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TRUSTS & ESTATES: STRATEGIES FOR EFFECTIVE WEALTH MANAGEMENT

Moderator: Autumn Ronda, MSK (US: Los Angeles, CA)

Panelists:

- Katie Callaway, Fennemore (US: Arizona)
- Maureen Keegan, Curtis Thaxter (US: Maine)
- Brian Sweet, Patterson Belknap Webb & Tyler (US: New York, NY)

TRUSTS & ESTATES: Strategies for Effective Wealth Management

September 20, 2024 Los Angeles, California

Presented by:

Katie Callaway, Fennemore (US: Arizona), Brian Sweet, Patterson Belknap Webb & Tyler (US: New York, NY)
Maureen Keegan, Curtis Thaxter (US: Maine) & Autumn Ronda, Mitchell Silberberg & Knupp (US: Los Angeles, CA)



U.S. Estate and Gift Tax

- Taxed on the worldwide estate of domiciliary.
 - Different test than income tax residency.
 - Lawful Permanent Residents (green card holders) likely US domiciled, but not always.
 - A domiciliary receives full exemption as citizen.
 - Gifts and bequests to citizen spouses are unlimited.
 - Very limited gift exemption for non-citizen spouses.
 - Must use special “QDOT” trust at death to obtain spousal exemption
- Combined U.S. Estate and Gift Tax Exemption for 2024 is \$13,610,000 (adjusted annually for inflation from \$10,000,000 since 2011). Applied to gifts and/or at death.
- Generation Skipping Transfer Tax is separate, but has the same exemption amount.
- Separate annual exclusion per donee is \$18,000 in 2024
- 40% tax on transfers after exemption is exhausted.



Estate Planning Before the Sunset

- Exemption will automatically “sunset” and revert to \$5,000,000 (indexed for inflation since 2011) as of January 1, 2026 (estimated to be about \$7 million for 2026).
- Modifications to the law depend on the election and an Congressional agreement, which will likely be difficult, so we must plan as though it will sunset.
- Largest estates should consider using both spouses’ full exemption (\$27,220,000) before reduction.
 - No “clawback” if exemption drops.
 - Must dip into “extra” Exemption to benefit.
- Difficulties in effectively using the exemption for many clients.
 - Concerns about maintaining cash flow necessary to live.
 - Can’t unwind if the laws change.

Common Techniques for Wealth Transfer

GRAT (Grantor Retained Annuity Trust)

- Grantor retains annuity for a set term with balance to trust for beneficiaries
- Transfer appreciating assets with little to no gift tax with a “zeroed-out” GRAT
- Terms vary, can be “rolling” and use multiple GRATs for asset categories.
- GRAT funded with family business or other assets; recent increases in interest rates make GRATs somewhat less appealing (IRS “7520” rate was 1% in October 2021; is 4.4% for Oct 2024).

ILIT (Irrevocable Life Insurance Trust)

- Trust holds life insurance policies outside of estate
- Provides liquidity for estate taxes while excluding death benefit from taxable estate
- Generally “cheapest” asset to remove from estate

SLAT (Spousal Lifetime Access Trust)

- Irrevocable trust benefiting spouse during lifetime, then to beneficiaries
- Assets grow outside both spouses' estates and appreciation is removed from taxable estate
- How to have your cake and eat it too, but:
 - Potential pitfalls in creating separate property
 - Risk of divorce: Could complicate access to trust assets if the spouses divorce
 - Risk of early death of donee spouse: Access to trust assets ends upon donee spouse's death, limiting flexibility for the surviving spouse
 - Careful planning required to avoid IRS scrutiny
- Shields assets from creditors, provides tax benefits, and retains access to trust income for the spouse

Other Techniques to be Discussed

IDGT (Intentionally Defective Grantor Trust)

- Income taxed to grantor, assets excluded from estate
- Often used with asset sales

CLT (Charitable Lead Trust)

- Charitable donations for a set period of time, remainder to beneficiaries
- Reduces estate and gift taxes while benefiting both charity and family

- **QPRT (Qualified Personal Residence Trust)**

- Transfers personal residence to beneficiaries at a reduced tax value and retains right to live in the home for a set period
- Reduces taxable estate while preserving use of residence

Qualified Personal Residence Trusts (QPRT)

CLIENT OBJECTIVE: To remove future appreciation of personal residence(s) from the taxable estate

- What is a QPRT?
 - An irrevocable grantor trust for a term of years
 - Grantor(s) must survive the term of the trust for the real estate to be excluded from the taxable estate
 - Up to two personal residences per grantor are allowed
- Advantages and Disadvantages of QPRTs
 - Removes future appreciation of residence from taxable estate
 - Grantor must survive the term of the trust – 5, 10, 20 years, etc.
 - After termination, grantor must pay fair market rent if living in the residence
 - Descendants receive a carryover basis on the taxable gift of the residence to the trust
 - Grantor trust rules may apply to include gain on sale of residence in grantor's taxable income

Testamentary Charitable Lead Trusts In General

- A testamentary charitable lead trust can reduce the amount of estate tax on the grantor's death, provide an opportunity for the grantor to meet his philanthropic goals, and preserve wealth for the grantor's heirs.
- A charitable lead trust is a split interest trust that pays an amount to charity during the initial term of the trust and then distributes the assets that remain at the end of the charitable term to non-charitable beneficiaries.



Testamentary Charitable Lead Trusts In General

- Created under a revocable trust or a Will
- Non-grantor trust because the grantor is deceased at the time the trust is established
- Assets distributed to one or more charities
- Amount to charity paid at least annually but may be paid semi-annually, quarterly, monthly, or weekly
- Payments to charity will be paid for term specified in the trust



Key Features of Testamentary Charitable Lead Trusts

- Term begins on donor's date of death
- Term can be based on a term of years or on a life or lives of certain individuals (or both)
- Payments to charity can be equal over the term, can be structured so amount to charity in first year is relatively small and increases gradually over the term of the trust, or can be de minimis in early years with a balloon payment in final year ("Shark-Fin" CLAT)



Charitable Lead Annuity Trust

Trust Type:	Term
Transfer Date:	5/7/2024
\$7520 Rate:	5.00%
FMV of Trust:	\$1,000,000
Growth of Trust:	10.22%
Optimized:	Yes
'0' Remainder Payout:	\$80,242.66
Payment Period:	Annual
Payment Timing:	End
Term:	20
Total Number of Payments:	20
Exhaustion Method:	IRS
Vary Annuity Payments?	No
Economic Schedule Compounding:	Annual

Annual Payout:	\$80,242.66
Annual Payment:	\$80,242.66
Term Certain Annuity Factor:	12.4622
Payout Frequency Factor:	1.0000
Present Value of Annuity:	\$1,000,000.00
Remainder Interest = FMV of Trust less PV of Annuity:	\$0.00
Charitable Deduction for Income Interest:	\$1,000,000.00
Donor's Deduction as Percentage of Amount Transferred:	100.000%

Year	Beginning Principal	10.22% Growth	Payment	Remainder
1	\$1,000,000.00	\$102,200.00	\$80,242.66	\$1,021,957.34
2	\$1,021,957.34	\$104,444.04	\$80,242.66	\$1,046,158.72
3	\$1,046,158.72	\$106,917.42	\$80,242.66	\$1,072,833.48
4	\$1,072,833.48	\$109,643.58	\$80,242.66	\$1,102,234.40
5	\$1,102,234.40	\$112,648.36	\$80,242.66	\$1,134,640.10
6	\$1,134,640.10	\$115,960.22	\$80,242.66	\$1,170,357.66
7	\$1,170,357.66	\$119,610.55	\$80,242.66	\$1,209,725.55
8	\$1,209,725.55	\$123,633.95	\$80,242.66	\$1,253,116.84
9	\$1,253,116.84	\$128,068.54	\$80,242.66	\$1,300,942.72
10	\$1,300,942.72	\$132,956.35	\$80,242.66	\$1,353,656.41
11	\$1,353,656.41	\$138,343.69	\$80,242.66	\$1,411,757.44
12	\$1,411,757.44	\$144,281.61	\$80,242.66	\$1,475,796.39
13	\$1,475,796.39	\$150,826.39	\$80,242.66	\$1,546,380.12
14	\$1,546,380.12	\$158,040.05	\$80,242.66	\$1,624,177.51
15	\$1,624,177.51	\$165,990.94	\$80,242.66	\$1,709,925.79
16	\$1,709,925.79	\$174,754.42	\$80,242.66	\$1,804,437.55
17	\$1,804,437.55	\$184,413.52	\$80,242.66	\$1,908,608.41
18	\$1,908,608.41	\$195,059.78	\$80,242.66	\$2,023,425.53
19	\$2,023,425.53	\$206,794.09	\$80,242.66	\$2,149,976.96
20	\$2,149,976.96	\$219,727.65	\$80,242.66	\$2,289,461.95
Summary:	\$1,000,000.00	\$2,894,315.15	\$1,604,853.20	\$2,289,461.95

Trust Type:	Term
Transfer Date:	5/7/2024
\$7520 Rate:	5.00%
FMV of Trust:	\$1,000,000
Growth of Trust:	10.22%
Optimized:	Yes
'0' Remainder Payout:	\$11,153.21
Payment Period:	Annual
Payment Timing:	End
Term:	20
Total Number of Payments:	20
Exhaustion Method:	IRS
Vary Annuity Payments?	Yes
Annual Annuity Payment Growth:	20.00%
Economic Schedule Compounding:	Annual

Annual Payout:	\$11,153.21
Annual Payment:	\$11,153.21
Term Certain Annuity Factor:	89.6603
Payout Frequency Factor:	1.0000
Present Value of Annuity:	\$1,000,000.00
Remainder Interest = FMV of Trust less PV of Annuity:	\$0.00
Charitable Deduction for Income Interest:	\$1,000,000.00
Donor's Deduction as Percentage of Amount Transferred:	100.000%

Varying Annuity Payments		
Year	Entered Rate	Payment
1	1.11532%	\$11,153.21
2	1.33839%	\$13,383.90
3	1.60607%	\$16,060.70
4	1.92728%	\$19,272.80
5	2.31274%	\$23,127.40
6	2.77529%	\$27,752.90
7	3.33035%	\$33,303.50
8	3.99642%	\$39,964.20
9	4.79570%	\$47,957.00
10	5.75484%	\$57,548.40
11	6.90581%	\$69,058.10
12	8.28697%	\$82,869.70
13	9.94436%	\$99,443.60
14	11.93323%	\$119,332.30
15	14.31988%	\$143,198.80
16	17.18386%	\$171,838.60
17	20.62063%	\$206,206.30
18	24.74476%	\$247,447.60
19	29.69371%	\$296,937.10
20	35.63245%	\$356,324.50

Charitable Lead Annuity Trust

Year	Beginning Principal	10.22% Growth	Payment	Remainder
1	\$1,000,000.00	\$102,200.00	\$11,153.21	\$1,091,046.79
2	\$1,091,046.79	\$111,504.98	\$13,383.90	\$1,189,167.87
3	\$1,189,167.87	\$121,532.96	\$16,060.70	\$1,294,640.13
4	\$1,294,640.13	\$132,312.22	\$19,272.80	\$1,407,679.55
5	\$1,407,679.55	\$143,864.85	\$23,127.40	\$1,528,417.00
6	\$1,528,417.00	\$156,204.22	\$27,752.90	\$1,656,868.32
7	\$1,656,868.32	\$169,331.94	\$33,303.50	\$1,792,896.76
8	\$1,792,896.76	\$183,234.05	\$39,964.20	\$1,936,166.61
9	\$1,936,166.61	\$197,876.23	\$47,957.00	\$2,086,085.84
10	\$2,086,085.84	\$213,197.97	\$57,548.40	\$2,241,735.41
11	\$2,241,735.41	\$229,105.36	\$69,058.10	\$2,401,782.67
12	\$2,401,782.67	\$245,462.19	\$82,869.70	\$2,564,375.16
13	\$2,564,375.16	\$262,079.14	\$99,443.60	\$2,727,010.70
14	\$2,727,010.70	\$278,700.49	\$119,332.30	\$2,886,378.89
15	\$2,886,378.89	\$294,987.92	\$143,198.80	\$3,038,168.01
16	\$3,038,168.01	\$310,500.77	\$171,838.60	\$3,176,830.18
17	\$3,176,830.18	\$324,672.04	\$206,206.30	\$3,295,295.92
18	\$3,295,295.92	\$336,779.24	\$247,447.60	\$3,384,627.56
19	\$3,384,627.56	\$345,908.94	\$296,937.10	\$3,433,599.40
20	\$3,433,599.40	\$350,913.86	\$356,324.50	\$3,428,188.76
Summary:	\$1,000,000.00	\$4,510,369.37	\$2,082,180.61	\$3,428,188.76



Estate Tax Considerations

- Charitable lead interest and remainder interest are included in the grantor's estate for estate tax purposes
- Unlimited estate tax charitable deduction for amount that passes to the charity
- Assets receive a basis adjustment to fair market value on trustor's (or testator's) date of death

Charitable Lead Trust Types

- Charitable lead unitrust vs. charitable lead annuity trust
- Use of a formula for a zeroed out charitable lead annuity trust (See e.g. Private Letter Rulings 199927031, 9631021, 9840036, and 9128051)



Income Tax Issues

- Charitable lead annuity trust taxed as complex trust
- Charitable income tax deduction for gross income paid to charity
- If income in excess of annuity amount is paid to charity, trust receives charitable income tax deduction under Internal Revenue Code § 642(c) - it does not receive an additional estate tax charitable deduction

Generation-Skipping Transfer Tax Issues

- Naming skip persons as remainder beneficiaries
- Charitable lead unitrust (Internal Revenue Code § 2642(d)) vs. charitable lead annuity trust (Internal Revenue Code § 2642(e))
- Charitable lead annuity trust - adjusted GST exemption applies and inclusion ratio determined at expiration of charitable lead term



Income Tax Issues and Considerations for Business Owners

Grantor Trusts vs. Non Grantor Trusts

- What is a grantor trust and how does it work?
- The leveraged sale to a grantor trust / estate freeze
 - Example: gift of \$20 million of stock; sale of \$30 million for 30-year note
- What to do when parents no longer want to pay their trust's taxes
- Keeping an eye towards other important tax issues
 - Qualified Small Business Stock incentives (\$10 million exclusion)
 - State and city income taxes

Gifting Tradeoffs: The Basis Step-Up

- Should everyone be gifting before 2025
- The problem with low basis assets



Income Tax Issues and Considerations for Business Owners

Planning an Escape Hatch

- Flexibility in distributions to beneficiaries
 - Grantor as beneficiary?
- Creating optionality to deal with changing tax regimes
- The increasingly mobile nature of our clients

Other Trends Affecting Business Owners

- Illiquidity (high-growth) and its effects
 - Using life insurance and buy/sell arrangements
 - Accessing credit
- Succession of the business and other non-tax issues
- Collaboration of advisors is key

Non-Tax Considerations And Trends: Managing Vacation Homes

- Tax issues
 - Real estate is subject to estate tax even if you are not a resident of the state
 - Maine estate tax exemption is currently \$6.4 million with rates 8-12%
 - Transferring the residence to an LLC or a trust does not avoid the tax
 - Estate plan should consider local tax issues and the rapidly increasing value of Maine real estate
- Probate and Title issues
 - If the real estate is owned outright and not in joint tenancy, local probate is required for title purposes
 - Probate is avoided by ownership in an LLC or a trust, changing real estate to intangible personal property (Probate is avoided but not estate tax)
- Family and Governance issues for Multi-generational ownership
 - A trust is the traditional vehicle for ownership of family camp
 - Should be funded with cash along with real estate
 - Allows future control of ownership and usage to descendants only
 - Trust income tax rules may be problematic
 - LLCs are much more common today due to tax planning and ownership flexibility of a partnership with the liability protection of a corporation
 - Provides asset and creditor protection
 - Property management and usage may be structured in the agreement
 - Formalizes income tracking and expense disbursing
 - Transfer of ownership within and outside of Family during Lifetime and after death may be restricted by buy-sell provisions
 - Estate and gift tax planning by transferring LLC ownership interests as well as probate avoidance



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Maureen Keegan focuses her practice in the areas of estate planning, estate and trust administration, family business transactions, and taxation. She previously practiced as a Certified Public Accountant and remains licensed as a CPA. She also has experience as a CFO of various business organizations in the commercial real estate, hospitality and retail industries. Maureen is a member of the Maine Estate Planning Council, and the Trusts and Estates and Federal and State Taxation Sections of the Maine Bar Association.



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Brian M. Sweet is Counsel in the Firm's Trusts & Estates group. Brian engages in sophisticated estate planning for individuals and families, often designed to accomplish transfers to family members and charitable organizations in a tax-efficient manner. Brian has served clients in a variety of situations, including entrepreneurs, investment fund principals, corporate executives, artists and collectors, and high net-worth families.





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Based in Los Angeles, Autumn Ronda is a Partner in MSK's Tax and Estate Planning Department. Autumn specializes in designing and implementing sophisticated tax and estate planning strategies for her clients. Autumn is regarded for her expertise in planning for cross-border estate and gift tax issues, including pre-immigration tax planning. She also manages complex trust and probate administration matters. Autumn is designated as a Certified Legal Specialist in Estate Planning, Trust & Probate Law by the Legal Specialization Board of the State Bar of California.



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Katie Callaway is a Director in Fennemore's Trusts and Estates practice group, specializing in estate planning, probate, and estate and trust administration. Katie's areas of expertise include preparing comprehensive estate plans, including drafting revocable trusts, Wills, durable powers of attorney, health care directives, and premarital agreements. Katie also works with clients on advanced wealth transfer strategies through the use of a variety of irrevocable trusts, including charitable trusts, grantor retained annuity trusts, qualified personal residence trusts, spousal lifetime access trusts, irrevocable life insurance trusts, and other sophisticated gift and estate tax planning techniques. Katie is a Vice Chair of Fennemore's Trusts and Estates practice group, and Katie has an LL.M. in Taxation from NYU.



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