Planning for the Modern Family

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Agenda

- Market Overview
- Introduction to case study
- Planning for blended families
- Planning for non-citizen spouses
- Planning for unmarried couples

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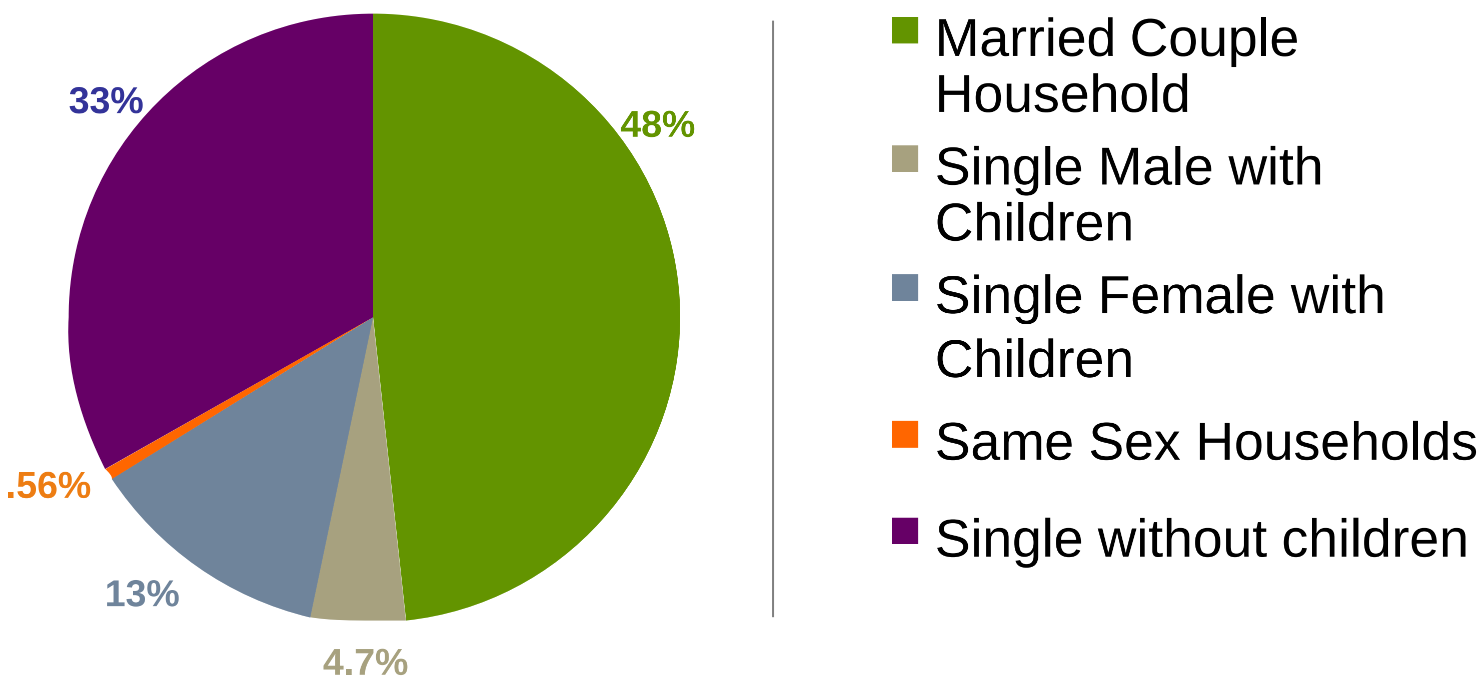
Modern Families

- Few U.S. households are the traditional family of the past
  - Working husband
  - Non-working spouse
  - Two children
- More varied arrangements today
  - Young non-married couples
  - Second marriages with children from a previous marriage
  - Divorced couples with children that do not officially marry
  - Senior couples that do not officially marry

Current Census Data

US Households



Source 2010 U.S. Census Bureau

Consider this "Modern Family"

- Jay (the family patriarch) is married to Gloria (a citizen of Columbia)
- Jay expects to have a taxable estate at the federal level
- 2nd marriage for both
- Jay is 25 years older than Gloria
- Jay has two children – Mitchell and Claire
  - Claire is older than Gloria
- Gloria has a son Manny who is a teenager
- Jay & Gloria have a newborn child

Modern Family

- Mitchell is in a committed same sex partnership with Cam
  - They have an adopted daughter Lilly who is three
- Claire is married to Phil
  - They have three teenage children

Issues for Jay & Gloria

- Blended family with significant age differences
  - Between spouses
  - Between children
- Non-citizen spouse
- Estate tax concerns

Planning for the Non-Citizen Spouse

- Transfers to a non-citizen spouse do not qualify for the unlimited marital deduction
- Consider portability

Planning Strategies for Jay & Gloria

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Qualified Terminable Interest Property (QTIP) Trust for Blended Families

- Type of marital trust
- Qualifies for the marital deduction assuming surviving spouse is a US citizen
- Surviving Spouse entitled to all income from trust for life
- No one, including the Surviving Spouse can appoint trust property to a third party

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How a QTIP works

Revocable Living Trust

Survivor's- A

- Full control
- All income
- All principal
- Pass through
- Survivors Tax ID #
- Revocable

Family- B

- Income
  - Net income
- Principal
  - H,E,M,S
- Trust Tax ID #
- Irrevocable

QTIP - C

- Survivor spouse must have income rights
- Limited principal
- Trust Tax ID #
- Irrevocable

At survivor spouse death:

Survivor's- A: Non-exempt

Family- B: Exempt

QTIP - C: Non-exempt

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Life Insurance for the Blended Family

- Life insurance is purchased in an ILIT on the parent with children from a previous marriage
- Provides for an equitable division of assets upon death *of the children's parent*
- Helps solve the problem of the lack of common beneficiary

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Planning for the Non-Citizen Spouse

- Transfers to a non-citizen spouse do not qualify for the unlimited marital deduction
- Options are to utilize the estate tax exemption amount, the non-citizen spouse to become a US citizen or a creation of a qualified domestic trust (QDOT)

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QDOT Requirements

- Must elect on decedents estate tax return
- One trustee must be US citizen or domestic corporation
- Distributions of principal must be subject to estate tax withholding
- Assets over $2M must provide security

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QDOT Security Requirements

- Over $2m must have security:
  - A U.S. bank as trustee
  - Post surety bond
  - Post letter of credit
- Under $2m:
  - No more than 35% of trust can be in non-US real estate
  - Or must follow security requirements

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QDOT

US Trustee

Income & hardship distributions
Not subject to estate tax

Principal subject to estate tax

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Life Insurance Ownership Issues

- Lack of marital deduction could cause death benefit to be taxed for personally owned policies
  - Gloria owns policy on Jay
  - Owned in life insurance / spousal access trust*

*Distributions from a SLAT should not be available to discharge any support obligation of the insured/grantor. SLATs should be drafted with care to avoid unintended tax consequences. It is important to confer with your independent tax and legal advisors regarding the use of this technique. It is important that the non-grantor spouse does not make gifts to the trust either directly or indirectly via joint accounts, gift splitting or community property as this could result in unintended tax consequences.

Lifetime Gift Planning Options for Non-Citizen Surviving Spouses

- Leveraging Gifts using Spousal Annual Exclusion
  - $143,000 for 2013
- Leveraging Gifts through Spousal Access Trusts
- Leveraging Gifts through Estate Freeze Techniques
- Sale of Assets to Non-Citizen Spouse

Planning for Same-Sex Couples

The Supreme Court Cases

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Hollingsworth v Perry (2013)

- California Proposition 8 Case
- Prop 8 overruled CA Supreme Court decision legalizing same-sex marriage.
- Supreme Court concluded that the proponents of Proposition 8 did not possess the legal standing to appeal the lower court rulings.
- In effect, this means that the December 2010 decision of the Federal District Court that found Proposition 8 unconstitutional is now permanent.
- Marriage can now resume in California.

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United States v Windsor (2013)

- DOMA denied same-sex married couples the benefits that heterosexual couples receive in the 13 states that allow and recognize same-sex marriage.
- DOMA - impacted the federal benefits that legally married people within several states were able to receive,
- More than 1,138 Benefits
- Windsor and Thea Spyer were married in Canada
- *The estate of Windsor's widow paid $363,053 in US* Federal Estate Tax

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United States v Windsor (2013)

- The Court ruled by a 5-4 decision that DOMA *established "two contradictory marriage regimes within a given state," which it deemed as* unconstitutional under the 5th Amendment of the *United States' constitution.*
- *The Supreme Court's decision is based on the* premise that marriage is defined and regulated by the states.
- Questions still remain on availability of Federal Benefits depending on place of marriage and residency.

Planning Issues for Mitchell & Cameron- Married and living in Same State*

- Married for Federal tax purposes
  - Eligible for Federal benefits
- Similar planning issues of Claire and Phil
- May have new income tax issues
- Should review their current plans
- Future residency changes must be kept in mind

Result is the same if they are living in any of the states that recognize same sex marriage.

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Planning Issues for Mitchell & Cameron-Married living in a non-marriage equality state

- Married for Federal tax purposes
  - Income tax returns, estate and gift tax marital deduction, IRA/Qualified Plans
- Married for ERISA Qualified Plan purposes
- Uncertainty remains for some benefits
  - *“Place*-of-*celebration” vs. Residency issue*
- State spousal recognition still an issue
  - e.g. intestacy laws

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Planning Issues for Mitchell & Cameron-Not Married

- Not married for Federal tax purposes
  - Unmarried partners not eligible for Federal benefits
- State intestacy laws
- Lack of common heirs
- Retirement and legacy issues
- Concerned about federal estate tax issues

Planning Issues

Intestacy

State determination of how assets are distributed if decedent dies without a valid will

Health Care Directives & POA

Health Care Directive

- Provides direction on how medical decisions are to be made
- Can be combination of living will and health care power of attorney

Durable Power of Attorney (Finance)

- Appointment of authorized agent for property and financial decisions
- Specific or general
- Effective even after incapacity

Property Ownership Issues for Unmarried Couple

- Asset title?
  - *The couple's home*
- Community property
- Gift tax issues

Retirement Planning Issues

- No Social Security Survivor benefits
- Lack of spousal rollover option
  - Must begin required minimum distributions
- Spousal IRA not available
- No marital deduction
  - Retirement benefits subject to potential estate taxation
- Cannot file joint tax returns
  - *NII healthcare surtax applicable at single filer's MAGI*

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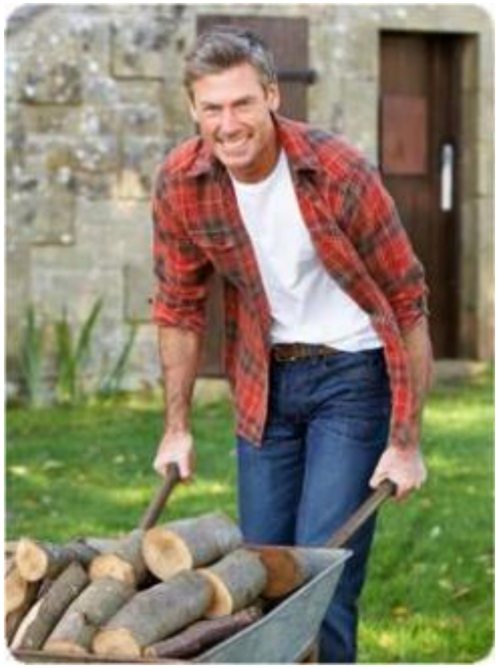
Retirement Benefits



Defined Contribution Qualified Plans & IRAs

- Beneficiary designations
  - Lack of spousal rollover
    - Options for surviving partner
      - Distributions over five years
      - Distributions over life expectancy
- Rollover to Decedent IRA from 401(k)

Planning Strategies for Mitchell & Cam

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Retirement Planning Options for Cam

- Contributions to deductible or non-deductible IRA
- Contributions to Roth IRA
- Deferred annuities and cash value life insurance
- Personal pension longevity insurance
- These could be funded by gifts from Mitchell

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Potential Life Insurance Solutions

Lack of a common beneficiary:

- For your other intended heirs
  - Surviving partner can inherit specific assets immediately
  - Beneficiaries of partner who dies first can receive life insurance as an equitable immediate distribution
- For your surviving partner
  - Surviving partner is provided with life insurance (possibly in irrevocable trust)
  - Beneficiaries of partner who dies first can inherit specific assets in a timely manner

Partnership Testamentary Trust

Lack of a Common Beneficiary

Partnership Testamentary Trust

- For the surviving partner
  - Surviving partner gets the use of the assets, BUT
  - Trust provides that beneficiaries of partner who dies first will inherit the remainder *after the surviving partner's death*
  - Issue – delay for the ultimate beneficiaries

Partner Lifetime Access Trust (PLAT)

- Very similar to a credit shelter trust, but funded during life
- Partner establishes trust for benefit of other partner and other beneficiaries (or charity)
- Partner makes gifts using annual exclusion and/or lifetime exemption
- Trust fund access defined in trust document
- Trust language defines partner

PLATs should be drafted with care to avoid unintended tax consequences especially when dealing with partners that have obtained status for state purposes as a result of registering as a domestic partner, entering into a civil union, or due to marriage. It is important to confer with your independent tax and legal advisors regarding the use of this technique.

PLAT – Design Issues

- Partner access to funds
  - Non-grantor partner can serve as trustee
  - Access would be limited to ascertainable standards (Heath, education, maintenance, support)
  - Plus greater of $5,000 or 5% of trust without limitation
- Access could be at the discretion of the trustee if independent trustee used

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PLAT Example

Mitchell

Gifts to trust

1

2

Access to trust principal

5 or 5

Health
Education
Maintenance
Support

Cam

3

Upon Cam's death

Tax Free Death Benefits

Beneficiaries or charity

This hypothetical is for illustration purposes only and actual results may vary.

PLAT Issues

- Only one partner can make gifts to PLAT
- Should not co-mingle any distributions from the trust
  - Possible retained interest
- Be careful about reciprocal trusts
  - Make trusts significantly different from one another

Couple should be in a stable, long-term relationship. Premature death of the donor or a break-up could limit the effectiveness of this planning technique.

PLAT Benefits

- Can provide life insurance for income replacement without estate inclusion
- Can provide Cam access to cash values without estate inclusion*
- Can stipulate ultimate beneficiary of assets while providing for Cam
  - Charity
  - Other family members
- May provide asset protection
- Orderly distribution of assets**

*Distributions from a life insurance policy through withdrawals of certain policy values (up to cost basis) and loans are generally not taxed as income provided certain premium limits are followed which prevent a policy from becoming a modified endowment contract (MEC). Distributions taken during the first fifteen years may be subject to tax. Loans and withdrawals will generally reduce the cash value available and death benefit payable. If policy loans are taken, there may be income tax consequences if one permits the policy to lapse or if the policy is surrendered or exchanged. If the policy has not performed as expected and to avoid a policy lapse, distributions may need to be reduced, stopped and/or premium payments may need to be resumed.

**Asset protection laws vary based upon governing federal and state law. The applicability of such laws also depends on the terms of the trust. One should be sure to confer with independent tax and legal advisors prior to establishing a trust for this purpose.

Grantor Retained Income Trust

Transfers to non-family members

- Unmarried couples
- Nephews & nieces
- Cousins

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How a GRIT Works

Step 1- Unmarried client creates a trust for benefit of partner

Step 2- Client retains the right to trust income

Step 3- Remainder passes to trust beneficiaries at termination of the trust (provides grantor survives the term)

Gift tax value of remainder interest

=

Value of trust property

Minus

Value of retained interest

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GRIT Case Study

Mitchell

1 $1 Million Gift to Trust: Taxable Gift $683,840

GRIT 4% Growth & Income

2 $40,000 Annual Interest used for life insurance premiums

4

Life insurance for beneficiaries

3 Trust Remainder After 20 Years: $2,191,123

Cam

7520=2.0%
$1 million transfer
20 Year Term

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GRIT Tax Treatment

- Grantor pays tax on the income
- *The value of the GRIT is included in grantor's estate* if grantor dies during the term

Life expectancy > trust term

GRIT vs. GRAT

GRIT

- Payout flexibility
- Higher payout potential
- Zero out-no
- Death during term-full inclusion

GRAT

- **Fixed** annual payout
- Lower payout potential
- Zero out-yes
- Death during term-may not include full amount

GRIT Benefits

- Transfer to non-family members for a discounted tax value
- Future appreciation removed from estate when grantor survives term
- Flexible income steam for grantor
- May be leveraged with life insurance

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* MetLife Worldwide corporate profile 2011
**Based on life insurance in force. Metlife 2011

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