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■ Shenkman

PRACTICAL PLANNER®

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RISKY BUSINESS

Summary: When you think “Risky Business” you probably think of the Tom Cruise movie, his parents on vacation, and the ensuing antics. Well, the risks in Tom’s adventures probably pale by comparison to the risks in your estate plan. But feel free to let loose and lip sync Old Time Rock n’ Roll while you read on. While you may have taken the Alfred E. Neuman “What, me worry?” approach to your planning, that might make you Mad!

■ **Risk?** What Risk? Gee, are your investment returns guaranteed? Surely not. Many estate planning techniques are interest rate dependent. Who can predict interest rates? Many estate planning techniques depend on when you die. Die too early and a GRAT might not work. Die too late and a private annuity might shift value into not out of your estate. Does your home contractor guarantee you that nothing will ever go wrong? Of course not. Even really common planning techniques, like a life insurance trust, are subject to uncertainty. The law on whether an insurance trust is a wholly grantor trust for income tax purposes (which can be really important to your planning) is as clear as mud. Oh, and by the way, and you might want to sit down for this one, tax laws change a lot! Yeah, that’s a shocker. So, whatever you did last year may not be optimal this year, and may not work well next year, and the year after it could be a disaster. And just to hopefully drive the point home, you wouldn’t drive your car for 50,000 miles without an oil change and expect it to hum, well your estate, insurance, and financial planning are no different. Get a check up every 5,000 miles or face the risk of serious damage and expensive repair bills.

■ **Insert Listing You Should Review:** A “Risk Factor” summary is attached as an insert in this issue of the Practical Planner. If you’re a real person doing estate planning read and understand the risk factors listed, understand that some or many may apply to all the planning you have done, and there are assuredly other risk factors unique to your planning not listed.

■ **Different Advisers Can Identify Different Risks** If you want to understand more of the risks, your planning might face, consult your entire advisory team. Members from different disciplines will have different insights. For example, your wealth manager, not your attorney or CPA, should be monitoring asset location decisions for securities as well as swap powers. Those are essential to the success of many plans. Oh, and that disclaimer that you have to rely on your tax adviser for tax matters - really? If you’re using a pure investment adviser that might be the case (maybe). But if you’re working with a wealth adviser that provides comprehensive financial planning services (and many advertise that they do estate planning as well, but just don’t draft documents), they gotta get on

this stuff since they have the handle on investment details other advisers generally don’t have. Further, the fact that any one of your advisers communicates verbally or in writing certain risks should never be interpreted as an indication that any such listing or communication is a comprehensive listing or communication of every risk involved.

■ **Deal with It:** If you plan, you have to understand that the results are never guaranteed. Many aspects of estate and related plans are uncertain and subject to a wide spectrum of different views by other advisers, the courts, and the IRS. Most strategies have negative

consequences (e.g. save estate tax, lose basis step-up). Even many common techniques are subject to tax, legal and other risks and uncertainties. While your advisers no doubt endeavor to identify and inform you of some of the risks of a plan, it is not possible to identify every risk and issue.

■ **Mitigating Risk #1:** Creating a collaborative team will help identify more issues with your plan. Identifying issues is the first step to being able to address them. The risks of any transaction can be further compounded by improper administration of the plan, failure to review and

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CHECKLIST:SANDERS PLAN

Summary: Might the Blue Wave continue in 2020? Who knows. But the Blue Wave might have those of wealth singing the Blues. If there is a Democratic shift in Washington in 2020 and if that has the tone of the current Presidential hopefuls that the rich don’t pay enough tax, harsh tax law changes may abound. Bernie Sanders introduced Senate Bill 309 “For the 99.8 Percent Act” that would reduce the exemption to \$3.5M and raise rates to 77%. You have two options: Plan now, or wait and see. If you wait — “you snooze you lose!” So what might be prudent to do now? Consider:

✓ **QTIPs** – Marital trusts such as Qualified Terminable Interest Property trusts are taxed in

the estate of the surviving spouse. Planners love this and have made this the default plan for many clients (one-fund QTIP with a disclaimer or Clayton) but hey if we end up with a much lower exemption those with QTIPs could be exposed to lots of tax. Consider a disclaimer of part of the income interest in the QTIP that would trigger a deemed gift of all QTIP principal under Code Sec. 2519. Another approach might be to distribute out the QTIP assets to the surviving spouse if the trust terms permit, and have her gift the assets to say a self-settled domestic asset protection trust (“DAPT”) of which she can be a benefi-

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...RISKY BUSINESS

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update the plan annually, changes in the tax and other laws that may reduce benefits or even create more costly results then had no planning been pursued. Annual meetings with a collaborative advisor team may identify risks, and mitigate risks, but still cannot provide certainty. If you do not meet regularly with a collaborative team of advisers your plan may not succeed. So, meeting with your entire planning team at least annually, before any significant transaction, and if there is a significant change in events (e.g. health issue, change in tax law, etc.). Regular pruning of your planning garden with your team is a great way to reduce (that word is not the equivalent to "eliminate") risks.

■ **Mitigating Risk Tip #2:** Buy life insurance. Yeah, I don't sell it so I can say it. You buy liability coverage to protect you from an auto accident. So buying life insurance can offset a loss of basis step up on assets transferred to an irrevocable trust, to use in a SLAT to offset the risk of your spouse

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dying prematurely, in case the Blue Wave results in a reduction in the estate tax exemption, in case you don't outlive the term of a GRAT, etc. It might all make sense. Insurance can protect against risk and there are a zillion ways you can creatively apply life insurance to mitigate planning risks. Long term care insurance or permanent life insurance with long-term care features, or even annuities (yeah, I said that word too) might be useful to mitigate longevity risk. So, to reduce risk. Insure!

■ **Mitigating Risk Tip #3:** Get zealous about formalities. The folks at the IRS and the Plaintiff's bar are smart cats. Why should they haggle over headache inducing nuances of tax esoterica if they can nail you on sloppy administration? If you're getting divorced and your ex's attorney finds that you deposited marital funds into your irrevocable pre-marital trust that's an easier line of attack to piercing the trust protection then arguing that the trust is somehow otherwise accessible. If you have an LLC and paid your personal bills, that could be an easy chink in the entity armor. If you have an insurance trust and didn't open a bank account, didn't issue Crummey notices, never filed a gift tax return, and so on, doesn't that make an easier avenue of challenge by just saying you ignored the trust so why should the IRS or a claimant be bound to respect it? If you created an irrevocable trust but had quarterly tax reimbursements paid, took loans out of the trust, and more, it starts to look like you had an implied agreement with the trustee. That won't help your cause. Do your trust statements reflect the assets the trust owns? Are you filing the correct tax returns? Have your advisers help you monitor the admiration of your plan and if you find the inevitable goof up fix it. But do everything possible to avoid the goof ups as that type of paper trail is not helpful. Never commingle.

■ **Mitigating Risk Tip #4:** Use an institutional trustee. Yeah, they charge you money, but Aunt Jane will serve as trustee for free and also give you homemade chocolate chip cookies at trust meetings. Skip the

cookies and get a pro involved. Professional trustees keep records, have policies and procedures, are really independent, and more. Aunt Jane might be sweet but having her involved likely won't reduce risks.

■ **Mitigating Risk Tip #5:** Use trust friendly jurisdictions. Sure, its simpler and cheaper to set up trusts in

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your home state but your home state may not love your trusts. States like AK, NV, DE and SD have made a point of creating trust friendly environments. Using these jurisdictions might reduce some legal, tax and other risks your plan is exposed to.

■ **Mitigating Risk Tip #6:** Layers. You know about layers. When you go fly-fishing you wear skivvies, long-johns 'cause that water can be cold even in summer, then waders. Well your planning needs layers too! If you have irrevocable trusts perhaps one or more LLCs owned by the trusts can own underlying assets. If asset protection is a concern, layer insurance and umbrella policies to serve as a line of defense before your trusts. If you are going to marry, even if you have trusts, get a prenup. If you completed a note sale transaction to lock in discounts and shift value out of your estate, revisit that plan and add new layers in future years. Might a trust that is the receptacle at the back-end of a GRAT be able to sell the remainder interest it will get from a GRAT to a dynasty trust? Might it be time to unwind a split-dollar agreement? Might an older trust be improved by decanting? Should appreciated assets be swapped back? Might powers of appointment be exercised? The list goes on. Planning needs to be tended to and new layers added to enhance the success of the initial or core plan. PP

...CHECKLIST: BERNIE SANDERS' ESTATE TAX PLAN

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ciary. If a QTIP is not GST exempt consider creating a grantor 678 trust and shifting value via a note sale to that new trust.

✓ **Crummey Trusts** – Lots of trusts including the typical life insurance trust are based on the premise of making annual gifts. What a hassle—gifts, writing checks, issuing annual demand notices (Crummey powers). That's as much fun as getting a root canal. Make a large gift to the trust (file a gift tax return) that will cover gifts for a long time and dispense with future annual hassles. If future laws lower the exemption or reduce annual gift exclusions this won't be possible. Get simplicity while you can.

✓ **Asset Protection** – Every doctor, and really every professional, board director, real estate developer, etc. should be concerned about liability exposure. Society seems to be getting meaner and more litigious. Big exemptions make it easy to transfer assets into protective irrevocable trust structure (whichever trust flavor you choose). Live the Nike slogan “Just do it!” if not the opportunity might be lost and only more complex, costly and riskier options may remain.

✓ **Bad Trusts** – Lots of old trusts are not optimally drafted, some have mistakes, many were created when planning styles were different (e.g. distribute assets to bennies outright at say age 30, instead of keeping in long term trusts), they may not have allocated GST exemption, and so on. Do your housekeeping now while there's gift and GST exemption in case you need them to cleanup.

✓ **Split-Dollar/Note Sales** – Many wealth taxpayers, who are barely wealthy now relative to the high temporary exemptions, engaged in split-dollar life insurance plans, and note sale transactions, and other techniques to shift wealth out of their estate. A simple gift to the trust involved in the plan might be used to unwind that old plan and simplify ongoing plan administration.

✓ **DAPTs/SLATs** – Domestic asset protection trusts (“DAPTs”) are trusts you create that you are a beneficiary of. Spousal lifetime access

trusts (“SLATs”) may allow you to continue to benefit indirectly from assets you shift out of your estate. There are risks and lots of options with either of these techniques but the key is that for most folks some form of access is critical to gift away sufficient assets to use most/all of their exemption.

✓ **Step-Transaction Doctrine** – If there are a sequence of steps in a plan that are not independent the IRS might disregard them. Example wife gives \$5M of assets to husband who the next day gifts those assets to a SLAT. The IRS might disregard the intervening step of the gift to the husband and the husband to the trust and treat the transaction as if wife gave the assets to the trust. If she has already used her exemption that could trigger a gift tax. If wife made the gift to husband now in

2019, If those funds were commingled with his and invested and then more than a year from now in 2020 he made a gift to a trust, the risk of a step-transaction challenge might be reduced. Waiting might harm your planning.

✓ **Upstream Planning**—this can entail creating a trust and giving a general power of appointment (“GPOA”) to an older family member with a small estate. That will cause appreciated assets to be included in their estate, and obtain a step-up in income tax basis on those assets. So long as their assets and the assets of the trust are under the \$11.4M exemption there will be no estate tax cost to getting the basis step up. But think of what a \$3.5M exemption might do to that planning? Be careful creating such arrangements going forward. **PP**

RECENT DEVELOPMENTS

■ **House Donation:** This rather detailed case is quite fact specific but offers valuable lessons on several important charitable giving topics that have much wider applicability. There is a detailed discussion of what is required in a qualified appraisal, with a number of points of what not to do in an appraisal for a charitable donation if you want it to be respected. Another key issue was the receipt of quid-quo-pro benefit that disallowed a portion of the taxpayer's hoped for deduction. There is also a discussion of the rules on donations of a partial interest that stress the importance of understanding applicable state law. These are all valuable lessons for donors, advisers and charities alike. *Lawrence P. Mann et ux. v. United States*, No. 8:17-cv-00200.

■ **New York Gift Clawback:** A proposal has been made to retroactively reinstate the New York gift clawback. A New York estate will be increased by taxable gifts made after April 1, 2014 and within three years of death. Thus was to sunset on January 1, 2019. The proposal would reinstate this clawback and extend it from January 1, 2019 to the end of 2025. For New Yorker's this gift tax clawback could make planning more difficult and costlier.

■ **Consent Dividend:** The personal holding company (“PHC”) tax was created when the corporate tax rate was below the individual tax rate to prevent taxpayers from accumulating income inside a corporation at a lower tax rate. The PHC tax has largely been off radar for many years because the corporate tax rates exceeded those applicable to individuals. The 2017 Act reinvigorates the PHC tax since the maximum individual rate of 37% + NIIT now exceeds the maximum corporate of 21%. There is a significant incentive to hold cash and investment assets inside the C corporation. The tax is assessed under IRC Sec. 541, on the undistributed PHC income (IRC Sec. 545) a personal holding company at a rate of 20%. In a recent PLR 201901002, a corporation was granted a 60-day extension to make a Code Sec. 565 consent dividend election to avoid the penalty because it relied on the mistaken advice of a CPA. The taxpayers were given additional time to file Schedule PH and Form 972, Consent of Shareholder to Include Specific Amount in Gross Income, and Form 973, Corporation Claim for Deduction for Consent Dividends. **PP**

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PLANNING POTPOURRI

■ **Closing Letter Doesn't Stop Audit:** The IRS can reopen or start an exam of an estate tax return even after it issues a closing letter. Closing letters sound like they should close the chance of an audit. Closing letters say that they do not constitute a formal closing agreement under Sec. 7121. So the IRS can reopen the exam and issue a deficiency notice. If an audit is closed the IRS won't reopen the file unless there is fraud, concealment or misrepresentation of a material fact. If you get a closing letter from the IRS and want to wrap up an estate have all bennies sign release and refunding agreements before distributing. The bennies agree to refund distributions in case the estate has a liability, such as from a later audit. Audits after closing letters might occur as the IRS questions the deceased spouse unused exemption ("DSUE"). The IRS was not precluded from auditing the first to die spouse's estate merely because it accepted the return as filed. In re Estate of Minnie L.

Sower, et al., v Commissioner, 149 T.C. No. 11 (September 11, 2017).

■ **Gift/Estate Tax Audits are Tough:** Here's some of the stuff the IRS asked for on a recent estate tax audit concerning a trust. Keep comprehensive trust records as the trust operates. This is a good checklist of what trustees (and maybe trust protectors?) might want to have in their trust files: ■ All fiduciary income tax returns Forms 1041. ■ List of all gifts made to the trust per donee for all prior years. ■ Family tree for decedent going up at least one generation and down at least two from the decedent. ■ All bank statements for 3 years prior to death and 2 months after death. ■ Each insurance policy held in the trust, all amendments, modifications, riders and supplemental policies. ■ For each life insurance policy total premiums paid, date and amount of each premium, who paid each premium. Copies of every check or other document that evidenced a premium payment, etc. ■ If an insurance policy was surren-

dered or cancelled copies of all surrender requests, documents relating to cancellation, ■ Policy applications and any transfer of a policy. ■ Documents designating, and changing any beneficiary. ■ Insurance broker info. ■ Complete accounting for the trust from inception to date of death. ■ Documents showing all transfers to the trust, dates, descriptions and fair value of transferred property on date of transfer. ■ Documentation of all disbursements from the trust. ■ Documentation of all trust income and expenses. ■ Balance sheet of the trust. ■ All gift tax returns for the decedent and spouse. PP



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ESTATE PLANNING RISK FACTORS LISTING

We have prepared this listing to inform readers of many, but not all, of the potential Risk Factors related to estate and related planning. Many of these risks may have already been communicated to you by your advisers if you are involved in planning. If you pursue planning because of the risks of a change in Washington from the 2020 election, many of the below risks may affect you. Please understand that estate planning is inherently complex, subject to varying interpretations, and the laws change frequently. Periodic review and maintenance of every plan and document by a collaborative team of multidisciplinary advisers is essential. There is no assurance that any particular result will be realized. There are risks and negative consequences to every planning step and technique, some of which have not been enumerated in this listing, and others of which have been indicated in other communications, and some of which might be indicated in future communications from your advisers. If you have questions on how any of the risks listed below apply to you, please contact your advisors to discuss them. In all cases you should only proceed with any planning step if you understand and accept the known risks, and that there are always unidentifiable risks. If you proceed with planning, you will have to accept the risks and uncertainties involved. If you have existing planning and believe you misunderstood a risk involved, contact your planning team.

GENERAL RISK FACTORS.

- Your counsel may not be admitted to practice in each state and local counsel may have to be retained.
- Your advisers are not guarantors of results. All planning undertaken faces an array of tax, legal, and other risks.
- There are assuredly other risks and issues which are not reflected in this partial listing.
- Consider other verbal, email, and written communications your advisers have sent, or may send in the future, during the course of an engagement that identify other risks and considerations.
- In preparing any document your advisers rely on information that is supplied by you. Few, if any, advisers perform due diligence to confirm information provided.

PERSONAL RISK FACTORS

- Family dynamics are unpredictable in all families and lead to a range of possible risk factors.
- Life expectancy is uncertain and may be relevant to supporting various components of your planning. These might include cash flow and forecasts, the term of GRATs, the term of promissory notes, insurance decisions, etc.

ADVISOR RISK FACTORS

- Few estate and related plans can be structured, implemented or maintained without the cooperation of a collaborative team that addresses all relevant disciplines to your plan. It is your responsibility to authorize and demand that all advisers on your team collaborate.
- Consider the indemnifications and disclaimer various advisers place in their engagement letters and other documents and how that may limit your rights.

FINANCIAL RISK FACTORS

- The completion of a judgement and lien search, and a forensic evaluation by an independent specialist, are recommended as part of the due diligence for asset transfers.
- Cash flow projections should be performed to evaluate whether sufficient funds will be available for various required annual payments for certain transactions, and to help support that the transactions are sustainable.
- Fluctuations in interest rates may cause estate planning techniques to have unintended or undesirable results, or even to fail, and may adversely affect cash flow analysis that are relied on to assure adequate resources for living expenses or for a planning transaction to succeed.
- The price of an asset that is critical to a plan may decline in reaction to various events that cannot be controlled.
- Inflation can affect the value of assets or the success of a planning technique. Unanticipated material changes to rate of inflation could adversely affect gift, estate, and retirement planning goals.

- Reinvestment risk can affect various aspects of a plan. There is the risk that future proceeds from investments may have to be reinvested at a potentially lower rate of return.
- Dependence on particular assets, particularly non-diversified assets, can present liquidity risks.
- Loss of access to and use of income from property gifted to an irrevocable trust could create hardships for the transferor.
- Divorce or death of a spouse could reduce or eliminate indirect access to assets in a trust thereby undermining financial security.
- Adverse cash flow pressures resulting from the grantor of a trust having to make payments of income tax on the “phantom” income generated by a grantor trust, may be problematic.

ENTITY RISKS

- If an entity is not operated with due respect and regard to the independence and formalities of an entity separate from its owners, and if commingling of personal and entity assets or attractions is not avoided, the IRS and other potential claimants may be able to disregard the entity and any asset protection the entity may have afforded.
- Governing documents for entities should be updated periodically to reflect changes in the state entity and other laws.
- Inconsistencies in the documentation of entity interests, values or other factors in lender, bank, tax, or governing documents could raise questions as to the validity or integrity of a transaction or the entity itself.

STATE TAX AND OTHER STATE RISKS

- State courts in any state where you have a home, other assets or interests, may seek to tax you.
- Trusts may be taxed by different states based on different criteria. The law in this area is also evolving and remains uncertain.
- Residency and domicile are different concepts and your obtaining or retaining a residence in a particular state may subject you to income or estate tax in that state.
- If your connections, or the connections of a trust or other entity or activity to a state are sufficient that state may assert jurisdiction over you or that entity, trust or matter. This could result in very different laws applying thereby changing the intended results of a plan or transaction.
- Many trust plans may require a New Jersey Inheritance Tax Return and the possibility of having a “compromise tax.”
- New York’s estate tax system is decoupled and has a “cliff” which results in the elimination of the estate tax exemption when assets are sufficiently above the state exemption amount. New York also taxes so-called “ING” trusts as grantor trusts. NY may also have a gift tax.

MARITAL PLANNING

- If you are married or have a partner, be mindful of the limitations on scope of what your advisers can do to advise either of you.
- There is no certainty to how a court may interpret marital documents or provisions in a trust that address a spouse, e.g. a “floating spouse” clause in a trust.

MEDICAID AND SPECIAL (SUPPLEMENTAL) NEEDS PLANNING

- You must retain a specialist in each state where a special needs beneficiary resides and be mindful that laws are state specific and often change.

IRREVOCABLE TRUST RISK FACTORS

GENERAL IRREVOCABLE TRUST RISK FACTORS

- Trusts must be operated in accordance with their terms and respected as independent entities. Examples include, but are not limited to filing income tax returns, maintaining separate bank accounts, paying bills from the trust that are trust expenses, filing Form 56 with the IRS, filing gift tax returns, etc. must be addressed.
- Trust law and drafting and planning techniques change frequently.
- Title to assets owned by a trust must assure that title documentation conforms with actual steps taken and is consistent.
- All fiduciary and non-fiduciary positions and powerholder positions should be reviewed with professional advisers and the persons serving in those positions.
- Appreciation on assets transferred to an irrevocable trust will not be stepped-up on death of the transferor.

■ While there are mechanisms that might permit modifying an irrevocable trust (e.g. trust protector action, trust decanting, non-judicial modification of the trust), none of these options are assured to be available or tax free.

■ Assets transferred to an irrevocable trust may not be available to access, depending on the terms of the trust, state law, and the decisions of the fiduciaries holding distribution powers.

GRANTOR AND NON-GRANTOR TRUSTS GENERALLY

■ Income on grantor trusts is taxed to the settlor and could create a financial hardship to the settlor.

■ Grantor trusts may include a “swap” power, which must be carefully monitored and exercised in conformity with the trust instrument.

■ If a trust is intended to be non-grantor, the trust must not include various provisions that can taint the trust status as grantor, and the trust must be operated in a manner consistent with non-grantor status.

■ If the status of a grantor trust changes to non-grantor, income tax on negative basis assets could be triggered.

■ If real estate interests are transferred to a grantor trust, and which have been or will be fully depreciated and are subject to liabilities, capital accounts may be “negative.” The cessation of grantor trust status will trigger taxable gain.

SPOUSAL LIFETIME ACCESS TRUSTS (“SLATs”)

■ SLATs need to be created, funded and operated differently to avoid the reciprocal trust doctrine. Tax authorities and creditors may “uncross” separate trusts that are too similar thereby undoing intended tax and asset protection benefits.

■ Differentiation of SLATs may be achieved by incorporating different rights and benefits in each trust. Each party may not be treated equally under each document, depending on the terms, the beneficiaries of each trust may be treated in different manners economically which could be viewed as unfair or even a hardship on one or more of the beneficiaries.

■ If a married couple creates SLATs for each other, the death of one spouse may prevent access of the surviving spouse to one of the trusts.

INSURANCE TRUST RISKS

■ If you transfer life insurance by gift to a trust, the policy proceeds may be included in your estate if you die within three years of transfer. If you instead sell a policy you might avoid the three year rule.

■ Life insurance policies often do not perform as initially projected. You must monitor life insurance annually with an insurance consultant.

■ There are inherent tax risks with every life insurance trust and the common use of such trusts belies the risks involved. As but one example, if an insurance trust can use income to pay premiums on insurance on the life of a grantor, some commentators believe that makes the entire trust a grantor trust, but that result is subject to some uncertainty.

■ Premium financing adds financial risk to an insurance plan.

■ Split-dollar life insurance is subject to risks and there have been recent negative case law developments.

GRANTOR RETAINED ANNUITY TRUSTS (“GRATs”)

■ GRATs must be administered precisely in accordance with the regulations, including but not limited to the proper payment of the periodic annuity payment, not making additional gifts to the GRAT, etc.

■ GRATs are not GST exempt so that values remaining in GRATs will be taxed in the estates of the beneficiaries of the GRAT.

■ Self-Settled Domestic Asset Protection Trust (“DAPT”) Risks.

■ Many commentators view these trusts as inherently risky.

■ Some commentators believe that a person resident in a state that does not have legislation permitting DAPTs can not successfully create such a trust, and that if they endeavor to do so it will not be respected. In other words, some commentators believe DAPTs don’t work for residents of non-DAPT states.

■ The more connections a DAPT has to its host state, the greater the trust assets held within that state are, and the fewer connections to a non-DAPT state, may all enhance the possibility of such planning succeeding, but favorable results are not assured.

VALUATION AND TRANSACTION RISK FACTORS

GENERAL TRANSACTION RISKS

■ Valuation discounts may not be respected. Legislative proposals have been made to eliminate discounts. Discounts may reduce basis step up.

■ Valuation determinations may be challenged.

■ The IRS may apply a step-transaction or sham transaction doctrine to challenge the intended results of each transaction.

■ The IRS may argue that the transferor/decedent, in conjunction with others, continues to control assets transferred and thereby argue that none of the purported transfers shift value out of the transferors estate.

■ Creditors may attack any transaction as a fraudulent conveyance.

■ A trustee in bankruptcy may void a transfer to a self-settled trust or “similar device.” It is not clear how broad the latter term may be defined.

■ The proper administration, accurate recordkeeping, and respecting formalities of a transaction are essential to the IRS or other potential claimants respecting the transaction.

DEFINED VALUE MECHANISM RISKS

■ The “defined value” mechanisms used in transactions to deflect a valuation challenge by the IRS may not be respected.

■ The IRS may argue that a “spill-over” of excess value into a GRAT as part of a defined value mechanism is a second and prohibited contribution.

■ The IRS may not respect the use of the mechanism selected as the “spill over” for a defined value mechanism such as a GRAT, marital trust, donor advised fund, incomplete gift trust, etc.

■ If a defined value mechanism succeeds, it may potentially bring a portion of equity back into the transferor’s estate under the Powell case.

NOTE RISKS

■ Valuation of promissory notes is subject to different views and risks. The IRS often challenges notes that are discounted in a family context.

■ The terms of a promissory note must be adhered to and interest and principal must be paid in accordance with the terms of each promissory note. A default under a note must be enforced.

■ Some commentators believe that the deferred gain on a note sale transaction to a grantor trust is triggered on the grantor’s death.

GENERAL TAX RISKS

■ Changes in the tax laws may dramatically change the impact and effectiveness of any planning advice offered, it may even make a plan that may have provided tax or other benefits a detriment.

■ Federal and state tax laws may be adversely affected by new legislation, new interpretations, new case law, changing IRS or state/local tax authority audit strategies, and other factors.

■ There is a wide array of differing views of tax practitioners on the effectiveness of what some view as common tax planning strategies.

■ The value of the gross estate may include the value of any property (or interest therein) of certain gifts made within 3 years of decedent’s death.

INCOME TAX BASIS RISKS

■ Assets that are transferred to irrevocable trusts, and held within those trusts on death, may not get an income tax basis adjustment on death.

■ Step-up in basis at death may permit additional basis for annual depreciation deductions and may allow a reduced gain on sale.

■ If a grantor trust has a swap or substitution power, unless that power is monitored and exercised properly, it will provide no benefit.

■ Dividing community property means that if one spouse dies no basis step up on the non-decedent ½ of the community property will occur.

■ Community property trusts established in states that permit these techniques are not assured to provide community property treatment for those domiciled in non-community property states.

GIFT TAX RISKS

■ A gift tax return must be filed and adequately disclose all transactions, if the statute of limitations for an audit is to run.

■ Gift tax returns should appropriately allocate GST exemption, or if advisable, opt out of automatic GST allocation.

■ A gift tax audit could result in incurring gift tax, interest and penalties.

ESTATE AND GST RISKS

■ An estate tax audit could result in all or a portion of the transferred property being included in the gross estate of the donor/transferor.

■ GST tax may be incurred on a taxable distribution from a trust.

OTHER AND UNIDENTIFIED RISKS

■ *There are a myriad of risks associated with every estate, financial, insurance or other planning transaction. No adviser can identify all of them, and most risks cannot be quantified. You must proceed with a plan, or retain an existing plan, based on your decision to accept the risks, both known and unknown, in that transaction or plan.*