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Advanced Estate Planning

"Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands."

-Judge Learned Hand, US Court of Appeals, 1934

Advanced estate planning involves techniques that are designed to maximize benefits to your heirs while keeping income and estate taxes to a minimum, while ensuring that your wishes regarding distribution are followed as closely possible. It makes use of several different instruments such as revocable and irrevocable trusts, life insurance, partnerships, and plans to handle estate tax payments.

These are described in more detail below with an indication of how and when they should be used. However, these advanced methods should be implemented with a competent business and estate planning attorney, who should be involved in the design of your entire estate plan in order to make best use of the legal tools that are available.

Irrevocable Trusts

Unlike a revocable trust, which is a basic and fundamental component of most estate plans, an irrevocable trust is one that cannot be changed after it is created. In effect it is like a revocable trust which, after you pass away, becomes irrevocable and cannot be altered by the heirs. When a trust is drafted deliberately as an irrevocable trust from its inception, it can be used to accomplish a number of goals that are not possible with a revocable trust.

Asset Protection: You can use an irrevocable trust to protect your assets from creditors. While assets of revocable trusts suffer the weakness of being available to creditors during your lifetime, irrevocable trusts do not. However, in California you cannot leave the trust to yourself (called a self-settled trust), so cannot escape creditors and still retain your assets, but your spouse, children and other beneficiaries can.

Minimize Estate Tax: A married couple can form a revocable trust with what are called A/B provisions and maximize the use of their exemption credits from the federal estate tax. In 2009 the exemption amount was \$3.5 million per spouse. However, the federal estate tax is repealed in

2010, and unless the Congress takes action on estate tax reform sometime this year, the exemption is scheduled to decrease to \$1 million again in 2011. It is possible the \$3.5 million exemption will be extended. Several bills regarding this are under consideration in the Congress, however, nothing is final yet.

With an A/B trust, at the death of the first spouse the estate is split, with up to the full \$3.5 million of the deceased spouse's estate tax exemption being placed into "Trust B", sometimes called the Decedents Trust or Credit Shelter Trust, and the remainder of the property into "Trust A", sometimes called the Survivor's Trust, for the surviving spouse. The trust can be designed so that the split into the "A" and "B" trusts is either mandatory, or optional (called a "Disclaimer Trust), at the discretion of the surviving spouse. If the estate is divided into the A and B trusts, the deceased spouse's exemption amount placed in the B Trust will not be subject to the federal estate tax, and any estate tax due on amounts in excess of the exemption amount that are placed into Trust A can be deferred until after the surviving spouse dies. This technique can effectively double the amount of assets that can pass to your heirs without estate taxation, and delays the payment of any estate taxes until both spouses have passed away.

During his or her lifetime, the surviving spouse can have full control of the assets in the A Trust, but there are restrictions as to what he or she can do with the property placed in the B Trust. The surviving spouse may receive any income or interest from the property in trust and can spend it on maintenance of lifestyle, living expenses, or for education or health care needs. If the primary residence is included, the surviving spouse can continue to live in the home for the remainder of his or her lifetime. The final beneficiaries of the B Trust, your children or other heirs, will not receive the assets of the two trusts until after the surviving spouse has passed away.

Charitable Estate Planning: If you make a gift of assets into a charitable trust while you are living, then you will qualify for an income tax deduction that year. If the gift isn't made until after your death then your estate will qualify for a charitable estate tax deduction. The gift can either be outright and immediately available to the charity, or you could use either a Charitable Remainder Trust (CRT) or a Charitable Lead Trust (CLT) to accomplish additional goals in your estate plan.

With the CRT, the trust pays an income stream to the donor(s) for either a fixed period, or lifetime, and is then distributed to named charities at the end of the income period or at death of the donor(s). The CLT is the reverse: the charity or charities are paid a fixed sum each year for a set number of years, after which the trust principal reverts to the beneficiaries you have named.

Before deciding on using these types of planning techniques, you should discuss them with an attorney experienced in charitable estate planning strategies.

Life Insurance and Estate Tax Payment Planning

Life insurance can also be used in advanced estate planning. Most people are aware that in most cases the death benefit of life insurance is free of income tax, but if you have any ownership or control over it, the proceeds are still subject to the federal estate tax. This can be avoided by placing the policy in an Irrevocable Life Insurance Trust (ILIT). With an ILIT, the policy is owned by the trust, not by you. This ownership arrangement is designed to keep the life insurance proceeds free of both income and estate tax. However, you and your spouse cannot be

a trustee of the ILIT or you would still be regarded as the owner of the policy, which would cause the proceeds to be subject to the estate tax upon your death.

By forming an ILIT and funding it with life insurance, the proceeds can be used by the trustee to assist your estate with payment of the estate tax due on your death. It can also be held in trust for your spouse, and then pass on to your children or other beneficiaries. Furthermore, if you have already estimated your potential estate tax liability, you could allow the trustees of the ILIT to purchase a life insurance policy for that amount with the trust as the beneficiary. This would help to cover the estate tax liability while simultaneously avoiding both income taxes and estate taxes on the insurance proceeds.

Family Limited Partnerships

A family limited partnership can be used to obtain estate tax reductions and protect your assets from creditors. You and your spouse can create a family limited partnership and transfer your assets to it. The partnership is comprised of General Partner (controlling) shares, and Limited Partner (non-controlling) shares. This is particularly useful for family run or closely-held businesses. You can then transfer, either through gift or sale, some of the Limited Partner interests in the partnership to your children. The gift/sale value of the Limited Partner interests is usually considered to be less than the fair market value of that percentage that was transferred to them. Because the transfer did not convey a voting or controlling interest in the property, and usually cannot be transferred to a third-party without the consent of the controlling owners, there are usually discounts applied to the gift/sale value of the transfer. These are referred to as “Lack of Control” and “Lack of Marketability” discounts.

The gift or sale value of the Limited Partner shares would therefore be discounted (say 30% to 40%), and thus the estate tax liability on that asset will also be reduced. With the federal estate tax currently at a top rate of 45% and possibly increasing, if the discounting on the assets gifted or sold to your heirs reduced your taxable estate by \$500,000 you would have saved your heirs \$225,000 of federal estate tax. In the right circumstances, this technique can be very useful in maintaining the control of a family-owned or closely-held business in the senior generation, while tax-efficiently transferring significant portions of it to the junior generation.

Tax Law Changes

Estate tax laws change frequently, and you have to keep up with these changes. There are a number of changes being considered by Congress right now, and others due in 2010 and 2011 if they do not act this year. The only viable way for you to keep up with all these changes is to consult with a competent estate and business planning attorney to look after your estate planning for you. Anything less and you could be exposing your heirs to unnecessary expense, shrinkage of your estate, and possible loss of business or income producing assets.

**“Nothing can be said to be certain in life, except death and taxes”
-Benjamin Franklin**