CRITICAL ISSUES IN PLANNING YOUR ESTATE

AFTER THE DECEMBER 2012 TAX LAW CHANGES

- Retirement and estate planning in uncertain times
- Recent changes in financial and estate tax rules that may impact your plans
- Ideas to preserve wealth, instill family values, and achieve charitable objectives
- Recent important income tax changes
- The future of estate and gift tax

A Seminar on Estate Planning
Sponsored by
Georgetown University
Legacy Society

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After practicing 12 years as a tax/estate planning/trusts and estates partner at two large law firms, one in Washington, one in Virginia, Fred Tansill started his own firm, Frederick J. Tansill & Associates, 15 years ago in McLean/Tysons. Fred graduated from Brown University and received both his law degree and his masters degree in tax law from Georgetown. He is the only person to ever Chair both the Virginia and D.C. Bar Sections on Wills, Trusts and Estates. He has been a Fellow of the American College of Trust and Estate Counsel ("ACTEC") since 1991 and was listed by *Washingtonian Magazine* many times, most recently in November 2012, as one of the "Best Lawyers in Washington" under the Estates and Trusts category. He has been selected more than 15 years in a row to be listed in the book Best Lawyers in America. He is frequently quoted in *The Washington Post* on estate and trust and tax matters, and has been quoted in many other publications, including *The Wall Street Journal*. He lives in McLean, has three children, and has practiced in Northern Virginia for 30 years. He is celebrating his 39th anniversary at the Bar.

Fred Tansill has specialized expertise in:

- Sophisticated Charitable Planning, including

  A. Private Foundations
  B. Charitable Lead Trusts
  C. Charitable Remainder Trusts
  D. Advised Funds at Community Foundations

- Asset Protection Planning, Domestic and Offshore

- International Estates and Offshore Trusts

- Closely-Held Businesses/Tax Planning

- Premarital and Post-Marital Agreements

- Sophisticated Planning to Reduce or Avoid Estate Tax, Gift Tax, Generation-Skipping Transfer Tax

INTRODUCTION

I. THE FEDERAL ESTATE AND GIFT TAX SYSTEM

A. One integrated transfer tax system for lifetime gifts and transfers at death

1. Tax rate is 40% cumulative transfers above $5.25 million.

2. $14,000 annual gift tax exclusion per donee per year ($28,000 from couple).

3. Exemption available during life to offset gift tax on cumulative lifetime gifts (above $14,000/$28,000 per year per donee annual gift tax exclusion) and at death to offset estate tax on testamentary transfers

   $5,250,000 million for persons dying in 2013 (maybe used during life or at death.) Indexed annually for inflation.
   Was $5,120,000 million for persons dying in 2012.
   Was $3.5 million in 2009.

   Predictions: Especially because of the budget deficit arising from the Great Recession of 2008-2011, the cost of the wars in Iraq and Afghanistan and the impending claims of baby boomers upon social security and medicare –

   - estate tax will not disappear
   - exemption will not revert to $3.5 million (as President Obama proposed effective some 5 years in the future.)

4. Unlimited exemption for lifetime or death transfers to spouse or to charity. Transfer to spouse may be outright or in trust (QTIP Trust) from which spouse must receive all income

B. The Federal Generation-Skipping Transfer ("GST") Tax System

1. A separate, additional transfer tax on transfers to those two or more generations younger than the donor

2. $5.25 million aggregate exemption in 2013. Indexed for inflation, will continue to match the estate tax exemption.

3. A 40% generation-skipping tax will be imposed in addition to the gift tax or estate tax on transfers in excess of the GST exemption.

4. If combined estates of husband and wife in excess of $10.5 million and there are grandchildren or grandchildren are expected, it will generally be desirable to use GST exemption and try to leverage the exemption. Never exceed the GST exemption and incur GST tax!

C. Portability.

There is an important new estate and gift tax concept known as "portability" whereby the unused portion of a deceased spouse's unified estate and gift tax exemption passes to the surviving spouse. For example, if Husband dies in 2013 having as his sole asset a $2,250,000 life insurance policy passing to his children by a first marriage, his surviving spouse will "inherit" his $3 million of unused exemption which, when added to her $5.25 million exemption, will give her an $8.25 million exemption to use during life or at death. (See our firm's March 2013 Newsletter - - attached as an Exhibit - -, page 2, for more information on Portability. There is no portability of the GST exemption.

II. TRUSTS

May be set up during life as revocable or irrevocable, maybe set up at death - - a testamentary trust. Many tax planning, charitable and asset protection strategies require trusts. Always draft them with the flexibility to accommodate unexpected future events.

A. A creation of English Common Law

B. Available generally only in English-speaking countries (not France, Germany, Spain, Switzerland, Latin America)

C. You, the Settlor or Grantor, create the trust, which is a contract between you and a second party, the Trustee, who agrees to hold certain property under agreed terms for the exclusive benefit of a third party, the Beneficiary. There may be two classes of Beneficiaries, one with an interest in the trust's income for a fixed or determinable period -- the holder of the income interest -- and the other with the right to the remaining principal at the end of the income interest -- the remainderman. The trust describes whether the named trustee can be discharged and replaced and by whom, how long the trust arrangement lasts, under what circumstances the Beneficiaries receive income and principal, whether the Settlor may revoke or amend the trust or not.

D. Trustee must be more than prudent -- a fiduciary duty

1. of loyalty to beneficiaries

2. to preserve principal of Trust

3. to balance interests of life tenants vs. interests of remaindermen

4. to invest prudently, in accordance with Portfolio Theory

E. Who May Serve

1. Institutional Trustees, e.g.,

a. Trust Companies

b. Banks with Trust Powers

c. Other Non-Bank Trust Companies

2. Lawyers, Accountants, Financial Planners

Caution: In many states, e.g., Virginia, it is unethical for an attorney to suggest himself or herself as fiduciary

3. Friends

4. Family Members (but consider conflicts of interest and tax issues, e.g., not second spouse for children of first marriage)

CAUTION: our firm sees a great deal of misbehavior by Family Members serving as Trustees. Consider naming a Bank or Trust Company as Co-Trustee with Family Members.

F. Investment Management and Trustee Fees

1. Investment Management Fees. Institutions- - banks, trust companies, independent investment advisors- - typically charge about one percent (1%) of the value of assets under management per year at about $3 million of assets. Below $3 million they will charge up to 1.5%, above $3 million they will charge less than 1% on a declining scale as the value of assets increases.

2. Trustees Fees. Institutions typically charge some additional percentage of the value of assets under management, or

an additional fixed fee (for example, maybe .2% but no more than $10,000/year), to serve as Trustee. Plus an investment management fee as described above. In effect, there is only a relatively modest extra charge for the bank or trust company to serve as Trustee.

3. Individuals should probably charge on hourly basis, as the trustee fee will be in addition to investment management fee. Generally there is no material fee savings in naming an individual to serve as Trustee, because you hope the individual will engage an institution to manage the money, and the institution will charge to serve as trustee little more than it would charge to serve as investment manager.

G. Who Should Be Trustee of a Discretionary Spendthrift Trust or QTIP Marital Trust

Consider whom do you want to trust, whom do you want to put in charge.

1. If you trust the beneficiary and want the beneficiary to control the Trust, for instance your spouse in a Marital Trust

2. Make the beneficiary Co-Trustee with an "independent" Co-Trustee

3. Give the beneficiary the power to fire and replace the independent Co-Trustee (This is almost always a good idea in trusts.)

4. The beneficiary will have to agree to investments

5. Note: Only the independent trustee can make discretionary distributions; the beneficiary who is Co-Trustee may not participate in that decision

H. If you do not trust the beneficiary and want the Independent Trustee to control the Trust

1. Make an institutional fiduciary sole Trustee

2. Permit the beneficiary to replace the Trustee discharged only with another institutional fiduciary or an attorney (This is frequently a good idea in trusts.)

3. The Trustee will control investments and distributions

as a completely neutral third party

III. CHARITABLE GIVING TECHNIQUES

Note: The new higher income and estate tax rates make charitable giving more attractive.

In the 43.4% federal income tax bracket, you can give away $100,000, in a charitable gift, and avoid income tax on $100,000, or you can keep $56,000 and pay $44,000 of federal income taxes plus more state income taxes.

In the 40% estate tax bracket, you can give away $100,000 in a charitable bequest and avoid estate tax on $100,000, or you can pass $60,000 to your children and pay $40,000 of estate tax plus maybe more state death tax.

A. Charitable Remainder Trusts

(See article on website: www.fredtansill.com)

In a Charitable Remainder Trust (CRT) the donor gives certain property to a charity, but retains the right to income from the property for a term of years, or for his or her life, or for the joint lives of the donor and the donor's surviving spouse. A charitable income tax deduction is available in the year of the gift calculated by subtracting from the current value of the property given the actuarially calculated value of the income interest retained. So, for example, an income interest retained for the joint lives of a 75 year old couple would be much less valuable than the income interest retained by a 50 year old couple, and the charitable income tax deduction would be much larger for the 75 year old couple.

The second tax advantage to the donor is that appreciated property donated to and sold by the CRT is not subject to capital gains tax, so the gross proceeds are available to generate income for the donor. If the donor simply sold the property, only the net proceeds after paying capital gains tax would be available to generate income. (The increase of capital gains tax rates from 15% to 20% increases the advantages of this strategy.) So by making a CRT gift the donor will actually generate more income for himself or herself for life. The downside is that at the death of the donor(s), the gift belongs to the charity and the heirs of the donor will take nothing. To offset this consequence donors will sometimes take out life insurance payable to their heirs (perhaps owned by an irrevocable life insurance trust to avoid the inclusion of the insurance in the insured's taxable estate) to offset the value of the property donated.

CRTs are a useful strategy when selling a business, to diversify a concentrated highly appreciated position in one stock or one piece of real estate and to generate liquidity from such an illiquid asset, because the

donated property will be sold tax-free and reinvested in a diversified portfolio which will, in turn, generate the income. It is particularly useful to generate retirement income.

There are two forms of CRTs, Charitable Remainder Annuity Trusts (CRATs) and Charitable Remainder Unitrusts (CRUTs). CRATs distribute annually a sum certain that is not less than 5% nor more than 50% of the fair market value of the assets initially placed in the trust. As the annual distribution is based on the original value, the income stream to the annuitant of a CRAT will lose value over time to inflation. In contrast, with a CRUT the specified annual distribution must be a fixed percentage not less than 5% nor more than 50% of the fair market value of the trust assets, valued annually. So, if a CRUT is properly invested, the income stream from a CRUT will increase over time to keep pace with inflation. The value of the charitable remainder may not be less than 10% of the original value of the gift, based on a present value calculation.

It is also possible to establish a CRT at death -- a testamentary CRT -- that will last for the life of a surviving spouse or child, and then pass to charity at the death of the annuitant. In that case the estate tax value of the property is reduced by the actuarially calculated value of the charitable remainder.

How to evaluate a possible CRT. Do not think of a CRT as a gift to Georgetown University or any other charity of the full amount contributed to fund the trust. Rather, in evaluating a lifetime CRT, realize that the only part you are giving away is the actuarially calculated (on special software) present value of the remainder gift in the future, which is the same as the amount deductible for income tax purposes. This will usually be a relatively small portion of the total gift. (A few years ago the author assisted a Georgetown alumnus who, to satisfy a million dollar pledge, made two CRT gifts to Georgetown at about age 58: a $500,000/20-year CRAT (he retained a 20-year income stream), and a $500,000 joint and survivor lifetime CRUT (he retained a lifetime annuity for himself and his spouse). His wife, who threatened to kill him when he proposed a $1 million gift, dropped her objections when she realized that the actual present value of these two combined CRT gifts was only $250,000. Economically the husband and wife in effect were able to retain 75% of the value of the property donated, while meeting the terms of a million dollar pledge. But Georgetown was happy, because at the end of the day it will receive a full one million dollars, or maybe even more depending on the investment performance. This is a win-win scenario.

Large CRT gifts may be effective vehicles for naming opportunities in new University construction, to endow chairs and scholarships, or for other specific purposes, e.g., to support particular university programs.

Because of the low current interest rates and the requirement of a 10% charitable remainder value, it may be impossible for a younger donor to make a CRT gift.

B. Charitable Lead Trusts

In a Charitable Lead Trust (CLT) the donor gives property to a charity, which receives income from the trust principal for a fixed period of time, after which the principal itself passes to individual remaindermen. Typically a grandparent might establish a CLT with income to a charity for 10-30 years with the remainder passing to children or grandchildren. A CLT may be established during life or at death. For various tax reasons lifetime CLTs are rarely used, but a charitable income tax deduction may be available in the year of gift calculated by subtracting from the value of the property given the actuarial value of the remainder. In the case of a testamentary CLT an estate tax charitable deduction will be available for the actuarially calculated (on software) present value of the charitable lead interest. The larger the charitable "lead" interest, the greater the charitable deduction. At some point, typically around 30 years, the value of the remainder interest has no actuarial present value (although it has potential huge actual value, potentially much greater than the original gift), and the charitable income tax deduction or estate tax charitable deduction equals 100% of the value of the gift or bequest.

As with CRTs, property sold by a CLT is not subject to capital gains tax, so the CLT is a useful strategy to diversify a concentrated, highly appreciated position in one stock or real estate, because the donated property may be sold tax-free and reinvested in a diversified portfolio which will, in turn, generate the income for the charitable annuitant and hopefully appreciation of principal for the individual remaindermen.

Like CRTs, CLTs generally have two forms, one in which the charity receives annually a fixed percentage of the original value of property donated (CLAT), one in which the charity receives annually a fixed percentage of the value of the trust property valued annually (CLUT), but the CLT is not bound to be more than 5% but less than 50% of any value.

Such trusts are normally not used for lifetime giving, to generate an income tax deduction. Typically they are testamentary arrangements established by will or revocable trust, with the goal of reducing or eliminating estate tax. A testamentary CLT may completely eliminate estate tax on the largest multi-billion dollar estate while preserving every penny of such estate for the donor's descendants tax-free. For example, a 35 year testamentary CLT with an income stream of 5% in favor of Georgetown with the remainder passing to the donor's grandchildren would avoid all estate and gift tax to the donor and his children and vest the entire principal undiminished and possibly substantially enhanced, at the end of 35 years, in the hands of the grandchildren.

In the current low interest rate environment testamentary CLTs are especially effective to preserve more of the total gift for family members. But

what will the interest rate be when you die? The uncertainty creates challenges for CLT planning.

How to evaluate a possible CLT. As with a CRT, do not think of a testamentary CLT as a gift to Georgetown or another charity of the full amount to be contributed to the trust. Rather, in evaluating a testamentary CLT, realize that while the present value of the lead interest to charity may approach 100% of the total initial value of the gift, thus wiping out most or all of the estate tax liability, most or all of the value given away may actually return to the family after a delay of years, so even if the deductible portion is a large percentage of the total trust funding, remember that the CLT may be designed to virtually guarantee the return to the donor's family at the termination of the charitable annuity period of the entire amount, or most of it, funding the trust. Again it is a win-win situation: Georgetown University or another charity gets a large, protracted income stream it may budget for, the donor avoids huge estate taxes, and the donor's children or grandchildren get virtually the entire gift back into their hands at the end of the charitable annuity period.

Large CLT gifts may be effective vehicles for naming opportunities in new construction, to endow chairs and scholarships at the University or for other specific purposes, e.g., support of particular university programs.

C. Other Charitable Giving Approaches

Charities, such as Georgetown, typically have other vehicles which are advantageous in particular situations, which your lawyer and the University can help you identify. Among these are pooled income funds and charitable gift annuities, both of which are additional forms of CRTs. And, of course, you can make outright lifetime gifts to the University, which gives you a charitable income tax deduction for the entire value of the gift. With all of the new construction at the University, there are numerous "naming opportunities" for large donations. A prospective donor and his or her tax advisors must be conscious of the deduction limits: a taxpayer may deduct gifts to public charities such as Georgetown University in full, but not in excess of 50% of his adjusted gross income for the year of gift, in the aggregate of all such deductions, but any excess charitable deduction above this 50% limit in the year of gift may be carried forward to the ensuing 5 years until it is completely exhausted, in each such year subject to the rule that aggregate charitable contributions may not exceed 50% of adjusted gross income. There is no limit on the testamentary estate tax charitable deduction.

There is a special limitation for appreciated property which, if sold, would generate capital gains, i.e., investment property such as stock and real estate. It is deductible at its full, fair market value, but the deduction limit in the year of gift is 30% of the donor's adjusted gross income. Again, any excess may be carried over and deducted in the 5 succeeding years, but never in excess of the 30% limit for such year.

Very wealthy donors may establish Private Family Foundations, or more modestly wealthy donors may establish an Advised Fund at a Community Foundation or at Fidelity or Vanguard, and direct or expect that the trustees will make distributions in the future to Georgetown University, possibly among other charitable beneficiaries of the Private Family Foundation or Advised Fund.

D. Complex Assets

There is an innovative way you may give complex assets to Georgetown indirectly, if Georgetown does not want to accept such assets: by giving them to a Fidelity (or Vanguard or possibly a Community Foundation) Charitable Gift Fund established by the donor, and designating Georgetown to take the proceeds when the complex assets are sold by the gift fund.

Complex assets might include:

Private Company C or S Stock
LLC and LLP interests
Restricted Stock
Real Estate
Oil and Gas Royalty Interests
Certain Alternative Investments,
e.g. Hedge Funds, Private Equity Interests.

You may donate such assets before an anticipated sale, obtain the full tax deduction for the fair market value of the asset donated and avoid capital gains tax. This is obviously more efficient than selling the asset, paying the capital gains tax, and donating after-tax dollars. In certain circumstances, private company stock could even be sold back to the company. The Fidelity Charitable Gift Fund is aggressively courting gifts of complex assets and has developed considerable expertise in handling and disposing of them.

E. Charitable Gifts from Individual Retirement Accounts (IRAs)

Once a person reaches age 70½ she is required to withdraw from her IRA account each year what is know as a Required Minimum Distribution ("RMD")

* The retiree pay tax on those distributions at ordinary income tax rates.

The IRA Charitable Rollover permits participants who have reached age 70½ to direct the plan Administrator of her IRA to distribute up to $100,000 directly to one or more eligible charitable organization ("QCD"). GEORGETOWN UNIVERSITY QUALIFIES as an eligible QCD.

The benefit to the donor: the $100,000 give to charity is NOT treated as

taxable income. Because the participant already received the deduction when contributions were made to the IRA, there is no additional deduction for this gift.

This opportunity will expire after 2013 unless Congress renews it.

IV. PROTECTING ASSETS FROM CHILDREN, THEIR SPOUSES AND THEIR CREDITORS

Always consider asset protection issues in estate planning -- the average American will be sued 5 times.

A. Assets inherited by children should be kept by children in their own accounts under their own separate names to protect from divorce property settlement claims. Make your children promise you that they will keep inherited assets in their own names, will not put them in joint name with a spouse.

B. Parents of minor or young children should make lifetime gifts to children using Irrevocable Discretionary Spendthrift Trust

1. within $14,000/$28,000 Annual Gift Tax Exclusion

2. within $5.25 million Unified Gift Tax Credit

3.a. normally such a trust is a separate taxpayer, only a nominal exemption is available, and it is taxed on income it retains at 15% to $2,400, 28% above $5,600, with a top bracket of 39.6% (43.4% including the medicare surtax) at only $11,950 of annual income. Income distributed from a trust to a beneficiary is taxed to the beneficiary.

b. if trust is "defective" parents pay income tax on trust income whether distributed or not and the payment of such tax is NOT considered a gift

4. trust may last for child's life with general testamentary power of appointment for child to exercise in child's Will

5. or trust may last for child's life, and then go automatically to child's children (grandchildren) -- generation-skipping transfer for which very careful planning is required

6. or trust may distribute all income when child reaches mature age, e.g., 21-25, so child becomes accustomed

to handling money before receiving any principal

7. and trust may distribute principal in 2 or 3 installments, e.g., 1/3 at 25, 1/2 balance at 30, balance at 35, so if children are foolish when young, they cannot squander all funds in trust

8. while held in trust assets are protected from divorce property settlement, from any other creditor of child, from creditors of donor parents

9. Consider §529 Plans described in VI. (L.) below and UTMA accounts described in VI.(B.-H.) below.

C. You can "uglify" a first or second home by transferring it to a Qualified Personal Residence Trust (QPRT) under which parents/transferors retain the exclusive right to use the property for a fixed period of time, at the end of which the children will irrevocably take title to it

1. There is a big discount on the valuation of the gift for gift tax purposes attributable to the retained interest

2. Parent's creditors will not be very interested in pursuing their term interest because children will eventually take

3. Great technique for vacation homes, even principal residences (must be personal use real estate)

4. Parents can rent it back from the children at fair rental value after the trust terminates

V. USE <u>TESTAMENTARY</u> (established at death of parent) DISCRETIONARY SPENDTHRIFT TRUST FOR CHILDREN (same design features as Trusts for children created during parent's lifetime) TO

A. Hold assets until children attain mature age, then distribute income before principal, distribute principal in 2 or 3 installments OR

B. Hold assets for life of child

1. subject to general testamentary power of appointment

OR

2. then to child's children (grandchildren) in a generation-skipping trust

C. While in trust assets protected from

1. creditors of child

2. divorce property settlement

D. Particularly use Trust where child is disabled or if there is a particular cause for concern: substance abuse, spendthrift, or unmotivated habits, unpleasant spouse. For a disabled child, consider having other non-disabled children as co-beneficiaries of the same trust. This makes it harder for a court to invade the trust to offset governmental programs for the disabled child.

E. A discretionary Trust will always permit the Trust to accelerate distributions or terminate the Trust with liquidating distribution early

VI. PROTECTING ASSETS FROM GRANDCHILDREN, THEIR SPOUSES AND THEIR CREDITORS

A. Generally, same considerations as for children, lifetime or testamentary discretionary spendthrift Trusts

B. As an alternative to a Trust for minor grandchildren (or minor children), consider custodial account at a bank or trust company

C. Under the Uniform Transfers to Minors Act (UTMA)

D. Set up in Virginia or Maryland, not in D.C.

E. Designate explicitly on account documents "Hold to Age 21"

F. Name someone other than parent of child as custodial, e.g., sibling or aunt or uncle

G. Do not accumulate in UTMA account more than can be spent on tuition, etc., before age 21. Whatever remains in the account at age 21 may be withdrawn by child

H. Children pay tax on UTMA account; under age 24, children who are full time students are taxed at parents' top bracket on

investment income in excess of some $1,900. Children 24 and older have regular individual brackets.

I. To accumulate more assets to older age, use custom trust drafted by lawyer

J. For lifetime transfers and testamentary transfers, beware of generation-skipping transfer (GST) tax, but do take full advantage of $5 million generation-skipping transfer tax exemption

K. To leverage GST exemption and shelter much more than $5 million for grandchildren from estate and gift tax consider

1. Irrevocable Life Insurance Trust, especially second-to-die policy

2. may hold single life or second-to-die policy

3. may last 100 years or in perpetuity

4. Charitable Lead Trust: makes estate tax optional, even for billionaires.

L. Consider using §529 Plan to provide for higher education of grandchildren (or children)

1. As an alternative to a trust for minor grandchildren (or minor children), consider a §529 College Savings Plan

2. Gifts for the benefit of children or grandchildren may be made to §529 College Savings Plans and Custodial Accounts under the Uniform Transfers to Minors Act (UTMA).

3. §529 College Savings Plans are generally completely immune from claims of creditors of the donor or of the beneficiary and are very flexible. Other important characteristics of a §529 account are the following:

(a) income accumulates tax-free

(b) distributions for qualified tuition expenses (including room and board and miscellaneous expenses of all kinds for disabled beneficiaries) are tax-free

(c) a contribution to the plan is a gift and therefore

amounts held in a §529 account are removed from the donor's taxable estate

(d) donor may retain control over §529 accounts and remove assets from plan accounts at the cost of paying taxes on the funds withdrawn plus a 10% penalty tax

(e) if first beneficiary does not need or use assets, donor or parent (as provided) may redesignate the plan balance for another family member

(f) donor may use up to 5 years worth of annual exclusions ($13,000 x 5 = $65,000) to make a large §529 gift for a child or grandchild or other, but this must be reported to the IRS.

VII. PROTECTING ASSETS FROM SPOUSE, SPOUSE'S CREDITORS, SPOUSE'S OWN CHILDREN (NOT YOURS) AND SUBSEQUENT HUSBANDS AND WIVES

A. There is an unlimited marital deduction for transfer tax purposes: lifetime gifts to a spouse or testamentary bequests to a spouse are NOT subject to federal or state gift tax or estate tax if

1. the transfer is outright OR

2. the transfer is in trust from which the spouse must receive all income for life (QTIP Trust)

3. spouse's income interest may NOT terminate on remarriage

4. spouse may be given generous rights to principal or stingy rights or no rights to principal

5. the balance in a QTIP Trust at the surviving spouse's death is subject to tax at that time

B. Classic Uses of QTIP Marital Trust

1. If your spouse is not the parent of all of your children, provide for the spouse in a QTIP Trust, so you can be assured that at the spouse's death the principal of the trust will pass to your children. Predeceasing spouse controls ultimate disposition of trust principal, not surviving spouse

2. If your spouse is a spendthrift, or cannot or does not want the responsibility of managing inherited assets or is in a business or profession where the threat of lawsuit is always present, e.g., where spouse is an ob/gyn, or where the spouse cannot be trusted to leave all such funds to the couple's children at the surviving spouse's death

3. If one spouse has plenty of assets to take advantage of the unified credit if he or she dies first, but the other does not, during life the wealthier spouse may create a QTIP trust for the less wealthy spouse in an amount sufficient to use up the less wealthy spouse's estate tax credit, so the QTIP Trust assets will pass at the beneficiary spouse's death to the wealthier spouse's heirs tax-free

4. There is no tax reason to use a Marital Trust. If none of the circumstances described in 1.-3. apply, there is no reason to create a Marital Trust. Leave the property outright to the surviving spouse.

C. Advantages of a QTIP Trust

1. Spouse who sets it up controls where principal of trust passes at beneficiary spouse's death. Beneficiary spouse does not.

2. If beneficiary spouse remarries, that new spouse cannot inherit deceased spouse's money.

3. If beneficiary spouse has children of his or her own (not deceased spouse's children), those children will not inherit deceased spouse's money (unless the spouse establishing the trust wants them to).

4. If beneficiary spouse has creditors, they cannot get at deceased spouse's money placed in the QTIP Trust, the principal of the trust (although they could attack the beneficiary spouse's income stream).

5. Trustee of deceased spouse's choice manages the money, not surviving beneficiary spouse.

D. The basic estate tax planning technique for couples with assets of $5 - $10 million and up is the Testamentary Unified Credit Shelter [Family] Trust which is typically a Discretionary Spendthrift Trust for the benefit of the surviving spouse and children of the deceased spouse,

and possibly grandchildren of the deceased spouse. The amount of this Trust is generally up to the exempt amount: $5.25 million in 2013.

1. if spouse remarries his or her interest can terminate.

2. spouse's creditors cannot attack his or her interest.

3. if spouse remarries, the new spouse cannot get at trust assets during marriage or in the event of divorce.

4. children's creditors/grandchildren's creditors cannot get at trust.

5. spouses of children/grandchildren cannot get at trust.

6. Trustee of deceased spouse's choice manages the money, decides whether and to whom to distribute income or principal.

7. the balance in a Credit Shelter Family Trust is NOT taxed when surviving spouse/beneficiary dies; the balance passes to children TAX-FREE. So the use of this trust may be dictated by the estate tax laws as they apply to that specific estate.

E. Special QDOT Trust is Required if Spouse is a Non-Citizen

F. If, because of uncertainty over the future of the estate tax or the size of your estate at death, you want to do "stand-by" tax planning, you can leave everything outright to a surviving spouse, but permit the surviving spouse to make an election after the first spouse's death to do tax planning, if it is needed, by disclaiming some assets into a Credit Shelter Family Trust -- a so-called Disclaimer Trust recently touted in the *Wall Street Journal.*

VIII. PROTECTING ASSETS FROM POSSIBLE FUTURE CREDITORS OF YOURSELF

A. Traditional American legal rule: It is against public policy to permit someone to set up an Irrevocable Spendthrift Trust of which he himself is a beneficiary to protect assets from his own creditors.

B. Since 1989 some 60 foreign jurisdictions have adopted laws permitting so-called Self-Settled Spendthrift Trusts, e.g., Cook Islands, Bermuda, Bahamas, Cayman Islands, Isle of Man, Gibraltar

C. Since 1996 Alaska, Delaware and some ten other states (e.g. Nevada, Rhode Island) have adopted laws permitting Self-Settled Spendthrift Trust in the U.S.

1. These are not as effective as foreign laws

2. There are substantial exceptions to protection

   (a) will not defeat claim for child support.
   (b) in Delaware will not defeat a claim for alimony or marital property settlement or tort claim.
   (c) can be challenged for at least 6 years after established, probably longer.

3. There are substantial Constitutional questions about domestic asset protection trusts that have never been answered.

4. A bankruptcy trustee can void a domestic asset protection created within 10 years of Bankruptcy.

There are two comprehensive outlines on my website on Offshore and Domestic asset protection strategies, very complex topics.

D. An offshore asset protection trust is not worth doing for less than $2 million of assets.

E. So-called Asset Protection Trusts -- and, in fact, all asset protection strategies -- work only against <u>prospective</u> <u>future</u> creditors, Do <u>NOT</u> work against current or currently contemplated creditors.

F. Revocable Trusts have no effect against claims of creditors of Trust's Settlor.

G. An Offshore Trust can protect against spouse's claim in the event of a possible future divorce or from a spousal claim at death (spouse is entitled to inherit 1/3 in most jurisdictions).

H. Offshore trust can maintain an account in U.S.; in other words, assets in offshore trusts can remain in U.S., only thing that changes is ownership of account if transferred to offshore trust.

I. Retirement Plan Trusts Under ERISA Qualified Plans -- 401(k), Pension, Profit-Sharing -- are <u>NOT</u> subject to claims of employee's creditors.

1. in Maryland, Virginia and DC IRAs are protected.

2. Under a recent U.S. Supreme Court decision IRAs have expanded, but

not unlimited, federal protection. Generally you may assume IRAs up to $1 million or so are protected.

IX. OTHER ASSET PROTECTION IDEAS (DO THESE EARLY, BEFORE YOU HAVE PROBLEMS)

A. Tenants By the Entirety Property: In some jurisdictions (Virginia, D.C., Maryland) not subject to claim of creditors of only one spouse. You can set up accounts as tenancy by the entirety accounts (as opposed to joint).

B. Life Insurance Trust: If you are in financial trouble, provide security for your spouse and children after your death. Moreover the cash value should be protected. When creditor problems go away you may borrow out the cash or redeem the policy for cash.

C. Family Limited Liability Company (LLC) and Family Limited Partnership (FLP). Assets may be held in name of LLC or FLP. Why is the LLC/FLP the Holy Grail of estate planning?

- Parent/Grandparent gives property away for income and estate tax purposes, but retains control as Managing Partner. (Generally the price of getting assets out of your estate is loss of control.)

- The donor gets a 30% discount on the gift tax valuation of a limited partnership interest, off the value of the underlying asset.

- If the donor by gifts moves into a minority position, his or her estate gets a 30% discount on the estate tax value of the retained interest at death.

- Partnership interests are protected from creditors, who cannot get at them.

3. Recent "bad" court cases regarding FLPs are not as bad as they sound.

D. Give it away to other family members.

E. Give it away to charity.

F. Umbrella Liability Insurance

G. Incorporation or Limited Liability Entity. Never operate any business or investment enterprise as a proprietorship or general partnership.

X. PROTECTING ASSETS FROM CREDITORS OF PARENTS, AVOIDING DISQUALIFICATION OF IMPOVERISHED PARENTS FROM STATE OR FEDERAL BENEFIT PROGRAMS

Where children want to provide a financial safety net for less financially secure parents who may survive them, the parents may be co-beneficiaries with spouse and children in discretionary Unified Credit Family Trust. If parents need funds, distributions may be made directly to the service provider -- landlord, doctor -- without putting assets in parents' hands which parents' creditors may attack or which may be subject to tax when parents die. Getting your elderly parents to give you all of their assets so they are Medicaid-eligible generally does not work; it is a bad idea.

XI. WILL MEDICAID BENEFITS BE AVAILABLE TO PAY FOR YOUR NURSING HOME CARE? -- NOT LIKELY

Change in Medicaid Eligibility Rules

The Deficit Reduction Act of 2005, signed by President Bush on February 8, 2006, contains major changes in Medicaid eligibility rules. The legislation aimed to reduce Medicaid entitlement expenditures by $10 billion. As approximately sixty percent of the nation's nursing home residents are Medicaid recipients, the impact of this new law will likely be widespread. A few of its more important provisions are summarized below.

Because Medicaid is intended as a welfare program for the truly underprivileged, a person must have assets below a certain threshold in order to be eligible for Medicaid assistance. (Certain assets, such as a home, are generally not taken into account in determining eligibility.) Both the new and the prior rules governing eligibility contained provisions designed to prevent individuals from transferring assets to family members in order to reduce their assets below the threshold for eligibility. These eligibility rules have been toughened considerably by the new law.

Five-Year Look Back/Delayed Start of Penalty Period. Under prior law, a person applying for Medicaid was required to produce financial records dating back three years. If uncompensated transfers had been made within that period, the applicant would be ineligible for Medicaid assistance for a penalty period determined by dividing the amount of the uncompensated transfer by a number representing the monthly average cost of care at a skilled nursing facility in the area where the applicant resides. The penalty period began at the time of the transfer. To illustrate the application of this rule, if in January 2005 an individual applied for Medicaid, he would be required to produce financial records dating back to January 2002. (Uncompensated transfers which occurred prior to January 2002 would not be taken into account in determining the applicant's eligibility for Medicaid.) If the applicant had made a $40,000 gift to a

family member in January 2004 and the applicable penalty divisor was $4,000, he would be ineligible for Medicaid for a period of ten months commencing with the date of the gift (i.e., through November 2004), and thus would be eligible for benefits at the time of his application in January 2005.

Under the new rules, however, the applicant would be required to produce financial records dating back five years from the date of the transfer (i.e., to January 2000) and his period of ineligibility, calculated in the same fashion using the amount of the transfer and the applicable penalty divisor, would begin with the date of his application for benefits. Thus if the applicant had made a $40,000 gift to a family member in January 2004, and in January 2005 had assets below the Medicaid threshold, entered a nursing home and applied for Medicaid benefits, he would not qualify for those benefits for ten months following his application, or through November 2005.

Many commentators have suggested that these new rules will cause hardship for persons that are truly needy and should qualify for Medicaid, as well as for nursing homes and hospitals. First, many Medicaid applicants simply will not be able to produce the five years of records now required to document their eligibility. And even if they are able to produce the required records, a relatively small transfer to a family member or charity within the past five years by an applicant who is essentially indigent at the time he seeks Medicaid benefits will result in his being ineligible for some period of time after he has applied for benefits. Nursing homes will have no means of being paid for their care for such persons for a time, and thus will not want to accept them as residents. Moreover, since nursing homes must provide care for their residents until they can be safely discharged, even if they are unable to pay, they will also be reluctant to accept residents who have modest assets at the time they enter the nursing home but are expected to exhaust those assets after a short period. If such persons cannot immediately qualify for Medicaid when their assets are exhausted either because they cannot produce the necessary records or because they have made a small gift within the five year period, the nursing home will be required to provide them with free care until they do qualify, which may be a lengthy period. Nursing homes may also be tempted to "dump" indigent persons in hospitals for real or imagined medical services to get them out of their facilities, thus imposing hardships on hospitals.

Other Provisions. The look-back and delay provisions discussed below are the most significant changes in the new law, but other changes, such as limitations on the use of annuities to avoid Medicaid asset restrictions, and a new rule for calculating the income and resources that may be retained by the spouse of a nursing home resident, have also made eligibility more difficult. Whereas under previous law a Medicaid applicant's equity in his home was not considered available to pay for his nursing home care, home equity in excess of $500,000 is now treated as available (unless a spouse, a minor or a disabled child resides in the home). States will have the option of exempting up to $750,000 of home equity value at their discretion.

The overall effect of the new law is to significantly toughen Medicaid eligibility requirements and make it very difficult to engage in planning designed to qualify oneself

for Medicaid benefits. Most people, except those whose assets are substantial enough to pay for nursing home care for a long period, should strongly consider the purchase of long-term care insurance to provide for nursing home care or in-home care.

XII. TAX INCREASES IN AMERICAN TAXPAYER RELIEF ACT OF 2012 ("ATRA")

This was signed into law in December 2012. The important changes are outlined in our firm's March 2013 Newsletter attached.