

Estate Planning in 2015 and Beyond

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Michael E. Kitces

MSFS, MTAX, CFP®, CLU, ChFC, RHU, REBC, CASL

Partner, Director of Research, Pinnacle Advisory Group

Publisher, The Kitces Report, www.kitces.com

Blogger, Nerd's Eye View, www.kitces.com/blog

Twitterer, @MichaelKitces, www.twitter.com/MichaelKitces



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The Sunsets of the Fiscal Cliff

- Economic Growth & Tax Relief Reconciliation Act of 2001 & JGTRRA of 2003 (“the Bush tax cuts”)
 - Sunset provisions scheduled for December 31, 2010
- Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010
 - Kicked the ball forward for 2 more years
- Compromise legislation finally resolved with the American Taxpayer Relief Act of 2012
 - ATRA was “permanent” legislation!

The American Taxpayer Relief Act of 2012

- ATRA made permanent key estate tax rules
 - Exemption stayed at (inflation-indexed) \$5M
 - Up to \$5.43M for 2015
 - Gift and estate tax systems remained unified
 - State estate tax deduction remained
 - State estate tax credit permanently gone
 - Top estate (& gift & GST) rate rises to 40%...
 - ...but made permanent!
- Portability of estate tax exemption now *permanent*

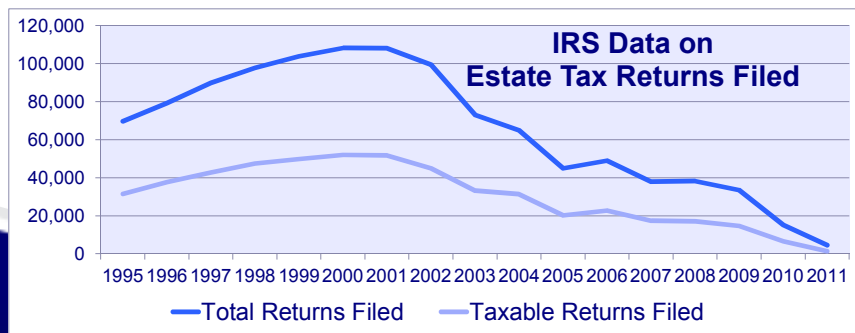
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Estate Planning in 2015 & Beyond

- Scope of estate tax declining dramatically
 - Heckerling estimates ~4,000 taxable estates annually now
 - And only ~half of those are taxable!
 - Filings for portability rising, but tax exposure still declining



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State Estate Tax Legislation

- *States* have been revisiting their estate tax legislation
 - No longer hoping for return of state estate tax credit
- State decoupling 2.0
 - States lost Federal (gift) system backing their exemptions
- Establish gift tax, gift-in-contemplation-of-death, recouple, or repeal?
 - Recoupling solves lack of state portability as well

Rules/Requirements for Portability

- Portability allows a surviving spouse to carry over the “Deceased Spouse’s Unused Exclusion Amount” (DSUEA)
 - Available to surviving spouse in addition to his/her own \$5.43M basic exclusion amount (BEA)
 - BEA indexed over time
 - Carryover DSUEA amount is *not* indexed!

Rules/Requirements for Portability

- *Requires* an estate tax return to be timely filed
 - Only available for deaths that had occurred after 2010
 - Simplified filing requirements for nontaxable estates
 - No proactive election to be made, beyond actually filing the return
 - Only opt *out* if not desired
- Applies for gift and estate tax exemptions
 - Does *not* apply for GST exemption, though
 - *No* state conformity at this point

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Examples of Portability

- Harold leaves \$4M to wife Betty
 - Marital deduction reduces taxable estate to \$0
 - Harold's unused exemption: \$5.43M *portable to Betty*
 - Betty's (new) available exemption: \$5.43M + \$5.43M = \$10.86M
- Harold leaves \$1M to Betty and \$3M to his children
 - Marital deduction only \$1M
 - Remaining estate uses \$3M of \$5.43M exemption
 - Exemption ported to Mary: \$2.43M
 - Betty's (new) available exemption: \$5.43M + \$2.43M = \$7.86M

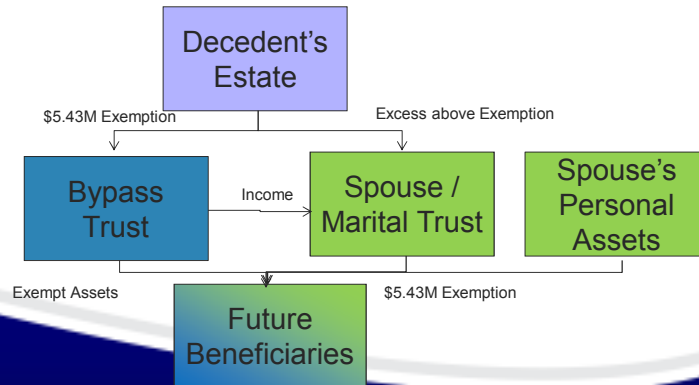
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Planning for Portability

- The decline of the bypass trust
 - No longer necessary to preserve the estate tax exemption amount at the death of first spouse



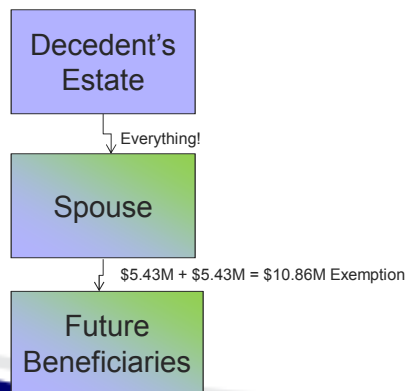
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Planning for Portability

- The rise of the “I love you” Will
 - “Honey I leave you everything, including my assets and my estate tax exemption!”



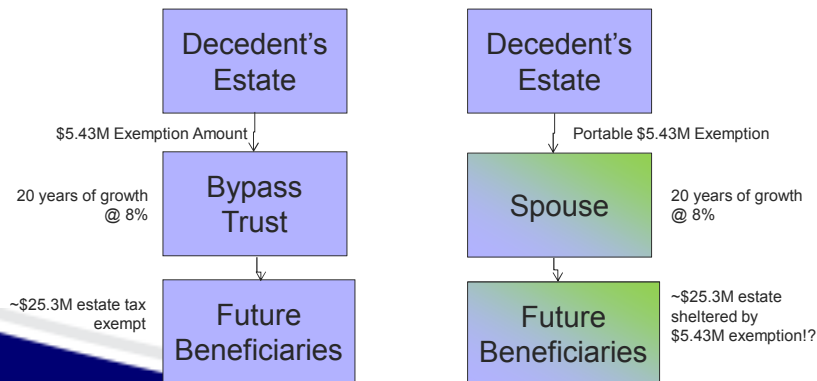
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Planning for Portability

- When “bypass” trusts remain relevant
 - Sheltering *future growth* from exposure



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Planning for Portability

- When “bypass” trusts remain relevant
 - State estate tax planning
 - Relevant for (still) decoupled states
 - Using GST exemption for multi-generational trusts
 - GST exemption not portable at all!
 - Protecting exemption for/from remarriage
 - Asset protection and other *non-tax* reasons for trusts

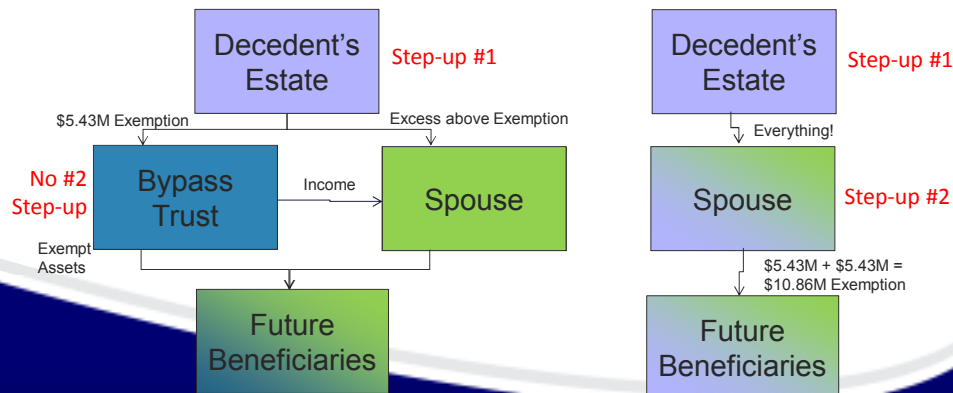
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Planning for Portability

- Do you really want to create a bypass if you don't *have* to? Impact on step-up in basis:



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Planning for Portability

- Do you really want to create a bypass if you don't *have* to?
 - Unfavorable trust income taxation
 - Top tax rate 39.6% at only \$12,300 of taxable trust income
 - 20% long-term capital gains, 20% qualified dividends, 3.8% Medicare surtax also apply
 - Doesn't apply if income passes through...
 - DNI deduction for trust
 - But does that defeat the purpose of the trust?

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Estate Planning in 2015 & Beyond

- 3 types of clients
 - High net worth (HNW) – exposed to estate tax
 - Net worth of \$10M+
 - Potentially HNW – might be exposed some day
 - Net worth that could grow (if client is young enough?)
 - Ongoing gifting to keep clients from crossing the line?
 - Everyone else

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Estate Planning in 2015 & Beyond

- *Most* clients will no longer have a Federal estate tax problem going forward!
 - Will it be difficult to motivate estate planning?
 - Will permanence finally pull fence sitters out?

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Estate Planning in 2015 & Beyond

- Any estate *tax* planning that remains will be primarily a *state* issue rather than Federal
 - Bypass trusts remain relevant at state level
 - But is it worth unfavorable income taxes & also losing step-up in basis?
 - It's not about what state the client *lives* in, but what state the client *dies* in!
 - Will clients be relocating (after 1st death?)
 - Challenges of mismatched state/Federal exemptions
 - Lifetime gifting & SLAT strategies?

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Estate Planning in 2015 & Beyond

- Introducing the Spousal Lifetime Access Trust (SLAT)
 - Structured similar to bypass trust
 - May distribute or retain income
 - May distribute or retain principal
 - Typically restricted to HEMS
 - Funded during life, *not* during death
 - Avoids state limitations when there's no gift tax
 - Can be done for both spouses...
 - But watch out for reciprocal trust doctrine

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Estate Planning in 2015 & Beyond

- Estate planning will shift away from estate *tax* planning
 - Renewed focus on *real* estate planning: the disposition of assets, including management, control, and protection
 - Providing for the needs and care of children/family
 - Still especially relevant for businesses!
 - Asset, divorce, & spendthrift protection
 - Revocable living trusts still useful for probate avoidance

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Estate Planning in 2015 & Beyond

- Estate planning will shift away from estate *tax* planning
 - *Income* tax ramifications of estate planning decisions
 - Preserving step-up in basis at death
 - Asset titling impact on step-up?
 - Avoiding trust tax rates where feasible?
 - Using portability to shelter IRAs
 - Are disclaimer trusts just unnecessary complexity?

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Estate Planning in 2015 & Beyond

- Greater attention to “supporting” documents
 - Powers of Attorney
 - Health Care Powers of Attorney
 - Advanced Medical Directives
- Filing Form 706 returns will *rise*, though, to maintain portability carryover
 - How small is “too small” for an estate to file a return?
 - Simplified filing will help?

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Transitioning Estate Planning *in 2015*

- Unwinding estate planning strategies for income tax benefits?
 - Updating documents to remove bypass trusts?
 - Shifting distributions to existing bypass trusts?
 - Busting QPRTs? Re-evaluating FLPs?
Unwinding ILITS?
 - But don't breach fiduciary duties of trustees!

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Estate Tax Legislation in the future

- Further “crackdowns” on estate planning coming
 - *Generally targeted at ultra-high-net-worth*
 - Minimum time limit (10 yrs?) for GRATs
 - Restrictions on FLPs & valuation discount strategies
 - Elimination of IDGT strategies
 - Maximum duration for GST?
- Limitations on stretch IRAs?
 - But relief on RMDs for small accounts?

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Estate Tax Legislation in the future

- What’s else might change:
 - Top rate: Maybe | Exemption: Unlikely

Year	Exemption	Top Rate	Year	Exemption	Top Rate
1916	\$50,000	10%	1985	\$400,000	55%
1917	\$50,000	25%	1986	\$500,000	55%
1918-1923	\$50,000	25%	1987-1997	\$600,000	55%
1924-1925	\$50,000	40%	1998	\$625,000	55%
1926-1931	\$100,000	20%	1999	\$650,000	55%
1932-1933	\$50,000	45%	2000-2001	\$675,000	55%
1934	\$50,000	60%	2002	\$1,000,000	50%
1935-1939	\$40,000	70%	2003	\$1,000,000	49%
1940	\$40,000	70%	2004	\$1,500,000	48%
1941	\$40,000	77%	2005	\$1,500,000	47%
1942-1976	\$60,000	77%	2006	\$2,000,000	46%
1977	\$120,000	70%	2007	\$2,000,000	45%
1978	\$134,000	70%	2008	\$2,000,000	45%
1979	\$147,000	70%	2009	\$3,500,000	45%
1980	\$161,000	70%	2010	Repealed	N/A
1981	\$175,000	70%	2011	\$5,000,000	35%
1982	\$225,000	65%	2012	\$5,120,000	35%
1983	\$275,000	60%	2013	\$5,250,000	40%
1984	\$325,000	55%	2014 - ???	\$5,340,000	40%

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Summary

- Permanent increase of estate tax exemption removes most from scope of Federal estate tax
 - Focus on maximizing step-up in basis instead
 - Portability “simplifies” planning & reduces need for bypass trusts
- State estate tax dominant theme for many clients
 - Watch out for changes to state estate tax systems!
- From estate *tax* planning to *real* estate planning

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