Wealth transfer planning

There is no easy way to say it—anticipating one’s death is an uncomfortable topic. Yet it is often worth pushing past the initial discomfort to pursue the potential rewards of effective wealth transfer planning. Once your estate plan is in place, periodic reassessment will help determine that it reflects recent life events, market and regulatory changes, and evolving legacy objectives. An effective plan may lessen the likelihood of family conflict, reduce estate costs, reduce taxes, and preserve wealth. Gathering an effective team of advisers will help facilitate the success of this ongoing process.
Wealth transfer planning

Take another look...

Wealth transfer planning determines how you will “slice up the pie” and encompasses the many activities necessary to confirm that your affairs are in order and the parties succeeding to your wealth do so as you intend. Keeping your wealth transfer plan current is essential to its success.

The wealth transfer planning process
Establishing who gets what, how they get it, and when they get it are, as a general rule, personal matters. But these decisions can have significant financial implications. While it is human nature to procrastinate on such issues, the entire family benefits if these matters are addressed.

Your wealth transfer plan anticipates the probability of future events in the face of imperfect knowledge. Consequently, it will always remain a work in progress, warranting periodic updates as anticipated events occur (or not), as market and regulatory developments occur (or not), and as new planning considerations arise (or not).

For your part, retaining competent advisers is important to help you navigate the wealth transfer tax system and understand how that system shapes the variety of effective planning considerations available to you. For example, statutory inflation adjustments impact the amount of assets that can be transferred free from tax each year and shifting regulations may alter, for example, how those assets are valued. Therefore, we invite you to look again at this framework and how it shapes your evolving wealth transfer plan.

You can’t take it with you—so where do you want your wealth to go?
There are three places your assets can go at your death: to your family and friends, to charity, or to the government in the form of taxes. For wealthy individuals subject to high estate taxes, effective wealth transfer planning helps you make confident decisions about the manner in which your wealth will be transferred after your death.

A note on tax reform:
As this edition of the wealth guide goes to press, separate tax reform bills are moving through the House and Senate that, on the individual side of the code, call for ambitious changes to the estate, gift, and generation-skipping transfer tax regimes.

For more information, see the Tax policy update section of this publication.
Wealth transfer planning

Reevaluating your wealth transfer planning goals

For wealthy individuals, the estate plan becomes the blueprint from which a legacy will be established and implemented.

What a wealth transfer plan entails

All estate plans should cover the basics, including having in place a current will, powers of attorney for property and health care (these documents will vary from state to state and may also include health care directives or living wills), and revocable trusts (where appropriate). In addition, planning should provide for guardians for minor children and confirm how assets are currently titled and that current beneficiary designations do not frustrate your intended wealth succession plans.

For wealthy individuals, the estate plan must do much more than direct assets as it becomes the blueprint from which a legacy will be established and implemented. Effective planning may reduce the likelihood of family conflict as well as the possible administrative and tax costs associated with your passing.

What facts and circumstances impact your wealth transfer blueprint?

Life events, as well as market and regulatory factors, can impact the wealth transfer planning process. Therefore, it is important for your wealth transfer plan to remain flexible and be revisited and adjusted periodically.

Estate planning checklist

- Current will
- Guardian and beneficiary designations
- Revocable trust
- Powers of attorney for property and health care
Wealth transfer planning

Transfer tax fundamentals

Increasing tax efficiency can provide for greater wealth transfer to heirs and/or charity, and is therefore an integral part of the wealth transfer planning process.

The transfer tax system includes three separate taxes: the gift tax, the estate tax, and the generation-skipping transfer (GST) tax.

**Gift tax basics**
Most uncompensated (or insufficiently compensated) transfers of property during life are subject to the federal gift tax. The gift tax is computed based on the fair market value of the property transferred. For 2017 and 2018, the top gift tax rate is 40 percent.

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**Not all transfers generate transfer tax**
The following asset transfers are excluded in determining whether a gift tax liability arises:

- Gifts utilizing the lifetime gift tax exclusion amount
- Gifts that qualify for the gift tax annual exclusion
- Certain payments of education and medical expenses
- Certain gifts to your spouse
- Gifts to qualified charitable organizations
- Transfers to certain qualifying organizations (including some political organizations) that have been granted a specific status by the Internal Revenue Service (IRS)
- Nongift transactions (i.e., transfers that do not diminish net worth)
Wealth transfer planning

Transfer tax fundamentals

The lifetime gift tax exclusion
The amount of property that each person can transfer tax free is referred to as the applicable exclusion amount. The applicable exclusion amount is used to calculate the credit available to offset the gift tax calculated for current-year transfers. The applicable exclusion amount, which has been indexed for inflation annually since 2012, is currently $5.49 million in 2017 and will increase to $5.6 million in 2018.

Gift tax annual exclusion
In addition to the lifetime gift tax exclusion amount, in 2017 each individual taxpayer is allowed an annual exclusion from gift tax for certain gifts valued up to $14,000 per recipient, which is also indexed for inflation, but only in increments of $1,000. The 2018 annual exclusion amount is $15,000. To qualify for the gift tax annual exclusion, gifts must be of a present interest. A present interest implies that the donee has a substantial present economic benefit arising from the gift property.

The power of annual gifting
Assume a couple has three married children and three grandchildren. In 2018, each spouse can transfer up to $15,000 per person free of gift tax. The couple could give $90,000 to their children, $90,000 to their children’s spouses, and $90,000 to their grandchildren—a total of up to $270,000—without using any of the couple’s combined $11.2 million lifetime gift tax exclusions ($5.6 million per person) and not incur any gift tax. Transferring assets today via annual exclusion giving can also save future estate taxes. Under this scenario, assuming an applicable estate tax rate of 40 percent, and assuming combined wealth in excess of the then applicable exclusion amount, $108,000 of future estate tax is saved.
Wealth transfer planning

Transfer tax fundamentals

Education and medical gift exceptions
Tuition payments made directly to educational institutions and certain payments made directly to health care providers are not taxable gifts and do not absorb a gift tax annual exclusion. For example, a grandmother who wishes to help pay for a granddaughter’s education can write tuition checks directly to the school and give her $14,000 in cash without making a taxable gift. However, if she reimburses her granddaughter for tuition the granddaughter paid, she will have made a taxable gift to the extent the amount gifted exceeds the $14,000 annual exclusion (in 2017). Tuition is not limited to college tuition; any qualified school’s tuition can be excluded. Medical expense does not just mean those for doctors and hospitals; any qualified medical expense, including health insurance premiums, can be paid under this exclusion.

Gifts to your spouse
Outright gifts to your spouse, assuming the spouse is a US citizen, qualify for an unlimited marital deduction and are not subject to gift tax. Gifts to noncitizen spouses are instead subject to an annual exclusion limitation ($149,000 and $152,000 for 2017 and 2018, respectively).

Gifts to qualified charitable and other tax-exempt organizations
Certain gifts to qualified charitable organizations qualify for the unlimited gift tax charitable deduction and are not subject to gift tax. This includes transfers to donor-advised funds. For gifts after December 19, 2015, the gift tax also does not apply to transfers to certain qualifying organizations (including some political organizations) that have been granted a specific status by the IRS.

Nongift transactions
Nongift transactions may include such transfers as a sale of property between family members for full and adequate consideration, or an intra-family loan arrangement that provides for adequate interest. Other more sophisticated techniques, including the use of the classic zeroed-out grantor retained annuity trust (GRAT), can also result in a zero-value gift. In many cases, although the transfer results in a zero-value gift, it is prudent to nonetheless adequately disclose the transaction on the transferor’s gift tax return in order to start the statute of limitations on that transfer.
Wealth transfer planning

Transfer tax fundamentals

Estate tax basics
The estate tax is imposed on the fair market value of all assets includible in your estate at the time of your death and the value of taxable gifts you made during your lifetime. The only permitted reductions to the taxable estate are debts and expenses of administration, the value of assets passing in a qualified manner to one’s spouse, the value of qualified assets passing to qualified charities, and the applicable exclusion amount at the date of death. The applicable exclusion amount for 2017 is $5.49 million, increasing to $5.6 million for 2018. Generally, if the total of one’s gross estate and prior gifts exceeds the applicable exclusion amount at the date of death, the excess is taxed at the then top marginal transfer tax rate, which is 40 percent in 2017 and 2018.

Qualified transfers to a spouse who is a US citizen are covered by the unlimited marital deduction, so such transfers may be made totally free from the estate tax. Thus, with proper planning, the estate tax for married individuals can be deferred until the death of the surviving spouse. Most transfers to qualified charities are covered by an unlimited charitable deduction.

However, leaving all of your assets to your surviving spouse and/or charitable organizations does not eliminate the need to develop an estate plan, nor is it necessarily tax efficient since, for example, there are assets that, if passed to a surviving spouse or a charity, do not qualify for the marital or charitable deductions.

Calculating the estate tax

If a single individual with no previous lifetime gifting, a gross estate of $20 million, and an estate plan leaving all assets to his or her children were to die in 2017, his or her estate would owe $7,945,800 in estate tax. Due to the increase in the applicable exclusion amount, if this same individual were to die in 2018, the estate tax would be reduced to $5,760,000.

<table>
<thead>
<tr>
<th>Gross estate</th>
<th>DOD in 2017</th>
<th>DOD in 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estate tax</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>Gross estate tax</td>
<td>$7,945,800</td>
<td>$7,945,800</td>
</tr>
<tr>
<td>Less unified credit</td>
<td>$(2,141,800)</td>
<td>$(2,185,800)</td>
</tr>
<tr>
<td>Net estate tax</td>
<td>$5,804,000</td>
<td>$5,760,000</td>
</tr>
</tbody>
</table>
Wealth transfer planning

Transfer tax fundamentals

Generally, the assets included in the estate of a decedent take an income tax basis equal to their fair market value at the date of death. Thus, except with respect to specific exceptions, any inherent income, gain, or loss at the date of death is extinguished.

Some assets are not allowed a basis step up upon a decedent’s death and therefore may be subject to double taxation (income and estate tax). For example, income in respect of decedent (IRD) are assets that are income that the decedent was entitled to but did not recognize prior to death (generally because of a method of accounting—the cash method or the installment method). IRD assets take carryover basis from the decedent (which is generally zero). Common IRD assets include uncollected wages, deferred compensation, and retirement accounts; rents, royalties, interest, or dividends accrued but unpaid at death; unrecognized gains from pre-mortem sales; and certain nonqualified stock options. Although the taxpayer succeeding to IRD assets is allowed an income tax deduction related to the amount of federal estate tax allocable to such assets, the deduction (unlike a credit) only reduces the burden of double taxation; it was never intended to eliminate it. Double taxation can be avoided by passing IRD assets to the surviving spouse or to a charity.

A note on portability

A surviving spouse can use his or her own basic exclusion amount ($5.49 million in 2017, $5.6 million in 2018) plus the unused exclusion amount of his or her most recent deceased spouse to offset the tax on the survivor’s subsequent gifts or to offset his or her taxable estate. The deceased spouse’s unused exclusion amount is available to the surviving spouse only if the executor of the deceased spouse’s estate makes a portability election by filing an estate tax return and computes the exclusion amount to which the surviving spouse is entitled. Note that the GST tax exemption (discussed later) is not portable.

As favorable as the potential simplicity promised by portability may be, it is unlikely to be as tax effective as conventional estate planning, particularly for high net worth families. Conventional estate planning involves spouses that each have wealth equal to at least their basic exclusion amount and affirmatively planning its use.
Wealth transfer planning

Transfer tax fundamentals

GST tax basics
The GST tax is imposed in addition to the gift and estate tax on direct or indirect transfers or bequests made to a “skip person”—a recipient who is at least two generations younger than the donor or decedent, such as a grandchild. An indirect transfer arises when a skip person is either distributed assets from or becomes indefeasibly vested in the assets of a trust.

If there were no GST tax, a transfer to a grandchild would be subject to the gift or estate tax once, while a gift to a child who then further gifts or bequeaths those assets to their child would be subject to transfer tax twice. The GST tax is intended to tax the transfer to the grandchild twice at the time it is made (through both the gift/estate tax and the GST tax), to compensate for the otherwise skipped level of tax. Furthermore, with respect to a taxable gift to a skip person, the cash used to pay the GST tax is also subject to the gift tax.

Generation assignment—related parties
(blue = skip person with respect to the transferor)
Wealth transfer planning

Transfer tax fundamentals

For GST tax purposes, when a gift or bequest is made within a family, the focus is on the relationship of the transferor and the transferee and not their age difference. The age difference is important only for nonrelatives.

Generation assignment—unrelated parties (blue = skip person)

The GST tax exemption amount protects that amount of assets until they pass into the hands of a skip person. Thus, an outright gift to a grandchild is protected, but those assets are still subject to gift, estate, or GST tax when transferred by the grandchild. A trust can be made exempt from GST until it distributes assets to a skip person, but the distributed assets are still subject to gift, estate, or GST tax when further transferred by the skip person. The GST tax exemption in 2017 is $5.49 million, increasing to $5.6 million in 2018, coinciding with the gift and estate tax applicable exclusion amount. The GST tax rate is equal to the maximum federal estate tax rate (40 percent in 2017 and 2018) for the year that the skip person receives or becomes permanently vested in assets.

There is also an annual exclusion amount available for transfers subject to the GST tax. The GST tax annual exclusion amount, like the gift tax annual exclusion amount, is $14,000 for transfers made in 2017 and $15,000 for transfers made in 2018. Unlike the gift tax annual exclusion however, the GST tax annual exclusion is very limited for gifts to trusts.
Wealth transfer planning

Transfer tax fundamentals

Many state transfer taxes are patterned after the federal transfer tax system. However, there are differences, and state taxes may be incurred even in situations in which there is no federal tax.

State transfer taxes
One benefit of wealth transfer planning by gift rather than by bequest may be the avoidance of state transfer taxes. Connecticut is the only state that currently has a gift tax. Thus, for many wealthy taxpayers, lifetime transfers may only result in a federal tax, but transfers at death may result in both a federal and state transfer tax.

Many state transfer taxes are patterned after the federal transfer tax system. However, there are differences, and state taxes may be incurred even in situations in which there is no federal tax. As of January 2017, 14 states and the District of Columbia impose an estate tax, while six states have an inheritance tax. Maryland and New Jersey have both. The estate tax has been repealed for 2018 and beyond in Delaware and New Jersey (though New Jersey’s inheritance tax remains). Remember that estate taxes are generally borne by the estate whereas inheritance taxes are borne by the beneficiary receiving assets from an estate.

Of note, only three states with an estate tax (Delaware, Hawaii, and Maine) have an exclusion that matches the inflation-adjusted federal exclusion amount. New York and Maryland are set to match the federal exclusion amount starting in 2019. In the states that have an exclusion amount smaller than the federal amount, unless planned for, an estate/inheritance tax may arise upon the death of the first spouse where the testamentary plan is built upon the federal exclusion amount.

The variety in state tax rules requires transfer tax planning focused not by the federal rules but by the rules of one’s state of legal domicile. In states that have estate and/or inheritance tax exclusions smaller than the federal exclusion, transfer tax planning with respect to the first death is paramount. In states without transfer taxes but with high income taxes, tax planning is balanced between federal estate tax planning and income tax basis planning for inherited assets.

Calculating the state estate tax
If a single individual with no previous lifetime gifting, a gross estate of $20 million, and an estate plan leaving all assets to his or her children were to die in 2017, and this individual also resided in Vermont, his or her estate would owe $2,760,000 in state estate taxes. For federal estate tax purposes, a deduction would be allowed for state death taxes, resulting in an estate tax of $4,700,000.

<table>
<thead>
<tr>
<th>Gross estate</th>
<th>Federal estate taxes</th>
<th>State estate taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000,000</td>
<td>$20,000,000</td>
<td>N/A</td>
</tr>
<tr>
<td>State death tax deduction</td>
<td>$(2,760,000)</td>
<td>N/A</td>
</tr>
<tr>
<td>Taxable estate</td>
<td>17,240,000</td>
<td>$20,000,000</td>
</tr>
<tr>
<td>Estate tax rate</td>
<td>4%</td>
<td>16%</td>
</tr>
<tr>
<td>Gross estate tax</td>
<td>$6,841,800</td>
<td>$3,200,000</td>
</tr>
<tr>
<td>Less unified credit</td>
<td>$(2,141,800)</td>
<td>$(440,000)</td>
</tr>
<tr>
<td>Net estate tax</td>
<td>$4,700,000</td>
<td>$2,760,000</td>
</tr>
</tbody>
</table>
Wealth transfer planning

Transfer tax fundamentals

State estate and inheritance tax rate and exemptions in 2017

<table>
<thead>
<tr>
<th>State</th>
<th>Estate tax</th>
<th>Inheritance tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>$2M; 7.2%-12%</td>
<td></td>
</tr>
<tr>
<td>Delaware*</td>
<td>$5.49M; 0.8%-16%</td>
<td></td>
</tr>
<tr>
<td>Hawaii</td>
<td>$5.49M; 10%-15.7%</td>
<td></td>
</tr>
<tr>
<td>Iowa</td>
<td>$4M; 0.8%-16%</td>
<td>0%-15%</td>
</tr>
<tr>
<td>Illinois</td>
<td>$4M; 0.8%-16%</td>
<td>0%-16%</td>
</tr>
<tr>
<td>Kentucky</td>
<td>$3M; 16%</td>
<td>0%-10%</td>
</tr>
<tr>
<td>Maine</td>
<td>$5.49M; 8%-12%</td>
<td></td>
</tr>
<tr>
<td>Maryland</td>
<td>$3M; 16%</td>
<td></td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$1M; 0.8%-16%</td>
<td></td>
</tr>
<tr>
<td>Minnesota</td>
<td>$2.1M; 10%-16%</td>
<td></td>
</tr>
<tr>
<td>Nebraska</td>
<td>$2M; 0.8%-16%</td>
<td>1%-18%</td>
</tr>
<tr>
<td>New Jersey*</td>
<td>$2M; 0.8%-16%</td>
<td>0%-16%</td>
</tr>
<tr>
<td>New York</td>
<td>$5.25M; 3.06%-16%</td>
<td></td>
</tr>
<tr>
<td>Oregon</td>
<td>$1M; 10%-16%</td>
<td></td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>$2.75M; 16%</td>
<td></td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$1.515M; 0.8%-16%</td>
<td></td>
</tr>
<tr>
<td>Vermont</td>
<td>$2.129M; 10%-20%</td>
<td></td>
</tr>
<tr>
<td>Washington</td>
<td>$2.129M; 10%-20%</td>
<td></td>
</tr>
<tr>
<td>District of</td>
<td>$2M; 8%-16%</td>
<td></td>
</tr>
<tr>
<td>Columbia</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* The estate tax has been repealed for 2018 and beyond in Delaware and New Jersey (though New Jersey’s inheritance tax remains).

Note: Exemption amounts are shown for state estate taxes only. Inheritance taxes are levied on the posthumous transfer of assets based on the relationship to the descendant; different rates and exemptions apply depending on the relationship.
Wealth transfer planning

Effective wealth transfer planning 101

Armed with a basic understanding of the wealth transfer tax system, let’s consider some fundamental components of effective wealth transfer planning.

The tax efficiency of transferring assets during life

Family wealth is preserved when it is taxed at the lowest possible combined federal and state effective tax rate. The gift tax is assessed only on the value of the property transferred, whereas the estate tax is assessed on the aggregate value of all of the decedent’s wealth, including the funds with which the estate tax will be paid. Thus, the effective tax rate for gifts is always lower than for bequests.

The “tax exclusive” nature of the gift tax makes taxable gifts a generally more efficient method of transferring wealth. Federal and state governments, aware of this advantage, generally require the gift taxes paid with respect to any gifts made within three years of death be added back to the gross estate. Doing so recaptures the “tax exclusion” benefit and thereby discourages so-called “deathbed transfers.”

Consider this simple example:

You die with $100 in a state that does not levy an estate or inheritance tax and are subject to a 40 percent federal estate tax rate. In this case, $40 will go to the government to cover your estate tax liability, and $60 will go to your heirs.

Estate tax

\[
\begin{array}{c}
\text{Government} & \$40 \\
\text{Donee} & \$60
\end{array}
\]

Gift tax

Assuming the same $100 is available for distribution and the gift tax rate is 40 percent, you can transfer $71.43 of the $100 to the donee, and only $28.57 (40 percent of the $71.43 transferred) would be remitted to the government to satisfy your gift tax liability.

\[
\begin{array}{c}
\text{Government} & 40\% \text{ of } 71.43 \approx \$28.57 \\
\text{Donee} & 71.43
\end{array}
\]

This increased transfer opportunity—$71.43 versus $60 in our example—demonstrates how much more efficient it is to transfer assets during one’s lifetime rather than at death.

This conclusion remains true even taking into account the time value of money, but assumes, as mentioned above, that the donor survives the third anniversary of the gift.
Wealth transfer planning

Effective wealth transfer planning 101

The effective use of trusts

Trusts have been used by wealthy families for centuries to protect, oversee, and manage wealth, passing it from one generation to the next. Trusts regulate access to assets by beneficiaries (typically younger family members or those without the legal or mental capacity to own assets outright).

Almost any dispositive planning can be accomplished with a trust. This, however, requires a skilled draftsman because once the trust becomes irrevocable, changes, while possible, are problematic. Moreover, trusts operate under state law, which often limits both the trust’s duration and a trustee’s conduct. Thus, choosing the governing state law is an important consideration.

A trust can be regarded for income and/or transfer tax purposes depending upon, among other things, the participation of the settlor (the person who created the trust). A trust can be disregarded for estate tax purposes if the settlor retains either an economic interest in or broad powers over the disposition of trust assets. For example, a revocable trust, while legally binding, is disregarded for both income and transfer tax purposes until the settlor dies. In contrast, an irrevocable grantor trust is regarded for estate tax purposes, but, due to the settlor’s retained powers, is designed to be disregarded for income tax purposes. Accordingly, care must be exercised that the trust agreement supports the intended result—having a trust disregarded that was intended to be regarded is likely to have dilatory wealth transfer tax consequences.

An irrevocable grantor trust can be excludible from the grantor’s estate. However, the grantor recognizes and pays income tax annually on the trust’s taxable income. As such, the grantor is consuming his or her remaining estate assets to pay tax on income that is not his or hers. Over time, the cumulative effect can be meaningful.

The importance of valuation

For many wealthy taxpayers, the $5.6 million exclusion amount ($11.2 million per couple) is more than enough to cover their lifetime wealth transfer goals—thus reducing the need for more complicated wealth transfer transactions.

Others may decide to gift minority interests in closely held businesses, private equity funds, or other investment entities, such as family investment partnerships or limited liability companies or fractional interests in real estate. Traditionally, a minority interest in a closely held family enterprise is valued at less than its proportionate share of going concern value (for a business enterprise) or net asset value (for an investment entity) due to valuation discounts applied for lack of control and/or marketability. Such discounts allow for more tax-efficient wealth transfers as minority interests in these family-owned enterprises may be passed at a relatively lower transfer tax value.

Section 2704 proposed regulations withdrawn

Proposed regulations under section 2704 published in August, 2016 had the potential to significantly reduce minority and marketability discounts relative to their current formulation when determining gift and/or estate tax values of interests in family-controlled entities. On October 20, 2017, the IRS withdrew the proposed regulations due to concerns the current administration has developed over the administrative burdens they might impose. Because the proposed regulations were never enacted, their withdrawal will leave the current state of valuation methodology and empirical interpretation unchanged.
Wealth transfer planning

Effective wealth transfer planning 101

The family uses of leverage

Parents can lend money to their children, trusts for their children (especially grantor trusts), or entities owned by their children and charge interest at the IRS-prescribed applicable federal rate (AFR)—the minimum rate required to be charged between related parties. In today’s interest rate environment, the AFR is significantly lower than the rate at which most individuals would be able to borrow from a bank.

The borrowed funds would be invested in assets (perhaps assets acquired from the grantor) anticipated to earn a rate of return greater than the interest rate being charged by the lender. If the asset’s performance meets expectations, the child, trust, or business will accumulate wealth in which the lender’s only participation is the interest rate. Of course, there may be gift tax consequences to the lender if the borrower defaults on the loan, or if it is apparent from the totality of the transaction that repayment of the loan was never anticipated.

The advantage of lending and selling assets to a grantor trust is that, for income tax purposes, because the grantor is deemed to own the trust and its assets, transactions between a grantor and his or her grantor trust are disregarded. Thus, they generate no income tax attributes (such as interest income or expense, gain on sale, etc.).

Consider this example:
Assume you identify an investment in which you wish to invest $1 million. However, instead of personally investing, you lend $1 million to a grantor trust for your child’s benefit. The trust makes the investment, which achieves a 7 percent annual rate of return. The promissory note provides for interest-only payments over the note’s nine-year term and a balloon payment of principal at the end of the term. The interest rate is set at the mid-term AFR, which we will assume is 2 percent.

In this scenario, after the note is paid off at the end of the term with the sales proceeds of the investment, the trust retains $598,899 that would otherwise have been in your estate had you made the investment. The opportunity savings is $239,560 in estate tax savings on the retained earnings (at a 40 percent tax rate). (Note, there is an additional element of estate tax savings associated with the income tax paid by the grantor on the sale of the investment that is not contemplated here.)

### Facts
- Loan amount: $1,000,000
- Interest rate on promissory note: 2.00%
- Assumed rate of return: 7.00%

### Result

<table>
<thead>
<tr>
<th>Year</th>
<th>Beginning balance</th>
<th>Return</th>
<th>Note payment</th>
<th>Ending balance</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,000,000</td>
<td>$70,000</td>
<td>$20,000</td>
<td>$1,050,000</td>
</tr>
<tr>
<td>2</td>
<td>$1,050,000</td>
<td>$73,500</td>
<td>$20,000</td>
<td>$1,103,500</td>
</tr>
<tr>
<td>3</td>
<td>$1,103,500</td>
<td>$77,245</td>
<td>$20,000</td>
<td>$1,160,745</td>
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<tr>
<td>4</td>
<td>$1,160,745</td>
<td>$81,252</td>
<td>$20,000</td>
<td>$1,221,997</td>
</tr>
<tr>
<td>5</td>
<td>$1,221,997</td>
<td>$85,540</td>
<td>$20,000</td>
<td>$1,287,537</td>
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<tr>
<td>6</td>
<td>$1,287,537</td>
<td>$90,128</td>
<td>$20,000</td>
<td>$1,357,665</td>
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<td>7</td>
<td>$1,357,665</td>
<td>$95,037</td>
<td>$20,000</td>
<td>$1,432,701</td>
</tr>
<tr>
<td>8</td>
<td>$1,432,701</td>
<td>$100,289</td>
<td>$20,000</td>
<td>$1,512,990</td>
</tr>
<tr>
<td>9</td>
<td>$1,512,990</td>
<td>$105,909</td>
<td>$1,020,000</td>
<td>$598,899</td>
</tr>
</tbody>
</table>

Value removed from taxable estate: $598,899

Estate tax savings (assuming 40% rate): $239,560

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Take another look
Reevaluating your wealth transfer planning goals
Transfer tax fundamentals
Effective wealth transfer planning 101
The wealth transfer planning process
Take another look
Effective wealth transfer planning 101

Transferring value can be independent from transferring control

Many wealthy individuals are reluctant to make lifetime transfers of wealth because they feel that they will lose their ability to manage or control the transferred assets. This fear of relinquishing control can often delay or completely derail the implementation of effective wealth planning.

One’s gross estate also includes assets to which the decedent once held title, but transferred for less than equal value in exchange, in a manner such that he or she continued to enjoy the assets, their income, or had the power to determine who would enjoy the assets or their income. The classic example is one in which assets are transferred to a revocable trust. The assets of such a trust are included in the gross estate at their date of death value because the retained power of revocation permits ultimate control of the beneficial enjoyment of the trust’s assets.

This treatment, however, has been extended to trusts for the benefit of others and to partnerships and corporations to which the decedent contributed assets in exchange for an equity interest. If the decedent is found to have retained too much control, the value of the transferred assets at the date of death will be included in the gross estate, not the value of the equity interest actually owned. Consequently, transfer tax planning will be effective only where the decedent relinquished both the economic benefits of the transferred property and the control of those benefits. Given these considerations, it is highly recommended that a strong governance structure be established to monitor the transferor’s relationship to previously transferred property in order to mitigate the estate inclusion risk.

A related but separate concern is that lifetime transfers will result in unproductive heirs. Many wealthy individuals believe that their children are unaware of the family’s wealth and that lifetime transfers of wealth will act as a disincentive, permitting the children to be less productive members of society. Effective planning can address these issues, but it requires striking a fine balance in order to satisfy the senior generation’s concerns about the ability to achieve the desired financial and nonfinancial goals. For example, where a family business is included in a family’s holdings and the senior generation seeks to maintain decision-making authority, value may be transferred to junior generation family members through the use of nonvoting (or low-voting) interests. Further, assets transferred to the junior generation are often placed in trust, and the dispositive terms of those trusts can be thoughtfully crafted to address a particular family’s goals and objectives.
Wealth transfer planning

The wealth transfer planning process

1 Identify what is important to you
   How you choose to approach your wealth transfer plan, taking
   incremental but meaningful steps employed through flexible structures
   will allow your plan to evolve over time.

   Upon your passing, your assets
   must be distributed to your family
   and friends, philanthropy, or to the
   government in the form of taxes.
   If you plan, over time there will likely
   be more assets transferred to
   family, friends, and/or the charities
   of your choice.

   The first step is to determine to what
   extent that is important to you and
   what limits, if any, might be important
   to impose. For example, is there a
   limit to the wealth you wish to leave
   for family?

2 Second, does your plan accommodate
   your heirs’ special considerations?
   For example, are there special needs
   family members for whom long-term
   care may be an issue? There are
   trusts specially designed to address
   these concerns. How much is
   needed to endow these trusts can
   be objectively evaluated.

3 Third, does the nature of your wealth
   require special considerations?
   Whether to retain a successful
   business enterprise or see to its
   orderly disposition should not be
   ignored. If the business is particularly
   sensitive to your unique contributions,
   its monetization during your lifetime
   must be considered.

4 Fourth, are you passionate about a
   specific charity? Many individuals build
   connections to charities through their
   own active involvement or a common
   passion for a particular cause, and
   have a strong desire to leave a portion
   of their wealth to such organizations.

   Your testamentary documents
   become particularly important if you
   have a closely held business and
   anticipate that the residue of your
   estate will pass to charity.

Most people can paint the landscape
above in broad strokes, but struggle
with the details. That’s not a problem.
Clear articulation of detailed goals is
not required to get started; instead,
start by taking incremental but
meaningful steps employed through
flexible structures to address the
goals you can identify now.
Define your approach to planning

The best estate plans are a collaborative effort. Meaningful advice from knowledgeable, experienced advisers reasonably reflected in the documents implementing the plan is the desired outcome.

Enhanced flexibility inherently increases complexity and may increase risk. More complex transfer planning options can often provide the flexibility to respond to post-initiation changes in circumstances to better serve the family’s interests and the ability to transfer more wealth more tax efficiently. However, added flexibility in the hands of the transferor risks asset inclusion, as previously discussed. Thus, prior to implementing such options, two considerations should be addressed. First, do you have an infrastructure in place that will help you navigate the complexity (for example, a family office)? Second, does the plan fit your level of risk tolerance? Certain options may attract greater scrutiny by federal or state tax authorities, particularly with respect to your post-initiation involvement.

Your team of advisers is there to help you assess these considerations and select the right tool(s) for the identified task. For those with significant wealth, an advisory team usually includes legal representatives, officers of the family office, financial advisers (including appraisers and life insurance agents), and tax advisers.

Assembling your planning team

Your planning team may assist in many areas, including:

- Addressing family goals and objectives
- Drafting and interpreting planning documents
- Asset governance structures
- Valuation of certain assets
- Retitling of certain assets
- Determining projected tax liabilities
- Analyzing liquidity posture during life and at death
- Filing necessary tax returns and disclosures
Define your approach to planning (cont.)

The more wealth involved, the more complex the relationships and the more advisers will typically be involved. The more input, the more ideas that may result—but in the wrong situation it may also produce more pressure. At a minimum, planning must involve the wealth owner (and his or her spouse or partner, if they are of like mind), as well as capable counsel and tax and investment advisers. Where a couple is involved, it is not uncommon for attorneys to interview both individuals separately to validate that they are both able to express their views and interests openly. Beyond that, you will need to consider family dynamics and relationships. At the appropriate time, you will need to involve the next generation and others in a position of trust—such as designated fiduciaries (executors, personal representatives, trustees, agents, etc.)—to communicate and confirm their understanding of your wishes and expectations.

As with many aspects of estate planning, there is no one-size-fits-all formula for choosing the right fiduciary; much depends on the size and complexity of your estate. Many wealthy families opt for a combined corporate/individual co-trusteeship—including an individual who understands the family dynamics and interests (such as the need to treat a certain child’s bequest differently from others) and a corporation that professionally approaches trust administration. Having one capable individual who may fulfill both roles offers some advantages, but keep in mind that when one family member is in a position of making decisions on behalf of other family members, there may be conflicts. In these cases, trust documents may be drafted to help reduce personal fiduciary liability for contests regarding a trustee’s actions and restraints may be imposed on beneficiaries to reduce the probability of such contests.
Wealth transfer planning

The wealth transfer planning process

1. Identify what is important to you
2. Define your approach to planning
3. Decide how you will distribute your wealth
   • Determine to whom, when, and under what circumstances
   • Evaluate wealth transfer plans
   • Implement and monitor the chosen plans
4. Keep your plan current

Decide how you will distribute your wealth

In the end, however, it's still about who gets what, when they get it, and how they get it.

In some instances, you may want your heirs or charity to have immediate access, control, and enjoyment of the assets you transfer to them, whether by gift or bequest. In other instances, you may consider placing constraints on your heirs' ability to access wealth. Many individuals transfer assets to trusts so that a third party (either an individual, corporate trustee, or private trust company) can oversee the access to wealth by the trust beneficiaries. Establishing trusts to hold, manage, and invest assets—rather than giving individuals complete control over assets—is commonly the key to maintaining family wealth over multiple generations.

Remember that when you transfer assets to a trust or an individual during your lifetime, you no longer have control over or access to those assets if you intend for them to be removed from your taxable estate. Consequently, it is paramount that you assess with your advisers the wealth required to maintain the lifestyle you desire before transferring large amounts of wealth beyond your control.
Wealth transfer planning

The wealth transfer planning process

The wealth transfer planning process:

1. Identify what is important to you
2. Define your approach to planning
3. Decide how you will distribute your wealth
4. Keep your plan current
   - Perform regular performance reviews
   - Adjust planning in light of life events and market conditions

Keep your plan current

Routine reviews of your wealth transfer plan allow you to verify that the strategies remain relevant to your goals and objectives.

Once you have a plan in place, it is a leading practice to review your plan with your advisers on a regular basis. There will be market and regulatory factors and life events that will occur, some with little or no warning. Such events may require that you reevaluate your plan, determine whether and to what extent your goals have changed, and suggest actions required to address the change in goals—much like where we started at step 1.

Exercising a little discipline by revisiting your plan periodically to address life, market, and regulatory changes means you will know whether you are meeting the goals you have and reduces the risk of having a plan in place contrary to your current goals (for example, inadvertently maintaining a wealth plan that continues to benefit a former spouse). While life events such as marriages, divorces, deaths, or births should prompt an analysis of plans, so too should certain market factors. For example, substantial increases or declines in asset values, sharp changes in the interest rate environment, and major tax law changes can be significant enough to warrant reviewing your wealth plan.

Many individuals have taken the step to quantify “who gets how much” based on the existing estate plan should the individual unexpectedly pass, including assessing the impact of federal and state taxes. Such an analysis tests the expected outcome of the plan against the mathematical computation dictated by the written word in the estate plan. From such reviews, additional considerations may arise and ambiguities in the wealth transfer plan may be identified, both of which may require further clarification. Thereafter, regular analysis provides the opportunity to monitor your plans against expected outcomes, reassess the continuing relevance of your goals and objectives, and mark your progress in prefunding wealth transfer strategies in light of a changing regulatory environment and a volatile economy.
Wealth transfer planning

Take another look

Regardless of the planning you undertake, a periodic reassessment is wise. Perhaps the complexity of your assets has grown. Perhaps a new executor or trustee designation is appropriate. Maybe the children are not really “children” anymore and their needs and abilities have evolved. Or perhaps you have decided to undertake a new philanthropic initiative. Whatever the reason, chances are it’s time to take another look at your wealth transfer plan.
## Resources

| Private wealth | Deloitte Private Wealth  
<table>
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| Tax reform     | Tax Reform insights  
|                | Tax News & Views: Capitol Hill briefing |
| Individual income tax planning | Private wealth tax controversies: Deep experience navigating interactions with taxing authorities |
| Wealth transfer planning | Wealth planning: Securing your legacy  
|                            | US estate and gift taxation of resident aliens and nonresident aliens |
| Philanthropy     | Private foundations: Establishing a vehicle for your charitable vision |
| Identity theft  | IRS Identity Protection Specialized Unit: +1 800 908 4490 |
|                 | IRS.gov, Identity Protection: Prevention, Detection and Victim Assistance |
|                 | IRS.gov, Taxpayer Guide to Identity Theft |
|                 | IRS.gov, Identity Theft Guide for Business, Partnerships and Estate and Trusts |
|                 | Helpful resources: Publications, articles, YouTube videos and other identity theft related outreach |
|                 | IRS.gov, Tax Scams / Consumer Alerts |
|                 | IRS.gov, IRS Publication 5027, Identity Theft Information for Taxpayers |
|                 | Federal Trade Commission: Consumer Information, Identity Theft |