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Advanced Estate Planning – Overview

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Larger estates; those in excess of the federal estate tax credit amount or applicable exclusion amount ($1 million per person beginning in 2011) may benefit from one or more of the following strategies and associated documents, which can be used alone or in conjunction with the others.

Irrevocable Life Insurance Trust

There is a common misconception that life insurance proceeds are not subject to federal estate taxes. While the proceeds are free from income tax, they are countable as part of your taxable estate and therefore about half its value can be lost to estate taxes. An Irrevocable Life Insurance Trust (ILIT) is created specifically for the purpose of owning your life insurance policy. The ILIT holds the policy outside of your estate and keeps the proceeds from being taxable to your estate. The proceeds can then be used to provide your estate with the liquidity to pay estate taxes, pay off debts, pay final expenses, and provide income to a surviving spouse or children. You can use your annual gift tax exclusion to make cash gifts to your trust to pay the premium on the life insurance policy.

Qualified Personal Residence Trust

A Qualified Personal Residence Trust (QPRT) allows you to give away your house or vacation home at a discount, freeze its value for estate tax purposes, and still continue to live in it.

Family Limited Partnerships and Limited Liability Companies
Family Limited Partnerships (FLPs) and Limited Liability Companies (LLCs) are entities involving members of your family. The main advantages of forming and funding FLPs and LLCs involve estate and gift tax savings and asset protection.

Grantor Retained Trusts
A Grantor Retained Annuity Trust (GRAT) is an irrevocable trust to which you contribute assets. You retain the right to receive annuity payments for a specified period of time based on an assumed discount rate determined by the IRS. At the end of the term, assets in the trust pass to other beneficiaries. The GRAT provides gift and estate tax savings if the return on the assets placed in the GRAT exceeds the assumed discount rate. Grantor Retained Unitrusts (GRUTs), where distributions are based on a percentage of assets instead of an annuity, and Grantor Retained Interest Trusts (GRITs), where you retain an income interest, are similar techniques.

Intentionally Defective Grantor Trusts
Alternatively, you may want to sell assets to an Intentionally Defective Grantor Trust (IDGT), an irrevocable trust you establish that is excluded from the your estate for federal estate tax purposes, yet owned by you for income tax purposes. The sale can be in exchange for a promissory note. Similar to a GRAT, the sale of the promissory note provides gift and estate tax savings if the return on the IDGT exceeds the interest rate on the note.

Charitable Planning
If you are charitably inclined and seeking to minimize taxes while enhancing the amounts going to your loved ones, you may want to consider charitable planning, including Charitable Remainder Trusts (CRATs and CRUTs), Charitable Lead Trusts (CLATs and CLUTs), and Private Foundations.

In preparing any of the foregoing documents, it is important to work with a qualified attorney because the law in this area is very specialized, changes often, and involves complex tax matters. The ramifications for you and your loved ones can be far-reaching, both emotionally and financially.