IVAN & DAUGUSTINIS, PLLC | PRESERVE YOUR LEGACY

Advanced Estate Planning

Overview

The Tax Cuts and Jobs Act of 2017 (the "Act") significantly increased the federal estate and gift tax exemptions, which stand at $13,610,000 per individual for 2024. However, the Act is set to expire on December 31, 2025, leaving much doubt as to the size of future estate and gift tax exemptions. Taking advantage of the current favorable tax environment may be critically important for individuals and families with larger estates. The IRS has issued "anti-clawback" regulations regarding the Act, confirming that individuals will be able to use current gift tax exemption amounts and not be penalized if the exemption is reduced in the future. However, the credits must be used in their entirety to take advantage of the full benefit before they disappear. Coupled with "dynasty planning," these planning tools can help clients save millions of dollars and protect family wealth for generations.

Dynasty Trusts

In general, dynasty trusts are long-term trusts designed to pass wealth from one generation to the next without incurring additional estate taxation. In many states, proper dynasty trust planning can also provide enhanced wealth and asset protection to beneficiaries, shielding the inheritance from the risks posed by divorce, malpractice, business failures and other creditors. It truly is the best of both worlds.

The Fundamentals

- Grantor creates a revocable living trust or an irrevocable trust during their lifetime.
- The grantor allocates part or all of their lifetime gift or estate tax credit and generation skipping transfer ("GST") tax exemptions (both currently $13,610,000 for 2024) to the trust in order to shelter it from future estate taxation. For an irrevocable trust, this allocation would be done on the grantor's gift tax return when the gift is made, and for a revocable trust, upon the grantor's death.
- Once the tax exemptions are allocated, the assets retained in trust and all future appreciation are free from future estate and GST taxation as the assets pass from generation to generation for the duration of the trust's existence. Additionally, the beneficiaries' own estate and GST tax exemptions will be preserved, allowing their tax credits to benefit their family too, since the inherited assets will not be included in their taxable estates.
- If drafted properly, dynasty trusts can also provide significant protection for the assets held in trust against creditors of a beneficiary.
- In Florida, the "Rule Against Perpetuities" statute allows dynasty trusts to remain in effect for up to 1,000 years – potentially protecting many future generations, but every state has its own rule.

The Dynasty Trust in Action – Irrevocable Trust

Example: Mr. Smith, a Florida resident, creates a spousal lifetime access trust (an irrevocable trust) with dynasty trust provisions for the benefit of his wife and children. Mr. Smith makes a $10M gift to the trust and allocates his lifetime gift and GST tax credits for this amount on his gift tax return. Assuming the trust assets grow at a rate of 7.2% annually, the gift doubles to $20M in 10 years. Using current exemption amounts, the assets held in this trust are exempt from estate and GST taxation because the gift is valued at $10M – the initial value of the gift. The appreciation of those assets also escapes estate and GST taxation during his wife's lifetime, and for so long as those assets are held in trust for his children, future grandchildren, and for generations to come, while also providing substantial asset protection to the surviving spouse and children for their lifetimes.

The Dynasty Trust in Action – Revocable Trust

Example: Mr. Smith, a Florida resident, creates a revocable living trust with dynasty trust provisions for the benefit of his wife and children. At his death, Mr. Smith's estate is worth $10M. Assuming the current estate and GST tax exemptions, the entire amount will be exempt from estate and GST taxation. The appreciation of those assets also escapes estate and

GST taxation in the same manner as described above, while also providing substantial asset protection to the surviving spouse and children for their lifetimes.

Without proper dynasty trust planning, the assets described in the above examples, and all subsequent appreciation, would continue to be subject to estate and GST taxation at each generation (currently 40%) and remain at risk to the beneficiaries' creditors.

Spousal Lifetime Access Trust (SLAT)

A Spousal Lifetime Access Trust (SLAT) is an irrevocable trust where one spouse ("grantor spouse") gifts assets to the SLAT with the other spouse as beneficiary ("beneficiary spouse"). The trustee (who may be the beneficiary-spouse) can make distributions from the SLAT to the beneficiary spouse during their lifetime, usually for health, education, maintenance and support. The SLAT also contains directions on how assets will be distributed on death of the beneficiary spouse, i.e., to children or trusts for their benefit (where, as discussed above, "dynasty trust" planning can be implemented). When creating a SLAT, the grantor spouse will use some (or all) of their lifetime gift tax exemption and will need to file a gift tax return.

SLAT Advantages

- **Use of Current Lifetime Gift Tax Exemption**. As mentioned, the "anti-clawback" regulations have created a "use it or lose it" opportunity. The SLAT permits individuals to use their significant current lifetime gift tax exemptions now even though they will be reduced in the future.
- **Tax Reduction**. Once assets are gifted to the SLAT, the gifted assets can grow estate tax free and are not included in either spouse's taxable estate at death. For example, if an individual gifts $10M to a SLAT and the gifted assets grow in size to $25M, the entire amount escapes estate tax. If the same individual otherwise retained $10M and the assets grew to $25M at death, the current estate tax exemption will only cover roughly the first $13.6M, leaving $11.4M subject to estate tax at 40%. This results in an estate tax liability of roughly $4.6M that could have been avoided by implementing a SLAT.
- **Wealth Protection**. SLAT assets are also protected under Florida law from both spouses' creditors. SLATs create significant wealth protection from lawsuits against the grantor, trustee and beneficiaries, potentially protecting the wealth in the event children or grandchildren divorce or remarry.
- **Multiple Beneficiaries**. Though its name may suggest otherwise, there may be multiple beneficiaries in addition to a grantor's spouse. This same technique is available for children, grandchildren or other beneficiaries. The utilization of a SLAT coupled with a generation-skipping plan design could literally save families millions of dollars in estate taxes over several generations.

See Exhibit A for a flowchart illustration of a SLAT.

Irrevocable Life Insurance Trust (ILIT)

Most people know there is no income tax liability for the payout of life insurance proceeds, but many do not realize that the face value of the death benefit is included in the calculation of federal estate tax liability. The Irrevocable Life Insurance Trust (ILIT) is an estate planning tool designed to reduce or even eliminate payment of federal estate tax upon death.

ILIT Basics

An ILIT is an irrevocable trust that is created by an individual (the "grantor") who "funds" the ILIT with one or more life insurance policies during the grantor's lifetime. The ILIT will be the owner and beneficiary of the policies based on the grantor's life. The grantor appoints a trustee (who may be a spouse, child, or other relative) who manages the ILIT and will be responsible for ensuring premiums are paid and making distributions to the grantor's beneficiaries after death of the grantor.

ILIT Advantages

- **Avoid Estate Tax**. Since the ILIT is the owner of the life insurance policy, the death benefits from the policy will not be part of the grantor's taxable estate and therefore will not be subject to federal estate tax upon the grantor's death.
- **Convert Old Policies**. Ownership of current life insurance policies can be transferred to an ILIT. This allows a grantor to convert an asset that may be subject to federal estate tax into an asset that will not be subject to federal estate tax.
- **Avoid Gift Tax**. If the ILIT is drafted and administered properly, the money used to pay policy premiums can qualify for the federal gift tax annual exclusion.
- **Dynasty Planning**. ILITs can also leverage a grantor's GST tax exemption. As a result, numerous generations may benefit from trust assets free of both federal estate and GST tax.
- **Asset Protection**. With proper drafting, assets left in an irrevocable trust for beneficiaries can be protected from their creditors.

ILIT Caveats

- **3-Year Rule**. - If an existing policy owned by a grantor is transferred to an ILIT and the insured dies within three (3) years from the date of the transfer, the life insurance proceeds will be included in the grantor's taxable estate.
- **Gift Tax Issues**. The transfer of a life insurance policy into an ILIT will be considered a gift of the fair market value (approximately the cash surrender value) of the policy, and if that value is in excess of the annual exclusion, the Grantor's federal estate tax exemption will be reduced by that amount.
- **Inflexibility**. ILITs are irrevocable by design and a grantor's ability to make changes may be limited after the creation and funding of an ILIT.

See Exhibit B for a flowchart illustration of an ILIT.

Lifetime Qualified Terminable Interest Property Trust (Lifetime QTIP)

Estate planning for blended families, especially when spouses have disparate levels of wealth, can be complex. An old but seldomly used technique, the Lifetime Qualified Terminable Interest Property Trust (Lifetime QTIP), can be a versatile tool for these families. A Lifetime QTIP allows the wealthier spouse to provide for the other spouse during his or her lifetime and simultaneously ensure that the assets held in the Lifetime QTIP ultimately benefit his or her own family. In addition, the Lifetime QTIP provides significant estate and gift tax benefits, as it allows the wealthier spouse to take advantage of the other spouse's federal estate and GST exemptions that otherwise might be wasted (especially the GST exemption, which is not portable). This allows the wealthier spouse to pass more wealth to the next generation than he or she otherwise would be able to.

Lifetime QTIP Overview

The donor-spouse creates a Lifetime QTIP and gifts assets to the trust. Provided the donor-spouse files a gift tax return and makes a proper QTIP election on the return, the gift to the Lifetime QTIP qualifies for the marital deduction, does not use the donor-spouse's gift tax exemption, and does not result in gift tax. The beneficiary-spouse receives all of the annual income generated by the Lifetime QTIP. If the donor-spouse so desires, the trust may also allow the beneficiary-spouse to receive distributions of principal and/or withdraw the greater of $5,000 or 5% of the principal value of the trust annually.

Upon the death of the beneficiary-spouse, the Lifetime QTIP assets will be included in his or her estate and allow the use of their federal estate and GST exemptions, which otherwise may have gone unused. At the death of the beneficiary-spouse, the remaining trust assets may be distributed as follows:

- If the donor-spouse survives the beneficiary-spouse, the assets fund a credit shelter trust for the donor-spouse.

- If the donor-spouse does not survive the beneficiary-spouse, the trust assets fund trusts for the donor-spouse's descendants.

- The above trusts will grow free of federal estate tax and GST tax, and also may provide significant asset protection depending on state law.

Example: Husband has a net worth of $40M and marries Wife who has a net worth of $500,000. Husband has been previously married and has three children from that marriage. Husband creates a Lifetime QTIP for the benefit of Wife and gifts $5M to the trust. Assuming the trust assets earn 3% in income each year, Wife receives an annual $150,000 income. At Wife's death, the Lifetime QTIP assets are included in her gross estate for federal estate tax purposes. Because Wife only has a net worth of $500,000, the balance of her unused estate and GST exemptions are applied to the trust. If the terms of the Lifetime QTIP provide for the creation of separate trusts for Husband's children at the death of the survivor of them, the trust assets are shielded from creditors and federal estate tax and GST so long as they remain in trust.

See Exhibit C for a flowchart illustration of a Lifetime QTIP.

Qualified Personal Residence Trust (QPRT)

A Qualified Personal Residence Trust (QPRT) is another way to reduce estate tax exposure by transferring certain real estate into trust and "freezing" the value from future estate taxation. In a QPRT, a grantor gifts real property to an irrevocable trust at a discounted value for gift tax purposes. The grantor retains the right to live on the property for a term of years and designates remainder beneficiaries, usually family members, at the end of the term. The property reverts to the remainder beneficiaries after the expiration of the QPRT term. However, the grantor may continue living in the house by leasing the property back from the remainder beneficiaries at fair market rent, which can further reduce the value of the grantor's taxable estate.

QPRT Advantages

- **Use of Gift Tax Exemption**. The amount gifted to beneficiaries in a QPRT falls under the grantor's lifetime federal gift tax exemption, helping to ensure that the current gift tax exemption amount does not go to waste.
- **Leveraged Gifting**. The value of the gift for tax purposes is the fair market value of the property minus the present value of the beneficiaries' right to receive the property at the end of the term of the QPRT. The "reduced" value of the gift allows the grantor to further leverage the current lifetime federal gift tax exemption by shifting wealth at a discounted valuation for tax purposes.
- **Tax Reduction**. The gift tax value is calculated at the time of the transfer, and all of the future appreciation will escape the grantor's taxable estate. In addition, a grantor can still claim real estate taxes and other associated deductions on their tax return.
- **Probate Avoidance**. Real property gifted to a QPRT is not subject to probate on the death of the grantor. A trustee or successor trustee has continuous and immediate access to the QPRT and can immediately transfer the subject property to the designated beneficiaries.
- **Multiple QPRTs**. Each individual may have up to two QPRTs at any one time, allowing a grantor to create a QPRT for a vacation home in addition to their primary residence.
- **Flexibility**. A grantor may sell real property that has been gifted to a QPRT without losing all of the tax benefits. To accomplish this, proceeds from the sale must be reinvested in a new real property that will now be subject to the original QPRT.
- **Low Risk**. If the grantor does not outlive the QPRT term, the value of the QPRT will be included in the grantor's estate and subject to estate taxes. However, the grantor's estate will receive credit for the initial gift to the QPRT and is no worse off than if the QPRT had not been created.

See Exhibit D for a flowchart illustration of a QPRT.

EXHIBIT A

SLAT Flowchart

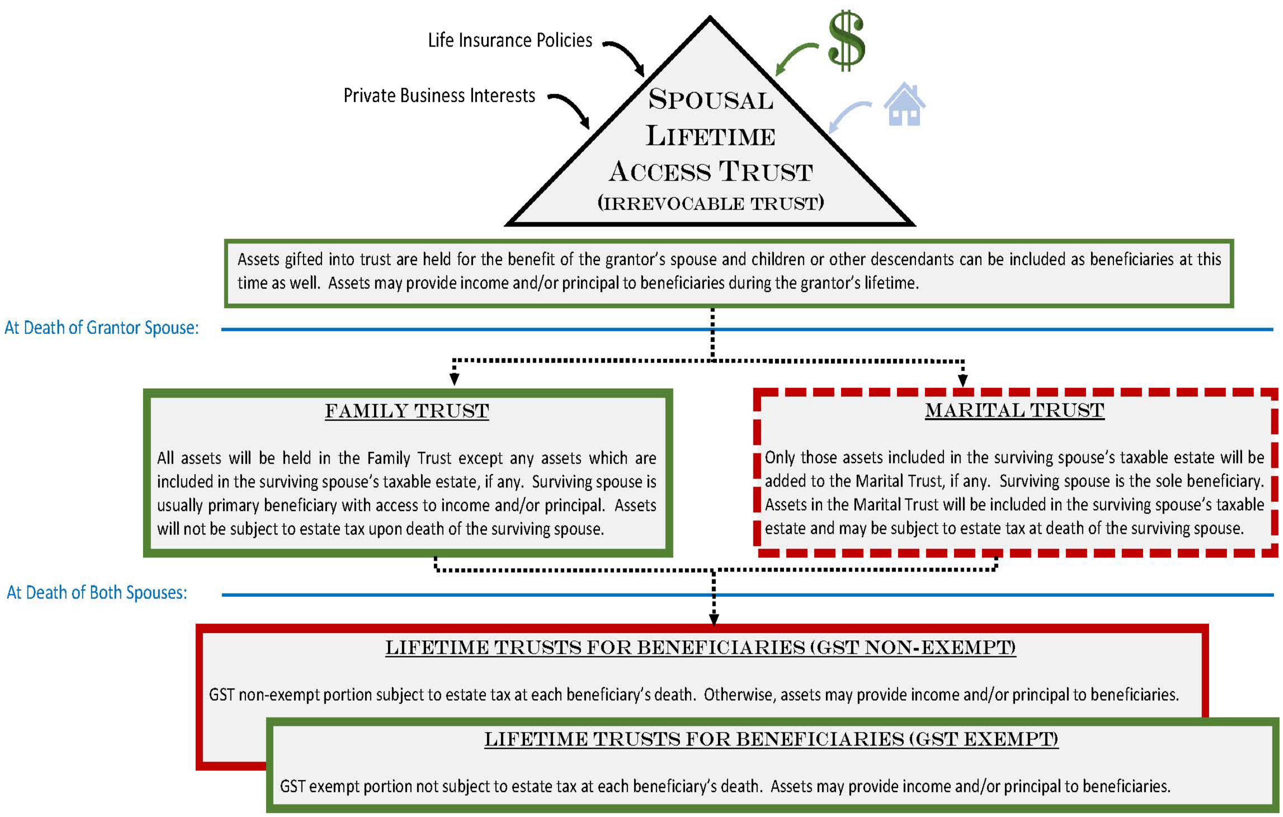

EXHIBIT B

ILIT Flowchart

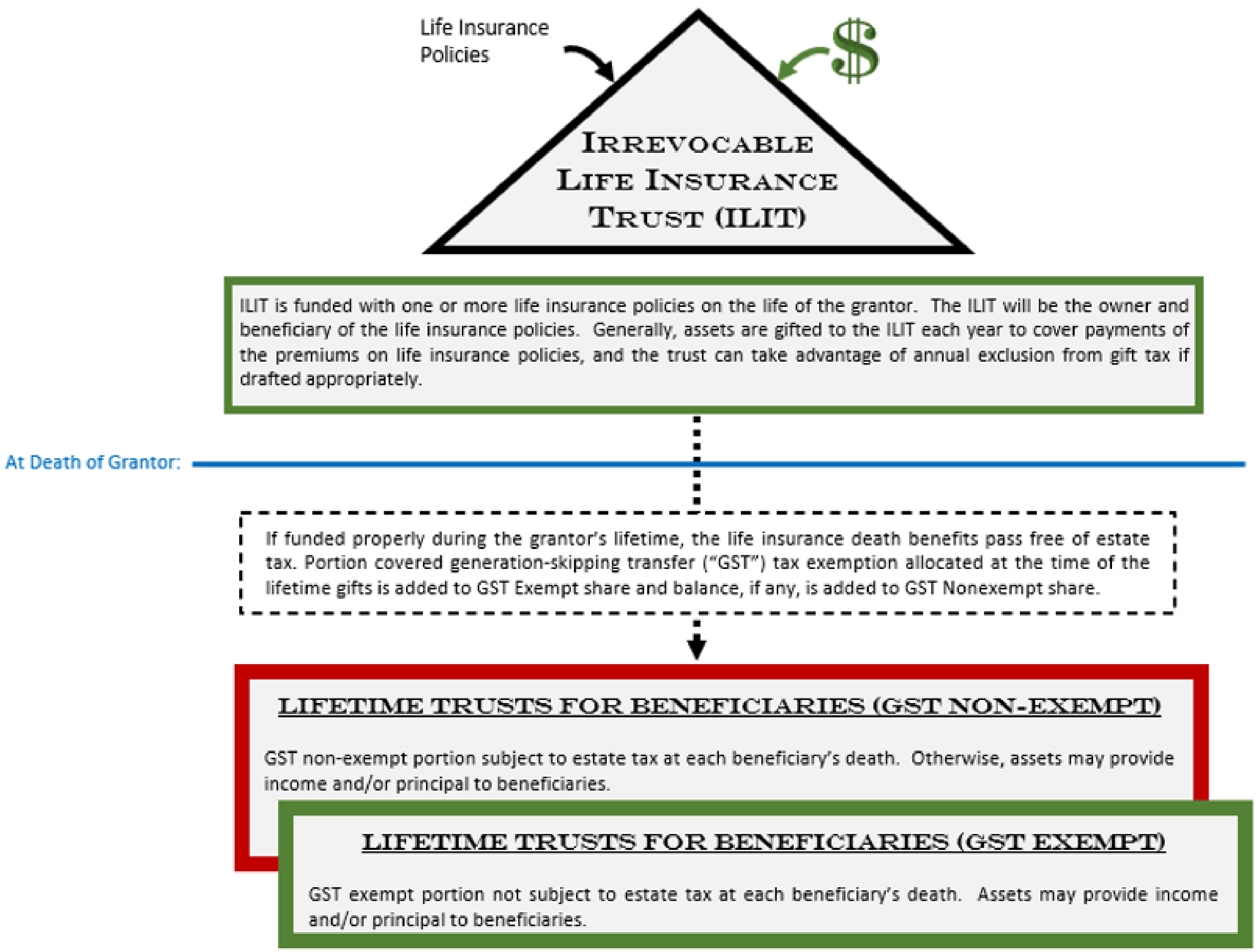

EXHIBIT C

Lifetime QTIP Flowchart

INTER-VIVOS QTIP TRUST (IV QTIP)

IV QTIP is held as a qualified terminable interest property marital trust for the grantor's spouse. The grantor must make the proper QTIP election on a timely filed gift tax return.

Generally, the wealthier spouse will be the grantor in order to utilize the federal estate and generation-skipping transfer (GST) tax exemptions that would otherwise be unused in the beneficiary spouse's estate. Beneficiary spouse must be the sole beneficiary and must receive all of the annual income generated by the IV QTIP.

At Death of Grantor's Spouse:

IV QTIP assets will be included in the beneficiary spouse's estate, allowing the allocation of the beneficiary spouse's remaining estate and GST exemptions at that time. IV QTIP could also provide for a A/B trust design to be held for the grantor spouse upon the death of the beneficiary spouse, if structured properly. Portion covered generation-skipping transfer ("GST") tax exemption allocated is added to GST Exempt share and balance, if any, is added to GST Nonexempt share.

LIFETIME TRUSTS FOR BENEFICIARIES (GST NON-EXEMPT)

GST non-exempt portion subject to estate tax at each beneficiary's death. Otherwise, assets may provide income and/or principal to beneficiaries.

LIFETIME TRUSTS FOR BENEFICIARIES (GST EXEMPT)

GST exempt portion not subject to estate tax at each beneficiary's death. Assets may provide income and/or principal to beneficiaries.

EXHIBIT D

QPRT Flowchart

QUALIFIED PERSONAL RESIDENCE TRUST (QPRT)

Personal residence is gifted into trust and is held for the use by, and benefit of, the grantor for a term of years (the "QPRT Term"). If grantor survives QPRT Term, all assets pass estate tax free.

At End of QPRT Term, If Grantor Survives:

FAMILY TRUST

All assets will be held in the Family Trust for the benefit of grantor's surviving spouse and/or descendants. The surviving spouse will have sole right to use the residence after the QPRT Term. Upon the death of the surviving spouse, or upon the expiration of the QPRT Term if there was no surviving spouse, the grantor reserves the right to lease the residence from the Family Trust for fair market rent. Rent payments are NOT considered additional gifts to the QPRT.

Assets allocated GST exemption at end of QPRT Term will flow to the GST Exempt Trusts. All other assets will flow to the GST Non-Exempt Trusts.

At Death of Both Spouses:

LIFETIME TRUSTS FOR BENEFICIARIES (GST NON-EXEMPT)

GST non-exempt portion subject to estate tax at each beneficiary's death. Otherwise, assets may provide income and/or principal to beneficiaries.

LIFETIME TRUSTS FOR BENEFICIARIES (GST EXEMPT)

GST exempt portion not subject to estate tax at each beneficiary's death. Assets may provide income and/or principal to beneficiaries.