



What's Hot in Estate Planning Right Now May Surprise You

Content provided by The Advisors Forum; Edited by James W. Garrett, Esq.

November 2015

Estate planning has truly evolved over the past 20 years. Gone is the uncertainty about federal estate taxes and the absolute requirement for married couples to use complex trusts to minimize these taxes. But also gone is planning for the “traditional” family.

Warning: Estate Planning Today is Harder Than Ever Before

In 1995 the federal estate tax exemption was only \$600,000 and the estate tax rate was 55%. Back then it was easy to accumulate a taxable estate by simply owning a home, a few investments and some life insurance. And while married couples could pass on two times the exemption (\$1.2 million) free from estate taxes if they incorporated Marital/Family Trusts into their estate plan, these trusts came with strings attached. Yet these inflexible trusts were worth it to avoid the hefty 55% tax on assets valued over \$600,000.

Aside from minimizing estate taxes, 20 years ago avoiding costly probate was another concern. No longer was a Last Will and Testament that required oversight by a probate court the preferred document for passing assets on to heirs. Instead the ultimate probate-avoidance tool – the revocable living trust – became the standard for estate planning.

Fast forward 20 years and in 2015 the federal estate tax exemption is \$5.43 million and will continue to increase annually based on inflation. In addition, between 2002 and 2013 the federal estate tax rate dropped from 55% to 40%. On top of the generous exemption and lower tax rate, married couples can now combine their estate tax exemptions and pass on two times the threshold (\$10.86 million) without Marital/Family Trust planning by making the “portability” election. Aside from this, probate can be easily avoided by establishing payable on death bank accounts and investment accounts and in some states payable-on-death vehicle titles and real estate deeds.

Thus, today the focus of estate planning has shifted away from estate tax planning and probate avoidance to more relevant concerns:

- While the federal estate tax rate has declined from 55% to 40%, since 2012 the top federal income tax rate has increased from 35% to 43.4% and the top long-term capital

gains rate has increased from 15% to 23.8%. This has made minimizing income taxes an integral part of estate planning.

- Today many families are blended, dysfunctional or completely estranged. This has made flexible estate planning and finding ways to modify what was thought to be an irrevocable plan the “new normal.”

Estate Planning for the “New Normal” – Minimizing Income Taxes, Maintaining Flexibility and Doing Over Irrevocable Plans

Under a traditional Marital/Family Trust plan the goal was to exclude the Family Trust assets, including all appreciation, from the surviving spouse’s taxable estate. While the Family Trust assets would not receive a step-up in basis, this type of planning made sense since the top estate tax rate of 55% dwarfed the top capital gains rate of 15%.

Today with the generous and ever-increasing estate tax exemption and “portability” of the exemption available to married couples, it is estimated that 99.8% of Americans will have no federal estate tax exposure. As a result, traditional Marital/Family Trust planning is no longer a necessity for the majority of families. In fact, an older Marital/Family Trust plan will lead to income tax liability for heirs since the assets of the Family Trust will not receive a step-up in basis.

Therefore, instead of planning for excluding assets from the taxable estate, the new trend for couples with less than \$10 million is to plan for *estate inclusion* so that their heirs will receive a basis step-up. This can be accomplished in a number of ways:

- Leaving assets outright to your spouse and making the portability election; but beware if your spouse is a spendthrift, has creditor issues, or if you want to make sure your assets stay within your bloodline. Instead of leaving assets outright, leave assets in a Marital Trust that allows for a basis step up at your spouse’s death.
- Taking a wait-and-see approach, such as all to the Family Trust with the ability to disclaim to the Marital Trust or vice versa.
- Including flexibility in the Marital Trust provisions.
- Using a Family Trust but allowing for basis increase through a customized power of appointment.

While building flexibility into your plan is ideal, what if your plan becomes irrevocable before you were able to make it flexible? What if the plan needs to be modified to obtain a step up in basis or for other income tax reasons? What if you create an irrevocable trust for the benefit of a

beneficiary who later becomes incapacitated or disabled? What if it would be advantageous to change the situs of your irrevocable trust or its governing law, add or remove beneficiaries, add a trust protector or advisor, or change the trustees? Is it possible to modify or even revoke your inflexible, irrevocable trust? The answer under many circumstances is yes, by:

- Reforming/Modifying the Trust: If all interested parties agree, changing the terms of the trust by a nonjudicial settlement agreement to meet your tax-saving and other objectives provided the resulting terms are not inconsistent with your intent. If all interested parties are not in agreement, you can always seek a judicial interpretation to determine and properly restate your intent.
- Invoking the Trust Protector: If permitted by the trust document, allowing a third party to exercise specific powers as defined in the trust agreement.
- Decanting the Trust: If permitted by the trust document, allowing the trustee to distribute property in further trust for a beneficiary.

Planning Tip: How old are your current estate planning documents? Do they still contain mandatory Marital/Family Trust funding provisions? Do they include a trust protector or advisor? Do they allow for decanting and changing the trust situs? Do they address the possibility that a beneficiary could become incapacitated or disabled? Do they allow trustees to appoint successors? Do they provide for an “anchor” institutional trustee to back up your other family member trustees?

Where Does Estate Planning Go From Here?

Estate-tax-driven estate plans are a thing of the past for most Americans. Higher income tax rates, changing state laws, unfavorable jurisdictions and wayward heirs all add up to the need for an estate plan that adapts over time. Modern families need modern estate planning solutions, and our firm is ready to help you and your loved ones plan for now as well as what may happen in the future. If your documents are more than a few years old, then it's time for an estate planning checkup. Please give us a call to schedule a review of your documents.