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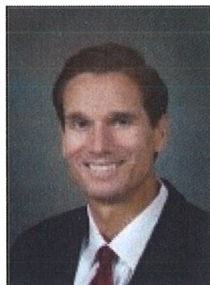
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❖ Opinion

Henry and Wilma can have their estate planning cake and eat it too

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John Dedon


We know nothing is certain but death and taxes, but at least regarding death taxes, there is nothing that has been more uncertain. The estate law uncertainty created by a dysfunctional Congress and political posturing has been extreme. Here are some possibilities:

- No estate tax? A possibility under the Bush Administration and a Republican Congress, but now extremely unlikely.
- A generous \$5.12 million gift and estate exemption? Current law for 2012, but unlikely to be preserved in 2013 forward.
- The re-imposition of only a \$1 million gift and death exemption amount with a 55 percent tax rate? The default rule if Congress and the President do not pass new law for 2013 forward.
- President Obama's 2013 budget proposal? This includes a \$3.5 million death exemption, a \$1 million gift exemption, a 45 percent estate tax rate, and limits on intra-family discounts and dynasty trusts.

Nobody knows what will happen, and whatever the 2013 law turns out to be is beyond our control and subject to change. But what is in our control is taking advantage of the "perfect storm" for estate planning in 2012 while it lasts. A \$5.12 million gift exemption amount and relatively low asset values from a stagnant economy present a current and unique opportunity for taxpayers to do their estate planning.

The estate advantages of transferring assets are easy to understand. But here is the \$1 million question (or more accurately, the \$5.12 million question): How do I give it away and yet have enough to live on for the rest of my life?

Consider this example:

Henry and Wilma, husband and wife, have \$10 million in marketable securities. Henry creates an irrevocable trust for Wilma, naming her as trustee and a beneficiary along with the children. Wilma creates an irrevocable trust for Henry, naming him as trustee and a beneficiary along with the children. They each transfer \$5 million of marketable securities into the other's trust. Henry and Wilma can be both the trustee and a beneficiary with their children. Thus, as long as Henry and Wilma are married and living, they can continue to benefit from the trust income and assets, yet take advantage of the \$5 million exemption amount while it exists, thereby sheltering \$10 million, and all appreciation, from estate tax.

There are added benefits. For example, the irrevocable trusts can be designed as dynasty trusts, thereby avoiding estate tax not only at Henry and Wilma's deaths but also for future generations. Further, the irrevocable trusts can be designed as "grantor trusts," so that the trust income continues to be taxed to Henry and Wilma. This simplifies the income tax reporting and also results indirectly in greater tax-free gifts to the trust beneficiaries.

This plan is incredibly effective and powerful to remove \$10.24 million of assets from Henry and Wilma's estates but still allow them, as a couple, to access those assets. But is it too good to be true? There most definitely are issues to consider, such as divorce and death. Regarding divorce, if the assets were accumulated during marriage, then the

funding of the two irrevocable trusts would simply be a pre-funding of the asset division that otherwise would occur in a divorce.

Also, what happens if either Henry or Wilma dies? For example, if Henry dies Wilma can no longer access the income and principle from the assets she transferred to the trust for Henry (now their children are the only beneficiaries). The solution: Wilma could purchase a life insurance policy on Henry's life to be owned by the irrevocable trust in which she is the trustee and beneficiary. The policy could be an inexpensive term policy, to cover a period of time, or a permanent policy. Either way, the death proceeds would be estate tax free, provide leverage for Henry and Wilma's portfolio, and be available for the surviving spouse.

Of course, these matters need to be thoroughly considered and analyzed, and this article only touches on a few of the nuances of the divorce and death issues. It is critical that Henry and Wilma thoroughly consider all the issues with their team of advisors.

There are also legal issues to resolve or the plan will not work. For example, Henry and Wilma can create similar trusts, but they cannot be "reciprocal trusts" as that term is used in the legal world. Also, Henry and Wilma cannot have "general powers of appointment" over the Trusts, or even better, neither would serve as a trustee. Again, it is important Henry and Wilma work with their advisory team to consider and answer all questions and issues.

The plan described above presents a rare and terrific opportunity for affluent taxpayers to take advantage of current law before it is too late.

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