

Leveraging the GST Exemption: An Alternative to Portability Planning

A Roadmap for Maximizing the Generation-Skipping Transfer Exemption

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Today's faculty features:

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Leveraging the GST Exemption: An Alternative to Portability Planning

CLE/CPE Webinar on Tuesday, December 2, 2014

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Leveraging the GST Exemption: An Alternative to Portability Planning



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PR ACTICE AREAS

ASSET PROTECTION PLANNING · ESTATE ADMINISTRATION · ESTATE PLANNING · ESTATES AND TRUSTS · TAX CONSULTING

PRACTIC E FOC U S

Mr. Kaufman has nearly twenty years experience as a trusts and estates attorney, providing client services in the areas of estate planning and estate and trust administration. His expertise covers the full range of traditional trusts and estates matters. Mr. Kaufman's legal expertise covers sophisticated tax analysis and planning, structured management arrangements for families, family businesses and family offices, and fiduciary and tax controversies.

EDUCATION

LL.M. in taxation, Georgetown University Law Center
J.D. (cum laude), American University, Washington College of Law
B.S., University of Maryland

BAR AND COURT ADMISSION S

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ACTIVITI ES

Mr. Kaufman is a member of the Section on Real Property, Probate and Trust Law of the American Bar Association; the Estates and Trusts Section of the Maryland State Bar Association; the Tax Section and the Estate Planning Committee of the District of Columbia Bar Association; and the Washington, D.C. Estate Planning Council.

PR E VIOU S WOR K

Prior to bringing his experience as an estate attorney to Offit Kurman, Mr. Kaufman trained and developed his career at prominent Washington, D.C. area firms, working as supervisor or head of department in the trusts and estates area.

SPEECHES/PUBLICATIONS

Mr. Kaufman is a frequent lecturer on estate planning and business succession planning topics throughout the Washington D.C. metropolitan area.

ARTICLES

Offit Kurman Welcomes Gal N. Kaufman to its Estates & Trusts Practice Group
Beware of State Estate Taxes
Named to Washingtonian Magazine's Top Money Advisers for 2014

Leveraging the GST Exemption: An Alternative to Portability Planning

- Overview of Transfer Taxes
 - Estate Tax
 - Exemption is \$5.34M (\$5.43M as of 1/1/15)
 - Effective Tax Rate = 40%
 - Unlimited Estate Tax Marital Deduction
 - Portability between spouses applies
 - Gift Tax
 - Exemption is \$5.34M (\$5.43M as of 1/1/15)
 - Effective Tax Rate = 40%
 - Gift and Estate Tax Exemptions are unified
 - Unlimited Gift Tax Marital Deduction
 - No Portability
 - GST Tax
 - Exemption is \$5.34M (\$5.43M as of 1/1/15)
 - Effective Tax Rate = 40%
 - Not unified with Estate and/or Gift Tax Exemptions
 - No portability

Leveraging the GST Exemption: An Alternative to Portability Planning

- Overview of Important Income Tax Concepts
 - Basis Step-up
 - Assets subject to Estate Tax are generally given a full Basis Step-up at death
 - No Basis Step-up for lifetime gifts
 - Carry-over basis applies to lifetime gifts
 - No Basis Step-up for IRD items
 - e.g., IRAs.
- With increased Gift/Estate Tax Exemption amount and with many states likewise increasing Estate Tax Exemptions or eliminating Estate Tax, some of the focus on planning has shifted from transfer tax to income tax/basis step-up issues at each spouse's death.
- FACTORS: increase in value of assets over time; state estate taxes; basis step-up; and, of course, GST Tax

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- Bruce's Example: H and W each have \$5,340,000. H leaves his estate to W.
 - No Estate Tax due at H's death due to unlimited marital deduction
 - If H's Estate elections portability, W will have a combined \$10,680,000 Gift/Estate Tax Exemption.
 - No use of H's GST Exemption will have occurred.
 - At W's subsequent death, her \$10,680,000 (or larger) exemption will be used to offset Estate Tax at her death.
 - In addition, since all of the assets will be includible in her estate, there will be a full basis step-up at W's subsequent death.

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- However, at W's death there will be potentially larger state Estate Tax since none of H's state estate tax exemption will have been utilized.
- In addition, the amount of transfer tax "leverage" for future generations has been minimized by not using any of H's GST Exemption at his (first) death.
- would only have \$5,340,000 of her own. W's estate could allocate W's GST exemption to her \$5,340,0

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- Alternative: At H's death, H's estate plan could call for H's \$5.34M to be left in trust for W's benefit.
 - H's estate allocates his full \$5.34M GST exemption to the trust for W's benefit.
 - At W's subsequent death, this trust will not be includible in W's estate for Estate Tax purposes.
 - This could allow for more full use of state estate tax exemptions
 - However, no step-up on assets inside this trust at W's death.

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- In addition, this trust could continue for the benefit of children and grandchildren.
- Viewing the planning from a generational perspective, the amount of wealth that could be transferred Transfer Tax-free could outweigh loss of basis step-up.
 - There may also be opportunities to mitigate loss of basis step-up at W's death and at subsequent family members' death.

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- Keep things flexible:
 - Use disclaimer planning
 - Or Clayton QTIP
 - Use lifetime trusts (with GST allocation)

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December 2, 2014

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- Bruce Steiner has over 35 years of experience in the areas of taxation, estate planning, business succession planning and estate and trust administration
- He is a frequent lecturer at continuing education programs for bar associations, CPAs and other professionals. He is a commentator for Leimberg Information Services, Inc., is a member of the editorial advisory board of *Trusts & Estates*, is a technical advisor for *Ed Slott's IRA Advisor*, and has written numerous articles for *Estate Planning*, *BNA Tax Management's Estates, Gifts & Trusts Journal*, *Trusts & Estates*, *Journal of Taxation*, *Probate & Property*, *TAXES*, *CPA Journal*, *CLU Journal* and other professional journals
- Bruce has been quoted in various publications including *Forbes*, *The New York Times*, *Wall Street Journal*, *Daily Tax Report*, *Lawyers Weekly*, *Bloomberg's Wealth Manager*, *Financial Planning*, *Kiplinger's Retirement Report*, *Newsday*, *New York Post*, *Naples Daily News*, *Individual Investor*, *Fox Business*, *TheStreet.com*, and *Dow Jones (formerly CBS) Market Watch*
- Bruce has served on the professional advisory boards of several major charitable organizations and was named a New York Super Lawyer in 2010, 2011, 2012, 2013 and 2014

Before the generation-skipping transfer tax

- After the initial taxable gift or inclusion in the estate, trusts could continue from generation to generation, free of transfer tax, subject only to the rule against perpetuities
- See George Cooper, “A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance,” 77 Columbia L. Rev. 161 (1977)

Taxable events

- Direct skip
 - T makes a gift to or in trust for a grandchild
 - T leaves property to or in trust for a grandchild
- Taxable transfer
 - T creates a trust for the benefit of child and child's issue. The trustees make a distribution to grandchild
- Taxable termination
 - T creates a trust for the benefit of child and child's issue. Child dies, and the trust is now for the benefit of the grandchildren and their issue

Tax rates and GST exemption

- The GST tax rate is 40%
- The GST exemption is equal to the estate and gift tax exempt amounts
- The GST exemption is \$5,340,000 in 2014, and is indexed for inflation. It will be \$5,430,000 in 2015

The estate tax is tax inclusive whereas the gift tax is tax exclusive

- The estate tax is tax inclusive, whereas the gift tax is tax exclusive, assuming the donor lives for at least three years
 - Example: T has \$100 at death. If there is no state estate tax, the estate tax is \$40, and the net after estate tax is \$60
 - Example: T has \$100. T makes a gift of \$71 and pays gift tax of \$29
 - The gift tax is 29% less than the estate tax. The donee receives 16% more
 - The benefit is greater in a state that has a state estate tax
 - The tradeoff is the loss of the basis step-up for gifts

Taxable termination

- Decedent has \$1 million.
- Decedent leaves his/her estate in trust for child, then for grandchildren
- The estate tax is \$400,000. The remaining \$600,000 goes in trust for child, then for grandchildren.
- At the child's death, the GST tax is \$240,000 (40% of \$600,000), leaving \$360,000 for the grandchildren

Direct skip at death

- Decedent has \$1 million, which passes to or in trust for grandchildren.
- The estate tax is \$400,000.
- The GST tax is 40% of what the grandchildren receive, i.e., $\frac{4}{14}$ of \$600,000, or \$171,429
- This leaves \$428,571 for the grandchildren

Direct skip during lifetime

- Donor has \$1 million to give to or in trust for grandchildren
- Donor makes a gift of \$510,204
- The gift tax on the gift is 40% of \$510,204, or \$204,082
- The GST tax is also 40% of \$510,204, or \$204,082
- The GST tax is also subject to gift tax. The gift tax on the GST tax is 40% of \$204,082, or \$81,633
- The grandchildren receive \$510,204 after gift tax and GST tax

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Taxable distribution

- Decedent leaves \$1 million in trust for child and child's issue
- The estate tax is \$400,000, so the trust receives \$600,000
- The trustee distributes the assets to a grandchild. The GST tax is 40% of what the grandchild receives
- The GST tax is $\frac{4}{14}$ of \$600,000, or \$171,429, leaving \$428,571 for the grandchild

No portability for GST tax

- There is portability for the Federal estate tax
- However, there is no portability for the GST tax
- Example: H and W each have \$5,340,000. H leaves his estate to W. W now has \$10,680,000. H's estate elects portability
- W dies. W's gets the benefit of H's unused estate tax exclusion amount, so W's estate tax exclusion amount is \$10,680,000
- W leaves her \$10,680,000 in trust for children. Only \$5,340,000 is GST exempt
- If H instead created a credit shelter trust, H's estate could have allocated H's GST exemption to the credit shelter trust. W would only have \$5,340,000 of her own. W's estate could allocate W's GST exemption to her \$5,340,000

Leveraging the GST exemption by allocating GST exemption to lifetime transfers

- Example: T gives \$1 million to a trust for child and issue. T allocates \$1 million of GST exemption to the trust
- The trust is exempt from GST tax. There is no GST tax on distributions to grandchildren, or upon child's death
- If the trust grows to \$2 million during the transferor's lifetime, the trust is still exempt from GST tax
- The trust can continue forever, limited only by the rule against perpetuities
- Many states have repealed the rule against perpetuities, or allow trusts to run longer than lives in being plus 21 years

The default allocation rules

- Before 2001, the default was no allocation of GST exemption. A transferor who wanted to allocate GST exemption had to do so on the gift tax return
- Under the Economic Growth and Tax Reform Reconciliation Act of 2001 (EGTRRA), there is a default allocation of GST exemption to certain transfers
- The default allocation rules are complicated
- Do not rely on the default allocation rules
- Allocate GST exemption on the gift tax return if desired, or elect on the gift tax return not to have the default allocation rules apply

Gift-splitting

- If spouses elect gift-splitting, each spouse is treated as the transferor as to one-half of the transfer for GST tax purposes

Annual exclusions generally not available for GST tax purposes

- Before the Technical Corrections Act of 1988, if the annual exclusion was available for gift tax purposes, it was also available for GST tax purposes
- Under the Technical Corrections Act of 1988, the annual exclusion is generally not available for GST tax purposes
 - Example: T gives \$100,000 to a trust for issue.
 - Each child has a *Crummey* withdrawal power, which allows for annual exclusions for gift tax purposes.
 - These annual exclusions are not available for GST tax purposes.
 - T can allocate \$100,000 of GST exemption to the trust

Exception for certain one-beneficiary trusts

- Exception: a trust with one beneficiary where the trust assets are included in the beneficiary's estate
 - Example: T creates a trust for a grandchild.
 - The grandchild has a *Crummey* withdrawal power
 - No distributions can be made to anyone other than the grandchild.
 - The grandchild has a testamentary general power of appointment over the trust
 - The annual exclusion will be available for GST tax purposes

Estate tax inclusion period (ETIP) rules

- A transferor cannot allocate GST exemption during the estate tax inclusion period (ETIP)
- There is an ETIP if the trust assets would be included in the estate of the transferor if the transferor were to die
 - There is an ETIP during the grantor's retained term in a qualified personal residence trust (QPRT)
 - There is an ETIP during the grantor's retained term in a grantor retained annuity trust (GRAT)

Appointing GST taxable trusts to or in trust for grandchildren

- The beneficiary can appoint the trust assets to or in trust for his/her grandchildren
 - This moves the property down two generations, at the cost of only one transfer tax
 - While many states have state estate or inheritance taxes, few if any states have state GST taxes

GST taxable trusts where the beneficiary won't have a taxable estate

- Distribute the GST taxable trust to the beneficiary. The assets will be included in the beneficiary's estate, but protected by the beneficiary's estate tax exclusion amount
- Give the beneficiary a general testamentary power of appointment

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Lauren A. Jenkins

- Lauren A. Jenkins focuses her practice on tax and estate planning, trust and estate administration, and tax compliance.
- Lauren represents individuals and families with creating and implementing estate plans to achieve their personal and financial objectives. Such planning often includes drafting wills, revocable trusts, and powers of attorney, as well as more advanced estate planning to preserve wealth for future generations. Lauren also has experience advising clients who require both domestic and international components to their estate plans.
- Lauren guides clients through the complexities and nuances of trust and estate administration. She advises fiduciaries with respect to their powers and responsibilities, including filing obligations under state and federal law. Additionally, Lauren represents beneficiaries who desire separate counsel to ensure their interests are protected and they receive their full entitlement.
- Lauren also represents clients before the IRS, including offers in compromise and voluntary disclosures to resolve noncompliance with respect to U.S. reporting obligations.

Predeceased Ancestor Exception

- Definition
- Application
 - All taxable transfers.
 - Descendants of a parent of the transferor or the transferor's spouse.
 - Rules regarding collaterals.
- Death within 90 Days Rule
 - Description
 - Limitations
 - Planning Tip

Reverse QTIP Election

- **General Rule.** Assets that qualify for the marital deduction result in the assets being subject to subsequent transfer tax by the surviving spouse. At such time, the surviving spouse is considered the transferor.
- **Reverse QTIP Election.** If the reverse QTIP election is made, the first spouse to die is considered the transferor at the death of the surviving spouse (instead of the surviving spouse).
- **Planning Opportunities**

Reverse QTIP Election (Cont.)

- Unlike the partial QTIP election, a partial reverse QTIP election cannot be made.
- Qualified Severances.
 - I.R.C. Section 2642(a)(3)
 - Requirements found in Treas. Reg. Section 26.2642-6(b)(4)
- Drafting for reverse QTIP election.

Late Reverse QTIP Election

- Estate Tax Return
 - Filing on late estate tax return, if it is the first return to be filed.
 - If estate tax return has already been filed, 9100 relief may be granted.

- Gift Tax Return
 - Must file a timely gift tax return.
 - No 9100 relief available.
 - Timely filed gift tax return, but election not made, 9100 available.

Separate Shares v. Separate Trusts

- Generally, a single trust cannot be treated as multiple trusts.
- Circumstances in which a single trust may be treated as multiple trusts.
 - Portions attributable to different transferors treated as separate trusts.
 - Substantially separate and independent shares with different beneficiaries treated as separate trusts.
 - Pecuniary amount payable on death of the transferor from a lifetime trust included in gross estate or from a testamentary trust, can be treated as a separate trust.
- Limitations on treatment for other purposes.

GST Planning for NRAs

- Definition of Nonresident Alien (NRA) for Transfer Tax Purposes
- Property Subject to U.S. Transfer Tax
- U.S. Situs Property for Gift Tax Purposes v. U.S. Situs Property for Estate tax Purposes
- Amount of Exemption/Tax Rate (Different Based on Type of Tax)
- Application to Taxable Distributions and Taxable Terminations
- Planning Tips for NRAs

Qualified Disclaimers for GST Tax Purposes

- Effect of Qualified Disclaimer
- Timing
 - 9 months from date on which the transfer creating the interest is made.
 - Determining when interest created.
 - Issues when transfer is not subject to gift or estate tax.
- Planning Tips
 - Don't Forget to Disclaim Powers of Appointment
 - Alternative to Judicial Modification
 - Advantages of Surviving Spouse Disclaimant
 - Disclaimers to Create Separate Shares