

TAX SECRETS

MADE SIMPLE



DISCOVER YOUR PATH
TO PAY LESS TAX

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Chapter 17

The “Give It Away Twice Trust”

Some people state, “When I am dead and gone, I don’t care who gets what or how”. That statement is one of the most overused, untrue statements a person with any level of financial means will ever express. Granted, it is a great statement to act as a defense mechanism to postpone any meaningful discussion about your eventual demise, but the reality is, you probably do care. Since there are only four places your money will go upon your death, you will desire that most of your wealth transfers to your heirs and / or charity with and the least amount of your wealth going to the government.

Considering the bulk of people who actually work to create their estates, most do care who does get what, when and how. Over a decade, I worked at a few estate planning law firms and discovered only a few estates have a remote chance of becoming multi-generational wealth transfers. In other words, due to poor planning, the transfer of wealth will last a short time period after the passing of the parents. In fact, studies show more than one third of estate beneficiaries (inheritance) had negative savings within two years. Another study suggested teenagers with an outright inheritance in excess of \$100,000.00 had a new car within seventeen days. Clearly, estate beneficiaries of today are poorly prepared to receive even the most modest of estates from their parents. Think of this. Could each of your children properly handle their inheritance if you died today?

The reason I share this up front is to help you think through the process of balancing the inheritance in a way to protect your heirs from becoming a statistic like the two above. One planning method I love, which is gaining broad popularity, is addressing those two important issues. First, the Income in Respect of a Decedent (IRD) tax disaster from Qualified Plans and second, creating an income stream to provide for the heirs for up to a maximum of twenty years from your grave.

In Chapter Eleven, we introduced Charitable Tax Planning Basics. Here is another powerful method using a Testamentary Charitable Remainder UniTrust (TCRUT). Simply, upon the death of the Qualified Plan Owner, part or all of the qualified fund could be directed to a Charitable Trust that springs into effect by a written document such as a Will or Revocable Trust (normally second death planning). Let’s explore an actual case I designed several years ago.

Tim and Susan raised four children. Tim passed away three years ago. Susan did not remarry. The estate was set up to provide for the survivor, then pass the entire estate to the children in equal shares, outright. The estate consisted of a paid off home valued at \$400,000.00, cash and other securities valued at \$400,000.00, and a Traditional IRA with \$800,000.00. Susan had no debt and the estate was not subject to estate taxes. On the surface, most will say this is simple math. Since the estate is valued at \$1,600,000.00, divided by four beneficiaries, each child’s pretax share will be \$400,000.00. Remember the IRA will be subject to income tax paid by the children at their respective tax rate.

Now for the rest of the story. Of the four children, two are strong money managers, one is borderline of being good with money and one child, well let’s say he is of the creative sort who is expected to blow his inheritance in less than two years. Granted, some will argue this is a waste of time, but Susan is losing sleep worrying if creative the child will become a financial burden to the three other children after her

death! Susan has every right to worry because if the creative child does blow his inheritance, it is likely he will become a burden to his siblings, potentially causing future social and emotional strife.

One suggestion Susan liked was to allow a small portion of the estate to pass outright to each heir. For example, \$50,000.00 outright distribution at some point shortly after the death of Susan. Then, using the proceeds from the sale of the home and the remaining non-qualified monies, fund a Personal Asset Protection Trust for each child with separate EIN numbers, etc., would be funded. A lengthy discussion about who should or could act as the trustee for each sub trust could be inserted here taking up another ten pages, but not today. Clearly, the creative child should not be trustee of his trust.

Upon Susan's death, a portion of funds (\$50,000) would be distributed outright, the remainder would be placed into asset protection trusts for each child - safe from their future divorces, law suits, bankruptcy, etc., and now we need to address the taxable IRA. Susan and Tim both have been very generous with their time and financial contributions to a few local charities. Sadly, when they had their estate plan created by their local attorney, no one discussed any form of testamentary gift to charity. Susan stated she and Tim wanted to do more, but their advisors told them their estate was too modest.

Thankfully, the existing Trust was an all to survivor trust which means, Susan has full control and ownership as trustor and trustee of the non-qualified assets. Susan also has the power to restate and amend the Trust in its entirety. Therefore, modifying the Trust to include the Personal Asset Protection Trust for the children can be easily drafted by a qualified attorney with the proper training and experience (a short list of attorneys qualify to do this level of planning).

In respect to the Traditional IRA which has been rolled into one account, Susan as the IRA owner, can change the designated beneficiary form to whomever or whatever charity she chooses. In this case, Susan's attorney would be shown how to also modify the Revocable Trust to include provisions for a springing, Testamentary Charitable Remainder Unitrust (TCRUT). The TCRUT will accept the qualified IRA funds shortly after her death and make a payout to her heirs for a maximum payout period not to exceed twenty years (limited by Federal law). That was a mouthful.

Here is how this will work. The attorney adds provision to establish the Charitable Remainder Unitrust naming her heirs as the Income Beneficiaries. Susan will also name the charities to receive the trust funds upon completion of the twenty year payout. Susan also has the right to allow the heirs to name the eventual gift to charity as well in the event she does not want to name a charity now. The payout income from the TCRUT to the heirs can be structured as monthly, quarterly, semi-annual or annual payments. Payments to the heirs are subject to the four tier accountings rules (taxable distribution). In other words, instead of the taxable IRA becoming a tax bomb as an outright distribution, or a five pay plan over five years or a stretch option payout, Susan has basically created an income stream to benefit her children from her grave!

When Susan passes, the heirs will receive a nice distribution (\$50,000.00 tax free), another part is placed into a sub trust (\$150,000.00 tax free), protected from creditors, predators, etc., and the "tax bomb" IRA converted into the TCRUT becomes a small income stream producing approximately \$10,000.00 of annual income for the next twenty years for each beneficiary (approximately \$200,000.00 of value per child) subject to the Tier Four accounting rules.

Now here is the cherry on top. Assuming the trust money manager has a net six percent rate of return on \$800,000.00 and using a five percent payout of \$40,000.00 a year, upon completion of the twenty year trust, a total of \$800,000.00 of taxable funds will be distributed to her heirs and approximately \$800,000.00 will be distributed to the charities of her choice when the trust is terminated. In effect, she gave away the most taxable part of her estate twice, \$800,000.00 of less taxable income over twenty years then \$800,000.00 to charity. And yes, since the payout income is only \$10,000.00 per year per beneficiary, she probably saved more income tax for each heir. The miracle here is recognizing how to address these IRA Tax Disasters with a pro-active tool to provide safe income to the heirs and a sizable gift to charity over time.

Susan was in tears when we explained the overall plan. She never imagined she would be responsible for creating a gift of \$800,000.00 to charity. Through her tears, she mumbled, "If only Tim were here to see this"!

I need to give credit where credit is due. This strategy was taught to me by one of my mentors, Charles Schultz, Esq., Owner of Crescendo Interactive, Inc. of Camarillo, CA. He and his team are thought leaders in the charitable tax world. Check out their work on their web site www.crescendointeractive.com.

In summary. It is up to you to ask the right questions of your advisors. If you have any form of a qualified plan, ask, "What happens to these funds when my spouse and I die"? "What strategies do you have to reduce my income tax when I start drawing funds from these plans?" "What can be done to protect these funds transferred to my heirs from their law suits, divorces, creditors, etc.?"

Remember, you have the right by default to overpay your tax by doing nothing. Our compulsory tax system is designed for the government to win at your expense. You also have the right to pay the least amount of tax – if you make wise choices annually and in your estate plans.