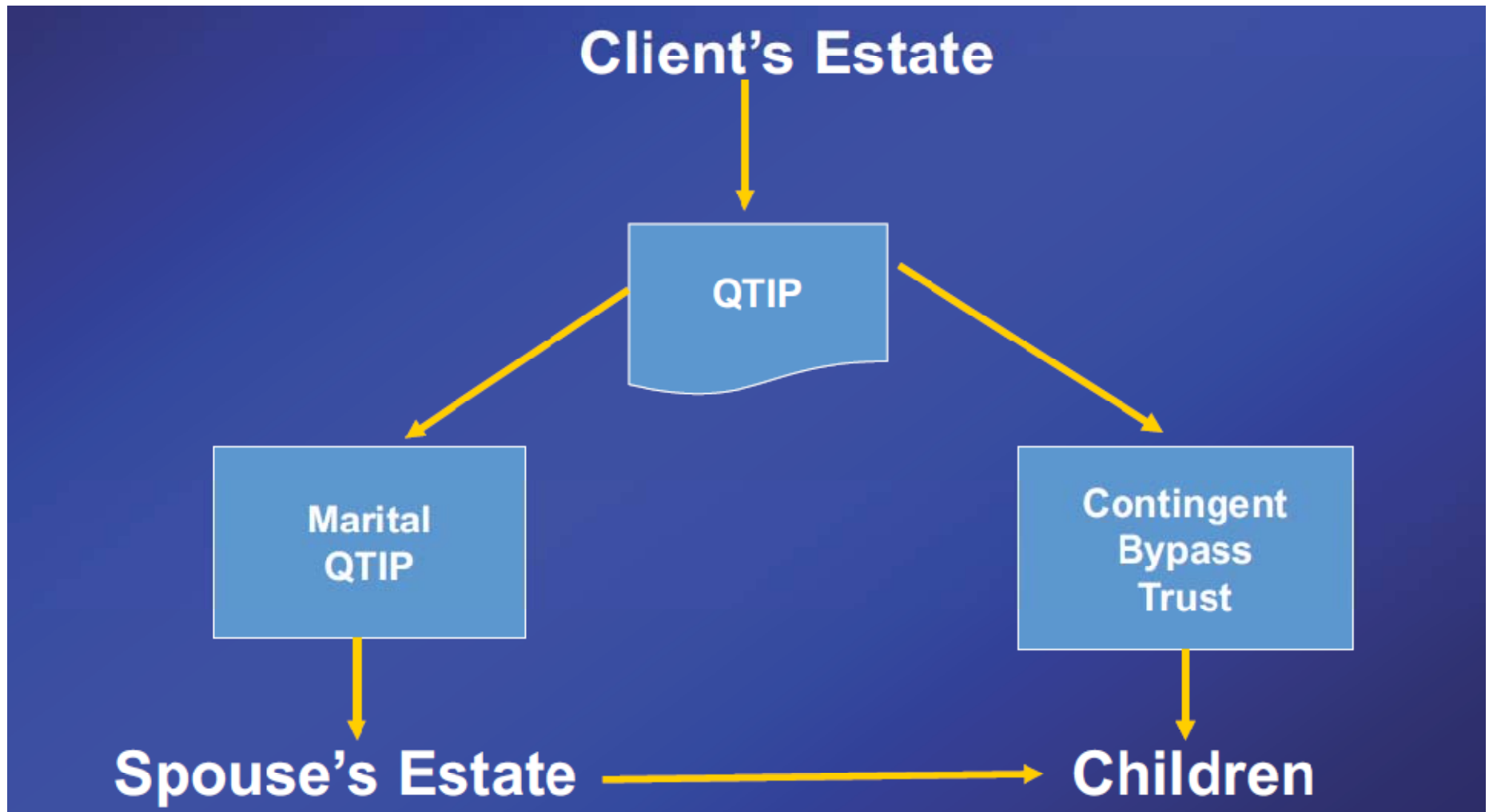
- OLMT and CCMT are alternatives "reduce-to zero" marital deduction formula;
- In both the OLMT and CCMT the QTIP election does not need to be made until 15 months (9 months plus a 6 month automatic extension) after the decedent's death.

“One-Lung” Marital Trust



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Clayton QTIP



Est. of Clayton, Jr. v. Comm.,
70 AFTR 2d 92-6262(976.2d 1486)
11/17/92

Favorable Wealth Transfer Factors thru 2012

- 5.12 million unified estate, gift, and generation skipping tax exemption and a 35% combined estate, gift and GST tax rate;
- The lowest federal interest rates, lowest gift tax rates & highest exemptions in modern times;
- Relatively low asset values, particularly with respect to real estate and closely held businesses; and
- Still, less in the way of restrictions regarding the use of GRATs and/or valuation discounts on family controlled operating enterprises.

The Rush to Avoid Gift Taxes

WSJ (March 16, 2012):

- *As the deadline approaches for taking advantage of the government's \$5 million gift-tax exemption, estate planners are dealing with the fear of "donor's remorse."*
- *Families are looking to set up so-called irrevocable trusts to pass along assets to their heirs without paying gift tax—but worry they will change their minds later in life or will need to get the money back one day.*
- *What if you run out of money later in life? Or have a fight with one of your kids? Or want to change the terms if your son develops a drug problem, or your daughter turns into a shopaholic? If you have an irrevocable trust, you generally are out of luck.*

Spousal Lifetime Access Trusts

- Husband in stable marriage funds SLAT with his separate property for amounts up to his \$5.12 million dollar transfer exemption fbo his wife and descendants;
- During wife's lifetime, the trustee (wife alone or as a co-trustee) can distribute income and principal to herself under an ascertainable standard;
- Husband has indirect access to the trust's income and principal through his wife;
- Upon wife's demise the assets can pass estate tax free to the children and/or grandchildren (assuming husband's GST exemption was properly allocated to trust contributions).

Planning Pointer:

- Wife might create an ILIT for the benefit of her husband in case wife dies first;
- Be wary of gift splitting and the Step Transaction Doctrine with a SLAT;
- Should husband and wife both create SLATs avoid the Reciprocal Trust Doctrine.

Beneficiary Taxed Grantor Trust (BTGT)

- Typically, a trusted third party (ie. parent) in a self-settled trust jurisdiction that has extended or revoked its perpetuities laws contributes a nominal amount of money, for example \$5,000 to an irrevocable dynasty trust;
- Client has the ability to withdraw that amount using a Crummey withdrawal power which the client allows to lapse;
- By using a Crummey withdrawal power the client becomes the “owner” of the trust for income tax purposes, but not for estate tax purposes.

Planning Pointer:

- Since the trust is a grantor trust with respect to the client, the client can sell appreciated assets like a closely held business to the BTGT (just like to an IDGT) in exchange for a promissory note without any capital gains tax consequences;
- Because the trust was not created by the client, transfers to the trust are not subject to the normal statute of limitations on fraudulent transfers.
- Need an Independent Trustee (Not Wells Fargo).

No Transfer Tax Planning Clarity Past 2012

- Vote to keep the current 35% transfer tax structure with an indexing \$5.12 exemption (estate, gift and generation skipping transfer (GST) tax);
- Eliminate the “death tax” altogether which currently brings in only a trickle of tax revenue in exchange for an income tax revenue raiser on the rich;
- Keep step-up in basis; or elect IRC 1022, Form 8939 carryover basis; or tax capital gains at death;
- Let Portability lapse; keep it; or re-instate it;
- Do nothing and allow the estate tax law to return to 2001 beginning in 2013, with a 55% transfer tax rate and a \$1 million estate tax exemption;
- Adopt the President’s proposed plan to return to 2009’s \$3.5 million estate and \$1 million gift & GST tax exemptions at a 55% transfer tax rate; or
- Craft up some other short term political surprise altogether.

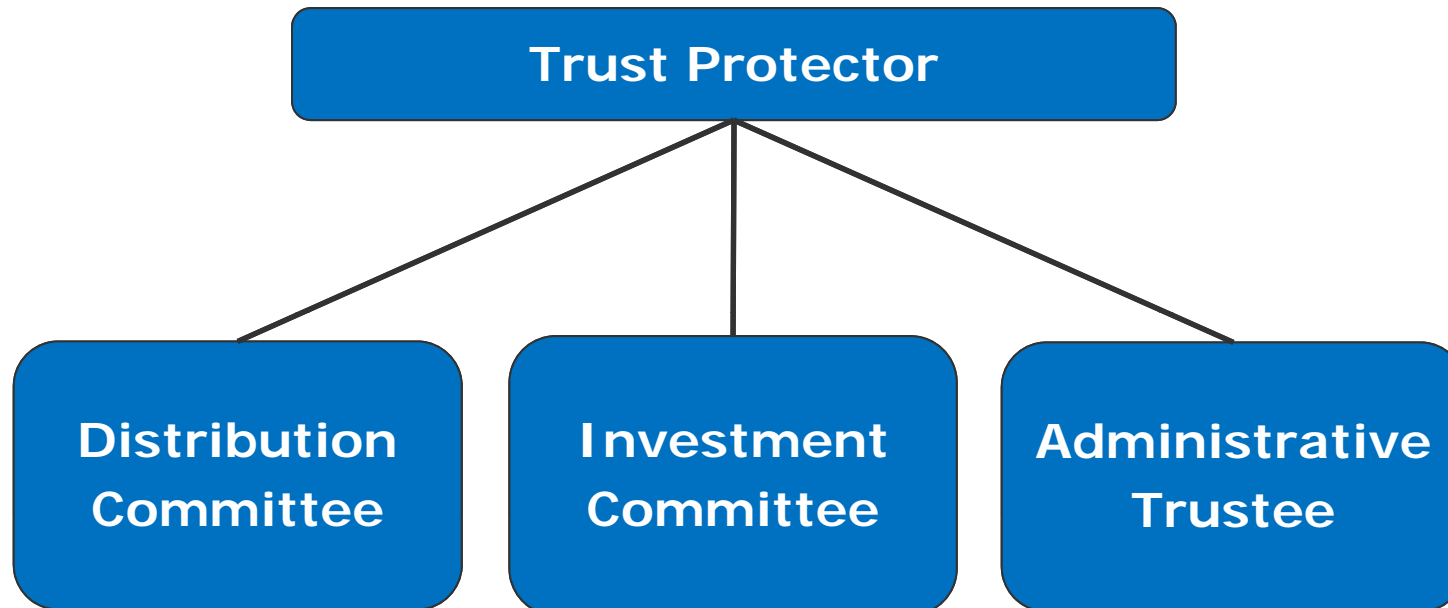
Client-Centric Planning Challenges

- Clients are living longer;
- Health care costs are skyrocketing;
- Family circumstances are in flux;
- Market volatility abounds with recurrent “Black Swan” events;
- Baby Boomers under-saved for the demands of retirement;
- A deficit-riddled America to negatively impact Tax Planning Policy.

Adaptable Trust Protector Powers

- Power to remove and/or to replace a trustee;
- Power to amend the trust re: administrative and dispositive provisions;
- Power to veto or direct trust distributions;
- Power to add or remove beneficiaries;
- Power to change situs and the governing law of the trust;
- Power to veto or direct investment decisions;
- Power to consent to exercise power of appointment;
- Power to terminate the Trust;
- Are the Powers Exercisable in a Fiduciary or Non-Fiduciary Capacity?

Adaptability With Trust Protectors



Which Situs is Most Ideal for 2012?

- No State Income Tax:

- Alaska, Florida, Nevada, South Dakota, Washington and Wyoming are the only perpetual or nearly perpetual jurisdictions with no state income tax.

- Flexibility for Trust Remodeling:

- South Dakota's decanting statute, effective July 1, 2007, provides the best example of flexibility for trust remodeling. (Discussion on potential drawbacks, infra).

- Asset Protection (Caution if primary motive):

- Alaska, Delaware and South Dakota have the strongest asset protection laws of the truly perpetual jurisdictions.

- Trusts & Estates (January 2012)

Adaptability Thru Defined Value Clauses

- Limits the quantity of assets gifted or sold until a final IRS determination of value can be made;
- Any excess value over the final determination amount typically passes gift tax free to a qualified charity;
- Helpful with promissory note sale to a intentionally defective grantor trust (IDGT) due to the large \$5 million gift tax exemption;
- Helpful with expressing the transferred assets as a dollar value rather than a percentage interest or number of units combined with a grantor retained annuity trust (GRAT).
- Note, a recent tax court memo upheld a defined value clause without a charitable component by limiting the gift of partnership units to a stated dollar amount.

Adaptable Powers of Appointment

- Special Powers of Appointment:

- Grant broad special powers of appointment exercisable by the primary beneficiary during lifetime and at death to essentially rewrite the trust among children, grandchildren, charities and friends.

- Power to Decant:

- Allows the trustee to pay over the trust corpus from the existing trust (situs change) to a new trust created in one of the existing fifteen states that has a decanting statute for the existing trust beneficiary(ies) in order to cure current trust issues and inadequacies or to simply modernize the trust.
- Although trustees arguably have the power to decant under applicable state common law, if the trust document does not specifically provide for decanting, it may be best to change the situs and governing law of the trust to one of the existing fifteen states which does explicitly permit decanting.
- Having the power to decant is wise but exercising it requires prudence.

Possible Adverse Tax Consequences of Decanting

IRS Notice 2011-101 (some of the 13 factors below):

- A beneficiary's right to or interest in trust principal or income is changed;
- Trust principal and/or income may be used to benefit new (additional) beneficiaries;
- A beneficial interest (including any power to appoint income or corpus, whether general or limited, or other power) is added, deleted, or changed;
- The transfer takes place from a grantor trust to one which is not a grantor trust;
- Obtaining and not obtaining a beneficiary consent;
- A change in the identity of a donor or transferor for gift tax (GST) tax purposes;
- Future power to make any such changes is created.

Key Adaptable Trustee & Distribution Provisions

- Primary Beneficiary as Trustee:

- Initially permit a responsible primary beneficiary to act as sole trustee to make permissible discretionary distributions to themselves and to others pursuant to an ascertainable standard.

- Independent Trustee:

- Provide for an independent trustee (perhaps springing) in order to make discretionary distributions to the primary beneficiary above an ascertainable standard and to hold tax-sensitive administrative powers.

- Legal Obligations of Support:

- Prohibit the trustee from making distributions that discharge a legal obligation of support that may result in adverse gift and estate tax consequences for the trustee.

Toggle Switch for Tax Consequences of Trust

- Consider an annual “toggle switch” where an independent trustee makes a loan to the grantor for less than adequate security and interest.
- If grantor trust status is desired simply make a loan to the grantor.
- To switch grantor trust status off merely have the grantor fully repay the trust loan.

20 Possible Provisions for Adaptability

(Drafting attorney alone provides legal advice)

1. Specify the grantor's intent, particular preference, or trust purpose;
2. Offer guidance regarding the exercise of distribution discretion;
3. Provide for virtual representation for unborn or unascertainable beneficiaries;
4. Consider flexibility, independence and expertise in naming the trustee;
5. Provide direction on whether or not to consider beneficiary resources;
6. Designate priority among trust beneficiaries;
7. Insert tie-breaker language where co-trustees are named;
8. Allow the trustee to terminate an uneconomical trust;
9. Permit the trustee to resign and establish a process for naming a successor;
10. Allow the trustee to hold "S" stock and preserve the "S" election;

20 Possible Provisions for Adaptability

(Drafting attorney alone provides legal advice)

11. Give the trustee broad discretion regarding investment powers;
12. Examine need for Trust Protector or Special Trustee where a closely held business is involved or where there is a possible beneficiary addiction to drugs or alcohol;
13. Incorporate \$5,000 or 5% annual withdrawal power ;
14. Avoid frozen fee language for trustee services;
15. Indemnify the trustee and use “permissive retention language” or direct the trustee to retain concentrated or closely held positions;
16. Provide the trustee the power to 1035 exchange or sell an insurance policy;
17. Allow the trustee to change trust situs and governing law;
18. Permit the trustee (not Wells Fargo) to make loans to beneficiaries;
19. Allow the trustee to merge or divide the trust;
20. Grant General Power of Appointment re: GST tax if overall transfer tax reduction.

“Survival of the Fittest” Planning

In the end, the long term method of planning that is most likely to survive is one where the planning advice proffered and the wealth transfer planning vehicles deployed can adapt with economic, legal and familial circumstances that are sure to change.

Disclosures

- The information herein is provided for educational and illustration purposes only.
- Team members should engage business succession planning specialists.
- Clients should consult their professional advisors.

Disclosures



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