



## ADVANCED ESTATE PLANNING TECHNIQUES

COUZENS, LANSKY, FEALK, ELLIS,  
ROEDER & LAZAR, P.C.

Country Club Office Centre  
39395 West Twelve Mile Road, Suite 200  
Farmington Hills, Michigan 48331

248-489-8600

[www.couzens.com](http://www.couzens.com)  
[info@couzens.com](mailto:info@couzens.com)

Estate planning involves providing for the orderly management and disposition of our property. Advanced estate planning techniques are used to minimize federal gift and estate taxes and to shelter assets from potential creditors. The key techniques involve leveraging the tax free amount, i.e. the applicable exclusion, and discounting the value of assets transferred.

Two rules are critical when analyzing the federal gift and estate tax. First, anyone may transfer during life or at death an unlimited amount to their U.S. citizen spouse without any federal estate or gift tax. This can delay any estate tax until the second death. Second, no out-of-pocket gift tax is payable on annual exclusion gifts and gifts exceeding that up to the lifetime gifting exclusion; and no estate tax is due at death on the unused applicable exclusion amount. In some circumstances, a surviving spouse may even use the part of the exclusion not used by their deceased spouse, so called "portability", if proper forms are filed on the first death.

Changes are expected. Care must be exercised. Planning should be reviewed and updated regularly.

With taxable transfers, tax rates of 55% or more have applied. States may impose a separate estate or inheritance tax.

### TWO A-B TRUSTS

A Living Trust is typically an agreement to hold property for yourself during life and then for your beneficiaries/ distributees. You may amend the trust. Assets in trust are not probated upon disability or death.

A married couple can shelter two (2) applicable exclusion amounts from estate tax, if they each properly use a Living Trust. Each trust would establish a residuary share to hold the exclusion amount when the creator dies. By contrast, joint ownership between husband and wife will provide only one (1) exclusion, unless portability applies.

### IRREVOCABLE LIFE INSURANCE TRUSTS

Irrevocable Life Insurance Trusts ("ILIT") have been used to eliminate estate taxes on life insurance. Other advantages include:

- Only the premium is treated as a gift.
- The premium gifts can qualify for the annual gift tax exclusion.
- A split dollar premium payment arrangement can further leverage the gifts being made.
- The insurance proceeds can support beneficiaries for several generations, if desired.
- The insurance proceeds can indirectly provide funds to pay taxes and administrative expenses.

An ILIT is typically the owner and beneficiary of life insurance on the creator. Existing insurance must be in the ILIT three (3) years before the death of the insured to be outside of the estate. New insurance can be excluded immediately. Premiums are gifted to the ILIT by the insured individual. Careful drafting is important, since an ILIT cannot be amended.

### ANNUAL GIFTING

Everyone may gift up to the annual gift tax exclusion amount (\$14,000 per year in 2017, increased by COLA thereafter), to as many individuals as the donor desires. These gifts are gift and estate tax free. The gifts must be either: (a) a present interest, (b) transfers under the Uniform Transfer to Minor's Act, (c) gifts to special trusts, or (d) special tax law arrangements. Unlimited gifts of tuition and medical expenses may also be tax-free. Gifts over the annual gift tax exclusion amount may be covered by the lifetime gifting exclusion amount.

### FAMILY LIMITED PARTNERSHIPS

A Family Limited Partnership ("FLIP") is a partnership between family members in which limited partnership interests are gifted to children or grandchildren at values that are discounted from full equity or liquidation value. Gifts of minority interest, non-voting and/or restricted stock in S corporations, C corporations or limited liability companies can have the same effect.

The following steps are typical:

- A parent establishes the business entity, receiving general/voting and limited/non-voting interests in exchange for real estate, securities or other assets.
- The parent retains the controlling voting interest and manages the entity.
- The parent gifts to children or grandchildren, directly or through gifting trusts, restricted interests that include significant equity. The gifts may be discounted. Future income and appreciation are shifted to the donees. Some state laws restrict the ability of creditors to reach the assets in such entities.

## **CHARITABLE GIFTS**

Even after Living Trusts, ILITs, annual gifting and discounted gifts have been used, some estates might still be subject to federal estate tax. However, several charitable planning techniques can reduce or eliminate applicable taxes completely. The primary arrangements include the following:

- A Charitable Remainder Trust or "CRT" provides income to a non-charitable beneficiary for a period of time, with the remainder passing to charity. The remainder value can be deducted from the donor's estate. The payout may be a fixed annual amount or a fixed percentage of the annual fair market value of the trust.
- A Charitable Lead Trust or "CLT" provides income to charity for a period of time, with the remainder returning to the donor's heirs later. Applicable estate tax on the amount received by heirs could be reduced depending on the charitable payout. With either the CRT or CLT, an ILIT or wealth replacement trust can be used to give children and grandchildren the inheritance desired, replacing with life insurance the assets that pass to charity.
- A private foundation may be the beneficiary of a CRT, CLT or other charitable gifts, keeping the assets dedicated to charitable use under the control of the donor or the donor's family.
- Bargain sales, charitable gift annuities, charitable gifts of IRA or other qualified retirement plan assets, sale of a residence to charity with a retained life use and similar charitable gifting techniques can generate tax deductions, reducing taxes.

## **QUALIFIED PERSONAL RESIDENCE TRUST**

A Qualified Personal Residence Trust ("QPRT") is an irrevocable trust into which a parent transfers a residence, keeps the right to use the residence for a fixed number of years and gives the remainder interest to children or grandchildren. The gift is the value of the

remainder interest, as determined under IRS regulations, not the value of the entire residence. Thus, a discounted gift results. The residence can be sold, replaced or leased, subject to applicable regulations.

## **GRITs, GRATs & GRUTs**

GRITs, GRATs and GRUTs are trusts into which an individual transfers assets and keeps a right to an annual income amount, for life or a set number of years. The value of the remainder is a discounted gift to the beneficiaries who receive the assets when the income payout ends. These are typically children or grandchildren. Compliance with applicable technical regulations is important.

## **WHAT SHOULD YOU DO NEXT?**

Contact one of our attorneys for additional information about advanced estate planning techniques.

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This publication does not attempt to give specific legal or tax advice. For advice in particular situations, the services of competent legal, tax or financial planning advisors should be obtained.