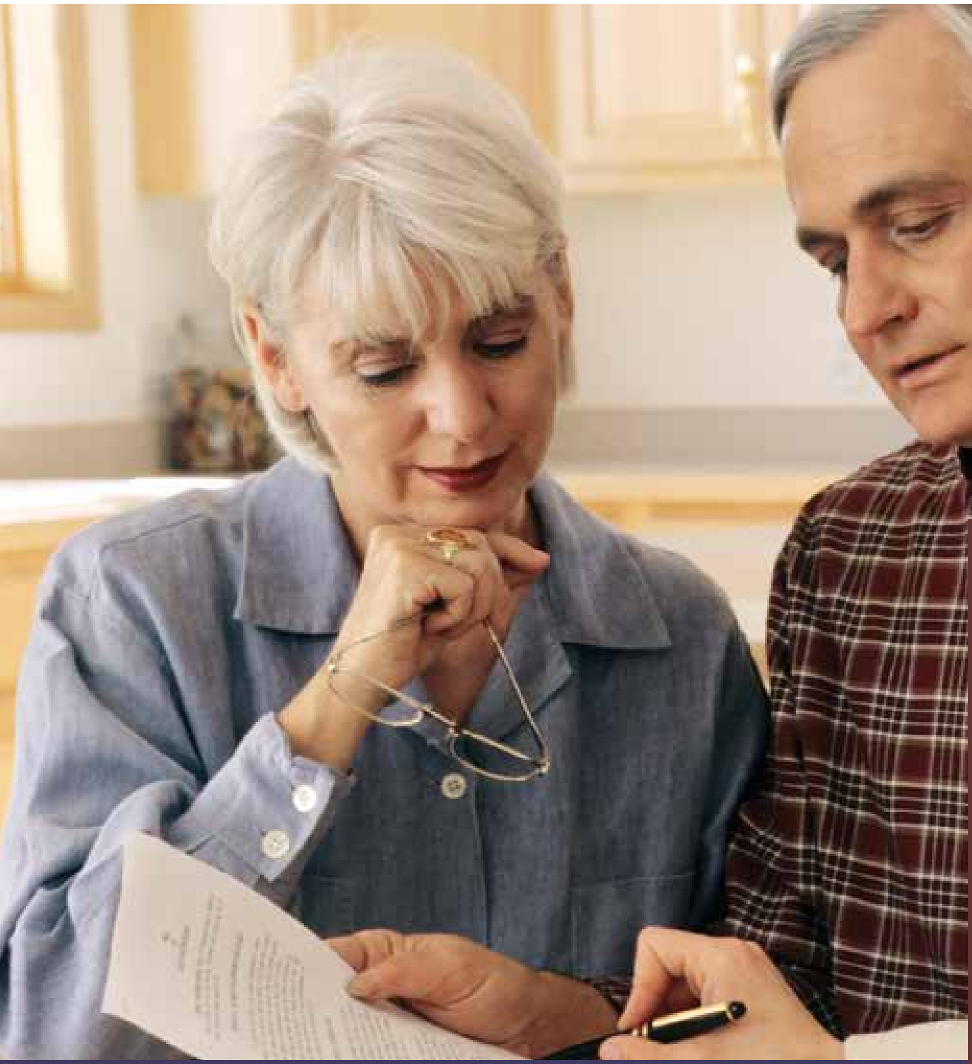
# INSIGHT ON ESTATE PLANNING



Who needs an estate plan?
**Quick answer: Everyone**

**NINGs, DINGs and WINGs**
Understanding the tax angles of self-settled trusts

Securities laws can derail your estate plan

**ESTATE PLANNING PITFALL**
You haven't properly funded your revocable living trust

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# Who needs an estate plan?

## Quick answer: Everyone

Despite what you might think, estate planning isn't limited to only the rich and famous. In fact, your family is likely to benefit from a comprehensive plan that divides your wealth, protects your well-being and provides a compass for your family's future.

Previously, avoiding or minimizing federal estate tax liability was a primary motivation for creating an estate plan. This isn't as critical for most people now that the Tax Cuts and Jobs Act (TCJA) has doubled the federal gift and estate tax exemption from $5 million to $10 million. (The inflation-adjusted amount for 2018 is $11.18 million.) Nevertheless, reducing exposure to federal estate tax is still significant for affluent individuals, while a wider segment of the population must consider the impact of *state* estate taxes.

### Dividing your wealth

Estate planning is often associated with the division of your assets, and this is certainly a key component. It's typically accomplished, for the most part, by drafting a will, which is the foundation of an estate plan.

With a valid will, you determine who gets what, where, when and how. It can cover everything from the securities in your portfolio to personal property, such as cars, artwork or other family heirlooms.

In contrast, if you die without a will — referred to as dying "intestate" — state law will control the disposition of your assets. This may result in unintended consequences. For example, children from a prior marriage may be excluded if state law dictates that all assets are to go to a surviving spouse.

In addition, you'll need to name the executor of your estate. He or she will be responsible for carrying out your wishes according to your will. Your executor may be a professional, a family member or a friend. Also, designate a successor in case your first choice is unable to handle the duties.

### Consider your current life circumstances

Of course, every estate plan is different. Yours should be geared to your personal situation. However, some basic principles may apply across the board, especially when your current status is taken into account.

For example, suppose you and your spouse are raising a young family. Besides naming a guardian for your children, you may acquire a life insurance policy for your family's protection. Because premium costs are based on age, among other factors, doing so can be relatively inexpensive to obtain the coverage you need.

Conversely, if you're at or nearing retirement, the need for life insurance diminishes. Instead, you may consider long-term life insurance that will absorb some of the costs if you're forced into an extended stay at a nursing home or other facility.

## Understanding probate


If your estate plan includes only a will, your estate will most likely have to go through probate. Probate is a court-supervised process to protect the rights of creditors and beneficiaries and to ensure the orderly and timely transfer of assets. The complexity and duration of probate depends on the size of your estate and state law.

Be aware that certain types of property aren't subject to probate or controlled by your will. For example, if you own real estate as "joint tenants with rights of survivorship" (JTWROS) with your spouse, the property automatically passes to your spouse upon your death. Frequently, a couple will own a principal residence as JTWROS or, in those states that permit it, as "tenants by the entirety," which is in essence a form of JTWROS available only to married couples.

*If your estate plan includes only a will, your estate will most likely have to go through probate.*

Furthermore, if you transfer assets to a living trust, those assets are exempt from the probate process. Thus, a living trust may supplement a will, giving heirs fast access to funds.

## Protecting your well-being

An estate plan can help ensure that your long-term health care is handled in the way that you wish. Notably, you can create a health care power of attorney. It grants another person — for example, a family member or a friend — to act on your behalf in the event you're incapacitated. A power of attorney may be coordinated with a living will specifying your wishes in end-of-life situations and other health care directives.

## Providing a compass

Finally, an estate plan can accomplish a variety of other objectives, depending on your preferences and circumstances. If you have minor children, name a guardian in your will in the event of your premature death. Without such a provision, the courts will appoint a guardian, regardless of your intent.

Your estate plan can also protect against creditors, primarily through trusts designed for these purposes. Accordingly, while trusts were often seen mainly as tax-saving devices in the past, they can fulfill a multitude of other roles.

There is one last document that ties up some loose ends. Although a "letter of instructions" isn't legally binding, it can express your wishes regarding numerous matters ranging from burial arrangements to the religious upbringing of children. It may also provide an inventory of your assets and their location.

## Let the planning begin

Now that the need for an estate plan is clear, don't delay any longer. Contact your attorney or estate planning advisor to begin the process or if you have any questions. •

# Understanding the tax angles of self-settled trusts

NINGs, DINGs and WINGs may sound like characters in a new Pixar animated film. In reality, they're the names bestowed on certain self-settled trusts (sometimes referred to as nongrantor trusts) in states providing a favorable tax environment for these trusts. The acronyms stand for Nevada Incomplete-gift Nongrantor Gift (NING) trusts, Delaware Incomplete-gift Nongrantor Gift (DING) trusts and Wyoming Incomplete-gift Nongrantor Gift (WING) trusts, respectively.

If you're noticing a trend — none of these three states impose an income tax on its residents — it's no coincidence. The use of NINGs, WINGs and DINGs is tied directly to tax savings on the state level for high-income individuals.

## Current tax landscape

Despite tax cuts implemented by the Tax Cuts and Jobs Act (TCJA), effective for 2018 through 2025, high wage earners can still face a hefty income tax bill. The TCJA reduces the top tax rate from 39.6% to 37% and retains the maximum 20% tax rate on long-term capital gains and the additional 3.8% net investment income tax (NIIT) on investment earnings. But that's only part of the equation.

Most states add their own income tax to the tax burden. In fact, in California this extra tax can reach double-digit rates. Thus, you might easily pay close to 50 cents on the dollar in combined state and federal income taxes — not even taking other taxes into account.

At the same time, the TCJA doubled the federal gift and estate tax exemption from $5 million to $10 million, indexed to $11.18 million in 2018. Currently, a married couple can effectively shelter up to $22.36 million from estate tax.

Of course, a few states still impose death and inheritance taxes, but the general trend is moving away from these taxes. For instance, in New Jersey, a state known for steep income taxes, the death tax was recently repealed, effective in 2018. Note, however, that New Jersey still has an inheritance tax.

One way to avoid high income taxes in your home state is to simply move to a low- or no-tax state. This has helped fuel a migration to states like Florida and Texas. But that may be a drastic step for some, especially if you're not ready to retire or move away from your family.

## Tax savings with self-settled trusts

Cue the introduction to NINGs, DINGs and WINGs. With these trust types, the main thrust is to shift tax liability for earnings from assets to the state where the trust is created — namely, Nevada, Delaware or Wyoming. Because the trust is a nongrantor trust, the earnings are taxable to the trust entity itself. As a result, you may avoid a big income tax bill in the state where you reside.

For example, a California resident, John, has a $5 million portfolio. For simplicity, let's say that he's held all his securities longer than one year (so that they qualify for long-term capital gains treatment) and the initial cost was $1 million.

If John sells off his entire portfolio in 2018, he recognizes a $4 million gain taxed at the 20% federal rate, not counting the NIIT. In addition, with the top 13.3% rate in California, he could owe another $532,000 on the $4 million gain.

This harsh state tax result could be avoided if John sets up a NING, DING or WING trust, which has no California resident trustee, and transfers the $5 million in assets to it. Currently, there's no state income tax to worry about. In this case, he currently saves more than $500,000 in state income tax, even though he lives in California and assuming the trust has no California resident trustee and no trust income is currently distributed or distributable to John. California income tax would be payable if and when the trust income is ultimately distributed to John, if at such time he's still a California resident.

## Gift and estate tax issues

Because the transfer of assets to the trust is considered an incomplete gift, no federal gift tax return must be filed with the IRS. This also means that there's erosion of the lifetime gift tax exemption, which is unified with the estate tax exemption. But then the assets will be included in the taxpayer's taxable estate upon death.

This isn't usually a problem, due to the generous gift and estate tax exemption, as discussed above. Furthermore, the taxpayer's heirs can benefit from a step-up in basis in the securities — and that reduces income tax liability on any future sales. It's a win-win-win situation.

## Turn to a professional

Bear in mind that self-settled trusts are complex arrangements. Various IRS private letter rulings have established subtle differences for NINGs, DINGs and WINGs that should be addressed beforehand. Needless to say, this isn't a do-it-yourself proposition: Consult with your estate planning advisor to learn whether this trust type is right for you. •

# Securities laws can derail your estate plan

It's not uncommon for high-net-worth individuals to hold their assets in trusts, family limited partnerships or charitable foundations. If the assets held in this manner include interests in hedge funds or other "unregistered" securities, it's important to ensure that the entity is qualified to hold such investments. Exemptions under federal securities laws require that investors in private funds and other unregistered securities qualify as "accredited investors" or "qualified purchasers."

## Learn the exemptions

Generally, companies or funds that offer securities for sale are subject to burdensome (and costly) registration and reporting requirements under the Securities Act of 1933, unless they fall within one of several exemptions. Perhaps the most common of these is Rule 506(b) of Regulation D, which exempts sales of securities to an unlimited number of accredited investors plus up to 35 nonaccredited, "sophisticated" investors.

Private investment funds also typically rely on two exemptions from registration under the Investment Company Act of 1940. These exemptions allow a fund to avoid registration if 1) it limits the fund to no more than 100 investors, or 2) if there are more than 100 investors, it allows only qualified purchasers to invest.

## Accredited investors

Accredited investors include financial institutions and other entities that meet certain requirements, as well as certain officers, directors and other insiders of the entity whose securities are being offered. They also include individuals with either 1) a net worth of at least $1 million (excluding their primary residence), or 2) income of at least $200,000 ($300,000 for married couples) in each of the preceding two years, and with a reasonable expectation of meeting the requirements in the current year.

A trust (including a foundation organized as a trust) can qualify as an accredited investor in one of three ways:

1. Its assets are greater than $5 million, it wasn't formed for the specific purpose of acquiring the securities in question and a sophisticated person directs its investments.

2. A national bank or other qualifying financial institution serves as trustee.


3. The trust is revocable and the grantor qualifies as an accredited investor individually.

Family investment vehicles are accredited investors if their assets exceed $5 million and they weren't formed for the specific purpose of making the investment in question. Alternatively, they can qualify as accredited if all of their equity owners are accredited. Generally, a foundation not organized as a trust is accredited only if its assets exceed $5 million.

## Qualified purchasers

Individuals are qualified purchasers if they have at least $5 million in investments. Other qualified purchasers include:

- An entity that has at least $5 million in investments, with all of its beneficiaries being either closely related family members (siblings, current or former spouses, or direct lineal descendants); estates, foundations, or charitable organizations of such family members; or trusts created by or for the benefit of the family member described,

- A trust that doesn't meet the family exception above, so long as the trust wasn't established solely to make the investment, and every individual associated with the trust as either creator, contributor or investment decision-maker is considered a qualified investor, or

- An entity with not less than $25 million in investments.

## Review your plan

When determining whether a family entity is an accredited investor or a qualified purchaser, turn to your advisor. There's a lot of nuance in the definitions, and the information provided here is intended to be a guideline. Your specific circumstances could vary from the general rules. Making sure that the entities are qualified to hold the investments will help to avoid unwanted consequences with respect to your estate plan. •

## ESTATE PLANNING PITFALL

# You haven't properly funded your revocable living trust

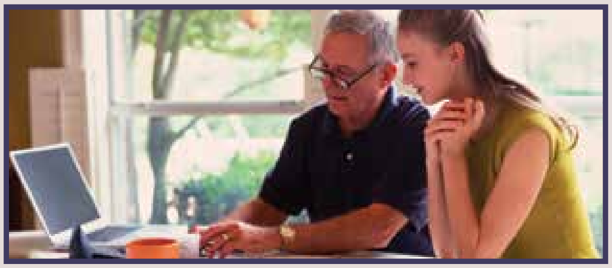
A revocable living trust is often used to complement a will. For instance, you might transfer specific securities to the trust. Notably, these assets generally don't have to go through the probate process, which can be time-consuming and expensive. They're also generally protected from creditors and may be managed by professionals.

Thus, a living trust enables your beneficiaries to receive some of your wealth upon your death, with no complications. However, it won't do anybody any good if the trust isn't properly funded.

Funding the trust is simply the process of transferring assets to it. Essentially, you change legal ownership of your assets from your name into the trust's name.

If you don't properly transfer assets to the trust, you run the risk that you won't accomplish your objectives, particularly with respect to avoiding probate. In that case, the disposition of the assets is governed by your will. For that reason, you should add a "pour-over" provision to your will, directing any leftovers to the trust.

What should you transfer? Some typical examples include bank accounts, securities, real estate and business interests. Generally, you can transfer these assets with little difficulty, although real estate may require some additional footwork. Rely on your attorney for assistance. You should also make sure to change the beneficiary designations for assets that are to be transferred to the trust. Typically you'll want to avoid transferring IRA and 401(k) plan or other retirement plan benefits to a revocable trust. Without careful consideration and proper planning, naming the trust as beneficiary can trigger unwanted tax consequences.



It's often recommended that you transfer ownership of life insurance policies and annuities to the trust. But note that, absent certain exceptions, there are rules that will cause insurance policies and annuities transferred within three years of your death to be included in your taxable estate. Rather than transfer the ownership, you might simply change the beneficiary designations. The decision may hinge on whether the estate tax is likely to be a factor.

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