DEAN MEAD

# Top 10 (or so) Mistakes We See in Estate Planning – And Tips to Avoid Them!

Prepared by:
Lauren Y. Detzel
David J. Akins
Matthew J. Ahearn
Brian M. Malec
Kyle C. Griffin

DEAN MEAD

# #1. Failure to Follow Through

# Failure to Follow Through

| Mistake | Consequences |
| --- | --- |
| 1. Not funding a revocable trust | 1. Domiciliary or ancillary probate necessary |
| 2. Failing to complete or update beneficiary designations | 2. Unintended beneficiaries receive assets; loss of creditor protection |
| 3. Not making payments on intrafamily notes | 3. Original loan could be reclassified as a gift; installment sale to grantor trust transaction pulled back into seller's gross estate; phantom income to lender |

DEAN MEAD

DEAN MEAD

# Failure to Follow Through (cont.)

| Mistake | Consequences |
| --- | --- |
| 4. Failing to respect entity formalities (e.g. commingling; improper titling of assets; poor record keeping, etc.) | 4. Creditor of LLC can "pierce the veil"; creditor of individual member can "reverse pierce" and reach LLC assets |
| 5. Disregarding obligations as Trustee | 5. Breach of fiduciary duty; personal liability for trustee |
| 6. Not updating asset ownership after Will or Revocable Trust executed | 6. Unintended beneficiaries receive assets; loss of creditor protection; GST exemption of first spouse to die is not used |
| 7. Not filing a gift tax return to report gifts | 7. IRS can assess gift tax, interest and penalties at any time; exemptions available for future planning are unclear |
| 8. Failing to confirm TBE ownership as opposed to JTWROS ownership | 8. JTWROS accounts are not protected from creditors. |

# 9. Failing to confirm TBE ownership as opposed to JTWROS ownership

DEAN MEAD

- F.S. 655.79
  - *unless otherwise provided in a contract, agreement or signature card* . . . a CD or deposit account in the name of two persons who are husband and wife shall be considered a tenancy by the entirety unless otherwise specified in writing.
- *Wexler v. Rich*, 80 So. 3d 1097 (Fla. 4th DCA 2012)
  - Court held account owners expressly disclaimed TBE status when the financial institution agreement had TBE and JTWROS options available and bank employee selected JTWROS without explaining options.
  - Account owners are deemed to know what they sign.
  - READ THE FINE PRINT

DEAN MEAD

# #2. Failing to Plan for the Elective Share

DEAN MEAD

# Elective Share and Homestead

Assume Husband dies first and is survived by his second wife and two children from his first marriage. There was no prenuptial agreement and Husband has a Will that leaves everything to his two children. Also assume Wife makes an elective share election and under Fla. Stat. 732.401(2) elects to take one half of the residence in lieu of a right to live in the house for life. At his death, Husband's assets are:

| | |
|---|---|
| Brokerage Account | $2,000,000 |
| Primary Residence | $1,500,000 |
| Total | $3,500,000 |

*What does the Wife get?*

**1.) If the house (protected homestead) was owned solely by the Husband:**

| | |
|---|---|
| Elective Estate: | |
| Brokerage Account | $2,000,000 |
| | x 30% |
| Elective Share | $ 600,000 |

***Wife receives:***

| | |
|---|---|
| Elective Share | $ 600,000 |
| ½ of the House | $ 750,000 |
| Total | $1,350,000 |

***Children receive:***

| | | |
|---|---|---|
| Brokerage Account | $1,400,000 | ($2,000,000 - $600,000) |
| ½ of the House | $ 750,000 | |
| Total | $2,150,000 | |

DEAN MEAD

# Continued…

**2.) If the House was owned as tenants by the entireties with the wife:**

| | |
|---|---|
| Elective Estate: | |
| Brokerage Account | $2,000,000 |
| ½ of the House | $ 750,000 |
| Total | $2,750,000 |
| | x 30% |
| Elective Share: | $ 825,000 |

But because Wife is treated as receiving one-half of the house which is counted towards satisfying the elective share, the Wife's elective share amount is only $75,000.

| | |
|---|---|
| Elective Share Amount | $ 825,000 |
| ½ of the House | $ (750,000) |
| Remaining Elective Share to be satisfied | $ 75,000 |

***Wife receives:***

| | |
|---|---|
| House (TBE) | $1,500,000 |
| Elective Share | $ 75,000 |
| Total | $1,575,000 |

***Children receive:***

| | |
|---|---|
| Brokerage Account | $1,925,000 ($2,000,000 - $75,000) |

# Elective Share and Life Insurance

In the prior example Husband was aware of elective share rules and wanted to preserve his assets for his children to the maximum extent possible. So he bought a term life insurance policy on his life with a death benefit of $600,000 and named Wife as beneficiary. Now what happens?

732.2045(1)(d) - Proceeds of life insurance policy on the life of decedent in excess of Cash Surrender Value are excluded from the elective estate regardless of how paid (whether to estate or otherwise).

732.2075(1)(d) - Proceeds of life insurance on life of decedent paid to spouse are counted towards satisfying the elective share if the policy is owned by someone other than the spouse.

| Assets: | |
|---|---|
| Brokerage Account | $2,000,000 |
| House | $1,500,000 |
| Life Insurance | $ 600,000 |
| Total | $4,100,000 |

***What does the Wife get?***

# Continued…

**1.) If the house was owned solely by Husband:**

| | |
|---|---|
| Elective Estate: | |
| Brokerage Account | $2,000,000 |
| | x 30% |
| Elective Share | $ 600,000 |

Because Wife received $600,000 of life insurance, the elective share is totally satisfied.

***Wife receives:***

| | |
|---|---|
| ½ of the House | $ 750,000 |
| Life Insurance | $ 600,000 |
| Elective Share | $ 0 |
| Total | $1,350,000 |

***Children receive:***

| | |
|---|---|
| Brokerage Account | $2,000,000 |
| ½ of the House | $ 750,000 |
| | $2,750,000 |

DEAN MEAD

DEAN MEAD

## 2.) If the House was owned as tenants by the entirety with Wife:

| Elective Estate: | |
|---|---|
| Brokerage Account | $2,000,000 |
| ½ of the House | $ 750,000 |
| Total | $2,750,000 |
| | x 30% |
| Elective Share: | $ 825,000 |

Wife is treated as receiving one-half of the house and the life insurance towards satisfying the elective share.

| | |
|---|---|
| Elective Share Amount | $ 825,000 |
| ½ of the House | $ (750,000) |
| Life Insurance | $ (600,000) |
| Elective Share Remaining to be Satisfied | $ 0 |

***Wife receives:***

| | |
|---|---|
| House (TBE) | $1,500,000 |
| Life Insurance | $ 600,000 |
| Elective Share | $ 0 |
| Total | $2,100,000 |

***Children receive:***

| | |
|---|---|
| Brokerage Account | $2,000,000 |

What if Husband had made his estate the beneficiary of the life insurance instead of Wife:

**1.) If the house was owned solely by the Husband**

| | |
|---|---|
| Elective Estate: | |
| Brokerage Account | $2,000,000 |
| | x 30% |
| Elective Share | $ 600,000 |

***Wife receives:***

| | |
|---|---|
| Elective Share | $ 600,000 |
| ½ of the House | $ 750,000 |
| Total | $1,350,000 |

***Children receive:***

| | |
|---|---|
| Brokerage Account | $2,000,000 |
| Life Insurance | $ 600,000 |
| Less amount to satisfy elective share | $ (600,000) |
| | $2,000,000 |
| ½ of the House | $ 750,000 |
| Total | $2,750,000 |

## 2.) If House was owned as tenants by the entireties:

| | |
|---|---|
| Elective Estate: | |
| Brokerage Account | $2,000,000 |
| ½ of the House | $ 750,000 |
| Total | $2,750,000 |
| | x 30% |
| Elective Share: | $ 825,000 |

Wife is treated as receiving one-half of the house towards satisfying elective share

| | |
|---|---|
| Elective Share Amount | $ 825,000 |
| ½ of the House | $ (750,000) |
| Elective Share Remaining to be Satisfied | $ 75,000 |

***Wife receives:***

| | |
|---|---|
| House (TBE) | $1,500,000 |
| Elective Share | $ 75,000 |
| Total | $1,575,000 |

***Children receive:***

| | |
|---|---|
| Brokerage Account | $2,000,000 |
| Life Insurance | $ 600,000 |
| Less amount to satisfy elective share | $ (75,000) |
| Total | $2,525,000 |

DEAN MEAD

DEAN MEAD

# #3. Failing to Satisfy Adequate Disclosure Requirements When Filing an Estate or Gift Tax Return

DEAN
MEAD

# Failing to Satisfy Adequate Disclosure Requirements When Filing an Estate or Gift Tax Return

- IRS generally has 3 years after a return is filed to assess tax. § 6501.
- Statute of limitations period is increased to 6 years if the taxpayer omits from the gross estate or total gifts items exceedng 25% of the value of the gross estate or total gifts.
- There is no statute of limitations for gifts that are not adequately disclosed on the return.

# Treas. Reg. § 6501(c)-1(f)(2) Requirements for Adequate Disclosure of Gifts

DEAN MEAD

- A description of the transferred property and any consideration received by the transferor;
- The identity of, and relationship between, the transferor and each transferee;
- If the transfer was made in trust, then the trust's taxpayer identification number and either a copy of the trust or a brief description of the trust terms;
- Either:
  - A qualified appraisal from an independent appraiser; or
  - A detailed description of the method used to determine the fair market value of the property transferred, including any financial data or restrictions utilized in determining the value and a description of any discounts claimed; and
- A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer.

DEAN MEAD

# Treas. Reg. § 6501(c)-1(f)(4) Requirements for Adequate Disclosure of Non-Gift Transfers

- E.g. Installment sales to grantor trusts
- Any other non-gift completed transfer will be considered adequately disclosed only if the following information is provided on, or attached to, the return:
  - A description of the transferred property and any consideration received by the transferor;
  - The identity of, and relationship between, the transferor and each transferee;
  - If the transfer was made in trust, then the trust's taxpayer identification number and either a copy of the trust or a brief description of the trust terms;
  - A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer; and
  - An explanation as to why the transfer is not a gift for gift tax purposes.

DEAN MEAD

# Office of Chief Counsel Memorandum 20152201F (March 13, 2015)

- Taxpayer filed a gift tax return reporting a gift to daughter of a LP interest and LLP interest.
- EIN for one entity was missing 1 digit and abbreviations were used for the entity names. Appraisals were submitted for the underlying real estate owned by the entities, but appraisals were not prepared for the entity interests actually gifted.
- Minority and lack of marketability discounts were claimed without further description.
- IRS took the position that gifts were not adequately disclosed because (1) EIN of one entity was incorrect, (2) entities were identified by abbreviations, not by name (3) valuation description was insufficient because it did not include financial data other than the real estate appraisals, the value of 100 percent of each entity was not reported, and the restrictions that were considered in determining the FMV were not identified
- Therefore, IRS claims that there is no statute of limitations to challenge the gift.

DEAN MEAD

# #4. Failing to Follow Trust Administration Requirements

DEAN MEAD

# Avoiding Liability by Following the Appropriate Standard of Care

- Trustee has duty to invest as a prudent investor would.
- Test of conduct, not performance.
- Standard applies to investment portfolio as a whole (not investments in isolation) and as a part of an overall investment strategy incorporating reasonably suitable risk and return objectives. F.S. §518.11(1)(a).
- Courts look at all circumstances surrounding the investment decisions at the time the investment is made. F.S. §518.11(1)(b).
- Duty to diversify. F.S. §518.11(1)(c).
- Duty to review existing investments within a reasonable time after acceptance. F.S. §518.11(1)(d).

# Investment Plan

DEAN MEAD

- In implementing the investment plan, the trustee should document the factors considered in determining a reasonable investment portfolio.
  - General economic conditions.
  - Inflation.
  - Tax consequences.
  - Role of each investment.
  - Expected total returns.
  - Costs.
  - Purposes, terms, distribution requirements and other circumstances of the trust.
  - Review the investment plan at least annually, and document the reasons for maintaining or changing the portfolio.

DEAN MEAD

# Reliance on the Terms of the Trust

- Duty to diversify is routinely modified, or even waived. Often a trustee may retain assets contributed to the trust, regardless of the risk of the contributed asset or the resulting lack of diversification.
  - If trust specifically authorizes certain investments, trustee can reasonably rely on such terms. F.S. §518.11(2); F.S. §736.1009.
  - If such terms are no longer reasonable, trustee can obtain a court order to deviate from terms. F.S. §518.11(3)(a).

DEAN
MEAD

# Reliance on Investment Advice

In Parker v. Shullman, 983 So.2d 643, (Fla. 4th DCA 2008), beneficiaries complained of decline in value of trust assets due to the trustee's investment decisions. The trustee was not held liable because the trustee's actions were reasonable at the time and the trustee relied on professional investment advice. The trustee took careful steps to interview investment advisors, schedule meetings with the advisors, and followed the advisors advice.

# Delegating Investment Decisions

DEAN MEAD

- A trustee may delegate duties and powers, including investment decisions, that a prudent trustee of comparable skill could delegate under the circumstances.
- F.S. §736.0807. If the investment functions are properly delegated to an agent, the trustee will not be held liable for any investment decisions by the agent. F.S. §518.112(4). To properly delegate the trustees' investment functions, the trustee must:
  - exercise reasonable care in selecting the agent, establishing the scope and terms of the delegation and periodically reviewing the agent's actions. F.S. §518.112(1); and
  - give notice of the intent to delegate the investment functions to all beneficiaries who are entitled to receive distributions from the trust. F.S. §518.112(3).
- In performing the delegated functions, the agent is subject to the same fiduciary standards as the trustee. F.S. §518.112(6).

DEAN MEAD

# Approval, Consent and Limitations Period

- Court Approval - F.S. §518.11(3)(b) authorizes trustee to obtain court approval for trust investments.
- Beneficiary's Consent - Trustee is not liable for a breach of trust if trustee fully discloses actions and beneficiary willingly consents. F.S. §736.1012.
- Statute of Limitations – Trustee should disclose investment transactions in a trust accounting or other trust disclosure document to begin the statute of limitations.

DEAN MEAD

# Conflicts of Interest

Generally - Trustee has a duty to administer the trust solely in the interest of the beneficiaries. Any transaction entered into by the trustee which involves the trust property and benefits the trustee or in which there is another conflict of interest is a breach of fiduciary duty and is voidable per se.

DEAN
MEAD

# Presumed Conflict

- Pursuant to F.S. §736.0802(3), a conflict of interest is presumed when a transaction is entered into by the trustee with:
  - the trustee's spouse;
  - trustee's relatives;
  - an agent, employee, officer or director of the trustee; or
  - an entity in which the trustee has a significant interest in.
- Unlike transactions which directly involve the trustee, a transaction in which there is a presumed conflict of interest is not void per se. The trustee may rebut the presumption by showing evidence that no conflict existed.

# Remedies Available to the Beneficiaries

- The transaction is voidable. F.S. §736.0802(2).
- Also, F.S. §736.1001(2) provides a non-exclusive list of remedies a court may order for any breach of trust. The court can:
  - compel performance by the trustee;
  - enjoin the trustee from committing the breach;
  - order the trustee to return the trust property or pay monetary damages;
    - the monetary damages against the trustee are the greater of the amount required to restore the value of the trust property or the amount of profit realized by the trustee. F.S. §736.1002(1).
  - compel the trustee to provide an accounting;
  - remove the trustee and appoint a successor trustee; or
  - reduce or deny the compensation of the trustee.

DEAN MEAD

DEAN MEAD

# Preventative and Remedial Measures

- Obtain Court Approval. F.S. §736.0802(2)(b).
- Obtain Beneficiary Consents. F.S. §736.0802(2)(d).
- Beneficiaries can ratify the transaction. F.S. §736.0802(2)(d).
- Transaction Authorized by the Trust Document. F.S. §736.0802(2)(a).
- Trustee can shorten the statute of limitations by disclosing the transaction in a trust accounting or other disclosure document.

DEAN MEAD

# Informing Trust Beneficiaries; Statute of Limitations; Representation

- Within 60 days of accepting as trustee, the trustee must give notice to qualified beneficiaries of the acceptance of the trust and the trustee's name and address. F.S. §736.0813(1)(a).
- Pursuant to F.S. §736.0103(14), a "qualified beneficiary" is a beneficiary who:
  - is a distributee or permissible distributee of trust income or principal;
  - would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described above, terminated on that date without causing the trust to terminate; or
  - would be a distributee or permissible distributee of trust income principal if the trust terminated in accordance with its terms on that date.

DEAN MEAD

# Things to consider when initially notifying beneficiaries:

- Waiver of future trust accountings. F.S. §736.0813(2).
- Limiting action for contesting the validity of a revocable trust. F.S. §736.0604(2).
- Getting release from duty to institute proceeding against prior trustee. F.S. §736.08125(1)(c).
- Determining representation of qualified beneficiaries.

# Trust Accountings

- A trustee has a duty to provide accountings to the qualified beneficiaries annually, on change of trustee, and on termination of the trust. F.S. §736.0813(1)(d).
- The accountings must include:
  - statement identifying the trust, the trustee, and the time period covered by the accounting;
  - all cash and property transactions and all significant transactions;
  - receipts and disbursements during the accounting period;
  - gains and losses realized during the accounting period;
  - to the extent possible, the identity and value (both acquisition or carrying value and estimate of current value) of the assets at the close of the accounting period;
  - all non-contingent liabilities;
  - allocation of receipts and disbursements between income and principal; and
  - for final accountings, a plan of distribution.

DEAN MEAD

DEAN MEAD

# Waiver of Accountings / Court Approval

- Qualified Beneficiaries can waive the right to receive accountings. F.S. §736.0813(2).
  - If beneficiaries waive the right to accountings, the trustee should consider providing "informal accountings" along with a limitation notice so as to reduce the statute of limitations. An "informal accounting" can be anything that provides the beneficiary with enough information so that the beneficiary could know of a claim or reasonably should have inquired into the existence of a claim. F.S. §736.1008(4)(a).
- Court Approval of Accountings - Trustee may ask the court to review and settle an interim or final accounting. F.S. §736.0201.

# Statute of Limitations

- Perhaps no damages, but a qualified beneficiary can compel the trustee to provide an accounting. §736.1001(2)(d). The benefit for providing trust accountings is the statute of limitations for bringing an action against a trustee is reduced for items adequately disclosed in the accounting.
- Without providing an accounting, a beneficiary may have up to forty years after a trust terminates or the trustee resigns to bring an action against a trustee. F.S. §736.1008(6).
- If trustee actively conceals facts supporting a cause of action, the applicable statute of limitations is extended an additional thirty years. F.S. §736.1008(6)(b).
- The statute of limitations is reduced to four years for matters adequately disclosed in an accounting or other trust disclosure document. F.S. §736.1008(1)(a).
- The statute of limitations is further reduced to six months if a limitation notice is given to the beneficiary along with the accounting or trust disclosure document. F.S. §736.1008(2).

DEAN MEAD

DEAN MEAD

- F.S. §736.1008(4)(c) provides sample language for a limitation notice:

  "An action for breach of trust based on matters disclosed in a trust accounting or other written report of the trustee may be subject to a 6-month statute of limitations from the receipt of the trust accounting or other written report. If you have questions, please consult your attorney."

# Representation

- Under F.S. §736.0301, certain individuals can represent beneficiaries.
- A holder of a power of appointment can represent permissible appointees and takers in default unless the holder is the sole trustee. F.S. § 736.0302(1).
  - A taker in default can represent permissible appointees. F.S. §736.0302(2).
- A guardian of the property may represent Ward's estate. F.S. §736.0303(1).
- An agent can represent a beneficiary as to specific issues. F.S. §736.0303(2).
- A trustee can represent trust beneficiaries. F.S. §736.0303(3).
- A personal representative may represent interested persons in an estate. F.S. §736.0303(4).
- A parent can represent and bind minor or unborn children, provided there is no conflict of interest. F.S. §736.0303(5).
- A minor, incapacitated person, unborn individual, or a person who cannot be located can be represented by another individual with a substantially identical interest, to the extent there is no conflict of interest. F.S. §736.0304.
- The court can appoint a representative of a minor, incapacitated or unborn individual, or a person who cannot be located. F.S. §736.0305(1).
- The trust can specify a designated representative or the trust can appoint someone, other than the trustee, to designate a representative in the future. F.S. §736.0306.

DEAN MEAD

# #5. Failing to Coordinate IRA with Estate Plan

DEAN MEAD

# Failure to Coordinate IRA with Estate Plan

- Why important?
- Tax Clause
- Disclaimer planning

DEAN
MEAD

# IRAs & Asset Protection

- Traditional and Roth IRAs are 100% exempt from owner's creditors under Florida law
- Federal bankruptcy laws also exempt IRAs <u>up to</u> an aggregate cap of $1,245,500 (2013 adjusted number)
  - Does not apply to amounts rolled into IRA from a qualified plan
- Inherited IRAs also 100% exempt from beneficiary's creditors under Florida law
- Inherited IRAs are <u>NOT</u> exempt in bankruptcy
  - *Clark* – US Supreme Court resolved the conflict among the circuits and ruled that inherited IRAs are not "retirement funds" within meaning of Bankruptcy Code.

DEAN
MEAD

# Trust as IRA Beneficiary

- Why:
  - Creditor protection
  - Management of IRA for disabled, distrusted, minor or substance abuse beneficiaries
  - Control of disposition of IRA and accumulated distributions on death of beneficiary (second marriage)
  - Shelter IRA for estate and GST tax purposes

DEAN
MEAD

# Trust as IRA Beneficiary

- "See-through Trust" = Oldest trust beneficiary's life expectancy determines MRDs. Requirements:
  - Valid under state law
  - Irrevocable on IRA owner's death
  - Trust beneficiaries readily identifiable
  - Trustee provides copy of trust or identifies beneficiaries by September 30 of the year following IRA owner's death
  - (THE HARD ONE) <u>All</u> trust beneficiaries that count are individuals

# Trust as IRA Beneficiary

- All potential trust beneficiaries and appointees may "count" when general trust designated
- Ways to limit who counts:
  - Name sub-trust directly (UCT/QTIP/DST)
  - Separate shares on beneficiary form
  - Direct funding of devise with IRA (or prohibit funding devise with IRA)
  - Disclaim or pay out by 9/30
  - Use "Conduit Trust" rather than "Accumulation Trust"

# Trust as IRA Beneficiary

- "Conduit Trust" = Trustee must distribute any distribution from an IRA to the current trust beneficiary
  - DB is current trust beneficiary who is in same position if named directly except cannot make distribution decisions
    - Do not count other beneficiaries or appointees
  - Not ideal for UCT or if goal is to preserve assets for remainder beneficiary because $0 left if DB lives to normal life expectancy
  - MRD carries out DNI so beneficiary taxed
  - MRD "for benefit of" rather than direct?
    - No IRS guidance; asset protection issue

DEAN MEAD

# Trust as IRA Beneficiary

- “Accumulation Trust” = Trustee may accumulate distributions from IRA
  - Better for asset protection and other trust goals
  - Current and remainder beneficiaries count and so do permissible appointees, but what about “mere potential successors”?
    - Regs. say “no” but give no guidance
    - Recent PLRs say when remainder beneficiaries take outright after current beneficiary’s death, stop there
    - “Last man standing” provision accelerates termination and outright distribution if only one of intended beneficiaries still living

# Trust as IRA Beneficiary

- Trust Tax Issues
  - Marital Deduction Trust
    - Spouse must be entitled to both income of the trust and income of the IRA
    - F.S. 738.602 defines how distributions from an IRA are treated for trust accounting purposes in absence of specific direction in trust
  - Avoid funding pecuniary devise with IRA = realization of income by trust
    - Applies to charitable pecuniary devises too!
    - Avoid pecuniary optimal marital shares
    - Use fractional formula devise or direct IRA directly to trust beneficiary or sub-trust

DEAN MEAD

DEAN MEAD

# #6. Failing to Address Homestead Issues

DEAN MEAD

# Homestead

- 3 protections
  - Property Tax; what if trust owned?
  - Creditor
    - During life (size limits and protecting excess, ownership requirements, bankruptcy)
    - At death (devisee an heir? trust for an heir same as heir? effect of direction of sale)
  - Family Devise Restrictions
    - Spouse?  Life estate or T/C 732.401(2) election
    - Minor children?
    - T/E and JTWROS
    - Inter vivos trust – new 732.4017 if joint ownership not desired and minor children

DEAN MEAD

# #7. Will and Trust Drafting Errors

DEAN MEAD

# Estate Tax Apportionment

Not specifically providing for apportionment of estate tax attributable to the effect of lifetime gifts and estate tax payable on gift tax paid on gifts within 3 years of death

- Lifetime gifts are taken into account in the computation of estate tax
- §2035(b) requires gift tax paid on gifts made within 3 years of death to be added to the gross estate for purposes of computing the estate tax

DEAN MEAD

- Florida law apportions the estate tax, including estate tax attributable to the gross up for lifetime gifts and gift tax on gifts within 3 years of death to the other interests subject to estate tax at the decedent's death, not the recipient of the gift
- The persons receiving the decedent's other assets subject to estate tax may be different from the recipient of the gift

DEAN MEAD

**William, Sr., father**

**William, Jr., son**

**Wilhelmina, daughter**

**In 2011**

| | |
|---|---|
| **Business FMV =** | $ 10,000,000 |
| **Other Assets FMV =** | 22,000,000 |
| **Total Assets =** | $ 32,000,000 |

DEAN MEAD

**Sr.'s gifts to Jr.**

| | |
|---|---|
| **50% of business in 2011**<br>**Using all of his Exclusion Amount** | $ 5,000,000 |
| **50% of business in 2014**<br>**Incurring gift tax** | 5,000,000 |
| **Total Gifts to Jr.** | 10,000,000 |
| **Paid gift tax in 2014** | 2,000,000 |
| **Reduction in Estate** | $12,000,000 |

- Sr. dies in 2015

| | |
|---|---|
| **Gross Estate** | **20,000,000** |
| **Prior Gifts** | 10,000,000 |
| **Gift Tax on Gifts Within 3 Years** | 2,000,000 |
| **Taxable Amount** | 32,000,000 |
| **Tentative Tax** | 12,745,800 |
| **Tax on Prior Gifts** | 2,000,000 |
| **Gross Estate Tax** | 10,745,800 |
| **Applicable Credit Amount** | 1,945,800 |
| **Estate Tax** | $ 8,800,000 |

DEAN MEAD

- Jr. and Wilhelmina's shares are determined by grossing Sr.'s residuary estate up for prior gifts and reducing Jr.'s share for lifetime gifts

**William, Jr.'s share**
**((20,000,000 + 10,000,000) / 2) – 10,000,000 = 5,000,000**
**25% of Sr.'s Estate**

**Wilhelmina's share**
**((20,000,000 + 10,000,000) / 2) = 15,000,000**
**75% of Sr.'s Estate**

- Estate tax is apportioned to shares pro rata

| | |
|---|---|
| **Jr. – Business** | **$ 10,000,000** |
| **– Estate** | 5,000,000 |
| **– Estate Tax** | (2,200,000) |
| | **2,800,000** |
| **Wilhelmina – Estate** | 15,000,000 |
| **– Estate Tax** | (6,600,000) |
| | **$ 8,400,000** |

- Should allocate estate tax based on total benefit received by each beneficiary

| | |
|---|---:|
| **Jr. – Business** | **$ 10,000,000** |
| **– Estate** | 5,000,000 |
| **– Estate Tax** | (4,400,000) |
| **– Net Estate** | **600,000** |
| | |
| **Wilhelmina – Estate** | 15,000,000 |
| **– Estate Tax** | (4,400,000) |
| **– Net Estate** | **$ 10,600,000** |

DEAN
MEAD

Estate tax apportionment clause directs that all estate taxes be paid from the estate or revocable trust, including estate tax attributable to assets passing outside the descendant's will or revocable trust (e.g., jointly owned property, life insurance, annuities, retirement benefits) which may pass to individuals other than the beneficiaries of the will and revocable trust

**Oscar's Assets**

| | Felix | Children | Total |
|---|---|---|---|
| **Estate** | $ 0 | - | $ 0 |
| **Revocable Trust** | 2,667,000 | - | 2,667,000 |
| **Homestead** | 1,000,000 | - | 1,000,000 |
| **IRA** | - | $1,500,000 | 1,500,000 |
| **Life Insurance** | - | 5,000,000 | 5,000,000 |
| **Joint Accounts** | - | 1,500,000 | 1,500,000 |
| **Total** | 3,667,000 | 8,000,000 | 11,667,000 |
| **Estate Tax** | 2,667,000 | - | 2,667,000 |
| **Net** | $ 1,000,000 | $ 8,000,000 | $ 9,000,000 |

DEAN MEAD

DEAN MEAD

- Apportion estate tax to each category of asset based on their values
- Consider paying estate tax on IRA from other source; paying estate tax from IRA triggers realization of ordinary income and income tax

| | |
|---|---|
| **Estate Tax** | **$ 342,857** |
| **Income Tax (includes §691(c) deduction for estate tax paid)** | 150,808 |
| **Total Tax** | $ 493,665 |

DEAN MEAD

# Mandatory Distributions from Trusts

DEAN MEAD

- Mandatory distributions of a trust share at ages 25/30/35 – lose creditor protection as each distribution becomes payable
- Power for beneficiary to withdraw a trust share at ages 25/30/35 – lose creditor protection as each withdrawal right becomes exercisable, but assets left in trust are segregated from marital assets
- Right for beneficiary to become a co-trustee or sole trustee upon attaining a set age with no mandatory distributions or power to withdrawal – creditor protection under Florida law (except, perhaps, alimony, child support and federal government), but perhaps not under the laws of other states
- No mandatory distributions or rights of withdrawal; beneficiary never becomes co-trustee or sole trustee – creditor protection under Florida law (except perhaps exception creditors), but perhaps not under the laws of other states

- Mandatory annual distributions of income to beneficiary
  - Make all distributions discretionary
- CREDITOR PROTECTION!
- Protect beneficiary from his/her spendthrift nature
- Allows trustee to invest for greatest overall return, without concern about income and principal
- Allows trustee to choose amount and timing of distributions in order to minimize overall income tax liability of trust and beneficiaries

DEAN MEAD

DEAN MEAD

# Not Taking Into Account Changes In the Applicable Exclusion Amount (Unified Credit)

DEAN MEAD

- Estate plan 10 years ago when widower, with two children from first marriage, married his second wife

| | 2005 | 2015 |
|---|---|---|
| **Gross Estate** | $7,500,000 | $7,500,000 |
| **Exclusion Amount** | 1,500,000 | 5,430,000 |

**Optimal Marital Formula to surviving spouse (2nd marriage) with balance to adult children from first marriage**

| | 2005 | 2015 |
|---|---|---|
| **Children's Trusts** | $1,500,000<br>20% | $5,430,000<br>72% |
| **Marital Trust** | 6,000,000<br>80% | 2,070,000<br>28% |

DEAN MEAD

# Not Taking Into Account Portability and Basis Step-Up

DEAN MEAD

- Death of first spouse in 2015
- $5,430,000 of assets value (FMV)
- Step-up in basis to FMV
- 3% growth for 10 years

- Death of second spouse in 2025

- Optimal marital formula at first death versus all to marital trust and DSUE election

| | Credit Shelter Trust | | Marital Trust | |
|---|---|---|---|---|
| | FMV | Basis | FMV | Basis |
| | $7,297,000 | $5,430,000 | $7,297,000 | $7,297,000 |
| **Estate Tax** | 0 | | 0 | |
| **Amount Realized** | 7,297,000 | | 7,297,000 | |
| **Basis** | 5,430,000 | | 7,297,000 | |
| **Gain** | 1,867,000 | | 0 | |
| **Income Tax (20%)** | $ 373,400 | | $ 0 | |

DEAN MEAD

DEAN MEAD

# Not Taking Into Account Changes in Circumstances

DEAN MEAD

- Marriage
- Divorce
- Birth, adoption or death of beneficiaries
- Move to another state
- Acquire or sell a business
- Change in relationship with fiduciaries; personal representative, trustee, agent under durable power of attorney, health care surrogate, guardian for a minor or the client

DEAN
MEAD

- Child attains age of 18 – needs to have will, durable power of attorney, designation of health care surrogate, living will and authorization for release of protected health information

DEAN MEAD

# #8. Failing to Update Estate Plan for Marriage

DEAN MEAD

- Prenuptial Agreement
- Change Will and Revocable Trust
- Change beneficiary designations
  - Annuities
  - Life insurance
  - Retirement accounts
- Balance interests of new spouse, children from prior marriage(s) and step-children

DEAN MEAD

# #9. Failing to Update Estate Plan After Divorce

DEAN MEAD

- Change estate planning documents
  - F.S. § 732.507(2) makes any provision in a Will that affects former spouse void upon divorce; former spouse treated as deceased
  - F.S. § 736.1105 makes any provision in a Revocable Trust that affects a former spouse void upon divorce; former spouse treated as deceased
  - F.S. § 709.2109(2)(b) Agent's power under a Durable Power of Attorney terminates when an action is filed for the dissolution of the Agent's marriage to the principal; BUT a third party can relay on a DPOA until they have notice that it is void, invalid, suspended or terminated F.S. § 709.2199
  - F.S. § 765.104(2) Surrogate's power under a Designation of Health Care Surrogate is revoked upon dissolution of marriage

DEAN MEAD

- May no longer own assets previously owned
- May own assets individually that were previously owned jointly with spouse that included a right of survivorship
- Modify estate planning to account for loss of estate tax marital deduction
- Have you named relatives of former spouse as fiduciaries?

DEAN MEAD

- Change beneficiary designations
  - Annuities
  - Life insurance
  - Retirement accounts
- Change ownership of joint assets
  - Bank and savings accounts
  - Investment accounts
  - Real property

# Beneficiary Designations

DEAN MEAD

- Rely on F.S. §732.703 – designation by decedent providing for the payment or transfer at death of an interest in an asset to or for the benefit of the decedent's former spouse is void as of the time the decedent's marriage is judicially dissolved or declared invalid prior to the decedent's death if the designation was made prior to the court order.
- Interest passes as though former spouse predeceased the decedent

- Applies to
  - Life insurance, qualified annuity or other similar tax-deferred contract whether or not held within an employee benefit plan *
  - An employee benefit plan *
  - Pay on Death (POD) account
  - Securities registered in a Transfer on Death (TOD) form

- Does not apply
  - * To the extent federal law provides otherwise (i.e., ERISA preempts state law)
  - If disposition of assets is governed by will or trust; which are governed by F.S. § 732.507(2) and § 736.1105, respectively
  - If the order of dissolution requires that the decedent maintain the asset for the benefit of the former spouse

DEAN MEAD

- If the designation of the former spouse is irrevocable
- If the governing instrument is governed under the laws of another state
- To an asset held in joint names that includes a right of survivorship
- If the decedent remarries the former spouse prior to death
- To plans under the Florida Retirement System

DEAN MEAD

# ERISA Preemption

- The preemption clause in the Employee Retirement Income Security Act of 1974 (“ERISA”) prevents state law from overriding or controlling the administration of a plan covered by ERISA

DEAN MEAD

- Defined benefit plans – pension plans
- Defined contribution plans
  - 401(k) Plan
  - 403(b) Plan (employees of public schools, employees of certain tax-exempt organizations and ministers)
  - Employee Stock Ownership Plans ("ESOPs")
  - Profit Sharing Plan
  - Stock Bonus Plan

DEAN MEAD

# #10. Inadvertent Terminations of S Election Due to Impermissible Shareholders

# Inadvertent Terminations of S Election Due to Impermissible Shareholders

DEAN MEAD

- "S corporation" means a corporation which has made an election to be taxed under Subchapter S of the Code.
- Permitted shareholders
  - Individuals, exempt organizations, estates or certain types of trusts
    - Electing Small Business Trust (ESBT)
    - Qualified Subchapter S Trust (QSST)
    - Grantor Trust
- Consequences of termination of S status
  - Corporation becomes taxed as a C corp. from the date of termination, which may be > 1 year ago.
  - Federal (35%) and state (5.5%) corporate income taxes since date of termination
  - Penalties, interest and professional fees!

# Trust Ownership of S Stock: Irrevocable Trusts

DEAN MEAD

*Example 1: Parent gifts S stock to an irrevocable trust for the benefit of child. Is the trust a permitted shareholder?*

- If the trust is not a grantor trust:
  - A QSST or ESBT election must be made within 2 months and 16 days of the trust receiving the S stock. Treas. Reg. § 1.1361-1(j)(6)(iii)(A).
- If the trust is a grantor trust:
  - A trust which is a grantor trust for income tax purposes qualifies as a permitted shareholder. § 1361(c)(2)(A)(i).
  - The trust continues to be a permitted shareholder until 2 years after the grantor's death. § 1361(c)(2)(A)(ii).
  - If grantor trust status is terminated during the grantor's life, then a QSST or ESBT election must be made within 2 months and 16 days after the termination of grantor trust status. Treas. Reg. § 1.1361-1(j)(6)(iii)(C).

# Estate Ownership of S Stock / Testamentary Trusts:

*Example 2: Parent dies while owning S stock in his name. Under Parent's Will, the stock is bequeathed to a trust for child.*

- During estate administration period:
  - Estate is a permissible shareholder, BUT, if the administration is unduly prolonged, then the stock will be deemed to be distributed to the beneficiaries, who must then qualify.
- Upon conclusion of estate administration period:
  - Testamentary trust for the child is a permitted shareholder for 2 years after the date the stock is distributed to the trust. Treas. Reg. § 1.1361-1(h)(1)(iv).
  - Upon the expiration of the 2 year period, a QSST or ESBT election must be made for child's trust within 2 months and 16 days to remain a permitted shareholder. Treas. Reg. § 1.1361-1(j)(6)(iii)D).



DEAN MEAD

# Trust Ownership of S Stock: Revocable Trust During Settlor's Life

DEAN MEAD

*Example 3: Parent contributes S stock to his Revocable Trust. Parent later dies on January 1, 2016. Under the Revocable Trust, the stock is bequeathed in trust for child.*

- During Parent's lifetime:
  - Revocable Trust is a permitted shareholder because it is a grantor trust for income tax purposes. § 1361(c)(2)(A)(i)
  - No election necessary.

DEAN MEAD

# Trust Ownership of S Stock: Revocable Trust Upon Settlor's Death

*Example 3: Parent contributes S stock to his Revocable Trust. Parent later dies on January 1, 2016. Under the Revocable Trust, the stock is bequeathed in trust for child.*

- Upon Parent's death:
  - The Trust (now irrevocable, non-grantor trust) will be a permitted shareholder for at least 2 years following Parent's death. § 1361(c)(2)(A)(ii).
  - If a § 645 election is made, then the stock is treated as if owned by an estate and the Trust will be a permitted shareholder for the duration of the 645 election period or until the stock is distributed to beneficiaries. Treas. Reg. § 1.1361-1(k)(1) Ex. 3(iii).
  - The 645 election period generally terminates the day before 2 years after death, if no estate tax return is required, or the day before the later of 6 months after final determination of liability for estate tax (e.g., 6 months after closing letter issued; date of settlement agreement or date of court order) or 2 years after death if an estate tax return is required. Treas. Reg. § 1.645-1(f).
  - Ex. If estate tax closing letter is issued on June 1, 2017, and 645 election was made, the Trust is a permitted shareholder until May 31, 2018.

# Trust Ownership of S Stock: Revocable Trust Upon Settlor's Death

*<u>Example 3</u>: Parent contributes S stock to his Revocable Trust. Parent later dies on January 1, 2016. Under the Revocable Trust, the stock is bequeathed in trust for child.*

- If § 645 election is made, then the trust for child will be treated as a "testamentary trust" and be a permitted shareholder for 2 years after receiving the stock. Upon the expiration of the 2 year period, a QSST or ESBT election must be made for child's trust within 2 months and 16 days to remain a permitted shareholder. Treas. Reg. § 1.1361-1(j)(6)(iii)D).
  - Ex. Parent dies January 1, 2016. If estate tax closing letter is issued on June 1, 2017 and a 645 election was made, the Revocable Trust is a permitted shareholder until May 31, 2018, and child's trust would be a permitted shareholder until May 31, 2020. A QSST or ESBT election must be made by August 15, 2020.
- CAUTION:
  - If stock was transferred to the Revocable Trust via Parent's pour-over Will, then Revocable Trust is a "testamentary trust", but child's trust is not. Revocable Trust is a permitted shareholder for 2 years from receipt of stock, but an ESBT or QSST election must be made for child's trust within 2 months and 16 days of receipt.



DEAN MEAD

DEAN MEAD

# How to Fix an Inadvertent Termination due to Impermissible Shareholder

- Rev. Proc. 2013-30
  - Relief must be requested within 3 years and 75 days after the "Effective Date."
    - Generally, the Effective Date must be within the 2 month and 16 day period after which S corporation stock has been transferred to the trust.
  - Requirements for Requesting Relief
    - Trust must meet QSST or ESBT requirements;
    - Separate statements by all S corporation shareholders that they have reported their income on all affected returns consistent with the S corporation election; and
    - A Reasonable Cause/Inadvertence Statement
- Private Letter Ruling (if Rev. Proc. 2013-30 relief unavailable)
  - Standard fee = $28,300
  - Reduced user fee for person with gross income < $250,000 = $2,200
  - Reduced user fee for person with gross income between $250,000 and $1,000,000 = $6,500

DEAN
MEAD

# #11. Generation-Skipping Transfer Tax Issues

# Generation Skipping Transfer Tax

- GST Tax Basics
  - $5,430,000 Lifetime Exemption
  - 40% tax rate
  - Direct Skip = Transfer from an estate or by gift to a skip person.
  - Taxable Distribution = Any distribution from a trust to a skip person (other than a direct skip or taxable termination).
  - Taxable Termination = Termination of an interest in a trust unless immediately after, a non-skip person has an interest in the property, or no future distributions may be made from the trust to a skip person.

DEAN MEAD

DEAN MEAD

# Allocation of GST Exemption and Crummey Withdrawal Rights

- Example: Donor contributes $28,000 to a trust f/b/o child and grandchild. Child and grandchild have crummey withdrawal rights.
  - If the trust is not intended to be GST exempt:
    - Is it necessary to allocate GST exemption to grandchild's withdrawal rights? No
  - If the trust is intended to be GST exempt:
    - Is it necessary to allocate GST exemption to child's withdrawal rights? Yes
    - Is it necessary to allocate GST exemption to grandchild's withdrawal rights? Yes
    - Does § 2646(c) exclusion apply? No
- Consequences of incorrect allocation:
  - Donor's GST exemption could be wasted.
  - Distribution to grandchild could be subject to 40% GST tax.

# Missing the Automatic GST Allocation Rules

- § 2632(c) provides that, for lifetime transfers made after December 31, 2000 any unused portion of an individual's GST exemption shall be allocated to an indirect skip in an amount necessary to make the trust exempt from GST tax.
- Indirect skip means any gift made to a "GST Trust", which is a trust that could have a generation-skipping transfer with respect to the transferor, unless the trust falls within 1 of 6 exceptions.
- Automatic allocation applies regardless of whether a gift tax return is filed.
- Example: Donor makes $100,000 gift to a Trust which provides for distributions to child during child's lifetime. The Trust principal is distributed to child at ages 50 (1/3), 55 (2/3) and 60 (all). At child's death, child has TLPOA and any unappointed assets pass to donor's grandchild. Is GST automatically allocated?
  - Yes

DEAN MEAD

# Predeceased Ancestor Exception

- § 2651(e) – If a donee is a descendant of a transferor's parent (or a descendant of the transferor's spouse's (or former spouse's) parent) and the donee's parent who is a lineal descendant of the transferor's parent (the transferor's spouse's (or former spouse's) parent) is deceased at the time the transfer is subject to gift or estate tax, then the donee will be treated as if he or she is in the generation that is one below that of the transferor or the generation assignment of the youngest living ancestor of such donee who is also a descendant of the transferor's parent (or the transferor's spouse's (or former spouse's) parent).
- A disclaimer by an individual does not invoke the predeceased ancestor rule. Treas. Reg. § 26.2651-1(a)(2)(iv)

# Predeceased Ancestor Exception

- **Trap**: Must look at the time the transfer was last subject to gift or estate tax, not at the time of the GST taxable event.
  - Example 1: Donor makes a gift to a trust for the benefit of child and, upon child's death, the remainder passes to the grandchildren. The predeceased ancestor exception does not apply if child predeceases the donor because the child was alive at the time of the original gift. Treas. Reg. § 26.2651-1(a)(2)(iii).
  - Example 2: Donor sets up a QTIP Trust for spouse, with a remainder to descendants per stirpes, and a child dies after the contribution, but before spouse dies. The predeceased ancestor exception would apply because the critical time to measure is the date of the spouse's death (i.e., the date the trust property was last subject to estate tax) when the spouse became the transferor for GST purposes. See Treas. Reg. § 26.2651-1(c) Ex. 3. (assumes no reverse QTIP election made).

# Failing to Complete Schedule R on an Estate Tax Return

DEAN MEAD

- Schedule R reports allocations of decedent's GST tax exemption at death.
- Without an affirmative allocation of decedent's GST tax exemption, automatic allocation rules will apply.
- § 2632(e) provides that any unused GST exemption remaining at death will be automatically allocated first to a direct skip occurring at death and second to trusts with respect to which the decedent is the transferor (i.e., trusts created at death or during life) and which may have a generation-skipping transfer occur after the decedent's death.
  - If there are multiple transfers or trusts to receive the automatic allocation, then the unused GST exemption is allocated pro-rata based on the nonexempt portions of such transfers or trusts.
- Relying on auto-allocation rules often leads to inefficient allocation, confusion and future GST tax.

# Administering A Trust With A Mixed Inclusion Ratio

DEAN MEAD

- Mixed inclusion ratio means trust is partially, but not completely, exempt from GST tax.
- ***<u>Issue</u>***: Distributions to skip persons (such as grandchildren) will be subject to GST tax when GST tax could have been avoided by severing the trust into exempt and non-exempt shares prior to distribution.
- Example: Assume children and grandchildren are beneficiaries of a trust which has an inclusion ratio of .5, meaning half of the trust is exempt and half is non-exempt.
  - A distribution to a grandchild will incur a GST tax of 20% (i.e., ½ x 40% GST tax rate).
  - Alternatively, the trust could have been severed into 1 share that is wholly non-exempt, and 1 share that is wholly exempt. A distribution from the exempt share to the grandchild would <u>not</u> incur GST tax.