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The zero estate tax plan

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For wealthy families and individuals, this period has provided a unique and robust canvas on which to craft an estate plan that helps meet their specific goals and objectives in a tax-efficient manner. Determining which estate planning vehicles and strategies are available and appropriate for any given family takes time, thoughtful discussion and a careful weighing of advantages and considerations.

When most people think about estate planning, they think of planning for the disposition of assets upon their death. What many miss are the opportunities that exist to implement strategies during life that can help mitigate taxes at their death, provide families the opportunity to enjoy their wealth together while multiple generations are still living, and fulfill charitable goals embraced by the family. Families should evaluate their goals regularly and be informed about the estate planning techniques that are most responsive to their particular needs and that promote a sense of financial and social responsibility in their heirs.

Getting started requires an in-depth look at the family's philosophies regarding its wealth as well as future expectations to be good stewards of its assets going forward. Such attitudes aren't always easy for families to articulate, but simply having the conversation goes a long way in maneuvering through the many emotional and practical decisions that pop up along the way.

Many families feel apprehensive about engaging in a comprehensive estate planning session due to their perception that a comprehensive estate plan must be exhaustingly complex. Advisors have likely heard clients say one or more of the following about their existing estate plans:

- "I'm not sure why I created all these complicated entities, but my attorney said it would reduce my family's estate tax liability. It made sense at the time, but I can't tell you how any of it works." Or,
- "I don't like the complexity of my current estate plan, but I want to be tax efficient. Can my plan be made simpler? Look at this huge binder and all these flow charts!"

For these families, the reality is that in order to be as tax efficient as possible and to achieve their estate planning goals, there will be some amount of complexity. The key question to ask is whether the plan is as tax efficient as possible while still attaining the family's goals and objectives. It is not an easy undertaking for many families. That is why it makes sense to break the project into various components, which will be referred to as "buckets," with each bucket being addressed and filled deliberately and thoughtfully. Each bucket must be coordinated with the others to ensure an efficient plan that the family is comfortable with and that fulfills their unique circumstances and needs.

Let's break it down

Bucket #1—You

Individuals and married couples need to make sure to keep access to and control of all resources they will need to maintain the lifestyle they intend to enjoy throughout their lives. Since no one has a crystal ball to tell them exactly how long this will be, this is not an easy first step. In filling the first bucket, families should think about ongoing expenses, future purchases and desired cash flow to determine what assets need to be allocated to this bucket. Once that amount has been determined, fill this bucket! It is important to build in flexibility and to develop plausible "Plan Bs" in the form of exit strategies or asset allocation adjustments in case unanticipated circumstances arise.

Bucket #2—Family

This bucket contains assets that are set aside and continually enhanced through various estate planning techniques, utilization of all or a portion of lifetime

exemption amounts, and vehicles designed to leverage the value and growth of assets in the bucket. This is the family bucket.

First, "family" must be identified. Family may include spouses and partners, children, grandchildren and more remote descendants, siblings, nieces and nephews, and many times parents and close friends. Basically, anyone you wish to identify as a beneficiary is a member of your "family." There are various ways in which to fill this bucket, many of which can help reduce the potential estate tax liability and/or freeze potential estate tax liability at a particular amount. However, tax mitigation must not be the only driver. Goals and expectations for beneficiaries should be carefully considered. How often advisors likely hear:

- "I don't want to ruin my children by giving them too much, too soon." And,
- "No one gave me a multimillion dollar trust fund. I want my children and grandchildren to make their own way in this world." Or,
- "I want to wait to let them know there may be a safety net available until after they've successfully sailed their own ship."

Deciding whether to fund this bucket and how much to allocate to it may be daunting and confusing, and your ideas about it may very well change as the years go by. Therefore, it's also important to build in flexibility for filling this bucket, to allow for changed circumstances or unexpected events that may happen over time.

Ways to fill Bucket #2

- **Lifetime gifts**
  Annual exclusion gifts. One simple way to begin filling this bucket is by making annual exclusion gifts of up to the applicable amount in any given year (the annual exclusion amount adjusts every few years so it is important to know the maximum amount at the time you make a gift). A donor may give this amount to as many donees as they wish. These gifts may be made outright or to a trust for the benefit of the donee, provided, however, that the trust must contain certain "withdrawal rights" for the gifts to qualify for annual exclusion treatment. While the annual exclusion amount may not seem like much (a mere drop in the bucket) for many wealthy families, the compounding of these gifts over time can lead to significant wealth transfer, thus mitigating future estate tax liability.

- **Utilization of lifetime exemptions**
  Under current federal law, each U.S. taxpayer has a certain amount of lifetime gift tax exemption, estate tax exemption and generation-skipping transfer tax exemption, which may be utilized through gifts made during life or upon the transfer of assets at death. Gifting all or a portion of your lifetime exemption amount, particularly if you give assets that may have a depressed value at the time of the gift, may allow you to begin to fill the family bucket and to transfer the appreciation of these assets from your taxable estate.

- **Leverage gifts to the trust**
  Once the family bucket has been initially funded with annual exclusion gifts and/or gifts of lifetime gift tax exemption, you may leverage and grow the trust's assets through the use of additional estate planning strategies. For example, you might choose to sell additional assets to the trust over time. Once it has assets, the trust can be a viable buyer and participant in future business opportunities and transactions.

  What might this look like? Let's say you own a closely held business. You may choose to sell a percentage of the business to the trust. First, a qualified business appraiser should appraise the value of the business interest to be sold to the trust (and may apply discounts to the fair market value due to lack of marketability and control). You then sell the interest to the trust in exchange for a promissory note. The note may be

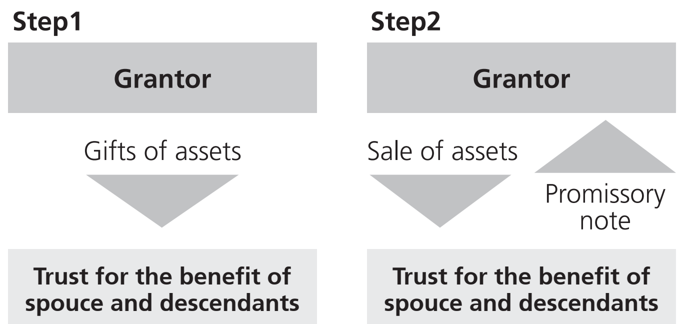
structured as you determine. Most often, such notes require annual interest payments and a balloon payment at the end of the note term. Assuming that the value of the assets is greater than the combined amount of the interest and balloon payments, the appreciation will remain in the trust for the benefit of the beneficiaries. The trust may be structured to benefit multiple generations in a tax-efficient manner.

- **Leverage gifts using life insurance**
  Another option is to leverage gifts to the trust through the purchase of one or more survivorship life insurance policies.

  Here's how it works. The trustee chooses to purchase one or more survivorship life insurance policies on the lives of the grantor and grantor's spouse. The policy will be owned by the trust and trust assets will be used to pay the required premiums. At the death of the last to die of the insureds, the proceeds are paid to the trust and are available for the benefit of the beneficiaries. This allows families to target an additional amount and use life insurance to ensure that this amount will be available for their beneficiaries.

  Some families have a specific amount in mind that they would like each beneficiary to receive, and life insurance can be a powerful tool to achieve this goal.

  By funding Bucket #2, the family bucket, you may set aside during your lifetime all or a portion of the amount that you intend to leave for the benefit of your family. This allows you to essentially "pre-fund" their inheritances. Other benefits of funding the family bucket include:
- The ability to mentor and coach beneficiaries regarding your expectations and their financial acumen to reflect your family's philosophies regarding wealth;
- The family can enjoy their wealth together while everyone is living, rather than waiting until the death of the matriarch and patriarch;
- Efficient transfer of wealth from your taxable estate to trusts for your beneficiaries.



Bucket #3—Philanthropy
The philanthropy bucket can be particularly helpful to charitably inclined families because this bucket allows families to potentially eliminate all remaining estate tax liability while achieving philanthropic intentions. Assuming that Bucket #1 was consumed during life to fund lifestyle expenses and Bucket #2 has been funded over time with a sufficient amount for the beneficiaries' inheritance, all remaining assets may be directed to Bucket #3 to fulfill charitable goals and to help reduce or eliminate estate taxes.

Under current federal law, any assets passing to charity upon death receive a charitable deduction for federal estate tax purposes. So, if an entire taxable estate is directed to charity at death, no estate tax would be due.

There are a variety of charitable vehicles to choose from, in addition to gifts to a specific charity, including a private foundation, donor-advised fund and different types of charitable trusts.

Family foundation
A tax-exempt nonprofit entity created for the sole purpose of managing and dispersing assets dedicated to charitable giving. A family foundation offers a high degree of control and flexibility but requires a great deal of skill and attention to manage.

Donor-advised funds
Created by making a contribution to a public host charity, which then deposits the funds in a separate investment account. Once transferred, the funds are owned and controlled by the host charity.

Charitable Lead Trust
Created and funded by the grantor, after which the trust transfers a portion of its assets each year to one or more charities chosen by the grantor. At the end of the trust term, the remaining trust assets are distributed to the grantor's children or other non-charitable beneficiaries.

Conclusion

By identifying appropriate amounts and methodically filling each bucket, over time, families are potentially able to maximize assets passing to beneficiaries while fulfilling their philanthropic goals in a tax-efficient manner.

The Bucket approach—Zero estate tax plan

Bucket #1—you	Bucket #2—Family	Bucket #3—Charity
Consumed during lifetime	Funded during lifetime through gifts Leveraged with other strategies such as sales and life insurance	Directed to charity at death May represent entire taxable estate such as sales and life insurance

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