Wealth Transfer Newsletter December 2014

CURRENT DEVELOPMENTS, PLANNING OPPORTUNITIES & UPDATES

Wealth Transfer Team

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GREETINGS

Although the estate and tax planning landscape has undergone substantial change in recent years, we can rest assured that even more change is ahead. We hope that you find this newsletter informative and useful for your personal estate plans, finances, and any other related issues you have recently encountered or may find yourself facing in the future. Specifically, as we have detailed in this issue, "decanting" may provide you with options to make needed modifications to an irrevocable trust, updating your estate documents may provide your estate plan with added flexibility or address changed circumstances, and income tax planning is now as important as ever to address the rising income tax rates and their effect on your estate plan and your financial circumstances.

These are just a few of many of the planning options we offer our clients for a customized approach to meet their unique needs. With change comes opportunity - both to reevaluate an existing estate plan and to consider taking advantage of changes in the law and innovations in estate planning techniques. As always, we would be delighted for the opportunity to assist you!

Neill McBryde

MODIFYING IRREVOCABLE TRUSTS BY DECANTING

Over the years, many clients have created irrevocable trusts and transferred life insurance policies or other assets to the trusts in order for the assets to be outside of their estates for estate tax purposes. In the past these trusts could not be modified, even if unanticipated changes in circumstances had occurred. However, with the help of "decanting" statutes that have been adopted or are being adopted in many states, certain terms of an irrevocable trust may be altered with the cooperation of the trust's trustee.

Decanting can be especially useful when the beneficiaries or the grantor of an irrevocable trust would like to change trustee appointment provisions, update the distributive provisions of a trust, or otherwise revise the administrative provisions of a trust in an effort to enhance the efficient use of trust assets or simplify the management of one or more trusts. For example, multiple irrevocable trusts can be combined using decanting to streamline the administration of the trusts and the management of the assets of the trusts. A change in trustee can be accomplished through decanting when a current trustee or named successor trustee is no longer an appropriate choice as trustee. If certain trust beneficiaries develop spending or substance abuse issues which were not originally known or anticipated, decanting can be used to modify distribution terms to protect those beneficiaries and the assets of the trust. It may also be possible to modify an irrevocable trust that requires outright distributions to beneficiaries at specified ages by decanting to a trust that instead provides for assets to be held in trust for the benefit of multiple generations, providing for creditor protection with respect to the trust assets. New planning ideas can also be incorporated to improve the administration of the trust. Including the appointment of an investment advisor may be desirable in cases where the existing trustee may not be the appropriate party to make certain decisions, such as investment decisions related to a closely-held business.

While decanting provides many opportunities, care must be taken to ensure that a decanting complies with the laws in effect in a particular state. Furthermore, the proper application of trust decanting requires taking various additional issues into account, including income, estate, gift, and generating-skipping transfer (GST) taxes.

More recently drafted estate planning documents that you may have executed, as further described in the following article, may allow the trustee to amend the trust without having to decant to a new trust.

ESTATE AND TAX PLANNING INNOVATIONS

Estate planning is an ever-evolving area of law, and with the passage of time comes new innovations in the terms and structures of estate plans. As a consequence, it is advisable to revisit estate plans entered into years ago – even if their substantive terms are still generally representative of a person's wishes – to ensure that they adhere to and take full advantage of any changes in the law and, where desired, are able to permit greater flexibility for the fiduciaries ultimately administering the estate and any trusts.

Property can now be held in trust for longer periods of time than ever before. This ability to put "dynastic" trusts into place provides a grantor of a trust with a greater ability to leave a legacy that benefits multiple generations. These trusts can be structured to avoid the imposition of estate and generation-skipping transfer (GST) taxes by continuing to have assets held in trust through multiple generations of descendants. Furthermore, those trust assets have far greater protection against creditors resulting from a beneficiary's divorce, involvement in an accident, or unsuccessful business ventures.

When reviewing your estate plan, it is also worth considering whether the status of any beneficiaries has changed since estate planning documents were last reviewed. As descendants who are beneficiaries age and their families develop, trust restrictions may need to be tightened or loosened depending on the circumstances. Perhaps a child or grandchild has developed health issues or a disability which warrants special planning provisions in the estate plan or a separately funded trust, such as a special needs trust. Perhaps concerns over a beneficiary's marriage should also be addressed in an updated estate plan.

More recently drafted estate planning documents generally provide for greater flexibility for fiduciaries than they were traditionally given in older estate plans, including the ability to adapt to changing circumstances that are either in place at the time of the decedent's death or that arise after death. It is now generally accepted practice in many revocable and irrevocable trusts to include language allowing the trustee of the trust to amend the trust after the death of the grantor so that the trust may be administered more efficiently, both for tax and other reasons. By the same token, it may be advisable to incorporate certain provisions that place restrictions on a trustee, such as a trust protector, in cases where a grantor of a trust would like additional third-party oversight of the trust.

Documents such as financial powers of attorney, health care powers of attorney and living wills should also be reviewed on a regular basis. Many current financial powers of attorney specifically authorize access to digital accounts, such as email and social media accounts, allowing them to be closed or updated as appropriate (subject to the provider's terms of service). Additionally, many current health care powers of attorney and living wills better describe one's wishes in end-of-life situations and allow the named health care agent to make funeral arrangements rather than "next of kin" which is what certain states provide unless an updated document is used.

Similar to an individual's financial plan, an individual's estate plan should be reviewed on a regular basis even if the basic goals have not changed.

INCOME TAX PLANNING

The recent increases in the estate tax exemption, the ability of a spouse to take advantage of the unused exemption from his or her deceased spouse through "portability," discussed in greater detail in one of our prior issues, and the increase in rates applicable to higher income taxpayers, including the additional 3.8% net investment income tax, have caused income tax planning to become an even more important part of a comprehensive approach to estate planning. Estate planning in the traditional sense, therefore, may be less important for many individuals from an estate, gift, and generation-skipping transfer (GST) tax perspective. Instead, the focus of comprehensive estate and tax planning may include various methods of minimizing income taxes to which a person may be subject during his or her lifetime. These include, but are not limited to, the following common techniques:

- Section 1031 exchanges, which permit the deferral of income taxes on certain business or investment property if transferred for "like-kind" property, typically through the use of a qualified intermediary. This technique is most frequently used to transfer real estate, although it can be more broadly applied to other asset classes as well. Gain is not realized until the disposition of the property received in the exchange, allowing for the taxpayer to temporarily avoid capital gains.
- In addition to your typical 401(k) retirement plan, small business owners may also want to explore the creation of various additional profit sharing, pension plans, cash balance pension plans, or other types of retirement plans for themselves and their employees so that an increased amount of income is not currently taxed.
- Conservation easements allow a real estate owner to limit the use of property and obtain favorable tax treatment in the form of federal deductions and often state tax credits which can be used personally or sold in some cases. For example, should an owner be concerned about the future development of his or her property, a conservation easement might permit the owner to enjoy the property but prevent its development for commercial or high density residential purposes in the future.
- Including low-basis assets in a taxpayer's estate can provide a step-up in basis for those assets upon the taxpayer's death, avoiding income tax on that appreciated amount once those assets are eventually sold. This is a viable technique for a taxpayer who will not have a taxable estate and can be accomplished, for example, by giving a taxpayer who is a trust beneficiary with a "general power of appointment" over low-basis assets that are put into trust or by decanting low-basis assets already held in trust to a trust providing a taxpayer with a general power of appointment over those assets. For a taxpayer who has funded an irrevocable "grantor trust," substituting low-basis assets held in the trust with high-basis assets owned by the taxpayer outside of the trust can also ensure inclusion of those low-basis assets in the taxpayer's estate and allow those assets to benefit from a basis step-up upon the taxpayer's death.
- Gifting low-basis property to a parent is another way to allow the property to receive a step-up in basis through the parent's estate if owned by the parent for more than one year before the parent's death. Such gifting is an effective income tax planning technique for low-basis property held by a child who plans to dispose of the property during his or her lifetime and whose parents will not have a taxable estate.
- Capital gains may be purposefully realized in a particular year in which a loss is present to offset the gain. Realizing capital gain can also provide an effective strategy where a taxpayer owns capital assets with large built-in gain and expects to find himself or herself in a higher capital gains tax bracket in subsequent years.

Of course, care should always be taken to ensure that the "wash sale" provisions of the Internal Revenue Code are not triggered with respect to generating a capital loss.

- Assigning income to lower-tax-bracket taxpayers may be possible in certain cases, including a business where children may be employed or in cases where a corporation may retain earnings as an alternative to distributing them to shareholders.
- Captive insurance companies provide business owners with the ability to self-insure certain risks which might otherwise be uninsurable or uneconomic to insure, allowing a company or an affiliated entity to obtain certain tax benefits from that structure and retain the partial benefit of the premiums it pays to insure against that risk.
- While legal counsel cannot be in a position to recommend the financial benefit of investments, capital commitments to oil, gas, solar, or wind projects or other energy infrastructure may offer significant tax benefits. Also, certain types of life insurance may be used to reduce or potentially eliminate altogether income tax on the earnings within the policies.
- Sales of assets to a "non-grantor trust" on an installment basis will allocate gain across an extended period of years, allowing gain to be both deferred and possibly subject to a lower taxable bracket than it would had it been realized immediately upon a standard sale.

This list is not exhaustive, and many tax planning techniques for individuals exist that can be tailored to the particular needs of an individual or a family.

DID YOU KNOW

- 529 accounts and 2503(c) trusts are two popular ways to fund educational expenses for children and grandchildren.
- 529 accounts provide for tax deferred growth of contributed funds, and gains realized that are used to pay for qualified educational expenses are not subject to federal income tax. Some states also offer state income tax benefits. Donors may contribute up to the annual exclusion amount (currently $14,000) each year or may elect to make a front-end contribution of up to $70,000 to cover contributions permitted to be made for a full five-year period.
- A donor may also want to consider a 2503(c) trust if additional flexibility for the investment of trust assets or the use of trust funds is desired. While the donor of a 2503(c) trust cannot serve as trustee and 2503(c) trusts do not offer the same income tax advantages as 529 accounts, they do provide for greater investment options by the trustee and allow for the use of trust funds for purposes other than higher education without a penalty.
- Many states have repealed or otherwise altered their estate and gift tax laws. As an example, the North Carolina estate tax, which was assessed at a rate of up to 16%, was eliminated in 2013.

TEAM ACTIVITIES AND DEVELOPMENTS

U.S. News & World Report and Best Lawyers® have recognized Moore & Van Allen in their 2013 & 2014 "Best Law Firms" rankings, both nationally and within the Charlotte and Raleigh, North Carolina, and Charleston, South Carolina metropolitan regions. The **Charlotte** and **Charleston** offices received a Tier 1 ranking for Trusts & Estates Law, and the **Research Triangle** office received a Tier 2 ranking for Tax Law.

The Wealth Transfer Team welcomes **Thomas Cooper** as an attorney in the Charlotte office. Thomas recently co-authored with **Neill McBryde** "Tax Consequences of Section 736 Liquidating Distributions to a Partner" in *West's Estate, Tax, and Personal Financial Planning.*

Mark Horn received the Charlotte Magazine Five Star Award for Best in Client Satisfaction Wealth Manager (SM), was named to Business North Carolina's 2014 Legal Elite list and made the Super Lawyers list in North Carolina Super Lawyers Magazine. Mark also was recently named Vice President of the Charlotte Estate Planning Council.

Mark Horn and **Matt Kain** worked to develop the Kulwicki Driver Development Program (KDDP), established by the family of the late NASCAR Champion Alan Kulwicki to honor Kulwicki's legacy and to provide financial and other support to aspiring race car drivers early in their careers. **Mark Horn** serves as an advisor to the KDDP.

Chris Jones received the Charlotte Magazine Five Star Award for Best in Client Satisfaction Wealth Manager (SM), was named to The Best Lawyers in America for tax law and was named Secretary of the Southern Federal Tax Institute.

Jody Joyner has been named to Business North Carolina's 2014 Legal Elite list, the Super Lawyers list, which is included in the North Carolina Super Lawyers Magazine, and The Best Lawyers in America.

Matt Kain joined the Legislative Committee of the Estate Planning and Fiduciary Law Section of the North Carolina Bar Association.

Wilson Loftis was named to the Pro Bono Honor Roll by the Access to Justice Pro Bono Partners Program of Legal Aid of North Carolina - Charlotte and is serving as the 2014-2015 Chair of the Legal Feeding Frenzy Committee of the Young Lawyers Division of the North Carolina Bar Association, where he will be coordinating the annual statewide food drive sponsored by the Young Lawyers Division.

Paul Lynch has been named to The Best Lawyers in America.

Neill McBryde was named to The Best Lawyers in America, receiving special recognition for being included on the list for at least 30 years. Neill also was recognized as a national leader in the 2013 and 2014 Chambers USA Guide and made the Super Lawyers Top 100 lists in North Carolina Super Lawyers Magazine. Attorneys who were included in the Top 100 list received the highest point totals in the state nomination, research and blue ribbon review process.

Brad Van Hoy has been named to Business North Carolina's 2014 Legal Elite "Young Guns" list. Brad also recently became a board member of InReach, a local non-profit organization that supports individuals with developmental disabilities and their families.

Beth Wood was appointed to the Planning Committee, as an ex-officio member of Council, and as Chair of the CLE Committee for the Trusts and Estates Division of the ABA Section of Real Property, Trust and Estate Law.

Beth Wood and **Caitlin Horne** presented a webinar CLE in March 2014 as part of the Paralegal eLearning Program sponsored by the Real Property, Trust and Estate Law section of the American Bar Association covering key provisions in wills and revocable trusts.