



ESTATE PLANNING OVERVIEW

Looking Beyond the Minimum Requirements

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A. ESTATE PLANNING: THE MINIMUM REQUIREMENTS AND BEYOND

A.1 Making an Effective Estate Plan: Estate planning is the arrangements of one's financial affairs through asset ownership and legal documents to provide for one's goals related to the management and disposition of one's estate¹. Your estate planning goals might involve the desire to provide for lifetime needs, protect assets against lawsuits and other claims, assure the distribution of your estate to your intended beneficiaries, reduce or eliminate taxes and other expenses, coordinate business and retirement planning with other planning, protect beneficiaries from mismanagement and from the claims of creditors and ex-spouses; and/or discourage or encourage certain types of conduct for family members. Most people focus on having a will or trust that meets the minimum legal requirements, but for a truly effective estate plan, the minimum legal requirements are usually not enough. An effective estate plan is one that truly accomplishes *your* objectives and that balances competing objectives according to *your* priorities.

A.2 The Role of Asset Ownership: Estate planning is implemented with legal documents, including change-of-ownership or change-of-beneficiary documents. ***Asset ownership and beneficiary designations are an essential element of effective estate planning.***

(a) *Methods of Death-Time Asset Transfers.* Assets are transferred at death in one of three ways:

(i) Operation of Law. Some forms of property ownership determine, by legal definition, who will immediately succeed to a deceased co-owner's interest in the property. Examples include joint tenancy, community property with a right of survivorship², and life estates. Financial accounts you hold "in trust for" a designated beneficiary and registered securities you hold "transferable on death to" a designated beneficiary will be given to the designated beneficiary upon your death. In these situations, legal title passes the instant of death.

(ii) *Contract.* You can arrange to have money or other assets transferred to designated beneficiaries upon your death under various contracts, including life insurance, trusts, retirement benefits, annuities, partnership agreements, and stock-purchase ("buy-sell") agreements. The beneficiaries' rights spring into being at the moment of your death. This can also include living trusts, whether revocable or irrevocable.

¹ "Estate", "assets", and "property" are used interchangeably to refer to everything a person owns. Of course, the term "estate" can be modified to refer to only part of one's entire estate. For example, "probate estate" refers to the property subject to administration in probate proceedings, and "taxable estate" usually refers to the property that is subject to the federal estate tax.

² Community property with a right of survivorship is recognized in Nevada, Arizona, California, Idaho, Texas, New Mexico, and perhaps other states.



(iii) Probate. All of your assets which do not pass by operation of law or by contract pass through probate or intestacy proceedings. Your personal representative is called an "executor" if named in your will or "administrator" if not. "Probate" refers to the court proceeding required to transfer the assets of a decedent which do not pass directly by law or contract. To avoid probate, either (a) don't die or (b) use the non-probate forms of ownership which allow your assets to pass to your beneficiaries by operation of law or under a contract. A will does NOT alleviate the need for probate. A will may clarify and simplify probate, but it is of very limited value until it is probated. Probate proceedings vary from state to state, but similar rules apply in most states.

(b) *Importance of Ownership Designations*. An effective estate plan requires that ownership and beneficiary-designation documents are consistent with the plan. Far too often, a person's ownership and beneficiary-designation documents are inconsistent with his or her will or trust and with his or her true objectives. For example, you cannot own a home in joint tenancy with one person (which passes title at death by operation of law) and leave that same home to someone else in your will (which only affects property subject to probate). Similarly, you cannot designate one person as a beneficiary under a life insurance policy (which passes the proceeds by contract) and expect that person to share with siblings or to use the insurance proceeds to pay off debts or pay funeral expenses.³

A.3 Distribution at Death; Management during Life: With assets owned in a manner consistent with your will or a living trust, those documents can provide for the distribution of your estate at death. In most states, however, a will requires probate proceedings to be effective, and a will alone does virtually nothing to provide for the management of one's estate during life. In contrast, a revocable living trust can provide for the management and disposition of your estate both during life (even if one becomes incompetent), as well as after death. One or more irrevocable trusts can protect assets from creditors, reduce transfer taxes, and provide a financial safety net for the designated beneficiaries.

A.4 Transfer Taxes: Under current federal law, there are three taxes that can be imposed on the transfer of assets: the gift tax, the estate tax, and the generation-skipping transfer tax ("GST tax"). In addition to the transfer taxes that may apply, income tax can also reduce transfers.

(a) *Gift Tax*. A taxable gift is any transfer of property for less than its fair market value. There are two exclusions for gift-tax purposes. The annual exclusion eliminates the tax on transfers of property of \$13,000 or less per recipient in each calendar year.⁴ The applicable exclusion (sometimes referred to as the "lifetime exclusion") eliminates the tax

³ In many states, including Nevada, the recipient of nonprobate transfers can be liable for a decedent's debts and other obligations if the assets subject to probate are insufficient to pay those debts and obligations; however, a legal proceeding similar to a lawsuit required to enforce that liability.

⁴ The \$13,000 exclusion applies in 2011 and 2012. Since 1998, this amount has been adjusted from \$10,000 to reflect increases in the cost of living, but only in \$1,000 increments.



until the cumulative gifts made during one's lifetime exceed the exclusion amount. For 2011 the applicable exclusion amount was \$5 million, and for 2011, the applicable exclusion amount is \$5⁵. After the lifetime exclusion is used up, the gift tax rate for gifts made in 2011 and 2012 is 35%.⁶

(b) *Estate Tax.* The applicable exclusion for the estate tax is \$5 million for people who die in 2011 or 2012, and the estate tax rate is 35%. The applicable exclusion for the estate tax is reduced by the amount of the applicable exclusion used for the gift tax.

(c) *Generation-Skipping Transfer Tax.* The GST tax applies to transfers to grandchildren and others in lower generations to the extent the cumulative transfers, either during life or at death, exceed the GST exemption. For 2011 and 2012, the GST exemption is the same as the applicable exclusion for gift and estate taxes.⁷ What happens after 2012 depends on Congressional action. The GST tax is imposed at the highest rate imposed for federal estate tax purposes, which is now 35%, as mentioned in paragraph A.4(b), above.

B. REDUCING TRANSFER TAXES

B.1 Tax Savings for Couples under A Revocable Trust: For couples who have a net worth that exceeds the "applicable exclusion", it is common to design a revocable trust (or will) to set aside assets belonging to the first spouse to die in an irrevocable "exemption trust" or "credit-shelter trust". The surviving spouse can be the trustee, the primary beneficiary, and can even have the right to designate the trust's beneficiaries after his or her death. If designed and funded properly, the credit-shelter trust will be exempt from the estate tax upon the survivor's death. Under the tax law that became effective in 2011, the exemption trust arrangement is not necessary because the surviving spouse can use the unused portion of the predeceased spouse's exemption. Even so, because the new law is only effective for 2011 and 2012, we will not recommend that anyone rely on that provision of the new law.

B.2 Beyond the Revocable Trust: Most estate-tax savings techniques require you to give up at least some control over your own assets and to limit or eliminate the benefits you receive from them. The first estate-reduction technique is to spend and use up your estate for your

⁵ Internal Revenue Code § 2010(c) provides for an "applicable exclusion", which is the cumulative amount that can pass free of gift and/or estate tax. This is sometimes called "the exemption equivalent of the Unified Credit". For ESTATE TAX purposes, the applicable exclusion has been, is and will be: \$600,000 in 1997, \$625,000 in 1998; \$650,000 in 1999; \$675,000 in 2000 and 2001; \$1,000,000 in 2002 and 2003; \$1,500,000 in 2004 and 2005; \$2,000,000 in 2006, 2007, and 2008, \$3,500,000 in 2009; unlimited in 2010; \$5,000,000 in 2011; \$5,120,000 in 2012; and \$1,000,000 in 2013 and beyond. The applicable exclusion for GIFT TAX purposes is the same as that for estate tax purposes from 1997 to 2004 and for 2011 and beyond. For 2005 through 2010, the applicable exclusion for GIFT TAX purposes was fixed at \$1,000,000.

⁶ The maximum rate imposed for federal estate tax purposes was 55% from 1997 to 2001. It was 50% in 2002; 49% in 2003; 48% in 2004; 47% in 2005; 46% in 2006; 45% in 2007, 2008, and 2009; 0% in 2010; 35% in 2011 and 2012; and 55% in 2013 and beyond.

⁷ The GST tax is imposed at the highest rate imposed for federal estate tax purposes, which is shown in note 6. For 2011 and 2012, the GST exemption is the same as the applicable exclusion for estate tax, as shown in note 5. For 2013 and beyond, the GST exemption will be \$1,000,000 plus cost of living adjustments since 1998.



own benefit. After that, most estate-reduction tools involve some sort of gift giving.

B.3 Irrevocable Trusts: There are several types of irrevocable trusts that can be used to make gifts to other persons with the assets under the control and management of a trustee. To be effective for estate-reduction purposes, the trust must be irrevocable, and the grantor of the trust cannot be a trustee or a beneficiary of the trust without creating problems. Some commonly used irrevocable trusts include (a) the irrevocable life insurance trust ("ILIT") that is the owner and beneficiary of life insurance; (b) a children's or grandchildren's trust that holds assets until one or more intended beneficiaries reach a specific age or accomplish a specific objective; (c) a bypass & spendthrift trust, which can save taxes and protect against the claims of a beneficiary's creditors and which can be designed as a generation-skipping trust or dynasty trust that benefits multiple generations and (d) a supplemental needs trust, which is designed so that discretionary distributions are made only to "supplement" governmental assistance benefits already being received by a beneficiary.

B.4 Discount Valuation; Estate-Freezing. Gifts and sales of nonvoting interests in business entities (such as a limited-liability company, limited partnership, or subchapter S corporation) can reduce one's taxable estate because such interests have a fair market value that is "discounted" from the pro rata value because of lack of voting control and lack of marketability. Some transfers and techniques do not reduce the value of one's estate, but they have the effect of "freezing" the estate-tax value of assets, which eliminates the estate tax on future appreciation. Methods to "freeze" a taxable estate to current values include lifetime gifts, installment sales, self-cancelling installment notes, private annuities, and grantor-retained interest trusts (which are mentioned below).

B.5 Grantor Retained Interest Trusts: Over the years, various trusts (or trust-like arrangements) have been devised that allow the grantor of the trust to retain benefits for a specified period of years so that the present value of the future gift to the children is reduced according to the IRS' own valuation tables. Two commonly used trusts include the qualified personal residence trust (QPRT) and the grantor retained annuity trust (GRAT). In both of those trusts, the benefit of assets are retained by the trust's grantor (settlor or creator) for a term of years. The transfer of assets to the trust is treated as a taxable gift, but the gift tax value of the gift is based on a "discounted" present-value calculation using IRS-approved formulas. If the grantor outlives the grantor's term, the estate-tax savings can be significant. If the QPRT or GRAT pours into an irrevocable life insurance trust ("ILIT") at the end of the grantor's term, it can provide a source of income that reduces the need to make taxable gifts to the ILIT.

B.6 Charitable Trusts: Charitable remainder trusts and/or charitable lead trusts can be combined with other estate-planning techniques (such as an ILIT) to maximize income and the value of the estate that ultimately passes to the family.

B.7 Business-Entity Planning: For those who have interests in one or more operating businesses, estate planning necessarily includes (a) business planning while the business ownership continues, (b) retirement planning, and (c) the planning for the ultimate disposition of that business, whether by sale (perhaps under a buy-sell agreement), by liquidation, by lifetime gifts, or by transfers at death. Sometimes the formation of a new corporation, partnership, or limited liability company can also help accomplish estate-planning objectives.



C. ASSET PROTECTION

C.1 Generally: “Asset protection” refers to various legal arrangements that make it difficult for creditors⁸ to reach certain assets without committing fraud or otherwise violating the law. As a general rule, Nevada law does not permit one to transfer assets to hinder, defraud, delay, or otherwise frustrate the collection of existing obligations⁹, but Nevada law does permit one to shield assets from future potential creditors under appropriate circumstances.

C.2 Business Entities: Business entities, such as corporations, limited partnerships, and limited-liability companies, can be used to shield personal assets from business liabilities and business assets from personal liabilities.

C.3 Spendthrift Trusts: A “spendthrift trust” is an irrevocable trust whose assets are protected under state law from the creditors of a beneficiary. Most states do not allow a spendthrift trust to be established for the benefit of the trust’s settlor (creator), but since October of 1991, Nevada law has permitted a settlor to establish a spendthrift trust for his or her own benefit so long as there is a Nevada trustee with specific authority required by law, a person other than the settlor must approve all distributions to or for the settlor, and transfers to such a trust cannot be fraudulent transfers¹⁰ or in violation of a contract or court order. This type of trust is referred to in technical treatises on trusts as a “self-settled spendthrift trust” (SSST). For greater protection, offshore trusts are often used, especially if protection is needed against claims governed by federal law, including claims by the IRS, SEC, FTC, and other federal agencies.

D. CONCLUSION

D.1 Custom Planning: Estate planning has competing goals. For example, saving transfer taxes on your assets will often reduce your lifetime control and benefit over those assets. The basic estate plan begins with a will or revocable trust. Other estate planning tools go beyond the basics. Some of these tools can be combined to become even more effective. The best estate plan for you is one that balances your objectives according to your own priorities.

D.2 Going Forward: We suggest that you, prepare a current estate inventory, make a prioritized list of your estate planning goals and objectives, have existing documents and plans reviewed in light of your current goals and objectives, and consult with experienced advisors that

⁸ “Creditor”, in this context, refers to any person or entity to whom a person owes a financial obligation, such as a lender, a plaintiff in a lawsuit, a party to a contract, a lessor, a vendor, a service provider, or a governmental entity that is owed taxes, assessments, or fees.

⁹ An “existing obligation” includes obligations arising from an event that has already occurred, whether or not a claim or lawsuit relating to that event has been formally asserted or filed. For example, if you were involved in an automobile accident that was your fault, as to any transfer of assets after the accident, all claims resulting from that accident are “existing obligations” even before those injured or harmed in the accident file an insurance claim or a lawsuit.

¹⁰ “Fraudulent transfers” include transfers that render a person insolvent or that are intended to hinder, defraud, or delay an existing creditor. Except as to an existing creditor without knowledge of a transfer to the spendthrift trust, there is a two-year deadline during which a creditor must allege a fraudulent transfer.



will help you explore your options and implement the plan you ultimately decide upon. Once your plan is in place, you cannot simply forget it: It will be up to you to keep it up-to-date.

NOTE: This memo provides general information only and does not contain legal, accounting, or tax advice. For brevity, this memo is oversimplified and should not be relied on for any particular situation. Although this memo may discuss tax issues, this is not a "covered opinion" as defined in Circular 230 issued by the U. S. Treasury Department, and nothing in this memo can be relied upon to avoid any tax penalties.

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