

# The Wealth Advisor

*A monthly newsletter for our valued clients*

## WHAT'S HOT IN ESTATE PLANNING?

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Estate planning has truly evolved over the past 22 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. In this issue you will learn why estate planning has become more complicated and what your clients need to do now to insure their estate plans are flexible enough to roll with the changes.

### **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, 22 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 all the rage.

#### From

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Fast forward 20 plus years and in 2017 the federal estate tax exemption is a whopping \$5.49 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 (\$10.98 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 transfer-on-death (TOD) investment accounts and in some states TOD 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%. Some irrevocable trusts might pay these high tax rates when realized but undistributed gains reach only \$12,300 (for tax year 2015). 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 an unnecessary 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 \$11 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 the surviving spouse and making the portability election; but beware of spendthrifts, creditor issues, remarriage complications and loss of bloodline protection.
- 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 the plan is ideal, what happens when the plan becomes irrevocable before it could be made flexible? What if the plan needs to be modified to obtain a step up in basis or for other income tax reasons? What if the trust is for the benefit of a beneficiary who would be eligible for government benefits but for the trust? What if it would be advantageous to change the situs of the trust or its governing law, add or remove beneficiaries, add a trust protector or advisor, or change the trustee structure? Is it possible to modify or even revoke an inflexible, irrevocable trust? The answer under many circumstances is yes, by:

- Reforming the trust: Using judicial interpretation to determine and properly restate the trustmaker's intent.
- Modifying the trust: Changing the terms of the trust by agreement or a court order to meet the trustmaker's tax-saving objectives provided that the resulting terms are not inconsistent with the trustmaker's intent.
- Equitably deviating the trust: Modifying the trust provisions by agreement or a court order upon the showing of an unforeseen change in circumstance the impact of which would frustrate the trustmaker's intent.
- Invoking the Trust Protector: Allowing a third-party to exercise specific powers as defined in the trust agreement.
- Decanting the trust: Allowing the trustee to distribute property in further trust for a beneficiary.

**Planning Tip:** Ask your clients when they signed their current estate planning documents and how long it has been since the documents were reviewed by their attorney. If the answer is more than a few years, then explain how the focus of estate planning has changed and why their estate planning documents must not be stashed in a drawer and forgotten until needed.

### **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 will be able to adapt over time. Modern families need modern estate planning solutions, and our firm is ready to help your clients plan for now as well as what may happen in the future.

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You have received this newsletter because I believe you will find its content valuable. Please feel free to [Contact Me](#) if you have any questions about this or any matters relating to estate planning.

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