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Subject: Barry A. Nelson & Cassandra S. Nelson - 6 Question 2018 Gift Suitability Analysis

“As a result of the Tax Cuts and Jobs Act of 2017 (the “2017 Tax Act”) 2018 provides a unique opportunity for you to make gifts using your federal estate, gift, and generation skipping transfer (“GST”) tax exemption (the basic exclusion amount) of $11.18 Million as reflected in Rev. Proc. 2018-18, issued March 2, 2018 (reduced by any prior use of such exemption).

Unless Congress takes action the increased basic exclusion amount will sunset on December 31, 2025 to $5 Million, as adjusted by the Consumer Price Index (“CPI”). As a result, if you miss the opportunity to use the increased basic exclusion amount prior to December 31, 2025 you may lose the ability to make significant tax-free gifts. Based upon the current estate and gift tax rate of 40%, the additional estate taxes that may result from not taking advantage of the increased basic exclusion amount of $11.18 Million before December 31, 2025 could be over $2.236 Million, or significantly more when appreciation on the gifted assets is taken into account.

Unlike in 2012, when taxpayers had only one year to plan for the possible loss of an increased gift tax exemption of $5 Million, there is no rush to make gifts in 2018. Although taxpayers have until December 31, 2025 to take advantage of the increased gift tax exemption, making gifts sooner rather than later will allow taxpayers to remove future appreciation of gifted assets from their estates. The following 6 Question 2018 Gift Suitability Analysis is provided to facilitate consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount.”

Barry A. Nelson and **Cassandra S. Nelson** provide **LISI** members with a 6 Question Checklist to help determine the suitability and appropriateness of making major gifts in 2018 or thereafter based upon the increase of the basic exclusion amount to $11.18 Million. Members will find their commentary particularly helpful as it is written in the format of a letter to clients.

Barry A. Nelson, a Florida Bar Board Certified Tax and Wills, Trusts and Estates Attorney, is a shareholder in the North Miami Beach law firm of **Nelson & Nelson, P.A.** He practices in the areas of tax, estate planning, asset protection planning, probate, partnerships and business law. He provides counsel to high net worth individuals and families focusing on income, estate and gift tax planning, and assists business owners to most effectively pass their ownership interests from one generation to the next. As the father of a child with autism, Mr. Nelson combines his legal skills with compassion and understanding in the preparation of Special Needs Trusts for children with disabilities. Mr. Nelson is a Fellow of the American College of Trust and Estate Counsel and served as Chairman of its Asset Protection Committee from 2009 to 2012. Mr. Nelson is named in *Chambers USA: America's Leading Lawyers for Business* and *HNW Guide* as a leading estate planning attorney in Florida. Mr. Nelson has been listed in *The Best Lawyers in America* since 1995 and is a Martindale-Hubbell AV-rated attorney. Mr. Nelson was named by Best Lawyers in America as the 2015 Trusts and Estates "Lawyer of the Year" in Miami.

As the founding chairman of the Asset Preservation Committee of the Real Property, Probate and Trust Law Section of the Florida Bar from 2004-2007, Mr. Nelson introduced and coordinated a project to write a treatise authored by committee members entitled *Asset Protection in Florida* (Florida Bar CLE 2008, 5th Edition 2017). Mr. Nelson wrote Chapter 5 entitled "Homestead: Creditor Issues." He is a past president of the Greater Miami Tax Institute. Mr. Nelson is a co-founder and current board member of the Victory Center for Autism and Behavioral Challenges (a not-for-profit corporation) and served as board chairman from 2000-2008.

Cassandra S. Nelson, an associate in the law firm of Nelson & Nelson, P.A. in North Miami Beach, Florida. She practices primarily in the areas of estate planning, asset protection, tax, special needs trusts, guardianships, and probate administration. She has co-authored articles published by *Trust & Estates*, *ActionLine* (Florida Bar), and *Leimberg Information Services.* Cassandra received her B.A. from the University of Miami in 2013 and her J.D. from Emory University School of Law in 2017. Cassandra Nelson is involved with The Victory Center for Autism and Behavioral Challenges (a not-for-profit corporation). As the older sister of a 23-year-old brother with severe autism, Cassandra has a unique interest in assisting children with disabilities and their families. As an attorney, she does so by counseling on the creation of special needs trusts and establishing guardianships for such children.

Here is their commentary:

EXECUTIVE SUMMARY:

As a result of the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act") 2018 provides a unique opportunity for you to make gifts using your federal estate, gift, and generation skipping transfer ("GST") tax exemption (the basic exclusion amount) of $11.18 Million as reflected in Rev. Proc. 2018-18, issued March 2, 2018 (reduced by any prior use of such exemption).

Unless Congress takes action the increased basic exclusion amount will sunset on December 31, 2025 to $5 Million, as adjusted by the Consumer Price Index ("CPI"). As a result, if you miss the opportunity to use the increased basic exclusion amount prior to December 31, 2025 you may lose the ability to make significant tax-free gifts. Based upon the current estate and gift tax rate of 40%, the additional estate taxes that may result from not taking advantage of the increased basic exclusion amount of $11.18 Million before December 31, 2025 could be over $2.236 Million, or significantly more when appreciation on the gifted assets is taken into account. Unlike in 2012, when taxpayers had only one year to plan for the possible loss of an increased gift tax exemption of $5 Million, there is no rush to make gifts in 2018. Although taxpayers have until December 31, 2025 to take advantage of the increased gift tax exemption, making gifts sooner rather than later will allow taxpayers to remove future appreciation of gifted assets from their estates. The following 6 Question 2018 Gift Suitability Analysis is provided to facilitate your consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount.

COMMENT:

Taxpayers must carefully weigh the loss of a step up in income tax basis for any gifted assets as compared to a step up in basis that would otherwise result if assets are held until death and included in the taxpayer's gross estate. If the gifted assets are actively managed marketable securities, the potential loss of a step up in income tax basis may not materially offset the potential estate tax savings and asset protection benefits. However, if (i) it is anticipated that the gifted assets will significantly appreciate in value or (ii) such assets have an income tax basis at the time they are gifted that is less than fair market value and (iii) there is likely to be a large difference between income tax basis as of date of death and estate tax value as of date of death, making gifts could result in an income tax cost that outweighs the estate tax savings of a gift for a net tax loss. This is especially likely for those who do not anticipate having taxable estates of at least $11.18 Million if single or $22.36 Million if married, increased by CPI.

For couples who have not made any prior taxable gifts, the potential estate tax savings that may result by taking advantage of the combined basic exclusion amounts of $22.36 Million is $4.72 Million. This calculation assumes that the basic exclusion amount is reduced to the $5 Million basic exclusion amount in effect prior to the 2017 Tax Act, increased by CPI, or $5.49 Million per person, that gift and estate tax rates remain at 40%, and there is no significant loss of step up in income tax basis for the gifted assets.

All projections should consider: (i) the tax benefits of removing future appreciation on assets gifted from estate, gift, and GST taxes (referred to as "Transfer Taxes") and (ii) the potential loss of a step up in income tax basis for gifted assets. Both factors require careful consideration as to which assets should be gifted and whether the potential Transfer Tax savings will be less than or greater than the loss that will result from not obtaining a step up in income tax basis by holding appreciated assets until death. Asset protection factors further complicate this quantitative analysis. To the extent that assets that could be gifted remain in the hands of the potential debtor, they enhance the amount that could pass to creditors rather than to intended beneficiaries. The analysis below considers such asset protection and tax factors.

If you believe you can afford to make gifts in 2018 (or before January 1, 2026), you must carefully select assets to gift and understand the consequences that may result if such gifts are determined to be undervalued in the event of an IRS audit. Gifts of easy to value assets can be made without concern that the IRS will dispute valuations. In contrast, gifts of closely held businesses and fractional interests in real estate provide leverage in the amount of gifts due to discounts for minority ownership and lack of marketability but could become subject to IRS valuation attack.

Whether you should proceed with making gifts of discounted assets now through January 1, 2026 (or earlier should it appear that a change in Congress may result in a reduction of the basic exclusion amount) to leverage use of the enhanced basic exclusion amount depends on your consideration of the following additional factors (the "Additional Factors"):

(i) the possibility of valuation increases of the gifted assets;
(ii) the current income tax basis of the gifted assets;
(iii) whether you are willing to incur the time and expense to defend a gift tax audit;
(iv) whether you are willing to pay the legal, accounting, and administrative expenses associated with gift planning;
(v) whether you are willing to sacrifice easy access, or possibly all access, to such gifted assets during your lifetime;
(vi) whether you have the desire to protect the gifted assets from potential future creditors;
(vii) whether such gifted assets will be actively managed so that over time it is unlikely that there will be a significant disparity between fair market value and income tax basis of such assets at death, even if there is significant appreciation;
(viii) whether such gifted assets will be sold in the future versus the likelihood that due to multiple owners, low income tax basis, or any other reason the assets are likely to be retained after death;
(ix) whether there is a possibility that the low basis assets gifted by you to a trust could be reacquired by you via a power you retain over such trust to transfer other assets you own of equal value to the trust in exchange for the low basis assets originally gifted by you to the trust (a "Substitution Power"), provided other high basis assets are available for you to make such exchange and there is sufficient time to effectuate the Substitution Power; and
(x) whether you are willing to pay income tax on assets gifted by you to a trust for your intended beneficiaries if the trust is intentionally created as a grantor trust. You can retain the ability to turn off grantor trust status if paying income tax on the gifted assets becomes overly burdensome. Alternatively, or in addition, the trust can provide an independent trustee with the ability to reimburse you for income taxes paid by you attributable to the trust. Many states, including Florida, have enacted legislation which provides

that the settlor of a trust will not be subject to creditors' claims solely because such trust grants the trustee a discretionary power to pay or reimburse the settlor for income tax on trust income or principal payable by the settlor under law (See, for example, Florida Statutes Section 736.0505(1)(c)).

Some may prefer to "reserve" a portion of their unused basic exclusion amount to offset any potential IRS valuation audit adjustments. However, this approach has pitfalls in and of itself. To the extent the full $11.18 Million of basic exclusion amount (increased by CPI) is not used and the basic exclusion amount is reduced after December 31, 2025, the "reserve" may be wasted. For example, if you gift discounted assets with an appraised value of $8 Million and reserve $3.18 Million of basic exclusion amount in the event of audit, and Congress reduces the basic exclusion amount to $5 Million, you would lose the ability to make $3.18 Million of gifts protected from gift tax by the current basic exclusion amount. Although gifts can be made using a number of valuation formulas, which have been recognized in court decisions and limit the value of gifts to avoid taxable gifts in the event the IRS challenges the valuation of such gifts, the IRS may nonetheless challenge the effectiveness of such formulas. Accordingly, you must evaluate your willingness to pay gift taxes or defend valuations in the event of a gift tax audit even if formula gifts are used.

Questions to Help You Determine if You Should Make Gifts Now

The following list of questions is provided to facilitate your consideration of whether to make gifts in 2018 (or before January 1, 2026) using the current basic exclusion amount. All decisions require careful consideration of the current income tax basis of assets to be gifted, projected future appreciation, whether the gifts will be made to a grantor trust that includes a Substitution Power to potentially mitigate the loss of income tax basis, and the extent of potential exposure to creditors' claims (see the Additional Factors, above).

1) To save future Transfer Taxes, would you be willing to make 2018 gifts of up to $5.59 Million (single), $11.18 Million (jointly with spouse), plus any amount of unused exemption that was available in 2017, $5.49 Million (single), $10.98 Million (jointly with spouse), if such gifts can be made free of gift taxes, provided that neither you nor your spouse would have access to such funds, regardless of any reversal in your financial position? Note: If prior taxable gifts were not

made, each person can make gifts in 2018 of $11.18 Million (single) or $22.36 Million (jointly with spouse).

If no, read on. If yes, you are a good candidate for gifting to a trust for your children and grandchildren subject to the Additional Factors.

2) To save future Transfer Taxes, would you make 2018 gifts of up to $5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, $5.49 Million (single), $10.98 Million (jointly with spouse), into a trust for your spouse (and possibly your children) where your spouse and children may receive distributions at the discretion of the trustee (you may not be a beneficiary or a trustee). Upon the death of your spouse, the trust assets will be held exclusively for your children (they will not pass back to you even if you survive your spouse).

If no, read on. If yes, you are a good candidate for gifting to a Spousal Limited Access Trust ("SLAT") without a back end retained interest subject to the Additional Factors.

3) To save future Transfer Taxes, would you make 2018 gifts of up to $5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, $5.49 Million (single), $10.98 Million (jointly with spouse), into a trust for your spouse (and possibly your children) in 2018 where your spouse and children may receive distributions at the discretion of the trustee (you are not a beneficiary or trustee). Upon your spouse's death, your spouse can decide on whether all or any portion of the assets in the trust revert into a new trust created by your spouse for your benefit and in such event, an independent trustee will determine the extent of distributions to you. Note: Based upon the Relation Back Doctrine (discussed below) it is possible your spouse's decision to distribute all or any portion of the assets back to you into a new trust for your benefit may be considered to be assets held in a self-settled trust created by you for your own benefit rather than a third party created trust created by your spouse. There is a possibility that such a trust, if created in a state that has not adopted domestic self-settled asset protection legislation, will be subject to your creditors' claims and accordingly, such assets may be includible in your estate.

If no, read on. If yes, you are a good candidate for a SLAT that includes a testamentary power of appointment that may be exercised by your spouse subject to the Additional Factors and the Relation Back Doctrine issues, described below.

4) To save future Transfer Taxes, would you make 2018 gifts of up to $5.59 Million, plus any amount of unused Transfer Tax exemption that was available in 2017, $5.49 Million (single), $10.98 Million (jointly with spouse), into a trust designating your spouse and children as discretionary beneficiaries but providing that on a predetermined future date, the assets are distributed outright or in trust for your children if your net worth is at least a specified value determined upon creation of the trust that you believe would result in you having sufficient assets outside the trust to provide for you and your spouse for the rest of your life?

If no, read on. If yes, you are a good candidate for a SLAT with a predetermined termination formula in favor of your children subject to the Additional Factors.

5) To save future Transfer Taxes, would you make a 2018 gift into a trust in one of a number of states that have enacted self-settled asset protection trust legislation (e.g., Alaska, Delaware, South Dakota, or Nevada) or to a foreign asset protection trust jurisdiction where you, your spouse, and possibly your children are potential beneficiaries with the understanding that the IRS may argue that, as a potential trust beneficiary, all trust assets will be included in your estate upon your death (especially if the trustee has exercised its power to make regular distributions to you during your lifetime)? See PLR 200944002, attached, for an IRS ruling in favor of an Alaska resident who created an Alaska self-settled trust (the "Alaska PLR"). Note: The Alaska PLR included important caveats (quoted on page 5 of this letter, below). If you prefer to have greater certainty as to Transfer Tax planning, consider making gifts as described in questions 1-4, above. If you prefer to have greater asset protection certainty, consider making gifts as described in question 6, below.

If yes, you may be a good candidate for a domestic or foreign irrevocable self-settled asset protection trust plan.

6) If (i) estate tax savings are not a concern because of the combined $22.36 Million basic exclusion amount for you and your spouse, (ii) you are comfortable that your net worth, when aggregated with your

spouse's net worth, will not exceed the basic exclusion amount that may be available in the future understanding that the $11.18 basic exclusion amount could be reduced, and (iii) you want to significantly enhance asset protection planning, would you transfer significant sums to an inter vivos QTIP trust for your spouse, retaining the right to such trust assets if your spouse predeceases you? If so, would your spouse consider a similar, but not identical, gift into a trust for you?

If no, making gifts of your increased 2018 basic exclusion amount is probably not for you. If yes, you are a candidate for an inter vivos QTIP trust, especially if you are domiciled in Florida or one of the other 16 states that have enacted inter vivos QTIP legislation, which protects trust assets that revert to a trust for the original settlor upon the death of the original donee spouse (i.e., the "Inter Vivos QTIP Trust Jurisdictions"). These states effectively override the Relation Back Doctrine concerns as any "deemed" self-settled trust is disregarded under the Inter Vivos QTIP Jurisdictions statutes because they consider the original donee spouse as the settlor of the trust that is held for the original settlor spouse should the original donee spouse die first. However, be aware of the potential income tax consequences that may arise in the event of divorce and recent repeal of Code Section 682. As a result of these potential consequences a post-nuptial agreement should be a part of any such plan.

The Relation Back Doctrine

If a SLAT is created and the original donee spouse is granted a testamentary power of appointment in favor of the original settlor spouse it is possible the original settlor spouse may be considered the settlor of the new trust rather than the person who exercised the power of appointment being considered to the be the settlor. A creditor of the original settlor spouse could argue that under the Relation Back Doctrine: (i) the exercise of a special power of appointment by the original donee spouse constitutes a transfer "from the donor of the power, not from the donee"[i] and (ii) the power of appointment is "conceived to be merely an authority to the power holder to do an act for the creator of the power."[ii] "The appointment is said to 'relate back' to the time of the creation of the power and to operate as if it had been originally contained in [the creator of the power's] will."[iii] Cases involving the Relation Back Doctrine have typically been in conjunction with whether trust assets subject to a general power of appointment should be considered when determining fiduciary fees upon the death of the donee spouse who exercised such power.

In *In re Estate of Wylie*, a husband created a testamentary trust for his wife. At his death, wife received all the income from the trust for her life and had a general power of appointment over the corpus of the trust at her death.[iv] The issue on appeal was whether the value of the husband's trust was includible in wife's estate for purposes of determining fiduciary fees because she exercised her general power of appointment by her last will and codicil in favor of her testamentary trustees, and the assets were distributed and paid to the trustees.[v] The court found the determinative question to be whether the power of appointment should be characterized as an interest in property or merely a mandate or authority to dispose of property.[vi] The court noted that:

> The doctrine of relation back, minimizing as it does the importance of the donee of the power, is the mainstay for that rule of law which treats the donee as a mere agent with no property interest. Although under attack by many commentators in the field of future interests, the prevailing view still remains that a general power of appointment is a mere mandate or authority to dispose of property and not an interest in property itself.[vii]

In keeping with the historical origin of powers of appointment and the "spirit of the law," the court in *Wylie* held that the power of appointment was an authority to dispose of property and not an interest in property.[viii]

Although none of the reported cases regarding the Relation Back Doctrine address its application to the settlor of a QTIP or SLAT who receives trust assets upon the death of the donee spouse through the exercise of a special power of appointment, Inter Vivos QTIP Trust Jurisdictions provide greater protection for inter vivos QTIP trust settlors by avoiding any possible Relation Back Doctrine attack.

<u>Can SLATs Provide Better Overall Tax Results as Compared to QTIP Trusts Without the Loss of Asset Protection?</u>

The inter vivos QTIP trust plan has limitations when compared to a similar plan using SLAT gifts to freeze estate tax values. For example, some attorneys have suggested planning to take advantage of the basic exclusion amount by making gifts in 2018 to SLATs using a taxpayer's remaining basic exclusion amount. The growth on any assets remaining in the SLAT will pass estate tax-free upon the death of the beneficiary spouse, even if the basic exclusion amount is reduced by Congress upon the date of death of the beneficiary spouse and even if the initial gifted assets appreciated significantly within the SLAT. The problem with using the inter vivos QTIP plan rather than a gift into a SLAT is that most Inter Vivos QTIP Trust Jurisdictions require that a gift tax QTIP election be made to obtain the asset protection benefit (that the beneficiary spouse is considered the settlor and not the initial settlor of the inter vivos QTIP) upon the death of the initial donee spouse.[ix] In such event, the assets in the QTIP trust will be included in the estate of the initial donee spouse at fair market value upon the death of the initial donee spouse. If the plan is to make the SLAT assets available for the surviving spouse who created the initial trust, there is a possibility such assets will be subject to inclusion in the estate of such spouse under Code Sections 2036 or 2041, as the creditors of the initial settlor spouse may be able to reach such assets upon the death of the first spouse. While Treas. Reg. Section 25.2523(f)- 1(f), Example 11, provides that assets held in an inter vivos QTIP trust — for the benefit of the donor (Note: Treasury Regulations refer to the original trust creator as the donor rather than the settlor) after the death of his or her spouse — will not be includible in the donor's taxable estate under Code Sections 2036 and 2038, no similar regulation exists for SLATs. It would appear that the favorable treatment is provided by said Regulation based upon the fact that such assets are includible in the estate of the donee spouse under Section 2044 which is not the case with a SLAT. Accordingly the tax treatment of assets reverting back to the original donor of a SLAT may be subject to estate tax.

Arizona, Kentucky, North Carolina, Tennessee and Texas' Statutes May Create Asset Protection and Estate Tax Benefits (but it may not!)

Arizona Statutes Section 14-10505(E) states:

> For the purposes of this section, amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:

1. An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under section 2523(f) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.

2. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust under section 2523(e) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.

3. An irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse.

4. An irrevocable trust for the benefit of a person, the settlor of which is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse. **[Emphasis Added.]**

5. An irrevocable trust for the benefit of a person to the extent that the property of the trust was subject to a general power of appointment in another person.[x]

North Carolina, N.C. Gen Stat. Section 36C-5-505(c) states:

Subject to the Uniform Voidable Transactions Act, Article 3A of Chapter 39 of the General Statutes, for purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor and a person who would otherwise be treated as a settlor or deemed settlor of the following trusts may not be treated as a settlor:

(1) If the settlor is a beneficiary after the death of the settlor’s spouse:

a. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust described in section 2523(e) of the Internal Revenue Code.

b. An irrevocable inter vivos marital trust that is treated as a qualified terminable interest trust under section 2523(f) of the Internal Revenue Code.

c. *An irrevocable inter vivos trust of which the settlor's spouse is a beneficiary during the spouse's lifetime but which does not qualify for the federal gift tax marital deduction, and during the lifetime of the settlor's spouse (i) the settlor's spouse is the only beneficiary or (ii) the settlor's spouse and the settlor's issue are the only beneficiaries.* [Emphasis added.]

d. Another trust, to the extent that the property of the other trust is attributable to property passing from a trust described in sub-subdivisions a., b., and c. of this subdivision. [Emphasis added.][xi]

For purposes of this subdivision, notwithstanding the provisions of G.S. 36C-1-103(3), the settlor is a beneficiary whether so named under the initial trust instrument or through the exercise of a limited or general power of appointment.

(2) An irrevocable inter vivos trust for the benefit of a person if the settlor is the person's spouse, regardless of whether or when that person was a settlor of an irrevocable inter vivos trust for the benefit of the person's spouse.

For purposes of this subsection, the "settlor's spouse" refers to the person to whom the settlor was married at the time the irrevocable inter vivos trust was created, notwithstanding a subsequent dissolution of the marriage.

Arizona, Kentucky, North Carolina, Tennessee, and Texas provide that the initial settlor of an inter vivos irrevocable trust created for the settlor's spouse will not be deemed to have been contributed by the settlor if the settlor is the beneficiary of the trust after the death of the settlor's spouse, even if there is no QTIP election.[xii]

While at first glance the Arizona, Kentucky, North Carolina, Tennessee and Texas statutes appear to create great asset protection and the possibility of enhanced estate tax benefits that are afforded to SLATs as compared to an inter vivos QTIP Trusts (i.e., all appreciation of assets in the SLAT would avoid future estate taxes and regardless of whether the applicable exclusion amount is reduced the assets in the SLAT should not be subject to estate tax inclusion), there are two potential pitfalls to the Arizona, Kentucky, North Carolina and Texas statutes: (1) the trust needs to have their situs in Arizona, Kentucky, North Carolina, Tennessee and/or Texas, as the case may be, and be subject to income tax there; and (2) there is no provision similar to IRS Treas. Reg. Section 25.2523(f)-1(f), Example 11 that assures that the initial settlor will not be subject to tax under Code Sections 2036 or 2038. As a result, the IRS could take the position that despite state law, the initial settlor has an interest under Code Sections 2036 and 2038, resulting in estate tax inclusion, and (iii) loss of step up in income tax basis.

Providing the initial donee of a SLAT a special power of appointment to direct the SLAT assets back to the initial settlor, as compared to retaining a reversion in a SLAT in favor of the settlor, may not change the estate tax consequences to the settlor due to the Relation Back Doctrine described above.[xiii] As a result, assets passing from SLAT back to a credit shelter trust for the initial settlor may be considered to be held in a self-settled trust and therefore subject to estate tax inclusion for the settlor spouse.

Some have suggested the creation of the initial SLAT in a jurisdiction that recognizes and protects self-settled asset protection trusts.[xiv] The IRS has ruled favorably for a trust created under Alaska law.[xv] A thorough analysis of this issue is beyond the scope of these materials. However, creation of a SLAT, in one of the 17 states that have enacted self-settled asset protection trusts,[xvi] does not assure that trust assets will be excluded from the initial settlor's gross estate if they are appointed back to the initial settlor, especially if there was an implied agreement that the assets would revert to the settlor and there is a pattern of distributions to the settlor. For example PLR 2009440002, which is frequently cited as support that the creation of an irrevocable Trust in a self-settled asset protection jurisdiction such as Alaska is a completed gift and assets will not be included in the Grantor's gross estate says: "We are specifically not ruling on whether Trustee's discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust's assets in Grantor's gross estate for federal estate tax purposes under Section 2036."[xvii] My concern is since Treas. Reg. Section 25.2523(f)-1(f), Example 11 assures that the trust reverting to the original settlor from an inter vivos QTIP trust created for the donee spouse is protected from estate tax inclusion under Code Sections 2036 or 2038 (and further protected in states such as Florida and Arizona with a state statute that says the settlor's spouse is deemed the settlor when assets pass back to the settlor spouse), that the inter vivos QTIP result is as close as definite as you get that such assets will not be includible in the gross estate of the original settlor spouse. The SLAT approach does not have a Treasury Regulation that says the original settlor will not be taxed under Code Sections 2036 or 2038. Further, most inter vivos QTIP statutes (such as Florida's) specifically say the initial donee spouse is deemed to be the settlor when trust assets revert in trust for the original settlor spouse, only if a QTIP election was made.[xviii] If a state statute does not shift settlor status to the original donee spouse from the original settlor spouse, then assets may be includible in the gross estate of the original settlor under Code Section 2036 if the IRS successfully asserts there was an understanding or pre-existing arrangement regarding the trustee's exercise of discretion in favor of the original settlor spouse.

Options for you to consider are: (i) use of an Inter Vivos QTIP Trust Jurisdictions, (ii) use of a combination of an inter vivos QTIP trust created by one spouse and a SLAT created by another spouse where the QTIP assets will revert to the initial settlor upon the death of the initial donee spouse and the assets of the SLAT pass to children (and not in trust for the initial settlor spouse) upon the death of the donee spouse, or (iii) if more aggressive, use of multiple SLATs, possibly in states or countries with favorable self settled asset protection laws. Life insurance could be purchased on the life of the donee spouse of the SLAT to replace assets that will pass to children upon the death of the donee spouse beneficiary of the SLAT.

Conclusion

If you answered yes to any of the above questions, now is a good time to proceed. Whatever you believe, benefits of current transfers generally include enhanced asset protection and the shifting of future appreciation without paying Transfer Taxes provided the loss of step up in income tax basis is considered. Now is a good time to start the conversation.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Barry A. Nelson

Cassandra S. Nelson

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[i] *In re Estate of Wylie*, 342 So.2d 996, 998 (Fla. 4th DCA 1977) (quoting Restatement (First) of Property § 318 comment (b) (1940)).

[ii] American Law Institute, *Donative Transfers* vol. 2 §§ 11.1-24.4, *in* Restatement (Second) of Property 4 (1986).

[iii] *Id.*

[iv] *In re Estate of Wylie*, 342 So.2d at 996-97.

[v] *Id.* at 998.

[vi] *Id.* at 999.

[vii] *Id.* at 998.

[viii] *Id.*

[ix] ARIZ. REV. STAT. ANN. § 14-10505(E); ARK. CODE ANN. § 28-73-505(C); DEL. CODE ANN. TIT. 12 § 3536(c); FLA. STAT. § 736.0505(3); KY. REV. STAT. ANN. § 386B.5-020(8)(A); MD. CODE ANN., EST. & TRUSTS § 14.5-1003(a)(1)-(2); MICH. COMP. LAWS § 700.7506(4); New Hampshire Chapter 564-B:5-505(a)(2)(C)-(D); N.C.GEN. STAT. § 36C-5-505(C); OHIO REVISED CODE § 5805.06(B)(3); OR. REV. STAT. § 130.315(4); S.C. CODE ANN. § 62-7-505(b)(2); TENN. CODE ANN. § 35-15-505(D); TEX. PROP. CODE ANN. § 112.035(G); VA. CODE ANN. §64.2-747.B(2); WISC. STAT. ANN. § 701.0505(2)(E); WYO. STAT. ANN. § 4-10-506(e).

[x] ARIZ STAT. § 14-10505(E). *See also* TEX. PROP. CODE § 112.035(g)(3)(A).

[xi] N.C. GEN STAT. § 36C-5-505(c). *See also* KY. REV STAT ANN § 386B.5-020(8)(a)(1)-(3).

[xii] ARIZ STAT. § 14-10505(E); KY. REV STAT. ANN § 386B.5-020(8)(a)(1)-(3); N.C. GEN STAT. § 36C-5-505(c); TENN. CODE ANN § 35.15-505(f); TEX. PROP. CODE § 112.035(g).

[xiii] *In re Estate of Wylie*, 342 So.2d at 998.

[xiv] Carol G. Kroch et al., *Taking a Fresh Look at Lifetime Gift Planning Opportunities*, 38 EST. PLAN. 3, 14 (Sept. 2011); Gans, Blattmachr & Zeydel, *supra*, note 14, at 59.

[xv] Gideon Rothschild et al., *IRS Rules Self-Settled Alaska Trust Will Not Be In Grantor's Estate*, 37 EST. PLAN 3, 13 (Jan. 2010).

[xvi] ALASKA STAT. §§ 13.36.310, 34.40.110; DEL. CODE ANN. TIT. 12, §§3570-3576; HAW. REV. STAT. § 554g; Mich. Comp. Laws 700.1041-.1050; Miss. Code Ann. §§91-9-701 – 91-9-723; MO. REV. STAT. §§456.5-505; N.H. REV.

STAT. ANN. § 564-B:8-5-505(A)(2)(C)-(D); NEV. REV. STAT. §§116.010-166.170; OHIO LEGACY TRUST ACT, CHAPTER 5816 OF THE OHIO REVISED CODE; OKLA. STAT. ANN. Tit. 31, § 10-18; R.I. GEN. LAWS § 18-9.2-1 – 18-9.2-7; S.D. CODIFIED LAWS §§55.16-1–55-16-17; TENN. CODE ANN. § 35-16-101-112 ; UTAH CODE ANN. §25-6-14 (Repealed And Re-Enacted In 2013); VA. CODE ANN. § 64.2-745.1 and 64.2-745.2; W. VA. CODE SECTIONS 44D-5-503A, 44D-5-503B; 44D-5-503C; AND 44D-5-505; WYO. STAT. §§4-10-505 & 4-10-510–523.

[xvii] PLR 200944002.

[xviii] FLA. STAT. § 736.0505(3)(a).