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Protecting and Transitioning Your Wealth

A Comprehensive View of Trust and Estate Planning for Family Offices

Cummings & Lockwood LLC and Family Office Association present a comprehensive white paper for ensuring that your family office addresses the essential elements of planning - from life planning and administration to trust selection and asset protection.

LIFE PLANNING 1

IF A FAMILY MEMBER MOVES TO A NEW STATE THAT HAS LOWER INCOME AND ESTATE TAXES, WHAT SHOULD THE FAMILY MEMBER DO TO ESTABLISH THEIR "RESIDENCE" FOR INCOME TAX PURPOSES AND THEIR "DOMICILE" FOR ESTATE TAX PURPOSES? 1
IN YOUR STATE OF DESIRED DOMICILE 2
IN YOUR FORMER STATE OF DOMICILE 3
IN ADDITION, YOU SHOULD 3
IF A FAMILY MEMBER PLANS TO GET MARRIED, WHAT STEPS SHOULD HE OR SHE BE TAKING TO PROTECT HIS OR HER ASSETS OR ACCESS TO THE FAMILY ASSETS? 4
IF A FAMILY MEMBER IS GETTING DIVORCED, HOW SHOULD HE OR SHE CHANGE THEIR ESTATE PLAN? 4
HOW SHOULD A FAMILY MEMBER STRUCTURE THEIR ESTATE PLAN IN THE SECOND MARRIAGE OR BLENDED FAMILY SITUATION? 5
WITH THE RISE OF ALZHEIMER'S AND OTHER COGNITIVE MENTAL HEALTH ISSUES, HOW DO YOU PLAN FOR A LONG PERIOD OF INCAPACITY? 5
WHAT SHOULD FAMILY MEMBERS DO TO PRESERVE, PROTECT AND PASS ON VALUABLE TANGIBLE PERSONAL PROPERTY (I.E., ARTWORK, CARS, JEWELRY)? 6

DIGITAL ASSETS 8

WHAT ARE "DIGITAL ASSETS"? 8
WHAT ARE THE CHALLENGES FACING DIGITAL ASSETS THAT ARE DIFFERENT THAN TRADITIONAL ASSETS? 8
UPON AN INDIVIDUAL'S DEATH, IS A FIDUCIARY (E.G., EXECUTOR, PERSONAL REPRESENTATIVE, TRUSTEE, AGENT, ATTORNEY-IN-FACT, OR GUARDIAN) PERMITTED TO ACCESS THE DECEDENT'S DIGITAL ASSETS? 8
WHAT ARE EXAMPLES OF "OUTSIDE THE ENVELOPE" NON-CONTENT INFORMATION? 9
WHAT ARE EXAMPLES OF ISPS THAT PROVIDE AN ONLINE TOOL FOR POST-DEATH ACCESS? 9
WHAT STEPS SHOULD A FIDUCIARY TAKE WITH RESPECT TO DIGITAL ASSETS? 9

ADMINISTRATION OF REVOCABLE TRUSTS 10

WHAT IS A REVOCABLE TRUST? 10
HOW IS THE REVOCABLE TRUST FUNDED? 10
WHO PAYS THE INCOME TAX FOR THE REVOCABLE TRUST? 10
WHAT HAPPENS UPON THE DEATH OF THE GRANTOR? 11

TRUSTEE SELECTION 12

WHAT IS THE PURPOSE OF THE TRUST? 12
WHAT IS THE NATURE AND VALUE OF THE ASSETS? 12
WHAT ARE THE FAMILY DYNAMICS? 12
WHAT SKILLS SHOULD BE CONSIDERED IN SELECTING A TRUSTEE? 13

MANAGEMENT OF FAMILY LIMITED LIABILITY COMPANIES AND LIMITED PARTNERSHIPS & GIFTING FOR HIGH NET WORTH INDIVIDUALS & BUSINESS SUCCESSION PLANNING 14

WHAT IS THE PRIMARY "TRAP FOR THE UNWARY" RELATED TO THE MANAGEMENT OF A FAMILY LIMITED LIABILITY COMPANY OR LIMITED PARTNERSHIP? 14
WHAT ARE THE INVESTMENT COMPANY RULES AND HOW CAN A FAMILY COMPANY AVOID THEIR APPLICATION? 15
WHAT IS DEFECTIVE ABOUT AN INTENTIONALLY DEFECTIVE GRANTOR TRUST? 15
WHAT IS A FAMILY BANK? 15
ARE THERE ANY GIFTING OPPORTUNITIES THAT ARE UNDEREXPLOITED BY WEALTHY FAMILIES? 16
WHAT FACTORS SHOULD TRIGGER A DISCUSSION ABOUT A DYNASTY TRUST? 16
WHY WOULD A DONOR EVER ELECT TO PAY GIFT TAXES? 17

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IS THERE A SIMPLE WAY TO PROVIDE A BENEFIT FOR CHILDREN WITHOUT MAKING A TAXABLE GIFT? 17
WHAT IS THE BIGGEST OBSTACLE TO BUSINESS SUCCESSION PLANNING? 18
WHAT ARE THE CALLING CARDS FOR USING A PRIVATE ANNUITY TO SELL AN INTEREST IN A BUSINESS? 18
WHAT UNIQUE CONSIDERATIONS APPLY TO A TRUST THAT WILL HOLD AN INTEREST IN A FAMILY COMPANY? 19
WHAT STEPS WILL A FAMILY BUSINESS ORDINARILY TAKE IN ORDER TO INSULATE ITSELF FROM THE PROSPECT OF NON-FAMILY OWNERS? 19
WHAT SHOULD A BUSINESS OWNER CONSIDERING A GIFT OF AN INTEREST IN A FAMILY COMPANY TO CHARITY KEEP IN MIND? 20

RETIREMENT PLANS AND EMPLOYEE BENEFITS 21

HOW DO RETIREMENT PLANS AND EMPLOYEE BENEFITS FIT INTO AN ESTATE PLAN? 21
BENEFICIARY DESIGNATIONS FOR RETIREMENT PLANS CAN IMPACT NOT ONLY THE RECIPIENT OF THE PLAN BENEFIT BUT ALSO THE TAX CONSEQUENCES ASSOCIATED WITH THE BENEFIT. WHAT ARE THE BENEFICIARY OPTIONS AND TAX CONSEQUENCES? 21
WHAT BENEFICIARY OPTIONS ARE AVAILABLE? 22
WHAT MINIMUM REQUIRED DISTRIBUTION RULES APPLY AFTER A PLAN PARTICIPANT'S DEATH? 22
WHAT IS A ROTH ACCOUNT? 25
WHAT ARE SOME OTHER CONSIDERATIONS FOR EXECUTIVE BENEFITS? 25

PRIVATE PLACEMENT LIFE INSURANCE (PPLI) 27

WHAT IS PRIVATE PLACEMENT LIFE INSURANCE? 27
WHAT ARE THE REQUIREMENTS OF PPLI TO ENSURE EARNINGS AND PROCEEDS WILL NOT BE INCOME TAXABLE? 27
WHAT ARE SOME ESTATE PLANNING SPECIFIC ARRANGEMENTS WHERE PPLI IS COMMONLY UTILIZED? 28

GRANTOR RETAINED ANNUITY TRUSTS 30

WHAT IS A GRAT? 30
HOW DOES THE GRAT WORK? 30
CAN YOU GIVE ME AN EXAMPLE OF A GRAT? 30
WHAT ARE THE TERMS AND CONDITIONS TO BE CONSIDERED IN A GRAT TRUST AGREEMENT? 31
WHAT ARE THE TAX IMPLICATIONS OF THE GRAT? 31
CAN YOU GIVE ME AN EXAMPLE OF THE GRAT TAX CALCULATIONS? 32
WHAT IF THE GRAT'S INVESTMENT PERFORMANCE IS EQUAL TO OR LESS THAN THE IRS INTEREST RATE? 32
IF THERE IS INSUFFICIENT INCOME TO PAY THE ANNUITY IN ONE YEAR, CAN THE DEFICIENCY BE PAID IN ANOTHER YEAR, RATHER THAN USING PRINCIPAL? 33
CAN AN INTEREST IN A CLOSELY HELD BUSINESS BE TRANSFERRED TO A GRAT? 33
WHAT ARE THE COSTS OF MANAGING A GRAT? 33

SALES TO GRANTOR TRUSTS 34

WHAT IS A GRANTOR TRUST? 34
WHAT ARE THE ADVANTAGES OF GRANTOR TRUSTS? 34
WHAT GIVES A TRUST GRANTOR TRUST STATUS? 34
WHAT IS AN INSTALLMENT SALE? 34
WHAT ARE THE BASICS OF AN INSTALLMENT SALE TO A GRANTOR TRUST? 34
WHAT ARE THE ADVANTAGES OF AN INSTALLMENT SALE? 35
WHAT ARE THE DISADVANTAGES OF A TRADITIONAL INSTALLMENT SALE? 36
ARE THERE INCOME TAX CONSEQUENCES OF USING A TRADITIONAL INSTALLMENT SALE? 37

QUALIFIED PERSONAL RESIDENCE TRUSTS 37

WHAT IS A QPRT? 37

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How does the QPRT work? 38
How is the QPRT calculated? 38
What are the terms of the QPRT Trust Agreement? 38
What are the estate and income tax implications of the QPRT 39
How long should the QPRT last? 39
Can you still use the residence after the QPRT ends and the children become the legal owners? 40
Can you give me an example of the QPRT tax calculations? 40
If the property to be placed in the QPRT is located in a state with a gift tax, are there any additional tax considerations? 40
Can I use a vacation home or condominium for my QPRT? 41
May I use my spouse's Unified Credit to shelter my QPRT gift if the value of my gift exceeds my own Unified Credit Exemption? 41
What happens if I wish to stop using the property in the QPRT as a personal residence? 41
What are the costs of managing a QPRT? 41
What if I have a mortgage against the residence or wish to borrow against the residence in the future? 41
Can I continue to pay for improvements to the residence after the residence is transferred to the QPRT? 42
Can my spouse have the right to live in our home after my term expires? 42
How do the IRS interest rates effect the value of the transfer of property to a QPRT? 42
Should you only transfer property to a QPRT when the IRS interest rates are relatively high? 42

SELF-CANCELLING INSTALLMENT NOTE 43

What is a Self-Cancelling Installment Note? 43
Why would a SCIN be of interest to me? 43
How does the transaction work? 43
What are the advantages to using a SCIN? 44
What are the disadvantages to using a SCIN? 44
Are there income tax consequences to using a SCIN? 45

PLANNING WITH RESIDENTIAL REAL ESTATE 46

What are the tax aspects of retaining a residence until I die? 46
Do my heirs have to probate the house? 46
What estate planning techniques can I utilize with my residence? 46
What approaches can I take for managing the family vacation home? 46
What are the Benefits of Making a Gift of a Residence in Trust versus Outright? 47

PRIVATE ANNUITIES 49

What is a private annuity? 49
What are the basics of a private annuity? 49
When should I use a private annuity? 49
How is a private annuity calculated? 49
What are the advantages to using a private annuity? 50
What are the disadvantages to using a private annuity? 50
Are there income tax consequences to using a private annuity? 51

ADMINISTRATION OF GRATS, QPRTS, IRREVOCABLE GIFT TRUSTS, IRREVOCABLE INSURANCE TRUSTS 52

What are the unique aspects of administering GRATs? 52
What are the unique aspects of administering QPRTs? 52
What are the unique aspects of administering Irrevocable Gift Trusts and Irrevocable Insurance Trusts? 52

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FAMILY OFFICE ASSOCIATION

ASSET PROTECTION PLANNING 54
What is the purpose of asset protection planning? 54
When should I consider asset protection planning? 54
What is a future unforeseeable creditor? 54
What assets are exempt from creditors' claims? 55
Are the assets held by a Revocable Trust exempt from creditors' claims? 55
Does a limited liability company protect assets from creditors? 55
Are some limited liability companies better than others? 56
What is the difference between a "member managed" LLC and a "manager managed" LLC? 56
ASSET PROTECTION TRUSTS 57
What is an Asset Protection Trust (APT)? 57
What advantages does an Asset Protection Trust offer over other entities that protect assets, such as a limited liability company (LLC) or limited partnership (LP)? 57
What jurisdictions can an Asset Protection Trust be created? 57
What is the difference between a domestic and a foreign Asset Protection Trust? 57
Who controls an Asset Protection Trust? 58
How much can one transfer to an Asset Protection Trust? 58
What type of assets may be transferred to an Asset Protection Trust? 58
FAMILY TRUST COMPANIES 59
What is a Family Trust Company? 59
What are some reasons to have a Family Trust Company? 59
Who can form and own a Family Trust Company? 59
Whom may a Family Trust Company serve? 59
CROSS-BORDER TAX ISSUES 60
Does a U.S. citizen's U.S. estate plan documents govern the disposition of their foreign assets? 60
Are there any tax issues if a non-U.S. citizen residing in the U.S. decides to move out of the U.S.? 60
In light of the increased cooperation between governments in sharing financial information of their citizens, are there any programs in place to help individuals become compliant before the government penalizes them? 61
Are there any problems with a U.S. citizen or U.S. resident holding investments in foreign businesses? 61
Can a non-U.S. citizen residing in the U.S. be subject to U.S. income tax on worldwide income but not U.S. estate or gift tax on worldwide assets? 62
Is there any tax planning that a non-U.S. citizen should do before becoming a U.S. resident or domiciliary. 63
Are there any problems with a U.S. citizen living overseas moving U.S. assets to a U.S. Revocable Trust? 64
Are there any issues with a non-resident alien transferring assets to a U.S. citizen or U.S. resident? 64
How should a non-resident alien purchase U.S. real property? 64
PLANNING FOR NON-U.S. CITIZEN SPOUSES 66
Does the U.S. estate tax marital deduction apply to transfer to a non-U.S. citizen spouse from a U.S. citizen spouse? 66
Are there any exceptions to the general rule that the U.S. estate tax marital deduction is not available where the surviving spouse is a non-U.S. citizen? Yes, there are three exceptions: 66
Does the U.S. estate tax marital deduction apply to transfers to a U.S. citizen spouse from a non-U.S. citizen spouse? 67

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Does the U.S. gift tax marital deduction apply to transfers to a non-U.S. citizen spouse from a U.S. citizen spouse? 67
Are there any exceptions to the general rule that the U.S. gift tax marital deduction is not available where the donee spouse in a non-U.S. citizen? 67
Does the U.S. gift tax marital deduction apply to transfers to a U.S. citizen spouse from a non-U.S. citizen spouse? 68
Can a non-U.S. citizen spouse and U.S. citizen spouse split a gift? 68
Can a non-U.S. citizen spouse make annual exclusion gifts? 68
Does portability of deceased spouse's unused lifetime exemption apply to a non-U.S. citizen spouse? 68
Are there any issues if a U.S. citizen spouse and non-U.S. citizen spouse hold an asset as joint owners (e.g., tenancy by the entireties or joint with rights or survivorship)? 68
Are there any issues if a non-U.S. citizen spouse transfers assets to a descendant? 69
Is the sale of assets from a U.S. citizen spouse to a non-U.S. citizen spouse considered a taxable event? 69
Are there tax issues if a non-U.S. citizen spouse who was a U.S. resident decides to move back to his or her country of origin? 70
Are there any issues in naming a non-U.S. citizen spouse as a fiduciary? 70

ISSUES WITH NAMING FOREIGN BENEFICIARIES 71

What are U.S. situs assets for estate tax purposes? 71
Why should a foreign beneficiary avoid taking title to U.S. situs assets? 71
What is U.S. source income? 72
How can a double tax occur on a distribution from a trust to a foreign beneficiary? 72
Is there a way to avoid the double taxation trap? 72
If a foreign beneficiary receives a distribution from a U.S. citizen or U.S. Trust/Estate, does the U.S. person or fiduciary have a reporting requirement to the foreign beneficiary or foreign beneficiary's country of residence? 73

THE WORLD OF CHARITABLE GIVING OPPORTUNITIES 74

What is a Charitable Lead Trust? 74
Why would a CLAT be of interest to me? 74
Is there an income tax benefit to creating a CLAT? 75
What are the basics of Charitable Lead Annuity Trust administration? 76
Do the assets used for funding affect the income tax consequences to you and the administration of the CLAT? 76
Must the Trustees be sensitive to certain requirements? 77
What is a Charitable Remainder Unitrust? 78
Is there an income tax deduction available for implementing a CRUT? 79
What provisions may be included in the CRUT? 79
What are the tax implications of creating the CRUT? 80
What about the taxation of the CRUT itself? 80
Who can be the beneficiary of the CRUT? 81
How long can the CRUT last? 81
Can you give me an example of the CRUT tax calculations? 81
Can I change the charitable remainder beneficiary after I fund the CRUT? 82
Can my private foundation be the charitable remainder beneficiary? 82
Does a CRUT have to pay me a unitrust amount? What other payment options are there? 82
Can I make additional contributions to the CRUT? 83
Is there a way for me to use a CRUT to diversify my low basis assets in a tax-efficient manner without "disinheriting" my family? 83

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WHAT ARE THE COSTS OF ADMINISTERING A CRUT? 83
WHAT PROPERTY SHOULD I USE TO FUND A CRUT DURING LIFE? WHAT PROPERTY SHOULD I USE TO FUND A CRUT AT DEATH? WHAT PROPERTY SHOULD I NOT USE? 83
WHAT ARE THE GENERAL ADMINISTRATION CONCERNS INVOLVED WITH ADMINISTERING A CHARITABLE REMAINDER UNITRUST? 84
WHAT TYPE OF ASSETS SHOULD BE USED TO FUND THE CRUT? 84
HOW DOES THE CRUT QUALIFY AS TAX-EXEMPT? 84
WHAT ARE THE LIMITATIONS ON THE CHARITABLE INCOME TAX DEDUCTION? 85
MUST THE TRUSTEES BE SENSITIVE TO CERTAIN REQUIREMENTS? 86
TAX-FREE IRA DISTRIBUTIONS TO CHARITY 88
WHAT IS A PRIVATE FOUNDATION? 88
HOW DO I CREATE A FOUNDATION? 88
WHO MAY MANAGE THE FOUNDATION? 89
CAN I RESTRICT THE ACTIVITIES OF FUTURE FOUNDATION MANAGERS? 89
ARE THERE ANY TAXES PAYABLE BY A FOUNDATION? 90
MUST A FOUNDATION MAKE DISTRIBUTIONS? 90
ARE THERE OTHER RESTRICTIONS ON HOW A FOUNDATION IS OPERATED? 91
SELF-DEALING 91
EXCESS BUSINESS HOLDINGS 91
INVESTMENTS WHICH JEOPARDIZE CHARITABLE PURPOSE 92
TAXABLE EXPENDITURES 92
WHAT ARE THE ALTERNATIVES TO A FOUNDATION? 92

CUMMINGS & LOCKWOOD CONTRIBUTORS 95

ABOUT CUMMINGS & LOCKWOOD LLC 98

OVERVIEW 98
PRIVATE CLIENTS PRACTICE 98
COMMERCIAL PRACTICE 98

ABOUT THE FAMILY OFFICE ASSOCIATION 100

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LIFE PLANNING

IF A FAMILY MEMBER MOVES TO A NEW STATE THAT HAS LOWER INCOME AND ESTATE TAXES, WHAT SHOULD THE FAMILY MEMBER DO TO ESTABLISH THEIR "RESIDENCE" FOR INCOME TAX PURPOSES AND THEIR "DOMICILE" FOR ESTATE TAX PURPOSES?

The concept of "residence" and "domicile" are similar and are easily confused. While frequently the state of one's domicile is also the state of one's residence, this does not hold true for everyone. While a person may have a number of different residences or be a resident of a number of different states, he or she may only have one domicile at any given time. Residence determines where one pays income tax. Domicile determines where one's estate will pay estate tax on assets other than real estate.

The concept of "residence" is based upon objective factors. Like domicile, a person's residence is dependent upon a finding of physical presence within the particular state. Whether a person is a resident of a state may be determined, for example, based on the number of days spent within the state or the ownership of property within the state. Reference must be made to each state's laws to determine the tax and legal consequences of being a resident of that state. However, no finding of intent is required for a person to be deemed a resident of a particular state. Thus, depending upon the laws of the particular jurisdiction, a person may be deemed a resident of more than one state and a domiciliary of yet another.

The choice of residence carries with it different legal consequences. For most states, a strict days present test will determine whether or not you are an income tax resident in that state even if you are domiciled in a different states. Some states have harsh rules that treat even a partial day physically present in that state as a day present in that state especially if you maintain real estate in the jurisdiction. As with estate taxes, it is important to avoid income taxation in two different states.

A person's "domicile" is his or her permanent home, to which he or she always intends to return. "Domicile" is often defined as (i) actual residence within a particular state, combined with (ii) the intention of making that state one's permanent home. Actual residence in a state without the intention to live in that state permanently does not suffice. Since domicile is a question of intent,

courts often look to a person's overall manner of living to determine whether there has been a change of domicile.

The choice of domicile carries with it various legal consequences. It often determines (i) jurisdiction to assess state income and death taxes; (ii) primary jurisdiction to probate wills and administer estates; and (iii) judicial jurisdiction over an individual. Domicile also determines whether and where a person may exercise various legal rights and privileges, such as voting.

Generally, you will be subject to death taxes only in your state of domicile. However, if you die owning real property in another state, that state may impose its own death taxes on the value of the real property located in that non-domiciliary state.

Federal courts have allowed two or more states each to make an independent determination of domicile and each to assess its own estate and inheritance taxes on that basis. The United States Supreme Court has held that such double taxation is constitutional. In one infamous case, New Jersey and Pennsylvania both claimed an heir to the Campbell Soup fortune as a domiciliary and each state collected $17 million in state inheritance taxes from the estate. Since a determination that you are domiciled in more than one state could have extremely adverse and costly consequences, it is imperative to take all the steps necessary not only to establish your new domicile, but also to revoke your prior domicile.

If you wish to change your domicile to another state but retain a home in your original state, you should take steps consistent with this change of domicile that manifest your intention to abandon your original domicile.

Court cases deciding the issue of domicile indicate that no one factor conclusively establishes domicile. As mentioned above, the determination of one's domicile is a matter of one's intent, therefore, courts often look to a variety of factors in determining whether there has been a change of domicile. A person's declarations as to what he considers to be his home, residence or domicile may be used as evidence of intent. Such declarations often are found in formal legal documents as well as in other written instruments, such as letters, hotel registrations and the like. To make your choice of domicile clear, you should take as many of the following steps as are possible in view of your particular circumstances:

IN YOUR STATE OF DESIRED DOMICILE

- Execute a new Will or a Codicil which recites your new domicile and which complies with all the legal requirements of your new state of domicile.
- Execute new Durable Powers of Attorney, Living Wills and Health Care Proxies which recite your new domicile and which comply with the legal requirements of your new state of domicile.
- File a Declaration of Domicile, if available.
- Purchase and furnish a home to be used as your primary residence.
- Register as a voter and vote.

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- File your federal income tax return with the appropriate IRS regional service center and show your state of desired domicile as your residence address.
- Pay state and local taxes as a resident.
- Obtain a driver's license.
- Register your automobile.
- File for any applicable tax exemptions on residential property.
- Be physically present within the state as large a part of each year as is practicable, especially during the initial year. Some individuals may wish to keep a diary of trips out of state and of nights spent in and out of state.
- Maintain a major portion of your bank accounts and brokerage accounts.
- Open a safe deposit box for your jewelry and other valuable property.
- Pay health insurance premiums.
- Conduct your business or profession in state to the extent possible.
- Join clubs, religious and social organizations.

IN YOUR FORMER STATE OF DOMICILE

- If you have filed a Declaration of Domicile in another state, mail a copy to the tax authorities of the non-domiciliary state.
- Have your name removed from the voting rolls.
- Surrender your driver's license.
- Pay any taxes due as a nonresident. Mark your last return as a resident "FINAL," using your new address.
- Spend as little time as practicable in the state.
- Close brokerage and bank accounts in the state.
- Change club, religious and social memberships to "nonresident" status.

IN ADDITION, YOU SHOULD

- Describe yourself as a resident of your domiciliary state in all legal documents that require a recital of residence, such as passports, real estate deeds, contracts, leases and credit applications.
- When traveling, use your new address as your residence when registering at hotels, motels, etc.
- Send a change of address to all business entities with which you deal, including those that presently owe you money or that may owe you money in the future, e.g., credit card companies, insurance companies or former employers that provide pension plans or death benefits.
- Consider transferring title to any residential real estate situated in your state of former residence to other family members, or to trusts for their benefit, but only after considering the estate planning consequences of such a transfer.
- Above all, *pursue a consistent course of conduct indicating an intention to abandon your former domicile and establish a home in the new state*.

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IF A FAMILY MEMBER PLANS TO GET MARRIED, WHAT STEPS SHOULD HE OR SHE BE TAKING TO PROTECT HIS OR HER ASSETS OR ACCESS TO THE FAMILY ASSETS?

Wealthy individuals contemplating marriage should consider entering into a premarital agreement. As its name suggests, a premarital agreement is an agreement in writing entered into by the future spouses prior to marriage which contains provisions regarding ownership of property. The Agreement may contain provisions regarding disposition of property upon marital dissolution, death, or the occurrence of any other event; modification or elimination of spousal support; ownership rights in death benefits from life insurance policies; and rights to retirement plans. The parties may also agree to execute a Will or trust that reflects these provisions.

Each state's law differs on the enforceability of premarital agreements. Generally, a premarital agreement may be deemed unenforceable it not properly prepared or executed. As a general rule, to render a premarital agreement unenforceable, one must prove that: (1) he or she did not execute the agreement voluntarily; (2) the agreement was unconscionable when it was executed or when enforcement is sought; (3) he or she was not provided fair and reasonable disclosure of the amount, character and value of property, financial obligations and income of the other party before execution of the agreement; or (4) he or she was not afforded a reasonable opportunity to consult with independent counsel. Absent the existence of any such facts, a premarital agreement may be amended or revoked only by a written agreement signed by both parties. Generally, courts will typically enforce a premarital agreement unless the terms are unconscionable either at the time it was executed or at the time of the separation.

It is important that an estate plan accurately reflect such person's obligations under the premarital agreement. The act of marriage will entitle the spouse to potentially contest the Will, elect against the will and take an "elective share" of the estate. Most states provide some sort of "elective share" for a spouse who was written out of her spouse's will. Each state differs as to what is included and what is not included in calculating the elective share. For example, New York includes assets held in a Revocable Trust at the time of death while Connecticut, currently, does not.

IF A FAMILY MEMBER IS GETTING DIVORCED, HOW SHOULD HE OR SHE CHANGE THEIR ESTATE PLAN?

It is important for a person who has recently divorced to re-evaluate his or her estate plan, specifically the disposition of assets. In addition, appointments of executors and trustees may need to be revisited, especially if the former spouse was named in either capacity. While local state law, may revoke any bequests or appointments in favor of the spouse automatically upon the entering of a divorce decree, it may not revoke bequests or appointments for the spouse's other family members.

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Divorce counsel should be consulted prior to changing any estate planning documents. Many states issue protective orders as soon as a divorce is filed that prevent the parties from changing their estate plans until the divorce is finalized.

In many states, Revocable Trusts are not automatically revoked by divorce. Instead, Revocable Trusts are governed by the terms of the document. Thus, the creator of the trust generally will wish to amend the provisions of the trust to remove the former spouse as a beneficiary.

Irrevocable trusts generally also are not revoked by divorce. Unlike revocable trusts, irrevocable trusts cannot be modified or terminated. However, irrevocable trusts are often drafted to provide contingencies in the event of a subsequent divorce.

HOW SHOULD A FAMILY MEMBER STRUCTURE THEIR ESTATE PLAN IN THE SECOND MARRIAGE OR BLENDED FAMILY SITUATION?

A thorough estate plan should take into account the possibility that one's surviving spouse, children or grandchildren may be married, and also potentially divorced, during their lifetimes. The impact of marriage and divorce law thus is quite relevant when structuring gifts or bequests to a spouse, children and grandchildren.

Many clients rightfully worry that gifts made now to a spouse, children or grandchildren may eventually inure to the relative's spouse. As a general rule, property one spouse receives by gift or inheritance should be accorded a somewhat different status than property resulting from earnings during the marriage, depending upon how long the property was held during the marriage, whether it has appreciated in value, whether the appreciation was the result of one spouse's efforts and whether there is other property available for division. Nevertheless, as discussed above, all or any part of the estate of one spouse may be awarded to the other spouse in a divorce and there can be no certainty as to how a judge will treat property received by gift or inheritance.

To reduce the risk that a spouse's, child's or grandchild's gift or inheritance could be lost in the event of divorce, many clients chose to establish "spendthrift" trusts for their spouse, children or grandchildren rather than making outright gifts or bequests. Children of spouses or spouses of children and grandchildren generally do not acquire any rights in properly-drafted spendthrift trusts created for the benefit of such person. In a divorce or remarriage, the court may still consider the value as one factor when making an equitable distribution of property. Nevertheless, the trust property should still enjoy greater protection than it would if such person owned such property outright.

WITH THE RISE OF ALZHEIMER'S AND OTHER COGNITIVE MENTAL HEALTH ISSUES, HOW DO YOU PLAN FOR A LONG PERIOD OF INCAPACITY?

Every estate plan should provide for the management of assets in the event of incapacity. Depending on the jurisdiction, each family member should have a durable power of attorney, living will and health care proxy (or Advanced Medical Director) and a Designation of

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Conservator or Guardian. In some states, these documents may be combined or each a separate document.

A durable power of attorney allows the named person to manage assets in the event the principal is no longer capable of doing so. This should be effective to avoid the expense and complications involved in having to petition a Court to appoint a Conservator or Guardian for that purpose. In some states, a Court will have continuing jurisdiction over the Conservator or Guardian which may require costly annual accountings.

A Living Will and Health Care Proxy or Advanced Medical Direction document contains two main parts. The "Living Will" expresses wishes regarding the removal or withholding of extraordinary life support measures in the event you are in a terminal medical condition or a permanent coma. The "Appointment of a Health Care Representative" appoints an individual to make medical decisions on the persona's behalf in the event he or she is incapacitated and authorizes that individual to communicate wishes relating to the withdrawal of life support under circumstances which are not expressly covered by the Living Will. It is important that this document contain an authorization to give the agent access to protected health information so as to make important decisions concerning care.

Finally, most states allow a person to execute a separate document or incorporate into a durable power of attorney or living will the appointment of a guardian or conservator in case one is needed. If the hospital or nursing home has concerns about relying on a durable power of attorney, a guardianship or conservatorship proceeding may be required. If the person has named a conservator or guardian in their documents, it is extremely difficult for a Court to name someone other than the named guardian or conservator.

We have found that a Revocable Trust that has been funded prior to incapacity as the best vehicle to manage incapacity. Without the practical complications of a durable power of attorney, the Trustees of a Revocable Trust can manage the family member's funds for a long period of incapacity.

WHAT SHOULD FAMILY MEMBERS DO TO PRESERVE, PROTECT AND PASS ON VALUABLE TANGIBLE PERSONAL PROPERTY (I.E., ARTWORK, CARS, JEWELRY)?

Tangible personal property in a legal sense means any property that is movable, that you can touch and feel, but is not real property like a house or real estate and is not intangible property such as cash and marketable securities.

In order to preserve and protect family heirlooms, it is important to take an Inventory from time to time to document what each person has in their possession. The Inventory can be useful in make sure the items are all adequately insured against fire, theft or other casualty losses. Appraisal should be updated from time to time as the market for collectibles is volatile and does not correlate to the financial markets. In addition, documents proving the authenticity of items should be maintained in safe place.

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In developing an exit strategy for tangibles, it is important to ask if the next generation would even want such items. While the senior generation may have great affinity for an item, the next generation may have little to no interest in retaining the item.

If the next generation is interested in receiving the property, a gift strategy described in this paper can be used to gift the property to the children. Keep in mind that the recipients will most likely have the same income tax basis in the property as the donor.

If it is decided to gift items to charity, a donor should enter into an agreement with the charity that dictates the term of the donation.

If the donor wishes to keep a collection of items in one place, the donor should consider setting up a charity or foundation to house the items. Caution will be required to avoid the prohibitions on self-dealing with respect to charities.

If the owner wish to sell the property and the property is a collectible, keep in mind that there is a special capital gains rate of 28% for the sale of collectibles.

Finally, if the owner wishes to retain the property until his or her death, the owner's estate plan should address the disposition of tangibles. Large value items or emotionally valuable items should be specifically addressed in the estate plan. Many states now allow a person to create a separate memorandum with respect to the disposition of tangible person property that is legal binding. Other states still require that a disposition must be in a Will or Revocable Trust in order for the bequest to be legally binding.

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DIGITAL ASSETS

WHAT ARE "DIGITAL ASSETS"?

Digital assets include photos and videos to music, whether on devices or in the cloud, as well as email accounts, social networking accounts, internet domain names, blogs, online gaming items, and client lists and other electronic files. According to a 2011 survey from McAfee, Intel's security-technology unit, American consumers valued their digital assets, on average, at almost $55,000.

WHAT ARE THE CHALLENGES FACING DIGITAL ASSETS THAT ARE DIFFERENT THAN TRADITIONAL ASSETS?

There are millions of internet-based accounts that belong to decedents. Some internet service providers (ISPs) have explicit policies on what will happen when an individual dies, whereas others do not. Even where ISPs include their policies in the terms of service agreements, most consumers only click through these agreements without a thought. Historically, few laws exist on the rights of fiduciaries over digital assets. Federal law, enacted more than three decades ago, imposes criminal penalties and possibly civil liability for the unauthorized access of computer hardware, devices and stored data.

UPON AN INDIVIDUAL'S DEATH, IS A FIDUCIARY (E.G., EXECUTOR, PERSONAL REPRESENTATIVE, TRUSTEE, AGENT, ATTORNEY-IN-FACT, OR GUARDIAN) PERMITTED TO ACCESS THE DECEDENT'S DIGITAL ASSETS?

In July 2015, the National Conference of Commissioners on Uniform State Laws established a model law to help states enact legislation. Although some states have enacted their own legislation, other states are enacting this uniform legislation that allows a fiduciary to "step into the shoes" of the decedent. What a fiduciary may access depends upon the type of information sought and what the decedent authorized during life. Pursuant to the uniform legislation, a fiduciary may access a catalog of "non-content" information (i.e., the outside of the envelope) without the express prior consent of the decedent. However, to grant access "content" information upon death (e.g., the letter inside the envelope), the user/decedent has options:

- First, the user may use the ISP's online tool to provide direction to the fiduciary, which will supersede a will, trust or power of attorney.
- Second, in the absence of the online tool, the user may provide a written direction in a will, trust or power of attorney.
- Finally, if there is no written direction, the ISP's terms of service agreement controls.

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WHAT ARE EXAMPLES OF "OUTSIDE THE ENVELOPE" NON-CONTENT INFORMATION?

- Logs of email communications, including email addresses of senders and recipients and date/time sent or received.
- Catalogs of photo or music titles.

WHAT ARE EXAMPLES OF ISPS THAT PROVIDE AN ONLINE TOOL FOR POST-DEATH ACCESS?

- Facebook's Legacy Contact. Facebook permits the legacy contact to write a pinned post for the decedent's profile, respond to new friend requests, update the profile picture, and download an archived copy of what the decedent posted on Facebook. To access more, such as messages, the decedent would need to have specified in a will or trust.
- Google's Inactive Account Manager. Google permits a user to name an individual to have access to his or her Google account information, with the option to close the account and/or obtain data from the account (including Gmail, Google Photos, YouTube, Google+, Google Drive, etc.) with a court order.

WHAT STEPS SHOULD A FIDUCIARY TAKE WITH RESPECT TO DIGITAL ASSETS?

- Identify digital assets, accounts and information.
- Locate them (e.g., computers and other devices, backup and flash drives, and online storage and accounts).
- Access them as permitted by law.
- Value them for inventory, tax and distribution purposes.
- Protect and preserve them. For example, if the ownership of a domain name is not maintained and expires, the domain is suspended for two months, then put up for auction.
- Retain knowledgeable, technical help.
- Transfer them to the intended beneficiaries.

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Administration of Revocable Trusts

WHAT IS A REVOCABLE TRUST?

A Revocable Trust is a document created during an individual's lifetime to manage his or her assets and distribute the remaining assets after the individual's death. The "Grantor" or "Settlor" is the individual who created the Trust and the "Trustee" is the person responsible for administering the Trust. The Grantor can serve as Trustee, or may appoint another person, bank or trust company to serve as the Trustee. The trust is "revocable" since the Grantor may amend or revoke the trust during his or her lifetime.

The Trustee manages the assets of the trust by making investment decisions, maintaining brokerage and other financial accounts, loaning or borrowing funds, retaining, acquiring, or selling real or personal property, hiring attorneys, accountants, investment counsel or other agents, and in any other manner as provided under the trust agreement or state law. Generally, the Trustee does not have to keep all of the beneficiaries informed of the trust, only the Grantor (if the Grantor is not the Trustee or co-Trustee).

HOW IS THE REVOCABLE TRUST FUNDED?

To fund the Revocable Trust, assets must be formally transferred to the trust. Failure to formally transfer the assets into the Revocable Trust could result in the assets being subject to probate. To accomplish this, the Grantor must transfer the assets to the legal name of the Revocable Trust, which is generally referred to as follows:

> "John. M. Smith, Trustee of the John M. Smith Revocable Trust
> dated November 1, 2016"

The exact method of the transfer will vary depending on the nature of the assets. Accounts with financial institutions will require new documents to be signed by the Grantor and the Trustee to open a new account or re-title an account in the name of the Revocable Trust. Transfers of real estate will require the preparation of a new deed, which will need to be recorded, but, it is important to consider the impact such a transfer may have on homeowners' insurance, title insurance, and any mortgage on the property. Ownership interests in closely held business interests must be formally assigned to the Revocable Trust, taking care to follow the requirements found within an operating agreement or similar document.

WHO PAYS THE INCOME TAX FOR THE REVOCABLE TRUST?

During the Grantor's lifetime, the Revocable Trust is not a separate taxpayer, and the Grantor must include all items of income earned by the trust and all corresponding deductions on his or her personal income tax return. When the Grantor is also a Trustee or co-Trustee of the Revocable Trust, the Grantor's social security number serves as the taxpayer identification

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number of the trust. When the Grantor is not a Trustee, the Revocable Trust must apply for a separate taxpayer identification number and the trust will be required to file a separate income tax return (unless there is no income for that tax year), although the Grantor is still responsible for the payment of income taxes during his or her lifetime.

WHAT HAPPENS UPON THE DEATH OF THE GRANTOR?

Upon the death of the Grantor, the trust becomes irrevocable. If the Grantor was the Trustee, the person appointed to be the successor Trustee must formally accept the position. The Trustee will generally work closely with the Executor or Personal Representative of the Grantor's estate during the estate administration process. The Trustee is responsible for paying claims and taxes of the Grantor's estate, and then distributing the assets to the beneficiaries as described in the trust agreement. The Trustee will generally have a duty to inform and disclose certain information regarding the trust to all of the qualified beneficiaries, except as otherwise provided for in the trust agreement or state law.

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TRUSTEE SELECTION

Choosing a Trustee can be a challenging decision, especially since Grantors commonly want a family member to be the Trustee. For a Revocable Trust, the Grantor will typically serve as a Trustee during his or her lifetime, either alone or together with the Grantor's spouse, another family member, or an Independent Trustee. After the Grantor's death, the Grantor's surviving spouse, if any, or one or more children of the Grantor are a common appointment. It is important that that the successor Trustee named to act upon the Grantor's death is able to work with the Executor of the Grantor's estate, as those two persons will have to work closely together during the estate administration. After the division of the trust assets for the beneficiaries, if there are ongoing trusts, many more factors enter into the equation. For an Irrevocable Insurance Trust, the Grantor cannot serve as Trustee, and an Independent Trustee may be the best option.

WHAT IS THE PURPOSE OF THE TRUST?

The purpose of a trust can help to narrow down who should serve as Trustee. If the trust is a spendthrift trust, the beneficiary should not be a Trustee, but asking a family member of the beneficiary to be a Trustee, especially a sibling, may cause additional problems. If the trust is primarily for asset protection, the beneficiary may serve as Trustee, but in some instances, for maximum protection, it is preferable for an Independent person or Corporate Trustee to serve as a Trustee or co-Trustee with the beneficiary.

WHAT IS THE NATURE AND VALUE OF THE ASSETS?

The nature and value of the assets also has an impact on the selection of a Trustee. If a trust consists of a residence and cash, the beneficiary may be able to manage the assets without any assistance. If the trust consists of a closely held business, one or more family members who have been involved in running the business for multiple years may be the best choice to serve as Trustee, either alone or together with the beneficiary. If the trust consists of many complicated investments, real property held in limited liability companies, and requires sophisticated tax decisions, the beneficiary may prefer to not be a Trustee at all, and a professional Trustee, such as a bank, trust company, or attorney, is the best choice to serve as Trustee.

WHAT ARE THE FAMILY DYNAMICS?

Choosing a family member or a friend to serve as Trustee may put additional strain on the relationship between the beneficiary and the Trustee. The beneficiary and the Trustee will have to work together and be able to get along with each other, so if there are any questions about the ability to do that, it may be better to appoint an unrelated person as the Trustee.

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WHAT SKILLS SHOULD BE CONSIDERED IN SELECTING A TRUSTEE?

A Trustee will need an attention to detail, time and organizational skills, interpersonal skills to communicate well with the beneficiaries, honesty and integrity to safeguard the trust assets, expertise to invest and manage the trust assets, and the knowledge on how to handle tax issues, or, the Trustee will need to be able to recognize the need for these skills and seek out help from professionals. The Trustee does not have to be an expert in every area, but the Trustee should have a sufficient enough grasp of the issues to recognize when help is needed and to be able to hire the appropriate professionals.

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WHAT IS THE PRIMARY "TRAP FOR THE UNWARY" RELATED TO THE MANAGEMENT OF A FAMILY LIMITED LIABILITY COMPANY OR LIMITED PARTNERSHIP?

Family limited liability companies and limited partnerships (referred to herein as "family companies") are ordinarily formed in order to take advantage of a number of tax and asset protection opportunities. However, those opportunities are jeopardized if the family company fails to adhere to a number of legal formalities. In sum, these formalities revolve around a single concept, which is the importance of respecting the family company as an operating business. Once a family company is in place, it is critically important to convey to the family members that the failure to respect the formalities associated with the operations of the company as a business imperil the very objectives that led to the family company's formation.

Family members must understand at the outset that the family company cannot operate as a "piggy bank" for members of the family. Assets which will be needed in order to satisfy family expenses unrelated to the business of the family company should not be contributed to the company. Once the company is in place, the owners must continue to adhere to this principal and avoid the temptation to commingle personal funds with the family company or add assets unrelated to the business to the family company. Most importantly, family company funds should only be used to pay company expenses; company funds must not be used to pay personal expenses of family members, or be tied to a pattern of distributions which correlates with the expenses of individual family members. Distributions to owners should be made following a pattern consistent with other for-profit businesses.

The family business must be identified as a business when interacting with the public. Accounts for the business must use the tax identification number and name of the family company, and not the name or Social Security number of an individual family member. Correspondence related to the business of the family company should appear on company letterhead, to clearly distinguish the business of the company from the business of individual family members.

A family company should keep scrupulous records of its activities. In addition to formation documents, the company should retain copies of bank statements and regular expense and income activity, including receipts. Experienced professional advisors should be in place to ensure that this recordkeeping function is satisfied. An experienced accountant should prepare tax returns, issue Schedule K-1s to the owners on a timely basis, track capital account changes and maintain books and records. An attorney should supervise the retitling of assets in the name of the family company, review the corporate records to confirm that they are in good order, attend to annual state filings and prepare annual written consents to memorialize decisions made in periodic meetings.

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WHAT ARE THE INVESTMENT COMPANY RULES AND HOW CAN A FAMILY COMPANY AVOID THEIR APPLICATION?

Prior to the formation of a family company which will be funded with 80% or more of assets composed of cash, stocks or securities, it is important to review whether or not that funding will trigger income recognition under the investment company rules. The investment company rules compel the recognition of unrealized appreciation if the partners of the family company have diversified their investments in connection with the formation of the family company. There are two safe harbors that partners can take advantage of in order to avoid the application of the investment company rules. First, partners who are contributing identical portfolios to the family company are not engaging in diversification and so do not trigger the investment company rules. Second, an adequately diversified portfolio of stocks and securities will not trigger the application of the investment company rules. A family company's portfolio is considered to be adequately diversified if it satisfies the 25% test and the 50% test, meaning that no more than 25% of its value is invested in one issuer and no more than 50% of its value is invested in five or fewer issuers. The proposed investment portfolio for a family company should be reviewed in advance by the family attorney and/or accountant in order to ensure that the investment company rules will not force unexpected income tax bills for any of the partners.

WHAT IS DEFECTIVE ABOUT AN INTENTIONALLY DEFECTIVE GRANTOR TRUST?

An intentionally defective grantor trust, frequently referred to as simply a "grantor trust," is a trust which requires the grantor to report the income generated by the trust assets on the grantor's individual income tax return. Many gifting vehicles are intentionally designed as grantor trusts so that the grantor can continue to bear the income tax burden associated with assets that have been removed from the grantor's estate through a completed gift. In short, the gift by the grantor is complete for gift tax purposes but not for income tax purposes. This allows the trust property to grow inside of the grantor trust without the drag of an income tax burden. Some grantors resist the suggestion that they continue to pay income taxes for funds that have been gifted to a trust off of their balance sheet to which they no longer have access. However, many grantors recognize that the annual income tax payments made in connection with trust income "feel" like an additional gift to the trust each year, even though the IRS does not treat those payments as gifts. Thus, grantor trust status is a powerful tool that a family can use to allow previously gifted trust assets to grow without making additional gifts. There are many administrative "defects" that can be used to intentionally trigger grantor trust status, but among the most popular are the ability of the grantor to "swap" assets with the trust, the ability of the trust to make premium payments for a life insurance policy on the life of the grantor and the appointment of a Trust Protector who has the right to add beneficiaries to the trust.

WHAT IS A FAMILY BANK?

Most wealthy individuals who are receiving tax advice are fully utilizing their $15,000 annual exclusions from the gift tax in order to make gifts to their children and any grandchildren. For

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the family member who would like to provide for siblings, nieces or nephews or more remote family members, a logical next step is to use the annual exclusions available with respect to that group of individuals in order to establish an Estate Reduction Trust for their benefit, sometimes referred to as a "family bank." The purpose of the family bank is to remove assets from the estate of the donor by placing them in a trust for the benefit of specified family members. That trust, which is ordinarily structured as an intentionally defective grantor trust for income tax purposes, is frequently used to provide for the needs of non-lineal family members, including weddings, educational expenses, down payments for homes, etc. The Trustees can have complete discretion over the circumstances under which distributions from the family bank will be made, and, it is important to note, this technique is not limited to benefiting only family members. Some wealthy families have more than one family bank, including separate family banks for different branches of their family and/or a family bank for non-relatives who are close friends of the family.

ARE THERE ANY GIFTING OPPORTUNITIES THAT ARE UNDEREXPLOITED BY WEALTHY FAMILIES?

Many wealthy families and their advisors are so focused on the use of their $15,000 annual exclusions from the gift tax that they overlook the exclusion for payments of medical and educational expenses. This exclusion provides that payments for tuition expenses (i.e., not "room and board") and medical expenses made directly to the school or medical provider do not count as taxable gifts. In other words, a donor can give a particular donee $15,000 in a year, and also pay all of the donee's tuition expenses for the year (for example, this figure would be approximately $50,000 at some private colleges) without making a taxable gift. This ability to pay tuitions, which is not limited to family members, can become a very powerful tool enabling donors to pay the tuitions of multiple grandchildren, nieces and nephews. If a family member is comfortably situated in a school, a donor can even further enhance this technique by pre-paying tuitions for the rest of the student's career at the school. In one notable case, a grandmother pre-paid the tuitions for a number of grandchildren in private schools, removing hundreds of thousands of dollars from her estate.

WHAT FACTORS SHOULD TRIGGER A DISCUSSION ABOUT A DYNASTY TRUST?

A wealthy family will ordinarily begin to consider a Dynasty Trust when they have reached the point at which they believe that their assets are likely to last beyond the lives of their children. The dynastic aspect of a Dynasty Trust ordinarily takes advantage of two concepts: (i) the statutes of one of the more than two dozen states (among the more popular jurisdictions are Alaska, Delaware, Florida, Nevada and South Dakota) that allow trusts to last for 360 years or more, and (ii) the application of exemption from the generation-skipping transfer tax to property held in the Dynasty Trust. By appointing a Trustee in one of the favorable jurisdictions in order for the Dynasty Trust to have a nexus in that jurisdiction, and then allocating exemption from the generation-skipping transfer tax to trust property, trust assets can be made available to multiple generations without being exposed to the estate tax or generation-skipping transfer tax.

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A Dynasty Trust can be funded at the donor's death by the donor's Will and Revocable Trust. However, if the donor's circumstances allow, a powerful planning opportunity is to fund the Dynasty Trust during the donor's life, thereby allowing the gifted property to appreciate in value outside of the donor's taxable estate. Moreover, the Dynasty Trust can be structured as a "grantor trust" for income tax purposes, so that the donor can continue to bear the income tax burden for the Dynasty Trust property during the donor's life. Finally, funding the Dynasty Trust during the donor's life enables the donor to leverage the use of the donor's exemption from the generation-skipping transfer tax. The donor can fund the Dynasty Trust with assets that have unusual potential to appreciate or have subjective value (for example, an interest in real estate, art or a business) that a formal written appraisal might not capture. In fact, the best candidate for a Dynasty Trust is the donor who not only can afford to give valuable assets to a Dynasty Trust, but one who is holding an asset with substantial potential to appreciate.

WHY WOULD A DONOR EVER ELECT TO PAY GIFT TAXES?

The average donor has such an aversion to voluntarily paying taxes of any kind that it is frequently much more effective to illustrate the tax-efficiency of intentionally paying gift taxes using simple numbers before describing the underlying concept. Assume the following fact pattern: A client with $7 million of cash, who has used up all of her lifetime exemption from the Federal gift tax, decides that she would like to make a gift of $5 million to her children during her life. She makes the gift, resulting in a gift tax payment of $2 million. Suppose the same client instead decided to retain all of the same $7 million until her death, providing in her Will that it will pass to her children. The inclusion of the $7 million in her estate would generate an estate tax of $2.8 million so that the children would receive $4.2 million. This means that the children would receive $800,000 less as a result of the client's decision to retain these funds in her estate rather than giving them to the children during her life.

The $800,000 swing/lost benefit in this example results from the different manner in which estate and gift taxes are calculated. Estate tax calculations are tax inclusive, meaning that the estate is also paying taxes on the dollars that are used to pay the tax. Gift tax calculations are tax exclusive, meaning that the donor is not paying tax on the dollars that are used to pay the tax. The IRS is fully aware of this planning opportunity, which is why tax payments made within 3 years of death are included in a decedent's estate. However, for the donor who is inclined to make a gift and likely to survive that gift by 3 years, electing to pay gift taxes can result in a meaningful benefit for the donor's beneficiaries.

IS THERE A SIMPLE WAY TO PROVIDE A BENEFIT FOR CHILDREN WITHOUT MAKING A TAXABLE GIFT?

Some individuals wish to provide a benefit to their children without making a taxable gift, particularly if they have used up all of their lifetime exemption from the Federal gift tax. For wealthy families, this wish frequently results from a desire to see children enjoy the fruits of their parents' financial success during the lives of the parents. Loans to the children memorialized with promissory notes are an attractive option in this situation, particularly in a

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low interest rate environment. A loan enables a parent to move a substantial amount to a child, and may require that the child only pay interest on the principal balance during the term of the loan with a balloon payment of principal at the end of the term. It is important for families to adhere to the terms of the promissory note in order to support the expectation that the loan will be repaid. This means that the child will have unlimited access to and control over the loaned amount, so that it is frequently perceived as an "advance" on an inheritance. The promissory note can be refinanced if the parent survives the term of the loan, and the loan may be distributed to the child as a portion of the child's inheritance at the death of the parent. From a tax efficiency standpoint, the loan operates as a partial freeze of the value of the parent's estate, because the loaned funds are likely to appreciate at a higher rate than the interest rate of the loan, but the real value of this simple technique is the parent's enjoyment in seeing the children's use of the loaned funds.

WHAT IS THE BIGGEST OBSTACLE TO BUSINESS SUCCESSION PLANNING?

Most successful business owners are very capable at managing variables and making decisions to respond to those variables. Nevertheless, many owners stumble over the application of that skill-set to business succession planning, presumably because it forces business owners to focus not only on the future direction of the business, but also their own mortality and family issues related to the business. In order to structure an effective business succession plan, experience advisors need to know who will be in charge of the business in the future, economic expectations of both current and future business leaders and the form that any future family involvement will take. These are not easy issues to address, and many business owners struggle with one or more of them, which results in placing business succession planning on the back burner. It is important for a business owner to recognize that efforts directed at addressing these difficult questions with a team of experienced professional advisors are rewarded through both the preservation of the owner's legacy in the business and the attendant financial well-being of the owner's family.

WHAT ARE THE CALLING CARDS FOR USING A PRIVATE ANNUITY TO SELL AN INTEREST IN A BUSINESS?

Private annuities are less common than installment sales to intentionally defective grantor trusts and, not coincidentally, flip one of the most common assumptions associated with an installment sale on its head. Like an installment sale, a sale in which a private annuity is used to purchase a business moves all of the future appreciation of the business from the balance sheet of the seller to the buyer. Unlike a standard installment sale, a private annuity does not operate under the assumption that the seller does not have short-term liquidity needs. In fact, the best candidate for an installment sale is a seller who is looking to use the liquidity resulting from annuity payments from the buyer to fund her retirement, or meet other known liquidity needs. It is important to note that the stream of annuity payments to the seller is based on a combination of the fair market value of the company and the seller's life expectancy (the seller cannot be terminally ill). Therefore, the risk to the buyer of a business who uses a private annuity to complete the purchase is that the seller will far outlive her life expectancy, resulting

in significant additional annuity payments by the buyer. Therefore, the health and family history of the seller is an important factor for the buyer to weigh prior to the sale.

WHAT UNIQUE CONSIDERATIONS APPLY TO A TRUST THAT WILL HOLD AN INTEREST IN A FAMILY COMPANY?

The primary concern of most business owners gifting an interest in a family company into a trust is the identity of the Trustee who will exercise voting control over the shares owned by the trust. Obviously, the owner can appoint the Trustee who will exercise control over all of the trust activity, but it is sometimes difficult to find one individual who is the right person to exercise voting power with respect to the family company, manage other trust investments, communicate with family members concerning distribution decisions and ensure that the trust files income tax returns and keeps clear records. One option that appeals to many business owners is to divide the Trustee role into three distinct categories to address the different skill-sets required to handle these different responsibilities. An Investment Trustee can be responsible for managing the trust assets, which would include exercising voting power associated with the family company. A Distribution Trustee will track the circumstances of the trust beneficiaries and exercise discretion concerning distributions. Finally, an Administrative Trustee will retain trust records, ensure that the trust files income tax returns and attend to other ministerial functions.

This division of labor between different Trustee roles corresponds with another objective of many business owners who transfer an interest in a family company into a trust: asset protection planning. The complete discretion of the Trustee of a trust over distributions to trust beneficiaries makes a trust structured in that manner an unattractive target for a claim by a divorcing spouse or other creditor. This layer of protection can be further enhanced by establishing the trust in a jurisdiction which has a favorable statutory framework for asset protection planning. Appointing an Administrative Trustee based in a jurisdiction with a desirable asset protection regime is a common manner in which to gain access to additional protection from claims against family members.

WHAT STEPS WILL A FAMILY BUSINESS ORDINARILY TAKE IN ORDER TO INSULATE ITSELF FROM THE PROSPECT OF NON-FAMILY OWNERS?

Most owners of family companies fear the possibility of a non-family member becoming an owner of an interest in the family company. Even if that owner is merely an assignee with no voting power, she will have the right to inspect company records. To protect against this prospect, the agreement that governs a family company should give the existing owners a right of first refusal which is triggered in the event of a proposed transfer to an individual who is not a member of the family. In the event of a proposed transfer, this provision would permit the existing owners to purchase the interest at issue under similar terms or for its fair market value. The agreement would ordinarily provide that the right of first refusal, if exercised, would result in a sale to the existing owners under favorable terms to the other owners. For example, many of these provisions provide that the sale will occur in conjunction with a balloon promissory

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note using a 15 year term with the lowest permissible interest rate. This kind of a provision serves the dual purpose of discouraging sales of interests in the family company and, should such a potential sale arise, making the purchase under the right of first refusal a palatable financial option for the existing owners.

WHAT SHOULD A BUSINESS OWNER CONSIDERING A GIFT OF AN INTEREST IN A FAMILY COMPANY TO CHARITY KEEP IN MIND?

Transferring an interest in a family company to a public charity is an attractive proposition because the business owner receives a deduction for the fair market value of the gifted interest and avoids paying capital gains, so that the charity receives a larger contribution than it might have had the business owner first sold the interest in the business and contributed the proceeds remaining after paying capital gains tax to charity. However, it is important to note that not all charities are treated equally. An owner is entitled to a deduction of 30% of her adjusted gross income ("AGI") for a gift of a business interest to a public charity or donor advised fund. The same owner would only be entitled to a deduction of 20% of her AGI for a gift of a business interest to a private foundation, and the availability of that deduction is limited to the value of the owner's cost basis in the gifted family company, which is frequently very low. Moreover, private foundations are subject to restrictions concerning self-dealing and excess business holdings, and those restrictions are enforced by exposure to punitive excise taxes. Therefore, the business owner who is considering a gift of an interest in a family business to charity needs to be fully familiar with these rules and should consult with her tax advisor in advance.

HOW DO RETIREMENT PLANS AND EMPLOYEE BENEFITS FIT INTO AN ESTATE PLAN?

The most important aspect of retirement plans and employee benefits from an estate planning perspective is ensuring that they are accounted for and included in the estate plan. Many such plans and benefits pass pursuant to beneficiary designations. Each beneficiary designation should be carefully completed to coordinate the assets passing pursuant to such designation with the remainder of the client's estate plan. Doing so will help to avoid having assets pass to unintended beneficiaries, incurring unexpected or unintended estate taxes, or both. In addition, many plans may, pursuant to federal law, require the plan or plan benefit to pass to a decedent's surviving spouse absent a waiver. Advisors should be sure to review the terms of all applicable plans to determine what rights, options and restrictions are present with respect to each particular benefit. To review each retirement plan or employee benefit would be beyond the scope of this paper. Instead we will focus on the more common plans and benefits.

BENEFICIARY DESIGNATIONS FOR RETIREMENT PLANS CAN IMPACT NOT ONLY THE RECIPIENT OF THE PLAN BENEFIT BUT ALSO THE TAX CONSEQUENCES ASSOCIATED WITH THE BENEFIT. WHAT ARE THE BENEFICIARY OPTIONS AND TAX CONSEQUENCES?

In general.

Before digging in too deep into the beneficiary rules, some introduction and overview regarding retirement plans is appropriate. There are qualified retirement plans, a common example of which would be a 401(k), and nonqualified retirement plans, such as individual retirement accounts (IRAs). Although there are many similarities between the two, there are some important differences. That said, most of the tax rules apply to both. One difference is that qualified retirement plans have requirements for including a surviving spouse as the beneficiary of the plan benefits upon the death of the participant.

Income tax deferral.

Earnings inside a 401(k) or IRA account are tax deferred, meaning no current income tax is payable. In general, distributions from a 401(k) or IRA are subject to income tax at ordinary income tax rates, to the extent consisting of deductible contributions and earnings. (Contributions that are nondeductible are distributed free of income tax.) Extending the deferral of the payment of income tax for as long as possible, if consistent with the participant's other planning goals, is typically a primary consideration when determining the beneficiaries to be named. An account with a beneficiary designation that is designed to take advantage of extended deferral of income tax is often referred to as a "stretch" IRA or 401(k).

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Lifetime distributions.

There exists a voluminous set of regulations which govern required minimum distributions from retirement plans during the plan participant's lifetime. We will not review them here. However, the failure of a participant to withdraw his or her full minimum required distribution during a taxable year results in a fifty percent (50%) penalty tax on the undistributed portion. Accordingly, attention to compliance is important.

Lifetime contributions to charity.

An individual age 70½ or older can make direct charitable gifts from an IRA, including required minimum distributions, of up to $100,000 to public charities (other than donor advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on his or her federal income tax return. Most private foundations are ineligible donees, but private-operating and pass-through (conduit) foundations are eligible donees. There is no charitable deduction for the IRA distributions. However, not paying tax on otherwise taxable income is the equivalent of a charitable deduction. Tax-free distributions are for outright (direct) gifts only—not life-income gifts.

Only distributions from traditional (and Roth) IRAs are tax free. Distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions (SEPs) aren't qualified charitable distributions; nor are distributions from Keoghs, 403(b) plans, 401(k) plans, profit sharing and other plans.

WHAT BENEFICIARY OPTIONS ARE AVAILABLE?

The participant's choice of beneficiary or beneficiaries for his or her retirement plans will depend upon a combination of the participant's estate planning goals, income tax consequences and estate tax consequences. The universe of potential beneficiaries would include the participant's spouse, a trust for the participant's spouse, one or more of the participant's children or more remote descendants, one or more trusts for one or more such individuals, one or more charitable beneficiaries, or the estate of the participant. In almost all cases, however, naming the estate of the participant as the beneficiary of a retirement account should be avoided if there is any desire to stretch the deferral of income taxes on the assets in the plan account.

WHAT MINIMUM REQUIRED DISTRIBUTION RULES APPLY AFTER A PLAN PARTICIPANT'S DEATH?

There are quite lengthy and often times confusing rules that govern the determination of minimum required distributions from a retirement plan after a participant's death. An understanding of these rules is necessary in order to properly structure the beneficiary designation to meet the client's goals. The following will serve only as an overview of the generally applicable rules.

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Designated beneficiary.

There are two primary factors that determine the calculation of minimum required distributions for the beneficiary or beneficiaries of a retirement plan after the participant's death. First, did the participant name a "designated beneficiary" as beneficiary of the retirement plan. Second, did the participant die before or after the participant's required beginning date. The term "designated beneficiary" is defined as an individual. An estate, charitable or other tax-exempt organization, or any other entity does not qualify as a designated beneficiary. If there are multiple designated beneficiaries, the oldest designated beneficiary will be the designated beneficiary for the plan. However, if any one of the multiple beneficiaries is not an individual then there is no designated beneficiary (unless it is possible to eliminate the non-individual beneficiary by September 30 of the year after the year of the Participant's death).

See-through trusts.

The one exception to the rule that a beneficiary must be an individual in order to qualify as a designated beneficiary is for certain trusts that qualify as "see-through trusts." If a trust qualifies as a see-through trust then the rules look through the trust to its beneficiaries. If all of the beneficiaries of the trust are individuals then the oldest trust beneficiary will be treated as the designated beneficiary. In order for a trust to qualify as a "see through trust" all of the following must apply: (i) the trust must be valid under state law, (ii) the trust must be irrevocable or become irrevocable upon the participant's death, (iii) all of the trust beneficiaries must be identifiable, and (iv) certain trust information and documents must be provided to the plan administrator by a certain date.

Distributions after participant's death.

In the year of the participant's death, the beneficiary must take the balance, if any, of the participant's remaining lifetime minimum required distribution for the year of the participant's death. The beneficiary (unless such beneficiary is the participant's surviving spouse) must start taking minimum required distributions beginning the year after the year of the participant's death. If the beneficiary is a designated beneficiary, the minimum required distribution is based on the life expectancy of the designated beneficiary using the IRS Single Life Expectancy Table.

Surviving spouse as beneficiary.

There are special rules that apply when the participant's surviving spouse is the only beneficiary. The surviving spouse may take distributions under the general rules for designated beneficiaries described in the prior paragraph. Alternatively, the surviving spouse may roll the plan benefits into his or her own IRA or other eligible plan and take advantage of the more favorable lifetime distribution rules for plan participants, including deferral of distributions until the surviving spouse reaches age 70-1/2. The surviving spouse may also name his or her own beneficiaries of the rolled over plan benefit.

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Required beginning date.

As mentioned earlier, the other important factor is whether the participant dies before or after his or her required beginning date. The required beginning date is April 1 of the year after the participant turns age 70-1/2. If the participant dies before his or her required beginning date, and has not named a designated beneficiary, the account must be paid out in full no later than the end of the year that includes the fifth anniversary of the participant's death. This is often referred to as the "five year rule." If the participant dies after his or her required beginning date and did not name a designated beneficiary, the account must be paid out no slower than over the participant's remaining life expectancy applying the Single Life Table.

Naming a marital trust as beneficiary.

There are many circumstances where naming a trust as beneficiary is necessary, desirable or preferred. There are also some circumstances when doing so would be discouraged. One option for a married participant is to name a trust for his or her spouse (often referred to as a marital trust or a QTIP Trust) as beneficiary. Doing so would prohibit the surviving spouse from rolling over the account into his or her own IRA. However, especially in the event of a second marriage or in light of other potential concerns, the protection and certainty of a marital trust will outweigh the desire for a spousal rollover. If qualification for the marital deduction from estate tax is desired, there are detailed rules that must be adhered to and the governing instrument must contain specific, technical language. In effect, both the retirement plan and the trust must qualify for the marital deduction. If use of the surviving spouse's life expectancy is desired for determining minimum required distributions, the trust must also qualify as a see-through trust.

Naming a credit shelter trust as beneficiary.

There are scenarios in which it could make sense for a credit shelter trust or estate tax sheltered trust to be named as a beneficiary of a retirement plan. Doing so would typically only be a consideration if the participant did not have sufficient other assets to fully utilize his or her remaining federal estate tax exemption. Of course, with portability of the federal estate tax exemption as an option, naming a credit shelter trust as beneficiary of a retirement plan is less appealing. If naming the credit shelter trust as beneficiary, the client will need to decide whether the trust should be designed as a see-through trust so that there is a designated beneficiary for life expectancy purposes.

Naming a trust for creditor protection and tax benefits.

Clients may also wish to consider naming a trust as a beneficiary of a retirement plan in order to take advantage of the protective benefits of trusts. A recent U.S. Supreme Court case held that an inherited IRA is not an exempt asset under federal bankruptcy laws. Accordingly, designating an individual beneficiary of an IRA may subject the inherited account to the claims of the beneficiary's creditors. A trust can be designed to be protective from creditors and divorcing spouses, a common concern for many clients. When leaving assets, including retirement accounts, to children and grandchildren, a trust is often utilized to take advantage of these protective benefits. Similarly, a trust could be used to take advantage of the client's generation-

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skipping tax exemption. In fact, a trust for a grandchild that qualifies as a see-through trust would maximize the stretch benefits of the plan.

WHAT IS A ROTH ACCOUNT?

Roth accounts in general.

Roth IRA and Roth 401(k) accounts differ from traditional accounts in several important ways. Unlike contributions to traditional accounts, contributions to a Roth account are taxable. Distributions from Roth accounts, with certain limited exceptions, are not taxable. The participant in a Roth account is not required to take minimum required distributions during the participant's lifetime. However, the same required minimum distributions, subject to the same rules discussed earlier, are required for beneficiaries of inherited Roth accounts as are required for beneficiaries of traditional accounts.

Roth conversions.

Participants may convert a traditional IRA account into a Roth IRA regardless of the participant's taxable income for the year. Of course, the value of the conversion will be included in the participant's taxable income for the year. A non-spouse beneficiary of an inherited IRA may make a qualified rollover to an inherited Roth IRA if such a rollover is permitted by the plan. Again, the amount of the rollover will be included in the taxable income of the beneficiary.

An IRA participant should consider a Roth conversion if the participant (i) has sufficient other liquid assets to pay the tax cost without withdrawing assets from the IRA, (ii) intends to transfer the IRA to one or more beneficiaries who will qualify as designated beneficiaries and stretch the required minimum distributions over their life expectancies, (iii) will not draw down on the IRA after conversion, and (iv) expects his or her effective income tax rate to stay the same or increase in retirement years.

WHAT ARE SOME OTHER CONSIDERATIONS FOR EXECUTIVE BENEFITS?

In addition to a traditional 401(k) and/or profit sharing plan, there is a wide range of employee benefits that could be incorporated into the compensation arrangements for a corporate executive. A common benefit is life insurance. Another common component of executive compensation is equity in the employer. There are many types of equity arrangements, including stock grants, stock options, restricted stock, restricted units, phantom equity profits or carried interests, and others.

At a minimum, it is important for the executive to be aware of how the benefits pass at death so that they can be incorporated into the overall estate plan, either by beneficiary designation or testamentary plan. It is also important for the executive to know whether any such benefits are transferable during the executive's lifetime. This could be especially important when planning for life insurance and equity awards. Certain equity awards, such as stock options and phantom equity, can cause estate tax problems at death. All assets owned by a decedent must be valued

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as of the decedent's date of death. A stock option could be underwater as of the executive's date of death. Even so, it will have a value greater than zero and may incur an estate tax as a result. Ultimately, the option could expire unexercised. Not only will the asset then be worthless but the estate will have paid estate tax on that worthless asset. The same could be true for a phantom equity award where the payout is based on company earnings (or some other measurement) over a term of years. The phantom equity will need to be valued as of the executive's date of death based on estimates of future earnings. Actual performance may exceed projections or fall short. If expectations fall short, there is a likelihood that the phantom equity will produce less wealth than the date of death valuation anticipated. If underperformance is significant, the estate taxes paid could exceed the value of the equity. In order to avoid such results, executives may wish to explore one or more of the charitable alternatives (either during lifetime or at death) that are discussed in other sections of this paper. In addition, if such compensation awards are transferable during lifetime, the executive would be prudent to consider some of the lifetime transfer alternatives (like grantor retained annuity trusts) discussed in other sections of this paper. In any event, the executive should be certain to understand the nature of the benefit and the potential impact it may have on his or her estate for estate tax purposes.

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PRIVATE PLACEMENT LIFE INSURANCE (PPLI)

WHAT IS PRIVATE PLACEMENT LIFE INSURANCE?

Private placement life insurance (PPLI) is a life insurance policy wrapped around an investment. It is similar to a variable universal life insurance policy but the investments owned by the policy are privately offered and meet very specific tax code requirements. The investments of many high net worth clients can be very tax inefficient (particularly hedge funds and similar investments). PPLI presents an opportunity to investors for otherwise tax-inefficient investments to be owned inside an insurance policy where investment earnings are not subject to income tax as earned or as realized, and are similarly not subject to income tax upon the death of the insured when the proceeds of the policy are paid out to the beneficiary of the policy.

WHAT ARE THE REQUIREMENTS OF PPLI TO ENSURE EARNINGS AND PROCEEDS WILL NOT BE INCOME TAXABLE?

Several requirements must be satisfied in order to ensure the tax-free treatment of PPLI. First, the investments must be held in a separate account which must be segregated from the general account of the insurance carrier. This is beneficial for the investor because the assets in the segregated account are not subject to the claims of creditors of the insurance carrier. Second, there are several investment restrictions that apply. Specifically, purchasers of PPLI, whether an individual or a trust, must generally qualify as both an "accredited investor" under section 501(a) of Regulation D of the Securities Act of 1933 and a "qualified purchaser" under section 2(a)(51) of the Investment Company Act of 1951. There are limits on the amount of control that the owner of the PPLI policy may exercise. The owner may not engage in conduct that would qualify as investor control. Investor control may occur when the contract owner directs investment strategy or makes investment decisions for the segregated account, including (i) determining the specific allocation of the assets of the segregated account, (ii) requiring the manager of the account to acquire or dispose of any particular asset, or (iii) requiring the account manager to incur or pay any particular liability of the account. To avoid investor control, there must not be any prearranged plan or agreement between the separate account manager and the owner of the policy to invest any amount in any particular asset or subject to any particular arrangement. With regard to the management of the account assets, the manager may not consult with or rely on the advice of any person who the manager knows is a policy owner, policy beneficiary, beneficial owner of any entity that is a policy owner, or a fiduciary or beneficiary of a trust, the trustee of which is a policy owner. Finally, there are diversification requirements that must be met in the separate account. No more than 55% of the value of the total assets of the account may be represented by any one investment, no more than 70% by any two investments, no more than 80% by any three investments, and no more than 90% by any four investments. Investment in an investment company, partnership or trust (such as a mutual fund or hedge fund) will not violate the diversification requirement as long as the fund meets the requirement of an insurance dedicated fund. In order to be an insurance dedicated fund, (i) all of the beneficial interests in the fund must be held by insurance company separate accounts, and

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(ii) public access to the fund must be available exclusively through the purchase of a variable insurance contract.

WHAT ARE SOME ESTATE PLANNING SPECIFIC ARRANGEMENTS WHERE PPLI IS COMMONLY UTILIZED?

It is important to keep in mind that there is no reason why PPLI must be used in any transaction strategy. Whether or not PPLI is utilized in a particular strategy will be wholly dependent on the client's wishes with the respect to the investments inside the policy. With that preface, the following are two strategies where PPLI is commonly promoted.

Charitable Lead Annuity Trust.

As discussed in greater detail in a different section of this paper, a charitable lead annuity trust (CLAT) is a common charitable planning technique used to benefit both charitable beneficiaries and family. A CLAT may be designed as a grantor trust in which case the client will receive a current charitable income tax deduction, subject to AGI limitations. The alternative would be a non-grantor trust which would not provide the client with a current charitable income tax deduction. In addition to the up-front charitable income tax deduction, a grantor CLAT is attractive from an estate planning perspective because the assets in the CLAT grow undiminished by income taxes due to the fact that the client is saddled with the income tax liability. For some clients, however, the income tax liability may be so significant that the client will reject the strategy as a result. To those clients, the grantor CLAT would likely be more palatable if the assets inside the CLAT generated little or no taxable income that would have to be reported by the client. PPLI may be just such an alternative as PPLI will not generate any taxable income or gain on its investments inside the policy. Accordingly, there should be no taxable income to the client. Of course, any insurance policy would receive similar treatment, as well as other investments that yield little or no taxable income.

Multi-generational split dollar.

Another strategy where PPLI is commonly promoted is called multi-generational split dollar. Until the middle of 2016, multi-generation split dollar transactions were generally considered to be aggressive arrangements and many conservative practitioners and clients shied away from them. After a pair of taxpayer favorable tax court decisions (Morrissette v. Commissioner and Estate of Marion Levine), several uncertainties were eliminated. Even still, these arrangements bear a significant amount of uncertainty and clients should be fully aware of the risks before proceeding.

A simplified example of a generational-split dollar arrangement may be summarized as follows: The client, the children of the client, and grandchildren and more remote descendants of client are all participants in and/or beneficiaries of the arrangements. The client enters into a private split dollar arrangement with a Dynasty Trust established by the client and the Dynasty Trust will purchase a PPLI policy on the life or lives of one or more of the client's children. As a result of the private split dollar arrangement, the client will own a receivable from the Dynasty Trust

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equal to the greater of (i) the cumulative premiums advanced or (ii) the policy cash value. The receivable may not be repaid until the death of the insured child under the policy and the client has no access to the cash value of the policy while the insured child is living. The client will file gift tax returns each year and report the annual gifts to the Dynasty Trust using the economic benefit or loan regime for accounting for split dollar arrangements.

The client may on a future date then transfer the private split dollar receivable during the client's lifetime by gift or sale. A gift or sale could involve one or more children or grandchildren of the grantor or one or more trusts for their benefit. Alternatively, the receivable may be retained by the client until his or her death. In either scenario, the value of the receivable should be subject to a significant discount based on the time deferral of the payment of the receivable until the death of the insured child.

Although any permanent insurance policy could be used, PPLI is commonly suggested for a generational split dollar arrangement given the investment options of PPLI policies.

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GRANTOR RETAINED ANNUITY TRUSTS

WHAT IS A GRAT?

A Grantor Retained Annuity Trust, or "GRAT", is an "estate freeze approach" that allows a Donor to give away the appreciation of an asset gift tax free. The Donor transfers high income-producing assets or assets with substantial growth potential (or cash to be invested in such assets) to a trust from which the Donor will receive a fixed amount annually (an "annuity") for a designated period of years ("GRAT Term"). At the end of the GRAT Term, if the Donor is living, the beneficiaries named in the trust instrument (individuals or a continuing trust) will receive the assets remaining in the GRAT after payment of the final annuity free of gift and estate tax. Depending on the GRAT's cash flow and/or the appreciation of the GRAT's assets (the "total investment return"), substantial estate and gift tax savings may be achieved.

HOW DOES THE GRAT WORK?

The tax advantage of this technique results from the way the taxable value of the gift to the GRAT is calculated. The value of the Donor's taxable gift is not the value of the assets transferred to the GRAT, but the current value of the beneficiaries' right to receive the assets remaining in the GRAT upon the end of the GRAT Term after payment to the Donor of the required annuity payments. The duration of the GRAT and the amount of the annuity payments are fixed to reduce the taxable gift to zero or a nominal amount. This form of GRAT is commonly called a "zeroed-out" GRAT.

If the total investment return of a GRAT exceeds the anticipated return based on the rate prescribed by the IRS for the month the GRAT is established (the "7520 rate"), this "excess" investment return will pass gift and estate tax-free to the Donor's beneficiaries at the end of the GRAT. If the total investment return is less than the 7520 rate, no assets will remain to be transferred to the Donor's beneficiaries upon the expiration of the GRAT, but as long as the taxable gift upon funding the GRAT is zero, nothing will be lost other than the expense of establishing and administering the GRAT.

CAN YOU GIVE ME AN EXAMPLE OF A GRAT?

Jane Jones transfers $1,000,000 worth of stock to a 2-year GRAT. Jane believes that the stock is undervalued and expects it to increase by 25% per year for the next two years. Assuming an IRS 7520 interest rate of 4.4%, Jane must receive an annuity of $533,248 for the two years of the GRAT to reduce the taxable gift to a nominal amount. If the stock appreciates in value at the 25% annual rate that Jane expects, $362,693 of stock will pass tax-free to her children at the end of the two year term.

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WHAT ARE THE TERMS AND CONDITIONS TO BE CONSIDERED IN A GRAT TRUST AGREEMENT?

- The Donor can be a Trustee or the only Trustee.
- A specified annual annuity payment will be made to the Donor for a term of years. If the Donor dies during the term of years, the annuity payments would continue to be paid to the Donor's estate.
- The determination of the amount of the annuity payment needed to reduce the taxable gift to a nominal amount involves a fairly complex tax calculation which takes into account the following factors:
    (1) the current value of the property;
    (2) the term of the GRAT; and
    (3) the 7520 rate for the month of transfer.
- After the term of the GRAT expires, the trust principal will be distributed to the beneficiaries specified in the trust agreement. The beneficiaries can receive the principal outright or the principal can be held in further trusts.
- Once assets have been gifted to the GRAT, no additional contributions may be made to the GRAT.

WHAT ARE THE TAX IMPLICATIONS OF THE GRAT?

Gift tax.

The goal of the GRAT is to transfer wealth to the designated beneficiaries without the imposition of gift or estate tax. It is similar to an outright gift in that it avoids estate and gift tax on the future income and appreciation on the gifted property. Unlike an outright gift that uses up lifetime gift tax exemption equal to the value of the gifted property on the date of the gift, a "zeroed out GRAT" will use up only a nominal amount of gift tax exemption. Also, unlike an outright gift, a GRAT gift will result in either a "win" or a "tie", but never a "loss". An outright gift on the other hand can have a negative result if the property declines in value after the gift is made.

Income tax.

During the term of the GRAT, the GRAT is treated as a grantor trust for income tax purposes. This means the Donor will be taxed on all of the income and capital gains earned by the trust, without regard to the amount of the annuity paid to the Donor.

At the end of the GRAT term, the beneficiaries' tax basis in the trust property will be equal to the Donor's tax basis at the time the assets were transferred to the GRAT. Therefore, if appreciated property is gifted to the GRAT and the beneficiaries sell the property after the GRAT terminates, any capital gains tax on the difference between the sales price and the Donor's tax basis will reduce the net value of the property transferred. If the property instead were included in the Donor's estate at death, the beneficiaries would receive a "step-up" in the property's tax basis to the fair market value of the property at the Donor's death. As long as the federal capital gains

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tax rate is less than the combined federal and state estate tax rate (up to 40%) which otherwise would have been due had the property transferred to the beneficiaries by the GRAT been retained until death, a GRAT will result in lower tax exposure for transferred assets.

However, it is important to note that, if, after the termination of a GRAT, the appreciated property is sold while it continues to be held in a trust that is treated as a grantor trust for income purposes, the grantor will pay the capital gains tax.

Estate tax.

If the Donor dies before the GRAT annuity payments cease, the trust assets will be taxable in the Donor's estate. Consequently, it is important to consider the Donor's life expectancy in selecting the GRAT Term. Also, if the Donor is married, careful consideration should be given as to whether and how to qualify the GRAT for the estate tax marital deduction if the Donor does not survive the GRAT term in order to avoid paying estate tax at the death of the Donor that could otherwise be postponed until the surviving spouse's death.

CAN YOU GIVE ME AN EXAMPLE OF THE GRAT TAX CALCULATIONS?

Example of $1,000,000 GRAT established when IRS interest rate is 4.4%, assuming total annual investment return of 10%. NOTE: For the past years, the IRS interest "hurdle" rate has been significantly lower (in the 1% to 2% range).

Term of GRAT (in years)	Annual Annuity Payment Made to Donor (Assuming 4.4% IRS Rate)	"Tax Free" Gift to Beneficiaries at End of Term (Assuming 10% Total Return)
2	$533,248	$90,180
3	$363,082	$129,200
5	$227,159	$223,682
10	$125,758	$589,490
15	$92,474	$1,239,107
20	$76,211	$2,362,498

WHAT IF THE GRAT'S INVESTMENT PERFORMANCE IS EQUAL TO OR LESS THAN THE IRS INTEREST RATE?

If the GRAT's annual compounded investment return equals the IRS interest rate, then the Grantor's annuity interest will be fully paid, but there will be only a small remainder in the GRAT to pass on to the Donor's children. If the GRAT's annual compounded investment return is less

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than the IRS interest rate, then the trust principal will be exhausted before the end of the GRAT term. There will be no tax savings, but nothing will be lost except the time and expense associated with establishing and maintaining the GRAT.

IF THERE IS INSUFFICIENT INCOME TO PAY THE ANNUITY IN ONE YEAR, CAN THE DEFICIENCY BE PAID IN ANOTHER YEAR, RATHER THAN USING PRINCIPAL?

No. The IRS regulations provide that an annuity interest is only valid if it is paid no later than the due date for the trust tax return to which it relates. Therefore, deficiencies must be made up from principal. Under current law, trust assets can be distributed in kind to pay the annuity without causing capital gains taxes to be paid on the distributed property.

IRS regulations also prohibit the Donor from loaning the GRAT funds with which to make the annuity payment.

CAN AN INTEREST IN A CLOSELY HELD BUSINESS BE TRANSFERRED TO A GRAT?

Yes. The GRAT can be an effective method of "freezing" the value of the business. It can also minimize any risk from a valuation of the business interest transferred to the GRAT that is challenged by the IRS. For example, if a 55 year-old business owner's interest in his business is valued at the amount of the owner's remaining gift tax exemption (assume $5,000,000), the business owner may be able to make an outright gift of the interest to his children and avoid gift tax by using his lifetime exemption. But if the value of the interest is doubled ($10,000,000) upon audit of the business owner's gift tax return, gift tax will be due equal to the gift tax rate multiplied by the amount of the gift tax exemption ($2,000,000). If the interest is instead transferred to a "zeroed-out" GRAT to pay him for 20 years an annuity equal to 7.6211% of the initial value of the property contributed to the trust ($762,113), then assuming an IRS interest rate of 4.4%, the value of the taxable gift will be $10.48. If the value of the business interest is increased upon audit by the IRS, the annuity payments required to be paid to the Donor would increase, but there would be no appreciable increase to the taxable gift.

WHAT ARE THE COSTS OF MANAGING A GRAT?

The costs of the GRAT include attorneys' fees for preparing the trust agreement and the gift tax return, and some cost if professional assistance is required in making certain the annuity payments are made correctly.

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SALES TO GRANTOR TRUSTS

WHAT IS A GRANTOR TRUST?

A grantor trust, also known as an "intentionally defective" grantor trust, is a trust which requires the grantor to report the income generated by the trust assets on the grantor's individual income tax return.

WHAT ARE THE ADVANTAGES OF GRANTOR TRUSTS?

Many gifting vehicles are intentionally designed as grantor trusts so that the grantor can continue to bear the income tax burden associated with assets that have been removed from the grantor's estate through a completed gift. In short, the gift by the grantor is complete for gift tax purposes but not for income tax purposes. This allows the trust property to grow inside of the grantor trust without the drag of an income tax burden. Thus, grantor trust status is a powerful tool that a family can use to allow previously gifted trust assets to grow undiminished by taxes. Under current law, the payment of taxes by the grantor is not considered a gift.

WHAT GIVES A TRUST GRANTOR TRUST STATUS?

There are many administrative "defects" that can be used to intentionally trigger grantor trust status, but among the most popular are the ability for the grantor to "swap" assets with the trust, the ability of the trust to make premium payments for a life insurance policy on the life of a grantor, and the appointment of a Trust Protector who has the right to add beneficiaries to the trust.

WHAT IS AN INSTALLMENT SALE?

An installment sale in the estate planning context is usually structured as a sale for a Note which provides for payments of interest only for a term of years with a balloon principal payment at the end of the term. This technique is useful to transfer investments or business interests to the next generation while simultaneously providing income to the seller. This is also useful if the buyer, usually a descendant of the seller, does not have the financial resources to purchase the interest with cash, or if the buyer/descendant cannot or will not obtain outside financing.

WHAT ARE THE BASICS OF AN INSTALLMENT SALE TO A GRANTOR TRUST?

The grantor sells assets to the Trustee of an irrevocable trust. The Trustee will pay for the interest by issuing a promissory note for the purchase price. The Trustee often does not make any down payment for the sale. Prior to the sale, the trust should either have its own assets or be "seeded" to provide enough trust assets to equal at least 10% of the property being purchased. If the assets in the trust are not sufficient for the transaction to be considered an

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arm's-length sale, the Internal Revenue Service ("IRS") could argue that the sale is really a contribution to the trust with a retained income interest, which could cause the entire value of the trust assets to be includible in the seller's estate for estate tax purposes. In exchange for the interests, the Trustee would give the seller/grantor a promissory note for the value of the interests it receives.

WHAT ARE THE ADVANTAGES OF AN INSTALLMENT SALE?

The installment sale offers several benefits:

The grantor pays income taxes on behalf of the grantor trust.

If the trust is designed to be a grantor trust, the grantor pays the tax liability on the annual income generated by the interests held by the trust, as well as the trust's capital gains in the event that the interest were to be sold inside of the trust. This results in an estate tax benefit because the grantor pays the income taxes on earnings that accrue to the benefit of descendants, but the payment of those income taxes is not treated as a taxable gift under current law. Having said that, however, the grantor must be willing and able to absorb the demands on his or her personal assets to pay these taxes.

No gift tax on the sale.

As discussed above, the transfer of the interests to the trust would be structured in the form of an arm's-length sale, i.e., an exchange of an interest for an installment note bearing at least an IRS "safe harbor" rate of interest (for example, the mid term rate for notes 3-9 years in February 2018 is 2.31%). As a result, this transfer should be respected as a sale for fair market value, in which case there should be no gift tax consequences, provided that the fair market value of the asset sold is in fact the same as the face amount of the promissory note.

Removal of appreciation from the taxable estate.

By exchanging a potential growth asset for a non-growth asset (the promissory note), the grantor would be "freezing" the value of property remaining in the taxable estate for estate tax purposes. If the interests sold to the trust outperform the interest rate on the promissory note, the transaction enables the grantor to pass that excess amount of value to the trust free of gift and estate taxes. Further, limiting the annual payments to interest, at least initially, it is easier to shift value to younger generations by deferring the payment of the principal to the maximum extent possible.

Generation-Skipping Transfer ("GST") planning.

Property held in a trust may be subject to a GST tax upon the death of the grantor's children and future generations of descendants. In 2018, the GST exemption is $11,180,000 (less any used for prior lifetime gifts), which means that the grantor can provide for up to $11,180,000 (less any used for prior lifetime gifts) to be held in trusts for the grantor's descendants, without any GST

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tax being imposed upon the death of each descendant. If structured as an installment sale, the grantor may immediately allocate her GST exemption to the trust upon its creation (i.e., the initial "seed money"). By allocating GST exemption to any transfer made to the trust upon its creation, any assets purchased by the trust (including the transferred interests) would be GST-exempt. This provides a better ability to leverage the use of GST exemption to maximize GST tax avoidance for successive generations.

WHAT ARE THE DISADVANTAGES OF A TRADITIONAL INSTALLMENT SALE?

An installment sale has the following primary disadvantages:

The sold assets will not receive stepped-up basis in the event of your death.

If you were to hold your interest in the asset until your death, such interest will be included in your taxable estate and will receive a step-up in cost basis at that time to its then fair market value. In that case, a sale of the interest shortly after your death would not generate capital gain. However, by selling your interest in the asset to a grantor trust (and thereby removing the interest from your estate), the property will not obtain the step-up in cost basis upon sale or at your death. Thus, a subsequent sale of the interest by the Trustee would generate a capital gains tax even if the sale occurs immediately after your death. Despite this concern, if the maximum federal estate tax rate is much higher than the capital gains tax rate, the advantages outlined above (i.e., the avoidance of gift tax on the transfer and on the future income tax liability paid by you, the avoidance of estate tax on future appreciation, and the leverage of your GST Exemption) may outweigh this disadvantage.

Promissory note included in your taxable estate.

If you die before the promissory note is satisfied in full, it would be an asset held by you and included in your taxable estate.

Reversal of traditional IRS income tax position.

Even if you sold your interest in the asset to a grantor trust, the IRS may claim that the sale results in capital gain to you at the time of the transaction. If the IRS successfully took this position, you would recognize a capital gain on the sale of the interest at the time of transfer to the trust.

Estate may recognize capital gain.

If you die holding the promissory note, your estate may recognize capital gain on any unpaid principal.

IRS may treat the entire transaction as a gift.

The IRS may assert that the transaction was really a gift and not a sale. To avoid this risk, it is important that there is no pre-arrangement to forgive any interest or principal due under the

promissory note. The transaction should be structured like a commercial or "arm's length" transaction.

IRS may treat a portion of the transactions as a gift.

Even if the IRS is unsuccessful in attacking the entire transaction as a gift as described above, the IRS could attack the transactions on another front by asserting that the fair market value of the transferred interests is greater than the fair market value of the promissory note given back to you. The IRS could argue that (1) the promissory note was not worth its face value because the trust was not a creditworthy borrower or (2) the appraised value of the interest in the asset was simply too low.

Sold interests may under-perform the IRS interest rate.

In this case, you will have actually increased the size of your estate and decreased the value sold to the trust because the interest and principal payments on the promissory note will exceed the value of the interests sold to the trust. Of course, this is always a risk that needs to be taken into account, and is difficult to predict or plan for.

Absence of express statutory sanction.

The installment sale to a grantor trust is a technique that does not have an express statutory sanction.

ARE THERE INCOME TAX CONSEQUENCES OF USING A TRADITIONAL INSTALLMENT SALE?

Often in this type of planning, the sale is structured to be made to a trust that is designed as a "grantor trust" (that is, a trust the assets of which are treated as being wholly-owned by the grantor for income tax purposes). If the trust is a grantor trust, the sale of the interests would be treated as if you were selling the interest to yourself. As a result, you could take a reporting position that no capital gain is recognized when the trust buys the interests. For the same reason, the trust's interest payments under the promissory note should not be treated as income to you.

If the trust is treated as a separate "person" for income tax purposes (referred to as a "nongrantor trust"), the sale would be a taxable event for income tax purposes and income reported under the installment method. Further, the trust would be liable for any income or capital gains earned by it, which, generally, are taxed at the highest rates that apply to individuals because the tax brackets that apply to trusts are very compressed.

QUALIFIED PERSONAL RESIDENCE TRUSTS

WHAT IS A QPRT?

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The Qualified Personal Residence Trust ("QPRT") can be an effective means of transferring one's residence to one's children or other beneficiaries at a reduced transfer tax cost: the owner of a personal residence transfers it to a trust, but retains the right to live in the residence for a specified period of years. At the end of that period of years, the children (or other designated beneficiaries) become the owners of the residence. Thereafter, the residence will no longer be a part of the former owner's taxable estate.

HOW DOES THE QPRT WORK?

The tax advantage of the QPRT technique comes primarily from the way in which the value of the gift to the trust is calculated for gift tax purposes. The value of the gift is not the full value of the residence on the date of the gift. Instead, the taxable gift is only the value of the children's right to take possession of the residence at the end of the specified period of years, which can be far less than the current value of the property. For example, a $1,000,000 home can be gifted to a QPRT, removing $1,000,000 from the donor's taxable estate, but the taxable gift may be as little as 10 or 20 percent of the value of the residence. By keeping the gift tax value of the QPRT transfer below the donor's remaining lifetime federal gift tax exemption amount, the donor can avoid paying federal gift tax on the gift.

HOW IS THE QPRT CALCULATED?

While the concept of a QPRT is simple, the decision to create one should not be made without a fairly complex tax calculation to determine the value of the taxable gift which will result. This value is a function of (i) the age of the donor; (ii) the number of years during which the donor will retain the right to occupy the property; (iii) the current appraised value of the property; and (iv) the current IRS actuarial tables and interest rates used to calculate future values.

WHAT ARE THE TERMS OF THE QPRT TRUST AGREEMENT?

- The trust would continue for a specified number of years, after which the property would be transferred either outright to children (or other beneficiaries) or in further trust for their benefit. Selection of the QPRT term of years requires careful thought since the tax benefits are lost if the donor dies before the QPRT ends. A longer trust term increases the tax advantages, but also increases the risk that premature death will erase those advantages.
- During the term of the QPRT, the donor is entitled to all rights of occupancy, and will be responsible for all costs of maintenance.
- If the residence is sold during the term of the QPRT, another home can be purchased. If a replacement home of equal value is not purchased, the unused cash proceeds must either be distributed back to the donor (thus forfeiting the tax benefit), or the cash must be invested and the donor will be paid an annuity for the balance of the QPRT term (thus reducing, though not necessarily entirely eliminating, the tax benefit).

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- During the QPRT term the donor can be the sole Trustee or a co-Trustee of the QPRT, and make all management decisions.

WHAT ARE THE ESTATE AND INCOME TAX IMPLICATIONS OF THE QPRT

Estate taxes.

The objective of the QPRT is to reduce estate taxes by removing the residence from the donor's estate. If the donor's death occurs after the QPRT has ended, the donor's taxable estate for federal estate tax purposes will include only the value of the original gift (the children's future interest in the residence when the trust was created), and all appreciation in value after the date of the gift will have been removed from the donor's estate. If the donor dies before the completion of the term of years specified in the QPRT, the trust will end and the property will be distributed to the donor's estate to be disposed of by the donor's Will. The tax advantages will be lost, but there will be no tax detriments—taxes will be calculated as though the QPRT had never been created.

Capital gains.

On the downside, if the donor has survived the QPRT term, the residence will not receive a "step-up" in its income tax cost basis to estate tax value because the residence will not have been taxed in the donor's estate. For this reason, the QPRT is best suited for a home likely to stay in the family until the children's deaths, when the residence will get the desired step-up in basis. However, even if the property is later sold by the children or other trust beneficiaries, the capital gains tax (at least under current tax law) will be far less than the inheritance tax that would have been due had the QPRT not been created.

Income taxes.

During the QPRT term, the donor will be treated for income tax purposes as if he or she were still the owner of the property; e.g., the donor can deduct real estate taxes on his or her personal income tax return. If the property is sold by the QPRT, a capital gains tax will be due in the same amount as if the donor still owned the property. The donor must pay any such capital gains tax out of his or her own funds, which can produce a good estate tax result because payment of the tax further reduces the donor's taxable estate if the proceeds of the sale are reinvested by the Trustee in another personal residence.

HOW LONG SHOULD THE QPRT LAST?

Generally, the QPRT should be designed to last as long as possible so as to make the value of the taxable gift to the children as small as possible - but not so long that the donor dies before the QPRT ends, which would result in a loss of the tax benefit because the property would be included in the donor's taxable estate.

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CAN YOU STILL USE THE RESIDENCE AFTER THE QPRT ENDS AND THE CHILDREN BECOME THE LEGAL OWNERS?

That is entirely up to the family. If the donor desires to continue to use the property as the donor's residence, he or she will have to rent it.

CAN YOU GIVE ME AN EXAMPLE OF THE QPRT TAX CALCULATIONS?

Looking at the table below and assuming an estate tax at a flat 50% rate, if a 60-year-old donor establishes a 20-year QPRT to hold a residence worth $1,000,000, the taxable gift is $251,220 (using an IRS 4% interest rate, which rate changes each month). If the donor dies at age 85 and the property is then worth $2,000,000, the donor's taxable estate will include the original taxable gift of $251,220, and, at a 50 percent tax rate, the estate tax attributable to that property will be $125,610. Had the QPRT not been created, the donor's estate would have paid tax on $2,000,000 at a 50 percent tax rate, or $1,000,000. The use of the QPRT results in a $874,390 tax savings. This tax savings may be reduced, however, by the income tax cost of any additional capital gains taxes if the house is sold without the benefit of the step-up in basis to the estate tax value of the house at the time of the donor's death.

Taxable gift if a $1,000,000 residence is transferred to a QPRT

AGE OF OWNER	If length of QPRT is 10	If length of QPRT is 20
50	$625,590	$352,560
55	$599,170	$307,700
60	$563,570	$251,220
65	$513,550	$182,340
70	$445,760	$109,020
75	$355,050	$47,430

IF THE PROPERTY TO BE PLACED IN THE QPRT IS LOCATED IN A STATE WITH A GIFT TAX, ARE THERE ANY ADDITIONAL TAX CONSIDERATIONS?

Yes, the transfer of the donor's residence in a QPRT would result in a taxable gift, and it would cause the donor's cumulative lifetime gifts tax would be due as a result of the transfer, or, the QPRT will use a portion of the state gift tax exemption.

Even in the case in which the state gift tax increases the initial cost of establishing a QPRT, establishing the QPRT may nonetheless still be valuable for those who can afford to pay the gift tax due when the QPRT is created. This only impacts gifts of real estate in states that impose a gift tax (currently only Connecticut).

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CAN I USE A VACATION HOME OR CONDOMINIUM FOR MY QPRT?

Yes. A QPRT can hold either a primary residence or one other residence that the donor occupies.

MAY I USE MY SPOUSE'S UNIFIED CREDIT TO SHELTER MY QPRT GIFT IF THE VALUE OF MY GIFT EXCEEDS MY OWN UNIFIED CREDIT EXEMPTION?

It is risky (and generally unwise) to do so because, if you die before the QPRT ends, your spouse's exemption will have been wasted. This unfavorable result can be avoided by giving your spouse a one-half interest in the residence first, and then creating two QPRTs, one for each of you.

WHAT HAPPENS IF I WISH TO STOP USING THE PROPERTY IN THE QPRT AS A PERSONAL RESIDENCE?

There are two choices. The trust agreement can provide that the trust will end and the property or its sales proceeds be given back to you. From a tax perspective, this is unattractive because the cash proceeds are distributed to you, and therefore all of the tax advantages are lost. Alternatively, the trust agreement can provide that the property be sold and either (a) a new residence purchased for you, or (b) the cash be invested and the trust must pay you a cash annuity for the remainder of the term.

WHAT ARE THE COSTS OF MANAGING A QPRT?

Little or none. If the donor or a family member or friend is the sole Trustee, which commonly is the case, there are no Trustee's fees. Usually no court costs or court supervision is involved. If the donor is also a Trustee, the trust is not required to file tax returns. There are costs involved in establishing the trust, however, such as attorney's fees for preparing the trust agreement and deeds of transfer and accountant's fees for preparing the gift tax return.

WHAT IF I HAVE A MORTGAGE AGAINST THE RESIDENCE OR WISH TO BORROW AGAINST THE RESIDENCE IN THE FUTURE?

If the property contributed to the QPRT is subject to an existing mortgage, you will make additional gifts each time you pay a mortgage payment after the QPRT is funded. One possible way to avoid this problem is to "indemnify" the QPRT from any obligation to pay off the mortgage, retaining the obligation to pay the mortgage yourself. In addition to the gift tax issue, if a mortgage exists at the time of the transfer of title on the residence to the QPRT, the transfer may result in a breach of mortgage which could cause the debt to be payable in full at the time of the transfer. Therefore, if there is mortgage indebtedness on your residence, you should discuss this issue with your tax advisor before establishing your QPRT.

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You should assume that the residence transferred to the QPRT is no longer a potential source of borrowing. So, for example, if you indemnify the QPRT from any obligation under an existing mortgage, you should not use the residence as collateral to "refinance" the old mortgage and you should not plan on being able to further borrow against the equity of the house in any manner.

CAN I CONTINUE TO PAY FOR IMPROVEMENTS TO THE RESIDENCE AFTER THE RESIDENCE IS TRANSFERRED TO THE QPRT?

Principal improvements to the residence, such as an addition or a new roof, constitute additional taxable gifts to the QPRT, if paid for by you. We suggest that you speak with your tax advisor before making such improvements.

CAN MY SPOUSE HAVE THE RIGHT TO LIVE IN OUR HOME AFTER MY TERM EXPIRES?

Yes. Taxes are not affected.

HOW DO THE IRS INTEREST RATES EFFECT THE VALUE OF THE TRANSFER OF PROPERTY TO A QPRT?

Higher interest rates make the QPRT more successful because higher interest rates cause the taxable gift you are deemed to make when creating your QPRT to be reduced. Mathematically, the higher the interest rate, the more value you are deemed to retain during the QPRT term and therefore the less is being distributed to your family at the end of the QPRT term.

SHOULD YOU ONLY TRANSFER PROPERTY TO A QPRT WHEN THE IRS INTEREST RATES ARE RELATIVELY HIGH?

Higher interest rates do make the QPRT a more attractive tool. However, the interest rate is not the only, or even the more important, factor in a QPRT's success. The QPRT technique is highly sensitive to the value of the real estate being transferred. If a property is "undervalued" in the sense you think it will likely appreciate considerably during the QPRT term, you should consider a QPRT even if interest rates are relatively low. Also, the longer the term of the QPRT, the greater the discount. Accordingly, the QRPT can make sense in a low interest rate environment if it is for a longer term with undervalued real estate. Often, a gift of a vacation home will fit this profile.

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SELF-CANCELLING INSTALLMENT NOTE

WHAT IS A SELF-CANCELLING INSTALLMENT NOTE?

A self-cancelling installment note (SCIN) is a debt instrument that contains a provision which calls for the cancellation of the liability upon the death of the holder during the term of the promissory note. If you, as the holder of the SCIN, die prior to the expiration of the term of the SCIN, the automatic cancellation feature may operate to remove a significant amount of assets from what would otherwise be includible in your estate.

WHY WOULD A SCIN BE OF INTEREST TO ME?

This technique is beneficial if you believe that you will not survive your actuarially determined life expectancy. Using the SCIN transaction you will exempt any portion of the sales price for your interest(s) that is not paid before your death, together with any post-sale appreciation, from estate tax at your death. Although your estate may be subject to income tax at your death (based upon the unpaid sales price) the applicable federal rate will be the capital gains tax rate (currently 20%), rather than the federal estate tax rate (currently 40%); furthermore, your estate will be in the position to argue that this capital gains tax should be deductible for estate tax purposes.

If you believe you <u>will</u> survive to or beyond your actuarial life expectancy a SCIN may not be the ideal solution, as you may end up with more value in your estate (to be subjected to estate tax) than if you did not engage in the transaction at all. In that case, a traditional installment sale would be preferable.

HOW DOES THE TRANSACTION WORK?

The key elements of the transaction closely resemble the traditional installment sale, discussed above, with some key differences:

- The term of the SCIN would be a period of years less than your life expectancy, otherwise it might be deemed a private annuity.
- The terms of the Note must take into account the possibility of your death before the Note is paid off by including an increased interest rate or an increased principal amount. This is known as a "risk premium." The sales price would be determined based upon (a) the fair market value of the interests being sold (b) plus the "risk premium" for the possibility that you may die before receiving all of the payments (i.e., the full purchase price). If the sales price includes these two values, then no gift tax consequences will result from the transfer. The risk premium is incorporated by either utilizing a higher interest rate (i.e., an "interest rate premium") or by increasing the purchase price (i.e., a "principal premium"). What constitutes an adequate risk premium is a fact-specific question. Since your life expectancy is a critical component of the risk premium, it must

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FAMILY OFFICE ASSOCIATION

be considered. If the seller has a "terminal illness," such actuarial tables may not be used. A terminal illness means that the seller has "an incurable illness or other deteriorating physical condition" which results in at least a 50% probability that the individual will die within one year.

- The SCIN can be arranged to be self-amortizing, interest-only with a "balloon" payment of principal at the end of the term, or to require level principal payments, or something in the middle like the traditional installment note. Generally, an interest-only SCIN (whether using an interest rate premium or principal premium) will likely result in the most estate tax savings.

WHAT ARE THE ADVANTAGES TO USING A SCIN?

In addition to the benefits outlined under the traditional installment sale discussion, the SCIN offers the following additional benefits:

Potentially greater estate tax savings.

Unlike a traditional installment sale, with a SCIN, the remaining principal balance would not be included in your estate at your death because, by the terms of the promissory note, it cancels at your death. The estate tax savings can be substantial if the seller dies materially prior to her life expectancy. The private annuity, discussed below, also shares this benefit.

Lower interest rate.

Although the issue is not settled, most estate planners agree that the applicable base interest rate (excluding a risk premium component) to use for the promissory note is the AFR in effect for the month of sale. However, a conservative approach would be to use the higher section 7520 rate, which is 120% of the mid-term AFR for the month in which the sale occurs.

Backloading of payments.

If you use an interest-only SCIN that defers the payment of principal, at least initially, the purchasing trust would have a greater opportunity to convert its illiquid interest into liquid assets (i.e., cash or marketable securities), which would leverage the proceeds, allowing you to more easily shift value to younger generations. More importantly, a SCIN offers a major advantage if you were to die prior to the end of the term because of the possibility for a sizeable principal balance payment never being made back to you or your estate. As previously explained, the estate tax savings could be substantial.

WHAT ARE THE DISADVANTAGES TO USING A SCIN?

In addition to the disadvantages outlined under the traditional installment sale discussion, the SCIN has the following disadvantages:

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Substantially greater seed funding.

If the principal premium approach is taken, the initial seed funding of the trust would accordingly increase, i.e., to maintain 10% of the principal obligation, at a minimum.

Risk of lengthy life.

If you outlive your life expectancy, the assets included in your estate will be substantially greater had the property been sold in a traditional installment sale. Because of the risk premium, the SCIN payments will be significantly higher. A similar risk, although less substantial, exists with a private annuity.

Uncertainty of calculations.

The calculation of payments under a SCIN can be uncertain, including the determination of the risk premium and your life expectancy. By comparison, private annuity calculations are relatively straightforward.

ARE THERE INCOME TAX CONSEQUENCES TO USING A SCIN?

There are different income tax consequences of a SCIN involving a grantor trust versus a nongrantor trust. If your interest is sold to a grantor trust, the sale of the interest and the interest "income" you receive from the grantor trust should be a nontaxable event for income tax purposes. If the SCIN is paid off while you are alive, the proceeds will be included in your estate and you will recognize gain, unless the purchaser is a grantor trust.

With respect to a nongrantor trust, if the SCIN is cancelled upon your death, any deferred gain will be recognized at that time. However, although the issue is not clear, such deferred gain arguably should not be recognized if the purchaser was a grantor trust. With respect to a nongrantor trust, if the principal premium approach is taken (i.e., increased purchase price), it will result in higher capital gains and lower interest income being reported by you. Accordingly, the trust would receive a higher basis in the interest and lower interest deductions. Conversely, if the interest premium approach is taken, it will result in less capital gains and higher interest income being reported by you, with a corresponding lower basis and higher interest deductions.

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PLANNING WITH RESIDENTIAL REAL ESTATE

WHAT ARE THE TAX ASPECTS OF RETAINING A RESIDENCE UNTIL I DIE?

If you own a residence at the time of your death, it will be included in your estate for estate tax purposes. As with other assets, your estate will get a "step-up" in cost basis as of the date of death so that there would be no gain on sale if it was sold at the date of death valuation price. For many people who purchased a home long ago, it be might be advantageous to hold onto the house until they die in order to wipe out the potential capital gains.

DO MY HEIRS HAVE TO PROBATE THE HOUSE?

Your executor has to open a probate in any state in which you own real estate at the time of your death. In order to avoid this, many people transfer their homes into the name of their revocable trust. This will not avoid estate taxes but it will avoid having to go through an ancillary probate. However, it is important before making any transfer to confirm it would not adversely affect any possible homestead exemptions in states such as Florida.

Another approach to avoid probate would be to place the house in the name of an LLC so that the membership interest is what is owned instead of the real estate itself. This may also avoid estate taxes in some states, but this area is still evolving.

WHAT ESTATE PLANNING TECHNIQUES CAN I UTILIZE WITH MY RESIDENCE?

There are several approaches that could be utilized when making gifts of real estate but, as with any gift, the recipient will receive a carryover cost basis in real estate. Accordingly, it is important to evaluate whether and how much capital gains might be passed on to the recipient and whether the tax effects will outweigh any potential estate tax benefits. The approaches most commonly used are:

- QPRT (see separate white paper topic)
- Sale to Grantor Trust (see separate white paper topic)
- LLC (see below)
- Outright gift or in trust (see below)

WHAT APPROACHES CAN I TAKE FOR MANAGING THE FAMILY VACATION HOME?

The threshold question with any of this planning is do the children want the home at all? Different beneficiaries may have different economic situations or live in different places across the country or world and may not make the same use of the property. It is important to have open conversations and discussions to ensure that over time the property (and expectations)

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can be managed properly. There also should be some discussion of how much money is needed to sustain the property and whether it can be rented to unrelated people.

A trust can be used in which a trustee controls the real estate, but that may place the trustee in the position of having to balance different beneficiaries' interests and use of the property.

A limited liability company is often a good way for managing a second or vacation home. The family or trusts for their benefit will own the property as members of the LLC and the LLC Operating Agreement will set out the rules for managing the property. The managers will manage the property, and the Operating Agreement will set out how managers will be succeeded and elected.

An exit plan for members should be thoroughly discussed: will there be provisions for buying out a member and, if so, how will that be done? Over time or immediately? At what price? Will there be any transfer restrictions on a member's death, divorce or creditor problems? How will the property be managed as generations continue? How will usage be scheduled? How will expenses be managed? Through an endowment or contributions? If there is a dispute how will it be resolved?

There are no "correct" ways to answer these questions or even best practices approaches other than to have open and honest discussions regarding the property. Property held at the "siblings" level can often be managed fairly well, but once the property descends to the "cousins" level and people's personal and economic situations begin to diverge, and the number of people with interests begins to multiply, it is difficult to balance interests unless the property is endowed with substantial funds.

WHAT ARE THE BENEFITS OF MAKING A GIFT OF A RESIDENCE IN TRUST VERSUS OUTRIGHT?

The benefits of making a gift in trust is if the donor is married, he or she can retain indirect use of the real estate, because the spouse, as beneficiary of the trust, would be entitled to use the property rent-free. Normally, if a donor makes a gift of a residence, the only way he or she can still use the property is if he or she pays fair market rent. Otherwise, the IRS would likely argue that the donor retained use of the property and seek to include the property in the donor's estate under the retained life estate provisions of Internal Revenue Code section 2036.

However, if the spouse dies or they become divorced and the grantor desires to continue to use the property, or, if the donor does not have a spouse, he or she would need to rent from the trust. This can actually be a positive planning technique, since if the trust is structured as a "grantor trust," the payment of rent will not be considered income for the trust and the payment of rent becomes, in essence, an additional gift tax free gift to the trust.

Making a gift of the real estate in trust versus outright is also a way to protect and preserve the real estate for the intended beneficiaries. If a gift is made outright to a beneficiary and the beneficiary dies, gets divorced or has creditor problems, the real estate would be disposed of in accordance with the beneficiary's estate plan or may be subject to divorce or bankruptcy

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proceedings. Retaining the real estate in a properly drafted creditor protection trust can keep the property protected from those claims.

The grantor can also set out in the trust agreement exactly how the real estate will be managed. Use of a trust will effectively restrict the transfer of the real estate and keep its use within a class of beneficiaries. The trustee controls how and when the property is used. An important part of putting the real estate in trust is to provide for how the real estate expenses will be made. Will it be expected that the beneficiaries contribute or pay rent? What if some of the beneficiaries use the property and some don't? It may make sense to endow the trust with a sum of money to cover capital expenses and repairs. Even so, it can be difficult for a trustee to manage the divergent interest of the beneficiaries.

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PRIVATE ANNUITIES

WHAT IS A PRIVATE ANNUITY?

A private annuity is an arrangement where in exchange for property sold, the seller/annuitant receives annual annuity payments for the remainder of his or her lifetime. An annuity is private if the purchaser is not in the business of making annuities. A private annuity is used where the seller's actual life expectancy is likely to be less than his or her actuarial life expectancy.

WHAT ARE THE BASICS OF A PRIVATE ANNUITY?

The client sells an asset or pays money to a buyer in exchange for such an agreement to pay an annuity to the seller for such seller's lifetime (or the joint lifetimes of such seller and his or her spouse). The seller removes appreciating stock from the seller's estate and retains the value of the annuity payments. This is a particularly useful strategy to provide income to the seller (and perhaps the seller's spouse) for life while transferring interest in closely-held business to the next generation.

WHEN SHOULD I USE A PRIVATE ANNUITY?

This technique is a bit of a gamble as the tax benefits of the technique are maximized if the transferee dies before life expectancy. If the transferor survives beyond his or her life expectancy, the transferee may repay an amount in excess of the value of the asset transferred, and potentially increase the value of the transferor's estate more than if the transfer had never occurred. This risk is minimized where the asset grows substantially in value while in the hands of the transferee. Private annuities work best for those who are ailing, but not someone who is terminally ill.

HOW IS A PRIVATE ANNUITY CALCULATED?

A properly structured private annuity agreement must meet the following criteria:

- The value of the annuity payments should equal the value of the property transferred, because the annuity transaction is not treated as a gift as long as the actuarial value of the annuity equals the value of the stock that is transferred. Unless the seller/annuitant has a terminal illness, the annuity payments are determined by using the section 7520 rate and the IRS-approved actuarial tables for the month in which the sale occurs. An essential element to this planning requires that you get a medical opinion that you have at least a 50% likelihood of surviving for one (1) year as of the date of the sale. Actuarial tables cannot be used to value the seller's life expectancy if there is a 50% or more chance that the seller will die within one (1) year after the transaction due to current health problems. If there is a 50% or more change that the seller will die within a year, the seller's actual life expectancy must be used. However, if the seller actually lives for

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eighteen (18) months after the transfer, then the seller is presumed to not have been terminally ill.

- The annuity payments cannot be tied to the income generated by the transferred interest, either directly or circumstantially. Doing so would give the IRS grounds to assert that you retained the right to enjoy the income for your lifetime, which would cause the entire value of the transferred interest to be includible in your estate for estate tax purposes.

WHAT ARE THE ADVANTAGES TO USING A PRIVATE ANNUITY?

The private annuity offers the following benefits:

Estate tax savings upon premature death.

The remaining principal balance would not be included in the seller's estate at their death because, by the terms of the private annuity contract, it cancels at the seller's death. The estate tax savings can be substantial if the seller dies materially prior to his or her life expectancy. If the purchaser is a nongrantor trust, the seller's estate would be further reduced by the capital gains taxes paid on the sale.

Backloading of payments.

The private annuity can be designed so that each annuity payment increases up to 120% more than the prior annuity payment. Such backloading offers the advantage of necessitating small payments in the beginning to leverage the return on the interest that was sold. Compare this with a traditional installment sale, where backloading is available in the form of interest-only payments with a balloon payment of principal at the end of the term.

Lesser Risk of Survivorship.

Survivorship beyond the seller's actuarial life expectancy is likely to result in a higher estate tax liability than if the seller were to implement a traditional installment sale. However, this risk is less severe with a private annuity than a Self-Cancelling Installment Note ("SCIN"), which includes a risk premium and provides for a balloon payment of principal at the end of a term that is shorter than the seller's life expectancy.

Fewer calculation uncertainties.

Since the factors on which a private annuity are based are given by the IRS, the calculation of payments under a private annuity are relatively straightforward. A SCIN does not come with such assurances.

WHAT ARE THE DISADVANTAGES TO USING A PRIVATE ANNUITY?

A private annuity has the following disadvantages:

Immediate recognition of capital gain if sale to nongrantor trust.

If the seller sells his or her interest to a nongrantor trust, the seller would immediately recognize capital gain.

No stepped-up basis in sold assets.

Since the seller will not hold the seller's interest at his or her death, such interest will not obtain the step-up in cost basis at the seller's death, and a subsequent sale of the interest by the Trustee would generate a capital gains tax even if the sale occurs immediately after the seller's death. However, if the sale is made to a nongrantor trust the buyers would have a basis equal to the purchase price (with any appreciation accruing after the sale being subject to future capital gains tax). If the maximum federal estate tax rate is higher than the capital gains tax rate, the advantages outlined above may outweigh this disadvantage.

Larger payments back to seller.

The annual payments back to the seller will be higher than the payments under a traditional installment sale for a term equaling your life expectancy. This is because the private annuity payments must account for the possibility that the seller may die prematurely. Additionally, the annuity payments are based on the higher 7520 rate as opposed to the AFR.

ARE THERE INCOME TAX CONSEQUENCES TO USING A PRIVATE ANNUITY?

If the seller's interest is sold to a grantor trust, the sale of such interest should be a nontaxable event for income tax purposes. Although grantor trust status ceases upon the seller's death, because the annuity payments cease at death, any deferred gain should not be recognized.

If the purchaser is a nongrantor trust, a sale of property in exchange for a private annuity is a taxable event for income tax purposes. Due to a recent change in position by the IRS, such sale to a nongrantor trust in exchange for a private annuity will cause an immediate recognition of capital gain because the sale will not qualify for installment sale treatment.

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ADMINISTRATION OF GRATS, QPRTS, IRREVOCABLE GIFT TRUSTS, IRREVOCABLE INSURANCE TRUSTS

As opposed to Revocable Trusts, GRATs, QPRTs, Irrevocable Gift Trusts, and Irrevocable Insurance Trusts are all irrevocable trusts, meaning that they cannot be changed by the Grantor or any other person, and each type of trust has unique items of administration on which the Trustee must focus. Typically, these Irrevocable Trusts are drafted to be "Grantor Trusts" for income tax purposes, during the Grantor's lifetime, so that the income taxes are paid by the Grantor.

WHAT ARE THE UNIQUE ASPECTS OF ADMINISTERING GRATS?

The administration of a GRAT has a few differences from the administration of a Revocable Trust. The Trustee, in addition to making investment decisions and managing the assets, will be required to make annual annuity distributions to the Grantor. Generally, the Trustee will make each annuity payment by distributing cash, to the extent there is cash available; however, since the goal is a high rate of return (to maximize the value received by the ultimate beneficiaries), often there will not be sufficient cash available to make all of the annuity payments, so the Trustee will have to make distributions with other assets. To make in kind distributions, the Trustee will be required to get a valuation of the assets being distributed as of the date of the annuity payment.

WHAT ARE THE UNIQUE ASPECTS OF ADMINISTERING QPRTS?

Since a QPRT cannot hold any other assets other than an interest in one residence and certain related assets, the administration of a QPRT is fairly straightforward, except for certain situations. Generally, the Trustee is managing the residence and may be paying certain expenses related to the residence. The Grantor may contribute cash to the QPRT for trust expenses that are expected to be paid within six months, such as improvements, and, if the Trustee has entered into a contract for purchase of the initial or replacement residence. If the QPRT is holding additional cash, the Trustee must determine quarterly, the amounts of cash that are in excess of the permissible amount, and, if any, such cash must be immediately distributed to the term holder. Additionally, proceeds from the sale of the residence or an insurance claim provide unique administration aspects. The Trustee must use the proceeds from the sale or insurance to purchase a new residence or convert the QPRT into a GRAT.

WHAT ARE THE UNIQUE ASPECTS OF ADMINISTERING IRREVOCABLE GIFT TRUSTS AND IRREVOCABLE INSURANCE TRUSTS?

One of the main administration aspects of Irrevocable Gift Trusts and Irrevocable Insurance Trusts is insuring the contributions to the trust qualify for the gift tax annual exclusion. To qualify, the Trustee must make sure that the trust notifies the beneficiaries that a contribution has been made and that the beneficiaries have a right to withdraw all or part of the contribution.

The notification is done through what is commonly referred to as a "Crummey letter." Beyond insuring the Crummey letters are sent to the beneficiaries, the Trustee will need to make investment decisions and manage the assets of the trust, in the same manner as any other trust. For an Irrevocable Insurance Trust, the Trustee will also need to make sure the insurance premiums are paid out of the trust assets.

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FAMILY OFFICE
ASSOCIATION

ASSET PROTECTION PLANNING

WHAT IS THE PURPOSE OF ASSET PROTECTION PLANNING?

Our judicial system is as fair as it can be, but it is inherently unfair in a significant way: it is often expensive to defend against unwarranted claims. It is no secret that society has become highly litigious and this trend is unlikely to change. This is in large part due to litigation services based on a contingency fee. In an ideal world, the contingency fee model would wean out frivolous claims because an unsuccessful attorney would not be reimbursed for costs and billable time. However, the "success" of the plaintiff's attorney is often achieved with a settlement before an expensive trial. Of course, the success comes at the expense of the defendant, who chooses to pay a known amount than risk the possibility of paying a much higher amount, potentially a catastrophic amount. Therein lies the purpose of asset protection planning: to obtain negotiating leverage against a future unforeseeable creditor by using local state law to protect exempt assets and using other laws, whether domestic or foreign to protect nonexempt assets.

WHEN SHOULD I CONSIDER ASSET PROTECTION PLANNING?

This question should be rephrased as follows: "When can I not engage in asset protection planning?" Answer: You usually cannot engage in asset protection planning when a claim is brought against you or you are aware (or should be aware) that a claim could be brought against you, especially if the value of that claim in the least favorable light (i.e., the worst-case scenario) exceeds the value of your assets that are available to satisfy the creditor's claim. Thus, if you have assets that you do not wish to be exposed to creditors' claims (whether a judgment or a negotiated settlement), you should consider asset protection planning while you only have future unforeseeable creditors.

WHAT IS A FUTURE UNFORESEEABLE CREDITOR?

From an asset protection perspective, there are three types of creditors: 1) a present creditor, 2) a future foreseeable creditor, and 3) a future unforeseeable creditor. The first two types of creditors are protected by so-called fraudulent transfer, fraudulent conversion and voidable transaction laws, which protect the property rights of creditors (i.e., the ability to collect on a judgment). A future unforeseeable creditor is one who could not be known or identified at the relevant time.

It would seem that future creditors are always foreseeable for those who work in high liability professions. However, most states do not define "foreseeability" in this hypothetical manner. For example, one would think that an OBGYN could never engage in asset protection planning because of the sheer possibility of committing malpractice during his or her career. Rather, to be foreseeable, the OBGYN would need to be aware of a specific patient who could bring a specific claim for malpractice.

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WHAT ASSETS ARE EXEMPT FROM CREDITORS' CLAIMS?

State law usually determines what assets are exempt from creditors' claims. Because laws differ from state to state, one should carefully review the current exemptions granted under his or her state law. The following are classes of assets that may be exempt under state law:

- Retirement plan assets, including, but not limited to, Individual Retirement Accounts (IRAs), Roth IRAs, Simplified Employee Pension plans (SEPs), and 403(b) annuities. 401(k) assets are exempt under ERISA (Employee Retirement Income Security Act), a federal law.
- Life insurance on one's life, whether the cash surrender value, proceeds upon death, or both.
- 529 Plans.
- Annuities.
- Homestead property (that is, one's primary residence). A handful of states fully protect homestead property. For example, in general, Florida law protects Florida homestead property from forced sale as long as it is within the size limitations, which are up to 160 acres of contiguous land if located outside a municipality or up to a 1/2 acre if located within a municipality.
- As between spouses, tenancy by the entireties property is exempt from a creditor of a single spouse. Tenancy by the entireties property is more commonly permitted in real estate but several states permit it in personal property, such as vehicles, and intangible personal property (e.g., financial accounts and interests in entities like corporations, partnerships and limited liability companies).

ARE THE ASSETS HELD BY A REVOCABLE TRUST EXEMPT FROM CREDITORS' CLAIMS?

No, because the grantor of the trust (that is, the person who transfers property to the Revocable Trust) has retained the power to revoke the trust. The law permits the grantor's creditors to reach the assets of a trust to the maximum extent a grantor has the power to control the assets. Since the grantor can revoke the trust, all of the trust assets can benefit the grantor at any time.

DOES A LIMITED LIABILITY COMPANY PROTECT ASSETS FROM CREDITORS?

The protection offered by a limited liability company (LLC) under a standard state LLC Act offers two types of protections, "inside" protection and "outside" protection. The inside protection is similar to that of any other corporate entity. The advantage of doing business through an entity such as an LLC is that in the normal course of business the only assets subject to the claims of those dealing with the LLC are the assets held by the LLC. This permits the owners of the LLC to limit the exposure of their personal assets if the LLC is subject to creditors' claims.

The outside protection deals with an LLC's *owner* being subject to creditors' claims. If the LLC owner is personally liable to a judgment creditor, often unrelated to the LLC, the applicable state

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LLC Act generally provides that the sole and exclusive remedy of judgment creditor is to obtain a "charging order" against the owner's membership interest in the LLC. The effect of a charging order is that any LLC distribution that would be made to the debtor/owner must instead be paid to the judgment creditor until the judgment is satisfied. This creates an advantage because the judgment creditor cannot take the LLC membership interest from the debtor/owner. Of course, the debtor/owner cannot benefit from LLC distributions during this period. Still, the owner is in a better negotiating position than without the outside protection because LLC distributions could be withheld until a settlement is reached.

ARE SOME LIMITED LIABILITY COMPANIES BETTER THAN OTHERS?

This question cannot be answered easily, but there is a key concern of which to be aware. A limited liability company with only one member (commonly referred to as a "single member LLC") may offer less outside protection than a limited liability company with two or more members (commonly referred to as a "multimember LLC"). In many jurisdictions, a charging order is the sole and exclusive remedy by which a judgment creditor of a member may satisfy a judgment. This means that the judgment creditor cannot attach the asset of the LLC but instead is limited to receiving distributions made by the LLC on behalf of the debtor member. Some states provide only limited outside protection to the owner of a single member LLC. For example, under Florida's Revised Limited Liability Company Act, if the judgment creditor can prove to the court that the judgment will not be satisfied in a reasonable time, a charging order is not the sole remedy and the court may order the sale of the LLC interest to satisfy the judgment. Other states, such as Delaware, Nevada and South Dakota, provide that a charging order is the sole and exclusive remedy, including for an LLC with a single owner. A related concern is whether a state like Florida can apply its charging order law to LLCs formed in another state. The law is not clear.

WHAT IS THE DIFFERENCE BETWEEN A "MEMBER MANAGED" LLC AND A "MANAGER MANAGED" LLC?

These terms are often confused. In general, the chief operating officer of an LLC is the manager. A member managed LLC is one that requires the manager to also be a member of the LLC, whereas the manager of a manager managed LLC can be anyone, including another LLC. For the greatest flexibility, a manager managed LLC is usually preferable.

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ASSET PROTECTION TRUSTS

WHAT IS AN ASSET PROTECTION TRUST (APT)?

A trust designed to protect the assets the grantor has transferred to it. This type of trust is technically referred to as a "self-settled irrevocable spendthrift trust." The trust is self-settled because the grantor is also a beneficiary of the trust. The trust cannot be revoked by the grantor. Finally, the trust contains spendthrift protection, meaning that the creditors of a beneficiary cannot attach the assets of the trust.

WHAT ADVANTAGES DOES AN ASSET PROTECTION TRUST OFFER OVER OTHER ENTITIES THAT PROTECT ASSETS, SUCH AS A LIMITED LIABILITY COMPANY (LLC) OR LIMITED PARTNERSHIP (LP)?

APTs have the distinct advantage of permitting the Trustee to make distributions to *or for the benefit of* any one or more of the trust beneficiaries. Consequently, if a beneficiary had creditor concerns, including the grantor, the Trustee can economically benefit the beneficiary without the beneficiary receiving trust assets (for example, making a mortgage payment or paying litigation fees). An LLC or LP must make its distributions directly to its owners, instead of for their benefit, which allows creditors to collect such distributions.

WHAT JURISDICTIONS CAN AN ASSET PROTECTION TRUST BE CREATED?

Domestically, the trend has been one state per year has added APT legislation. Unless you live in a state that has such legislation, the general sentiment is that there are four top tier states, which are (in alphabetical order) Alaska, Delaware, Nevada and South Dakota. In 1996, Alaska was the first state to authorize APTs. However, foreign jurisdictions have permitted APTs even earlier. Two of the most common foreign jurisdictions used are Nevis and the Cook Islands, although there are many others.

WHAT IS THE DIFFERENCE BETWEEN A DOMESTIC AND A FOREIGN ASSET PROTECTION TRUST?

Other than their geographic location and specific legislation, the primary difference is that the Trustee of a foreign APT is not subject to the laws of any state in the United States of America. There is a concern that the United States Constitution may require an asset protection state to honor judgments from her sister states. The widely-held view is that this will not be the case. However, as of 2017, no case has examined this issue. Establishing an APT outside the United States should eliminate this possible risk.

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WHO CONTROLS AN ASSET PROTECTION TRUST?

Ideally, the Grantor should not have any control over the APT. Although the Trustee is the legal owner of the trust assets, often a "Trust Protector" or "Trust Advisor" is the person who has the authority to control trust activities. Typically, the Trust Protector of a domestic APT has the power to direct the Trustee how to invest trust assets and to make distributions to beneficiaries. With respect to a foreign APT, usually the Trust Protector must consent to Trustee decisions before they are authorized. Finally, the Trust Protector will usually have the power to remove and replace the Trustee. Given this central role, the selection of the Trust Protector is significant.

Instead of a Trust Protector controlling distribution or investment decisions, an alternative is to incorporate Distribution or Investment Committees.

HOW MUCH CAN ONE TRANSFER TO AN ASSET PROTECTION TRUST?

Most trust companies will limit the funding to be no more than 50% of the Grantor's liquid assets. Exceptions may be made on a case by case basis. The concern is that overfunding may result in the Grantor's inability to satisfy his or her debts in the as they come due or may render the Grantor insolvent. In either situation, the legally result may be that the Grantor may have violated the fraudulent transfer or voidable transaction laws, which would expose the assets to creditors' claims.

WHAT TYPE OF ASSETS MAY BE TRANSFERRED TO AN ASSET PROTECTION TRUST?

Almost any asset can be transferred to an APT if it is acceptable to the Trustee. Transferring cash and marketable securities is the simplest. Less liquid assets, such as real estate or closely-held companies, must be handled with more care and examination. Qualified retirement accounts, such as Individual Retirement Accounts (IRAs) and 401(k)s, cannot be transferred to an APT unless the account assets are distributed to the owner, which may result in taxable income.

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FAMILY TRUST COMPANIES

WHAT IS A FAMILY TRUST COMPANY?

In general, a Family Trust Company is an entity which provides trust services similar to those that can be provided by an individual or financial institution (i.e., a bank or public trust company). This includes serving as Trustees of trusts held for the benefit of the family members, as well as providing other fiduciary, investment advisory, wealth management, and administrative services to the family.

WHAT ARE SOME REASONS TO HAVE A FAMILY TRUST COMPANY?

- The family needs an independent trustee and the traditional trustee options do not suit the family's circumstances (e.g., operating a significant family-owned business).
- A Family Trust Company focused on the family's circumstances may be better suited to handle specialized assets, such as agricultural properties, family-owned businesses, or alternative investments, including private equity and venture capital investments.
- A Family Trust Company can provide heightened responsiveness and flexibility for a family, including allowing the family to select separate investment managers for specific asset classes.
- A Family Trust Company fosters consolidation of investments and family officer matters.
- A Family Trust Company can promote non-family financial objectives, including family succession planning and wealth education for younger generations.
- A Family Trust Company can provide entrepreneurial mindset to the management of the family's investments.
- The family may desire to avoid being subjected to supervision by the Federal Securities and Exchange Commission (SEC), by instead subjecting the Family Trust Company to the supervision of the relevant state regulator.

WHO CAN FORM AND OWN A FAMILY TRUST COMPANY?

Generally, a Family Trust Company must be owned exclusively by family members.

WHOM MAY A FAMILY TRUST COMPANY SERVE?

A Family Trust Company may provide fiduciary services only to the participating family members (not to the general public).

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CROSS-BORDER TAX ISSUES

Due to numerous international financial and asset disclosure agreements, the countries around the world are sharing an individual's asset and income history and forcing tax compliance. As a result, individuals who live in less secure countries are beginning to fear for the safety of their families and turning to countries like the United States for residence. The following is a discussion of the various traps one may encounter in dealing with a cross-border transaction.

DOES A U.S. CITIZEN'S U.S. ESTATE PLAN DOCUMENTS GOVERN THE DISPOSITION OF THEIR FOREIGN ASSETS?

When a U.S. citizen or U.S. resident owns foreign assets, the individual needs to make sure that the tax and estate planning issues concerning the foreign jurisdiction have been considered. In most cases, the use of a U.S. Will to control the disposition of foreign assets will be sufficient. If the property is located in a jurisdiction where the succession laws (e.g., forced heirship) of that country will produce a result that is contrary to the U.S. estate plan, then it must be determined whether the succession laws of the applicable state within the U.S. can be used in the foreign jurisdiction. For example, most countries of the European Union permit a U.S. Will of a U.S. citizen domiciled in the U.S. to expressly opt out of the succession laws of the applicable European country and apply the U.S. succession laws. Another example is Switzerland has legislation that allows one to opt out of their succession laws.

After one has analyzed the applicable succession laws, the impact of using a trust to hold foreign assets must be analyzed. Most countries have difficulty in understanding trust law and its impact under their respective tax codes. Careful consideration needs to be made on using a trust to hold any foreign assets. There can be significant income, gift and inheritance tax consequences. If the trust is not a viable option, then the use of a Limited Liability Company (owned by a trust) may provide the estate planning benefits for the individual. Other options can be using foreign structures to hold title of the foreign assets that could then be owned by the U.S. citizen or U.S. entity. However, you must analyze whether the foreign entity will cause an adverse U.S. income tax.

ARE THERE ANY TAX ISSUES IF A NON-U.S. CITIZEN RESIDING IN THE U.S. DECIDES TO MOVE OUT OF THE U.S.?

Yes, it is dependent on the length of stay in the U.S. Unless modified by a tax treaty, a non-U.S. citizen who has been a lawful permanent resident (e.g., holds a green card) of the U.S. for eight of the fifteen years ending with the year during which the individual leaves the U.S. is considered a Long-Term Resident. If a Long-Term Resident moves from the U.S. resulting in the cessation of their status as a U.S. resident, then the Long-Term Resident will be deemed to have expatriated from the U.S. A tax treaty may provide a planning opportunity by having the individual claim a residence tie-breaker with a foreign country prior to becoming a Long-Term Resident. However, a tax treaty can also cause an accidental expatriation. If an individual is considered a Long-Term

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Resident and decides to exercise a right under the treaty to change their tax residence to a non-U.S. country, then the individual will have deemed to have expatriated. If a Long-Term Resident is deemed to have expatriated from the U.S. by becoming a non-U.S. resident, then the individual will be known as a covered expatriate and will be subject to an exit tax.

A covered expatriate is treated as having sold the individual's worldwide assets upon expatriating and must report the built-in gain as income and pay taxes on it accordingly. The wash sale rules and provisions that avoid the recognition of gain (e.g., sale of residence) do not apply. The first $713,000 of gain is exempt from tax. Thus, if expatriation is planned, an individual can leverage the exemption by recognizing long-term gain prior to expatriation and allocating the exemption on short-term gain. In addition, the individual could engage in the wash sale transactions prior to expatriation. There may also be an opportunity to defer the deemed recognition of built-in gain until the assets are actually sold.

After an individual is considered a covered expatriate, any attempted transfer to or for the benefit of a U.S. resident or U.S. citizen will be treated as a covered gift or bequest and subject to U.S. estate or gift tax.

IN LIGHT OF THE INCREASED COOPERATION BETWEEN GOVERNMENTS IN SHARING FINANCIAL INFORMATION OF THEIR CITIZENS, ARE THERE ANY PROGRAMS IN PLACE TO HELP INDIVIDUALS BECOME COMPLIANT BEFORE THE GOVERNMENT PENALIZES THEM?

There are various voluntary disclosure programs that allow an individual to become tax compliant. The voluntary disclosure programs are known as either a general voluntary disclosure program or a special voluntary disclosure program. The general programs are programs with no specified end date. The special programs are programs with a specific date that the program ends. Some examples of general programs are Chile, Colombia, Mexica, Russia and Taiwan. Some examples of special programs (the expiration dates are in parenthesis) are Argentina (March 31, 2017), Brazil (October 31, 2016), India (September 30, 2016), Indonesia (March 31, 2017), Malaysia (December 15, 2016), South Africa (still in draft form but soon to be opened), Turkey (December 31, 2016) and the United States (scheduled to be closed upon a date to be released soon). If an individual opts not to become tax compliant under a voluntary disclosure program, then the individual runs the risk of having penalties levied against them, forfeiture of assets and income, and criminal prosecution. In addition, the failure to become tax compliant could also jeopardize the individual's relationship with banks and other financial institutions.

ARE THERE ANY PROBLEMS WITH A U.S. CITIZEN OR U.S. RESIDENT HOLDING INVESTMENTS IN FOREIGN BUSINESSES?

It is a common trap for a U.S. citizen or U.S. resident ("U.S. Person") to take ownership of an interest in a non-U.S. entity. It could be a situation where a non-U.S. citizen spouse or relative transfers an interest in a non-U.S. entity to a U.S. Person. Another common way to fall into the

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trap is for a non-U.S. citizen that moves to the U.S. while owning a non-U.S. entity. The two common traps are having the foreign entity classified as a Controlled Foreign Corporations (CFC) and Passive Foreign Investment Companies (PFIC).

A U.S. shareholder of a foreign corporation that is treated as a CFC for 30 or more consecutive days during a tax year must include in the shareholder's gross income for U.S. income tax purposes the shareholder's pro-rata share of the CFC's (i) earnings invested, or considered to be invested, in U.S. property and (ii) Subpart F income. It does not matter whether the income is actually distributed. Holding the shares in an entity or Trust will not help the individual because the IRS will look-through to the beneficiary or owner. A foreign corporation is treated as a CFC only if the U.S. shareholders collectively own more than 50 percent of the total combined voting power or total value of the corporation's stock.

A PFIC is a foreign corporation that satisfies on of the following: (i) 75% or more of its gross income for the tax year consists of passive income under Subpart F of the Code, or (ii) 50% or more of its assets, on average, consists of assets that produce, or are held for the production of, passive income. In the absence of any corrective elections (e.g., QEF election), a U.S. shareholder is subject to U.S. tax and a special interest charge if the shareholder receives an excess distribution from the PFIC or disposes of the stock. The PFIC status of a foreign entity should be reviewed to determine a corrective measure can be taken, for example, restructuring the entity, distributing tainted assets, converting to a flow-through entity, making a QEF or mark-to-market election.

CAN A NON-U.S. CITIZEN RESIDING IN THE U.S. BE SUBJECT TO U.S. INCOME TAX ON WORLDWIDE INCOME BUT NOT U.S. ESTATE OR GIFT TAX ON WORLDWIDE ASSETS?

Yes. The U.S. tax rules subjecting a non-U.S. citizen to income tax are different than the rules for estate and gift tax. In order to be subject to U.S. income tax on worldwide income a non-U.S. citizen must meet one of the following tests: (i) a "lawful permanent resident" of the U.S. at any time during the calendar year (e.g., holds a green card); (ii) satisfies the "substantial presence test" in the U.S.; or (iii) makes a special election to be treated as a U.S. tax resident. The "substantial presence test" is satisfied if an individual is present in the U.S. for (i) 183 days or more during that calendar year, or (ii) at least 31 days during that calendar year and satisfies a physical presence test (183 days or more over a weighted three-year look-back). The physical present test is the sum of the (i) the number of days of physical presence in the U.S. in the current calendar year, (ii) one-third the number of days of physical presence in the U.S. in the first preceding calendar year, and (iii) one-sixth the number of days of physical presence in the U.S. in the second preceding calendar year. If an individual does not average more than 121 days per year the current year and two prior years, then the physical presence test will not be satisfied.

Even though the individual may satisfy the "substantial presence test", the individual may be classified as an exempt individual under the Internal Revenue Code (e.g., government official, full-time student, teacher, medical conditions, and professional athlete). In addition, the

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"substantial presence test" is not satisfied under the closer connection test which means the individual is present in the U.S. for fewer than 183 days in the applicable calendar year and establishes that the individual has a tax home in a foreign country and has a closer connection to such foreign country than to the U.S. Under the closer connection test, the individual cannot be in the process of applying for a green card or applying for adjustment of status. The closer connection test must be made by an election on Form 8840 which is attached to Form 1040NR. Finally, the individual should verify that an income tax treaty is not in effect that may alter the standards for residency or provide a tie-breaker.

If the individual is a U.S. tax resident, then the individual is subject to U.S. income tax on worldwide income. If the individual is a non-U.S. tax resident (and non-U.S. citizen), then the individual is subject to U.S. income tax on U.S. source fixed or determinable annual or periodical income (FDAP income) (e.g., interest, dividends, rent, salary) and income that is effectively connected with the conduct of a trade or business within the U.S. (ECI). ECI is taxed at the regular graduated income tax rates (0 to 39.6%). FDAP income is taxed at a flat rate of 30%. An income tax treaty may alter the tax rate and/or type of income subject to tax. If a tax treaty is applicable, then a Form W-8BEN or W-8ECI must be provided to the withholding agent.

Even though one is U.S. resident for income tax purposes, the individual may not be considered a U.S. domiciliary subject to U.S. estate, gift and generation skipping transfer taxes. In order to be domiciled in the U.S., the individual must (i) intend to permanently live in the U.S., (ii) be physically present in the U.S., and (iii) be capable of making an informed, intelligent decision about living permanently in the U.S. The facts and circumstances will show whether an individual had the intent to live permanently in the U.S. or a foreign country. If the person is not domiciled in the U.S., then the individual will be subject to U.S. estate, gift and generation skipping transfer taxes on U.S. situs assets. The lifetime exemption amount against estate taxes is $60,000. If the individual is domiciled in the U.S., then the individual will be subject to U.S. estate, gift and generation skipping transfer taxes on worldwide assets. As a U.S. domiciliary, the individual will have the same lifetime exemption amounts as a U.S. citizen.

IS THERE ANY TAX PLANNING THAT A NON-U.S. CITIZEN SHOULD DO BEFORE BECOMING A U.S. RESIDENT OR DOMICILIARY.

Yes. A non-U.S. citizen (who is also not considered a covered expatriate - see above) should take advantage of the favorable U.S. tax rules for non-U.S. citizens. The individual will need to take into consideration foreign tax implications and applicable tax treaties. Some planning options include (i) avoiding tax residency by relying on the exceptions for exempt individuals, treaty tie-breaker provisions or the closer connection exception, (ii) accelerating the recognition of non-U.S. source income, (iii) recognize gain on appreciated non-U.S. situs assets, (iv) transfer non-U.S. situs assets to a foreign trust, (v) reorganize foreign entities to avoid U.S. anti-deferral provisions (e.g., Controlled Foreign Corporations, Passive Foreign Investment Companies), and (vi) transferring assets to a U.S. Trust. Each method will need to be analyzed to determine whether it is appropriate.

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ARE THERE ANY PROBLEMS WITH A U.S. CITIZEN LIVING OVERSEAS MOVING U.S. ASSETS TO A U.S. REVOCABLE TRUST?

There can be potential problems. The use of a trust is mostly an American estate planning vehicle. Some countries have difficulty in understanding the purpose of a trust and the taxation of contributions to, and distributions from, a trust. For example, if a U.S. citizen is residing in the United Kingdom and is considered a domiciliary of the United Kingdom, then a transfer of U.S. situs assets to a U.S. revocable trust would be treated as a taxable disposition by the client. The United Kingdom would impose a 20% tax on the transfer, which could eventually increase to 40%. Prior to funding a trust, it is important for the individual to analyze the tax implications of the funding of the trust and distributions to beneficiaries.

ARE THERE ANY ISSUES WITH A NON-RESIDENT ALIEN TRANSFERRING ASSETS TO A U.S. CITIZEN OR U.S. RESIDENT?

Before a non-resident alien transfers assets to a U.S. citizen or U.S. resident, it should be determined that the non-resident alien is not a covered expatriate (discussed above). Assuming the individual is not a covered expatriate, a non-resident alien can transfer non-U.S. situs assets to a U.S. resident or U.S. citizen with no U.S. gift or generation skipping transfer tax issues. An asset is considered non-U.S. situs if it is not U.S. situs. U.S. situs assets include (i) U.S. real estate, (ii) tangible personal property located in the U.S., and (iii) currency located in the U.S., (iv) cash deposits in a U.S. bank. Intangible assets such as stock in a U.S. corporation and U.S. treasury obligations are non-U.S. situs assets for gift tax purposes but U.S. situs assets for U.S. estate tax purposes.

A non-resident alien who makes a gift of U.S. situs property subject to U.S. gift tax is entitled to the annual gift tax exclusion and a limited charitable gift tax deduction. However, the non-resident alien is not entitled to the unified credit (currently $11,180,000 for a U.S. resident or U.S. citizen) and gift splitting with a spouse. Thus, the non-resident alien should limit the gifts of U.S. situs assets subject to U.S. gift tax.

The non-resident alien should consider gifting non-U.S. situs assets for U.S. gift tax to a U.S. citizen or U.S. resident or a trust for the benefit of such person. If the gift is made directly to the U.S. citizen or U.S. resident, then such individual's estate subject to U.S. estate tax will be increased. However, if the gift is made directly to a an irrevocable U.S. trust for the benefit of the U.S. citizen or U.S. resident, then the assets could avoid U.S. estate tax. In addition, the trust could be structured as a dynasty trust and the assets would avoid U.S. estate tax for multiple generations.

HOW SHOULD A NON-RESIDENT ALIEN PURCHASE U.S. REAL PROPERTY?

If a non-resident alien is planning on purchasing a residence it the U.S. with no intentions of becoming a U.S. domiciliary, then the foreign national must be very careful not to create an estate subject to U.S. estate taxes. Real property located in the U.S. is considered U.S. situs

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property for U.S. estate and gift tax purposes subjecting the asset to a 40% estate tax. In addition, if the property is going to be subject to a mortgage, then it is important to understand the difference between a recourse and non-recourse loan. A non-recourse loan provides that the borrower is not personal liable for the debt. A recourse loan provides that the borrower is personally liable for the debt. If a non-U.S. citizen, non-U.S. resident dies owning a residence in the U.S. subject to a non-resource loan, then only the net equity value is included in the estate. However, if the property was subject to a recourse loan, then the full fair market value of the residence is included in the estate with only a portion of the loan being deductible only if the worldwide assets are disclosed.

Since the non-resident alien should not directly hold U.S. real property to avoid the U.S. estate tax on real property, the preferred structure is have the U.S. real property owned by a U.S. entity (e.g., Limited Liability Company) and then the U.S. entity would be owned by a foreign entity. The non-resident alien would then own an interest in a foreign entity which will remove the U.S. real property from U.S. estate tax.

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PLANNING FOR NON-U.S. CITIZEN SPOUSES

In order to understand the tax implication for transferring assets to a non-U.S. citizen spouse, it is important to understand the U.S. estate and gift tax implications for a U.S. citizen spouse. In general, an unlimited marital deduction from U.S. estate and gift tax is available, so that U.S. citizen spouses may transfer assets to one another without the imposition of any U.S. estate and gift tax.

DOES THE U.S. ESTATE TAX MARITAL DEDUCTION APPLY TO TRANSFER TO A NON-U.S. CITIZEN SPOUSE FROM A U.S. CITIZEN SPOUSE?

Unfortunately, the estate tax marital deduction is not available where the surviving spouse is not a U.S. citizen. This is true even if the surviving spouse holds a U.S. green card. However, the lifetime exemption amount (currently $11,180,000) is available to offset estate tax on transfers to the non-U.S. citizen spouse or a trust for the benefit of a non-U.S. citizen spouse.

ARE THERE ANY EXCEPTIONS TO THE GENERAL RULE THAT THE U.S. ESTATE TAX MARITAL DEDUCTION IS NOT AVAILABLE WHERE THE SURVIVING SPOUSE IS A NON-U.S. CITIZEN? YES, THERE ARE THREE EXCEPTIONS:

- A decedent may transfer assets to the surviving non-U.S. citizen spouse without incurring estate tax if the assets pass to a Qualified Domestic Trust ("QDOT") for the benefit of the surviving spouse. The estate tax will be deferred until principal is distributed to the surviving spouse during the surviving spouse's lifetime (estate tax is incurred with each distribution). Upon the death of the surviving spouse, the balance of the trust will also be subject to estate tax. The QDOT may be created by the decedent, the decedent's executor or the surviving spouse. If the QDOT is created by the surviving spouse, and the surviving spouse is not a U.S. income tax resident, then the QDOT can be structured as a grantor trust to the surviving spouse. This will allow the QDOT to avoid any potential throwback taxes and accumulation distributions which will be very beneficial to the remainder beneficiaries if one or more of them are U.S. citizens or residents. Finally, before the QDOT is chosen as the planning vehicle, you must consult with counsel from the jurisdiction of the surviving spouse to determine whether the use of a QDOT will result in an adverse income tax.
- The marital deduction will apply to assets being transferred to the surviving non-U.S. citizen spouse if the surviving spouse becomes a U.S. citizen before the filing of the estate tax return and was domiciled in the U.S. at all times between the death of the decedent and the date the surviving spouse became a U.S. citizen.
- An estate tax treaty between the U.S. and the country of origin for the deceased spouse may provide for a marital deduction equal to a prorated unified credit amount. If the marital deduction under the treaty is desired, then an election must be made by the decedent's executor. If the treaty benefit is elected, then a QDOT cannot be used.

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Accordingly, the treaty election may not be the desired choice if the assets passing to the surviving non-U.S. citizen spouse exceed the prorated unified credit amount determined under the treaty.

DOES THE U.S. ESTATE TAX MARITAL DEDUCTION APPLY TO TRANSFERS TO A U.S. CITIZEN SPOUSE FROM A NON-U.S. CITIZEN SPOUSE?

If the non-U.S. citizen spouse is a resident of the U.S., then transfers to the U.S. citizen spouse will be entitled to the unlimited marital deduction. As a resident, the lifetime exemption amount (currently $11,180,000) is available to the non-U.S. citizen spouse. If the non-U.S. citizen is not a resident of the U.S., then transfers of U.S. situs assets to the U.S. citizen spouse are entitled to the unlimited marital deduction and transfers of non-U.S. situs assets will not be subject to U.S. estate tax. U.S. situs assets include U.S. real estate and tangible personal property located in the U.S. Shares of stock in U.S. corporations, debt obligations of U.S. persons and certain intangible property rights issue by or enforceable against U.S. persons are usually subject to U.S. situs assets for estate tax purposes. However, an estate tax treaty may exempt some items from U.S. tax. Although the transfer of non-U.S. situs assets to the U.S. citizen spouse will not be subject to estate tax, those assets will become part of the surviving U.S. citizen spouse's estate subject to U.S. estate tax. In order to avoid the inclusion of those assets in the surviving spouse's estate, the non-U.S. citizen (who is also a non-U.S. resident) spouse should consider transferring the non-U.S. situs assets to a trust for the benefit of the U.S. citizen spouse. The trust can be structured to avoid estate tax upon the death of the surviving spouse.

DOES THE U.S. GIFT TAX MARITAL DEDUCTION APPLY TO TRANSFERS TO A NON-U.S. CITIZEN SPOUSE FROM A U.S. CITIZEN SPOUSE?

No. The marital deduction does not apply for transfers to a non-U.S. citizen spouse. In addition, the use of a QDOT is not available to bypass this exception. Finally, the transfer may also be subject to taxation if the couple were residing in a non-U.S. jurisdiction.

ARE THERE ANY EXCEPTIONS TO THE GENERAL RULE THAT THE U.S. GIFT TAX MARITAL DEDUCTION IS NOT AVAILABLE WHERE THE DONEE SPOUSE IN A NON-U.S. CITIZEN?

Yes, there are three exceptions:

- If there is an obligation to support each other (e.g., no prenuptial agreement that provides otherwise), then payments to support the spouses and their family should not be considered gifts between the spouses.
- The U.S. citizen spouse has an annual gift tax exclusion amount for transfers to a non-U.S. citizen spouse. The amount for 2018 is $152,000. In order to qualify for the annual exclusion, the gift must otherwise qualify for the marital deduction (if made to a U.S. citizen spouse) and be a present interest.

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- Payments made directly to medical care providers or educational institutes on behalf of the non-U.S. citizen spouse are not treated as gifts.

DOES THE U.S. GIFT TAX MARITAL DEDUCTION APPLY TO TRANSFERS TO A U.S. CITIZEN SPOUSE FROM A NON-U.S. CITIZEN SPOUSE?

Yes. The unlimited U.S. gift tax marital deduction applies to transfers to a U.S. citizen spouse because the citizenship or domicile of the donor is irrelevant.

CAN A NON-U.S. CITIZEN SPOUSE AND U.S. CITIZEN SPOUSE SPLIT A GIFT?

Yes, only if the non-U.S. citizen spouse is domiciled in the U.S.

CAN A NON-U.S. CITIZEN SPOUSE MAKE ANNUAL EXCLUSION GIFTS?

Yes. If the non-U.S. citizen spouse is domiciled outside the U.S., then the non-U.S. citizen spouse is not subject to U.S. gift tax on transfers of non-U.S. situs assets. Thus, the annual exclusion is only applicable on transfers of U.S. situs assets.

DOES PORTABILITY OF DECEASED SPOUSE'S UNUSED LIFETIME EXEMPTION APPLY TO A NON-U.S. CITIZEN SPOUSE?

If the non-U.S. citizen spouse is not domiciled in the U.S., then the deceased U.S. spouse's unused lifetime exemption is not portable to the non-U.S. citizen spouse. If the non-U.S. citizen spouse is domiciled in the U.S., then the deceased U.S. spouse's unused lifetime exemption is portable to the non-U.S. citizen spouse. Accordingly, if the non-U.S. citizen spouse is not domiciled in the U.S., then the U.S. citizen spouse must utilize the lifetime exemption amount.

ARE THERE ANY ISSUES IF A U.S. CITIZEN SPOUSE AND NON-U.S. CITIZEN SPOUSE HOLD AN ASSET AS JOINT OWNERS (E.G., TENANCY BY THE ENTIRETIES OR JOINT WITH RIGHTS OR SURVIVORSHIP)?

When both spouses are U.S. citizens, the unlimited marital deduction means that spouse may hold property jointly, with no regard to the amounts contributed by either spouse, without incurring any tax liability. However, the lack of an unlimited marital deduction with respect to gifts or bequests to non-U.S. citizen spouses means that unintended estate or gift tax consequences can result where a U.S. citizen spouse owns property jointly with a non-U.S. citizen spouse. The estate and gift tax implications are as follows:

- **Estate Tax:** If the surviving spouse is non-U.S. citizen, the amount includable in the deceased spouse's estate is the portion of the value of the asset attributable to the contribution made by the decedent spouse. Where the surviving spouse is a non-U.S.

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citizen, the entire value of the jointly held property is included in the decedent spouse's estate unless the decedent's executor submits facts sufficient to show that the property was not entirely acquired with consideration furnished by the decedent or was joint acquired by gift or inheritance. The portion of the value includible in the estate of the decedent spouse would need to be placed into a QDOT in order for such value to escape the imposition of estate tax at death. If the property was a residence and considered homestead property, then the QDOT may not be available.

- **Gift Tax:** The creation of a joint tenancy in real property after July 13, 1988 will not be treated as a taxable gift to a non-U.S. citizen spouse regardless of which spouse provided the consideration. However, upon the termination of the joint tenancy other than by death (e.g., sale), there will be a taxable gift to the extent that the non-U.S. citizen spouse receives a greater share of the proceeds than the share representing the spouse's contribution. Regarding personal property, the general rule is that the creation of a joint tenancy after December 31, 1953 is treated as a taxable gift made by the contributing U.S. citizen spouse to the non-contributing non-U.S. citizen spouse upon the creation of the joint tenancy of one-half of the value of the property. However, this general rule usually does not apply to the creation of a joint brokerage account or joint bank account because most jurisdictions treat the transfer as revocable and an incomplete gift. If the contributing spouse cannot unilaterally withdraw the funds or the state treats the creation of the account as a completed gift (e.g., New York), then a gift may occur upon the creation of the account. Unfortunately, the IRS has not been consistent in its treatment of such accounts. If the creation of the account is considered non-taxable, then the withdrawal of funds from the account may be a taxable gift.

ARE THERE ANY ISSUES IF A NON-U.S. CITIZEN SPOUSE TRANSFERS ASSETS TO A DESCENDANT?

If the non-U.S. citizen spouse is domiciled in the U.S., then the spouse will have access to the full lifetime exemption amount available to U.S. citizens. However, if the non-U.S. citizen spouse is not domiciled in the U.S., then the spouse will only be subject to U.S. gift tax or estate tax on the U.S. situs assets transferred to a descendant. Since the non-U.S. citizen spouse will only have access to a nominal exemption (annual exclusion amount for gifts and a $60,000 lifetime exemption amount for estate tax), the ownership and transfer of U.S. situs assets must be carefully planned.

IS THE SALE OF ASSETS FROM A U.S. CITIZEN SPOUSE TO A NON-U.S. CITIZEN SPOUSE CONSIDERED A TAXABLE EVENT?

In general, a sale of assets between spouses is a non-taxable event. This is also true if the purchasing spouse is a non-U.S. citizen as long as the spouse is a U.S. tax resident. However, if a U.S. citizen spouse is selling an asset to a non-U.S. citizen spouse who is not a U.S. tax resident, then the sale will be a taxable event to the selling spouse.

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ARE THERE TAX ISSUES IF A NON-U.S. CITIZEN SPOUSE WHO WAS A U.S. RESIDENT DECIDES TO MOVE BACK TO HIS OR HER COUNTRY OF ORIGIN?

Yes. A non-U.S. citizen who has been a resident of the U.S. for at least eight out of fifteen taxable years is considered a Long-Term Resident (the length may be different under an income tax treaty between the United States and the spouse's country of citizenship). If a Long-Term Resident moves from the U.S. resulting in the cessation of their status as a U.S. resident, then the Long-Term Resident will be deemed to have expatriated from the U.S. This may result in an exit tax on the built-in gain of the spouse's worldwide assets. In addition, if the spouse subsequently transfers any assets to a U.S. resident or U.S. citizen, then the transfer will be subject to a 40% transfer tax. Another trap is that a non-U.S. citizen spouse may cause an accidental expatriation if the spouse makes an election under a tax treaty that results in the shift of residency from the U.S.

ARE THERE ANY ISSUES IN NAMING A NON-U.S. CITIZEN SPOUSE AS A FIDUCIARY?

Yes. The naming of a non-U.S. citizen spouse who is not resident in the U.S. as a Trustee of a Trust and giving the spouse substantial decisions under the Trust can result in the Trust being classified as a Foreign Trust. In addition, naming the spouse as a Trustee may pull the Trust into the spouse's country of residence (or citizenship) and subject the Trust to tax in that country. Finally, state law may prohibit the naming of a non-U.S. citizen spouse who is not resident in the U.S. as a fiduciary.

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ISSUES WITH NAMING FOREIGN BENEFICIARIES

The U.S. and non-U.S. tax implications must be considered before a non-U.S. citizen who is neither residing or domiciled in the U.S. is named as a beneficiary ("foreign beneficiary") of an estate plan.

There are three cardinal rules for transferring assets to a foreign beneficiary:

- Minimize a foreign beneficiary's U.S. situs assets to avoid U.S. estate tax.
- Minimize a foreign beneficiary's taxable U.S. source income to avoid U.S. income tax.
- Minimize the imposition of double taxation on distributions from trusts to a foreign beneficiary.

WHAT ARE U.S. SITUS ASSETS FOR ESTATE TAX PURPOSES?

The following assets are considered U.S. situs assets for estate tax purposes: (i) real estate located in the U.S.; (ii) tangible personal property located in the U.S.; (iii) shares of stock of U.S. corporations (including, shares of co-ops); (iv) money market accounts with U.S. mutual funds; (v) cash deposits with U.S. brokers; (vi) cash in U.S. safety deposit boxes; (vi) debts of U.S. obligors (however, publicly traded bonds issued after July 18, 1984 are considered non-U.S. situs); (vii) interests in partnerships that transact business in the U.S. or own assets in the U.S.; and (viii) cash surrender value of U.S. life insurance owned by a foreign beneficiary on the life of another person. An estate tax treaty could alter the definition of U.S. situs assets. Accordingly, you will need to verify whether a treaty is applicable.

WHY SHOULD A FOREIGN BENEFICIARY AVOID TAKING TITLE TO U.S. SITUS ASSETS?

A non-U.S. citizen who is not domiciled in the U.S. ("non-resident alien") is subject to U.S. estate tax on U.S. situs assets. The estate tax rate is the same as for U.S. citizens. However, the exemption amount is only $60,000 (unless increased under a treaty). Finally, debts and administration expenses may be deducted in proportion that the U.S. situs assets bears to the worldwide assets.

If the foreign beneficiary receives U.S. situs assets from an individual or an estate or trust, then the foreign beneficiary will be creating an estate subject to U.S. estate tax. Instead of receiving the U.S. situs assets, you should consider whether the U.S. situs assets can be sold and converted to non-U.S. situs assets (any assets that are not listed as U.S. situs assets). Another option is that the foreign beneficiary should hold U.S. situs assets through foreign corporations or foreign trusts. The use of a foreign corporation or foreign trust to hold U.S. situs assets will not cure the U.S. income taxation of U.S. source income earned from the U.S. situs assets. The transfer of U.S. real estate to a foreign corporations or foreign trusts may result in an income tax consequence.

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WHAT IS U.S. SOURCE INCOME?

A non-resident alien is taxed on U.S. source income. The tax is generally a 30% withholding rate. However, an income tax treaty may be in effect that reduces the withholding rate. U.S. source income is as follows: (i) dividends from U.S. corporations (gain from the sale of U.S. securities is not taxable); (ii) rent from U.S. real property; (iii) gain from the sale of U.S. real property; (iv) interest on debts of U.S. obligors (however, interest on publicly traded bonds issued after July 18, 1984 are non-U.S. situs); (v) salaries paid by U.S. entities and non-U.S. entities for services performed in the U.S.; and (vi) U.S. royalties. Income earned in connection with the conduct of a trade or business is subject to income tax at the same graduated rates as a U.S. resident or U.S. citizen.

Since publicly traded bond income is exempt from U.S. income tax, the foreign beneficiary may benefit from replacing U.S. rental income and dividends from U.S. stocks with bond income.

HOW CAN A DOUBLE TAX OCCUR ON A DISTRIBUTION FROM A TRUST TO A FOREIGN BENEFICIARY?

Most countries do not have laws that deal with trusts. In those countries, the tax authorities and courts have had difficulty in trying to classify a distribution from a trust to a beneficiary that is residing in that country. Some countries will classify the trust as a corporation and tax the distributions to the beneficiary as ordinary income. Some countries will tax not only the income distributions but also tax principal distributions as ordinary income or a taxable gift. The non-U.S. taxation of the distributions to a foreign beneficiary must be considered. If the foreign beneficiary is taxed on the trust distribution, then a double tax can occur if the income being distributed to the foreign beneficiary was also taxed in the U.S. If the taxpayer in the U.S. is not the foreign beneficiary, then the double taxation relief under an income tax treaty and foreign tax credits under the Internal Revenue Code will not be of help since there are two different taxpayers. Another issue to be weary of is that some countries will treat all of the trust income as taxable to the foreign beneficiary even though it is not distributed.

An example of the double taxation can be found with a U.S. grantor trust. With respect to a U.S. grantor trust, the trust income is taxable to the grantor rather than to the trust or beneficiaries. If there is a foreign beneficiary of the trust and income or principal is distributed to the foreign beneficiary, then the country where the foreign beneficiary resides is more likely than not to tax the foreign beneficiary on the distributions. Since the grantor paid the U.S. income taxes and the foreign beneficiary is paying foreign income taxes (or gift taxes) on the receipt of the income, a double tax will occur. a Treaty or the code will not provide any relief since the taxpayers are different.

IS THERE A WAY TO AVOID THE DOUBLE TAXATION TRAP?

In order to avoid the double taxation, it would be necessary to avoid the use of a grantor trust. If the trust is a non-grantor trust, then the trust would pay the income tax on the trust income.

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However, if the trust distributes the income to the beneficiaries, then the trust can deduct that income from its taxable income, to the extent that such income enters into the trust's distributable net income ("DNI") for the year. The DNI deduction allows the trust to allocate its taxable income to the beneficiaries that receive the income. The DNI deduction applies to distributions to U.S. beneficiaries and foreign beneficiaries. A planning technique is that if the income is considered non-U.S. situs income, then the foreign beneficiary does not have to pay U.S. income tax on it. This is true even though the trust avoided income tax on the income by claiming a DNI deduction. You will need to check to see if an income tax treaty alters the definition of U.S. source income and the applicable tax rates.

If the beneficiary is a foreign beneficiary, then the foreign beneficiary would receive a trust distribution of income that may or may not be subject to U.S. income tax depending on whether it is U.S. source income. The foreign beneficiary most likely would owe tax to the beneficiary's country of residence. If there was tax paid in both the U.S. and the foreign country, then a foreign tax credit may be allowed to offset the double tax.

IF A FOREIGN BENEFICIARY RECEIVES A DISTRIBUTION FROM A U.S. CITIZEN OR U.S. TRUST/ESTATE, DOES THE U.S. PERSON OR FIDUCIARY HAVE A REPORTING REQUIREMENT TO THE FOREIGN BENEFICIARY OR FOREIGN BENEFICIARY'S COUNTRY OF RESIDENCE?

In general, distributions to a foreign beneficiary require the withholding of tax. A distribution of income to a foreign beneficiary will require the U.S. person to file a Form 1042, Annual Withholding Tax Return for U.S. source Income of Foreign Persons. In addition to Form 1042, the U.S. person must also file Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, and Form 1042-T, Annual Summary and Transmittal of Forms 1042-S. If the foreign beneficiary wants to claim that the income is not subject to tax or subject to a lower withholding rate, then the beneficiary must provide the U.S. person with Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, or Form W-8ECI, Certificate of Foreign Person's Claim that Income is Effectively Connected with the Conduct of a Trade or Business in the United States. If the foreign beneficiary feels that the U.S. tax liability was not fully satisfied by the withholding, then the foreign beneficiary must file a Form 1040NR, U.S. Nonresident Alien Income Tax Return. Finally, the U.S. person responsible for withholding taxes on the distribution to the foreign beneficiary should request the foreign beneficiary to obtain an individual taxpayer identification number (ITIN) by filing Form W-7, Application for IRS Individual Taxpayer Identification Number. The Form W-7 can be complicated for a foreign beneficiary due to the documentation required by the IRS. In addition, it can take four to six weeks to obtain the ITIN. The ITIN is required if the foreign beneficiary wants to claim a treaty benefit under Form W-8BEN or Form W-8ECI.

In addition to the various filings in the U.S., the foreign beneficiary may also have reporting requirements to the beneficiary's country of residence. The U.S. person who is acting as an executor of an estate or Trustee of a trust should also confirm that the U.S. person is not required to also file an annual statement with the foreign beneficiary's country of residence.

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THE WORLD OF CHARITABLE GIVING OPPORTUNITIES

The opportunity for philanthropic giving is vast and ranges from simply writing a check to your favorite charity to implementing a comprehensive and through charitable giving plan to last for generations as part of your family legacy. Here we review some of the techniques that may of interest to you.

WHAT IS A CHARITABLE LEAD TRUST?

A charitable lead trust is a trust that makes annual or more frequent payments to one or more charities for the charitable term. The charitable term can be a fixed number of years or it can be based on the lifetime of the donor or certain related individuals. At the end of the charitable term, any property remaining in the lead trust is distributed or held in further trust for individual beneficiaries (typically the donor's children or grandchildren). The amount paid to charity each year may be an annuity (a stated dollar amount) or a unitrust interest (a stated percentage of the value of the trust assets, as calculated annually). There is no minimum or maximum percentage that must be paid to charity. The percentage or amount to be paid to charity can remain the same each year or can be designed to increase over the charitable term.

WHY WOULD A CLAT BE OF INTEREST TO ME?

A charitable lead trust can be used to make a future gift to individuals while satisfying the donor's charitable goals.

When the donor funds a lead trust, he or she makes one gift to charity that is deductible for gift or estate tax purposes and a second, taxable, gift to the individuals who will receive the trust property when the charitable term ends. The value of the charitable gift is the present value of the stream of payments to be made to charity over the charitable term, determined by using the lowest applicable federal discount rate in effect at the time the trust is funded. The value of the taxable gift to the individual beneficiaries of the lead trust is the difference between the value of the property used to fund the trust and the value of the charitable gift.

The applicable federal discount rate used to value the donor's taxable gift to the lead trust is the government's assumption as to the expected rate of return for the trust's investments at the time of funding. The potential for the trust's actual investment performance to exceed the government's assumption presents an opportunity for the donor to make a tax-advantaged gift to individuals by using a charitable lead trust to make the donor's charitable gifts. If the annual rate of return on a charitable lead annuity trust's investments exceeds the federal discount rate used to value the charitable gift to the trust, all of the excess investment return will accrue for the benefit of the individual beneficiaries at no further gift or estate tax cost. With a charitable lead unitrust, the charity and the individual beneficiaries share the benefit of the excess investment return based on their relative interests in the trust.

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The benefits of using an annuity trust to transfer property to individuals must be weighed against the generation-skipping transfer tax advantages of using a unitrust when grandchildren or more remote descendants are the beneficiaries.

A charitable lead annuity trust can be structured to "zero out" the taxable gift so that no portion of the donor's lifetime exemption from gift tax is used and no gift or estate tax liability is incurred in connection with the lead trust. To zero out the taxable gift, the donor selects a charitable term and payment amount that, using the applicable federal discount rate, creates a charitable gift that is equal in value to the value of the entire property used to fund the lead trust. If the trust's investments earn an annual rate of return that exceeds the federal discount rate, assets will be distributed to the individual beneficiaries at the end of the charitable term at no gift or estate tax cost. A charitable lead unitrust can also be structured to reduce, but not to "zero out," the taxable gift.

IS THERE AN INCOME TAX BENEFIT TO CREATING A CLAT?

Generally, when a charitable lead trust is created for gift or estate tax planning purposes, it is not structured to qualify for a federal income tax charitable deduction.

A lead trust gift that does not qualify for an income tax charitable deduction can still be useful to the donor for income tax purposes. Although the donor receives no income tax charitable deduction for funding the trust, the trust's income will not be includible on the donor's tax return. For a donor whose charitable deductions already exceed the amount he or she can use to offset taxable income, this type of lead trust can generate an indirect tax deduction for the donor because the trust's income will be taxed to the trust, instead of the donor. Although the lead trust will report and pay tax on its own income, it is allowed an unlimited deduction for income it distributes to charity. Generally, if the lead trust's taxable income each year does not exceed the amount it pays to charity for the year, the trust will not pay any income tax.

If the donor wishes to receive an income tax deduction for funding a charitable lead trust, the donor must create a special kind of trust that is treated as if it were owned by the donor for income tax purposes. This means that in order to claim an income tax deduction for funding a lead trust, the donor must be willing to report all of the trust's annual income and gains on his or her individual tax return. The donor's only income tax deduction will be for funding the trust. The donor will not be able to claim any additional deductions when the trust makes its payments to charity each year. If the donor dies during the charitable term, a portion of the tax deduction benefit the donor received from funding the lead trust will be included as income on the donor's final income tax return.

This type of lead trust can be useful when the donor is in an exceptionally high income tax bracket in the year the donor funds the trust and expects to be in a lower income tax bracket in subsequent years when the trust's income will be taxed to the donor. The donor's deduction for funding the trust is equal to the value of the charitable gift, subject to certain limitations that are based on the type of property used to fund the trust, the status of the charity as a public charity

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or a private foundation, and the rules limiting how much income the donor can offset with a charitable deduction in any year (the maximum amount is 30% of adjusted gross income).

In appropriate planning situations, a "super charitable lead trust" can be created to combine the income, gift and estate tax advantages of the two types of charitable lead trusts. The structure of a super lead trust is more complicated because the donor must create a trust that will be treated as if it were owned by the donor for income tax purposes, but do so in a manner that does not cause the trust to fail to achieve its intended gift and estate-tax advantages. The donor must also be in such a financial position that the donor's obligation to pay tax on the lead trust's income and gains for a number of years (e.g., 10 to 25 years) would be viewed as a tax-planning opportunity rather than a burden.

Please note that the federal discount rate is recalculated each month. The lower the rate, the easier it is to structure a charitable lead annuity trust that will "zero out" the taxable gift. Donors have some planning flexibility because they can use the discount rate in effect in the month they fund a lead trust or the rate that was in effect in either of the two preceding months.

WHAT ARE THE BASICS OF CHARITABLE LEAD ANNUITY TRUST ADMINISTRATION?

Administration of a Charitable Lead Annuity Trust (the "CLAT" or "trust") involves investing the trust's assets, making timely annuity payments to the Charitable Beneficiary, preparing and filing returns in a timely manner, and accounting for the trust's administration.

DO THE ASSETS USED FOR FUNDING AFFECT THE INCOME TAX CONSEQUENCES TO YOU AND THE ADMINISTRATION OF THE CLAT?

If a donor wishes to transfer assets other than cash, cash equivalents and unrestricted publicly traded securities to a CLAT, the donor should review the funding plan with his or her accountant and legal counsel to confirm the income tax consequences of the proposed gift to the donor, as well as the tax and administration consequences to the trust and the trustees of accepting and holding the proposed gift.

Funding the CLAT with appreciated assets will not cause the donor to recognize capital gain, and the unrealized appreciation will not be a preference item for AMT purposes on the donor's income tax return. However, if the CLAT must pay a large capital gains tax in order to reinvest low basis assets contributed to the trust, it will be harder for the CLAT to make all the required annuity payments and build up property to be distributed to the remainder beneficiaries when the charitable term ends.

Care should be taken to ensure that the funding of the CLAT is not deemed to be an "assignment of income" by the donor. If a CLAT is funded with appreciated property that is subject to a binding sales contract or any agreement or understanding under which the trustees are obligated to sell the property to a third party, the donor will recognize gain on his or her personal income tax return when the trust sells the property. Caution should also be exercised if

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the donor transfers stock in a closely held corporation during an ongoing tender offer and pending merger that the donor has participated in negotiating and planning. In such a case, the donor could be deemed to have already converted the stock into a fixed right to receive cash at the time the stock is contributed to the CLAT.

The CLAT does not qualify as a shareholder of S corporation stock.

If the CLAT will hold more than 2% of the ownership interests in any business enterprise (corporation, partnership, other entity), the trustees should consult legal counsel with respect to the application of the excess business holdings rules.

Holding or making investments in entities that are disqualified persons, as well as co-investing with or holding investments in common with disqualified persons can create a variety of self-dealing problems. The trustees should review the private foundation self-dealing rules to confirm that the CLAT's investment plan will not give rise to any potential self-dealing issues.

Care should be taken before funding a CLAT with or investing it in stock of a donor-controlled corporation, stock subject to a voting trust, or policies of insurance on the life of the donor and/or the donor's spouse, and before funding a CLAT with property encumbered by a mortgage or other similar lien. While there are certain exceptions that may be applicable in a given situation, generally a donor risks that a gift of mortgaged property to a CLAT will generate relief of indebtedness income and be taxed as a bargain sale, be a prohibited act of self-dealing at the time the gift is made and when the CLAT makes payments on the debt, and give rise to debt-financed income as to which only a portion (not more than 50%) can be sheltered from income tax by the annuity amounts paid to charity.

MUST THE TRUSTEES BE SENSITIVE TO CERTAIN REQUIREMENTS?

To minimize the income taxes that a CLAT must pay, trustees should consider avoiding borrowing and debt-financed investments (mortgaged property, margined securities accounts, partnerships with debt-financed investments) as well as interests in a partnership or other pass-through entity that operates an active trade or business or holds debt-financed property. Such investments produce unrelated business taxable income or debt-financed income, and annuity payments made to charity will shelter only a portion (up to 50%) of such income from tax.

The CLAT is a taxable trust. It will be subject to income tax to the extent that its gross income exceeds its deductions. It is not subject to alternative minimum tax. The trustees must file a federal fiduciary income tax return (Form 1041) and split-interest trust information return (Form 5227) with the Internal Revenue Service each year. The trust's Form 5227 (other than Schedule A) will be open to public inspection. The trustees may also need to file a state fiduciary income tax return depending on the situs of the trust.

The CLAT will be entitled to a charitable deduction each year for the gross income of the trust that is distributed to the Charitable Beneficiary when the annuity payment is made.

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The trustees may need to register the trust and file annual reports depending on the situs of the trust. For example, the trustees of a New York CLAT are required to register the trust within six months of its funding and to file annual reports (Form CHAR004) within six months following the end of each taxable year of the trust with the Charities Bureau of the New York Attorney General's Office.

Annuity payments must be made each year in a timely manner and in accordance with the provisions in the trust document regarding frequency of payments. Failure to make the payments in a timely manner can give rise to private foundation excise (penalty) taxes.

CLATs are subject to the private foundation excise tax rules under Code section 4945 that prohibit the trustees from making taxable expenditures. If the charities are named in the trust and their shares are fixed by the terms of the trust, the trustees may simply distribute the annuity amount to the named charities in the shares stated in the trust.

If, however, the trustees have discretion to select the charities to receive the annuity amount or to determine their respective shares of the annuity amount, then the trustees must follow special procedures when making annuity payments in order to avoid incurring a penalty tax and having to try to recover the payments made. If the trustees document that the charities are 501(c)(3) tax-exempt organizations that have been classified by the IRS as "other than" private foundations because they are described in Internal Revenue Code section 509(a)(1) or (2) ("501(c)(3) publicly supported charities"), the trustees may simply pay the annuity amount to those charities. If, however, the trustees determine that a charity is not a 501(c)(3) publicly supported charity (for example, a 501(c)(3) charity that is classified as a private foundation, a private operating foundation, or a 509(a)(3) supporting organization), then the trustees must obtain certain additional documentation required by the IRS and/or use a grant agreement and require annual grant reports from the charity in connection with any annuity payments made to that charity.

The trustees may wish to prepare informal accountings and request that the beneficiaries release them from personal liability in connection with the trust's administration. The trust document describes the information to be provided in an informal account. Or, the trustees may file periodic court accountings, with notice to the specific state's Attorney General's office (which would represent all charitable beneficiaries) in order to ensure that the trustees are effectively released from personal liability in connection with their administration of the trust.

WHAT IS A CHARITABLE REMAINDER UNITRUST?

The Charitable Remainder Unitrust ("CRUT") can be an effective means for diversifying highly appreciated assets while avoiding or postponing capital gains tax, increasing cash flow during your lifetime, obtaining a current income tax deduction and providing for your favorite charities upon your death. The concept is extremely simple: you transfer a highly appreciated asset to a trust, retaining the right to receive payments from the trust for your life. On your death, the charities you wish to benefit receive the assets remaining in the trust. The trust is included in your taxable estate, but qualifies for the estate tax charitable deduction.

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The tax advantages of the CRUT come primarily from its tax-exempt status, which allows the trust to sell appreciated assets without paying any capital gains tax, and from the income tax deduction generated when you fund the trust.

IS THERE AN INCOME TAX DEDUCTION AVAILABLE FOR IMPLEMENTING A CRUT?

Your income tax deduction for funding a CRUT is limited to the present value of the charity's right to receive the assets remaining in the trust at your death. If you fund the CRUT with assets that, if sold by you, would generate a long-term capital gain, your income tax deduction generally will be calculated using the fair market value of the appreciated assets. Nevertheless, you will not be required to recognize any gain when you fund the trust, either for regular income tax or for AMT purposes. If your CRUT will benefit a private foundation, then your deduction will be calculated using your basis in the assets contributed to the CRUT unless you fund the CRUT with "qualified appreciated stock" (basically, unrestricted publicly traded securities). There are "percentage limitation" rules that limit how much of your adjusted gross income can be sheltered from income tax in any year with a charitable deduction. Excess deductions can be carried forward for up to five years. It is important to work with your accountant to confirm the actual tax benefits that can be achieved by funding a CRUT with a particular asset.

The value of the charitable remainder interest in the CRUT must be at least 10% of the value of the assets contributed to the trust. The value of the charitable interest is a function of (i) the length of time that payments will be made to you; (ii) the percentage of the trust assets that will be distributed to you each year, and the frequency with which payments will be made during the year (monthly, quarterly, semi-annually, or annually); (iii) the fair market value of the property being contributed to the trust at the time of the contribution; and (iv) the current IRS actuarial tables and interest rates used to calculate future values.

WHAT PROVISIONS MAY BE INCLUDED IN THE CRUT?

The CRUT trust document may allow for the following:

- The trust would make distributions to you for life, and upon your death, the remaining trust property would be transferred or held in further trust for one or more U.S. charities.
- During the term of the CRUT, you would receive a set percentage (at least 5%, but not more than 50%) of the fair market value of the trust's assets, as redetermined each year (the "unitrust amount"). The unitrust amount must be paid in accordance with the terms of the trust, that is, in monthly, quarterly or semi-annual installments, or annually. The CRUT may not make any other distributions to you.
- When you receive the unitrust amount, it will be taxable to you under the Four Tier system applicable to CRUTs, which treats the unitrust amount as paid first from the trust's ordinary taxable income (from the current year and any undistributed ordinary taxable income from prior years), next from the trust's net capital gains (current and

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prior years), and then from the trust's tax-exempt income. If the amount distributed to you exceeds all the trust's current and previously undistributed income and gains, the excess will be a tax-free return of principal.

- You can be the sole Trustee of your CRUT. If your CRUT holds assets that are difficult to value (restricted stock, closely-held stock, real estate, partnership interests), you must either appoint an Independent co-Trustee to value those assets each year or obtain a qualified appraisal of the hard-to-value assets each year.

WHAT ARE THE TAX IMPLICATIONS OF CREATING THE CRUT?

If you and/or your spouse are the beneficiaries of the CRUT, the objective is to diversify highly appreciated assets in a tax-efficient manner and to secure an income tax deduction for funding the trust. Your retained interest in the trust is not a taxable gift. If your spouse has an interest in the trust, then gift and estate tax deductions will be allowed for your spouse's interest as long as your spouse, or you and your spouse, are the only non-charitable beneficiaries and your spouse is a U.S. citizen. Gift and estate tax deductions also will be allowed for the charitable remainder interest in the trust.

If someone other than you or your spouse is the beneficiary of the CRUT, the objective will be to benefit that individual with a stream of payments over the individual's life. The charitable remainder interest in the trust will reduce your taxable gift to the beneficiary of the CRUT, but you will use gift tax credit and/or will pay gift tax on that gift. Because the CRUT is a tax-exempt trust, the normal adverse consequences of using low basis assets to make a gift to someone are mitigated to some extent, and your income tax deduction for funding the CRUT (and avoidance of recognition of gain when funding the CRUT with low basis assets) may help to offset some of the gift tax cost of funding the CRUT. When you use a CRUT to make a taxable gift, it is important to structure the trust in a manner that will avoid having it included in your taxable estate should you predecease the beneficiary.

WHAT ABOUT THE TAXATION OF THE CRUT ITSELF?

The CRUT is a tax-exempt trust. However, it is extremely important for a CRUT to avoid holding debt-financed property or other investments that produce unrelated business taxable income ("UBTI"). UBTI is subject to a 100% excise tax. The CRUT should be able to avoid UBTI, and the confiscatory excise tax on UBTI, by investing in an unleveraged diversified portfolio of marketable securities. CRUTs should avoid any borrowing and should be very cautious with respect to accepting gifts of and/or investing in mortgaged property, margin accounts, and partnerships and other pass-through entities that may produce UBTI for the trust.

The CRUT's income and gains will be taxed to the beneficiary receiving the unitrust amount when and to the extent that the unitrust amount is treated as paid from the trust's income and gain. The CRUT will keep a record of its undistributed income and gains. If the current year's ordinary taxable income is less than the unitrust amount, some or all of the prior years' ordinary taxable income that has not previously been distributed to the beneficiary will be treated as part

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of the distribution and will be taxed to the beneficiary. If the ordinary taxable income (current and prior years') is less than the unitrust amount, the CRUT's current and prior years' undistributed capital gains will be treated as part of the distribution and will be taxed to the beneficiary. To the extent that the CRUT produces ordinary taxable income, the capital gain realized by the trust from the sale of appreciated assets remains untaxed in the trust. In this way, the tax on the capital gain from the sale of appreciated assets you contribute to the trust is deferred and possibly avoided entirely.

WHO CAN BE THE BENEFICIARY OF THE CRUT?

Any individual can be a lifetime beneficiary of a CRUT, as long as the value of the charitable remainder interest in the CRUT is at least 10% of the value of the assets transferred to the trust.

Any individual, class of individuals (whether or not then living) or any entity (trust, corporation) can be the beneficiary of a CRUT for a term of up to 20 years.

CRUTs that are funded during the donor's life generally benefit the donor and/or the donor's spouse.

CRUTs that are funded upon the donor's death often benefit the donor's spouse or children.

If there are multiple beneficiaries, their interests in the CRUT may be successive interests or joint interests.

If a CRUT benefits both the spouse and other family members, the spouse's interest will not qualify for the marital deduction for gift or estate tax purposes. In such cases, it may be preferable to create a marital trust for the spouse, followed by a CRUT for the children, securing a marital deduction for funding the marital trust, and delaying and reducing the transfer tax to be paid at the spouse's death for the children's interest in the CRUT.

HOW LONG CAN THE CRUT LAST?

A CRUT can last for the lifetime of a beneficiary or the lifetimes of multiple beneficiaries, or for a term of years (not to exceed 20), as long as the value of the charitable remainder interest in the CRUT is at least 10% of the value of the assets transferred to the trust.

CAN YOU GIVE ME AN EXAMPLE OF THE CRUT TAX CALCULATIONS?

If a 60 year old donor establishes a CRUT to pay a 5% unitrust amount to himself for his life, and funds the CRUT with appreciated marketable securities with a basis of $500,000 and a fair market value of $1,000,000, the value of the donor's deductible gift is $383,410. If the donor is age 75 at the time of the transfer, the value of the deductible gift is $603,470. The donor's retained interest in the CRUT is not a gift for gift tax purposes. The gift of the charitable remainder interest is deductible for both gift and income tax purposes. In addition to the benefit of the income tax deduction, the donor defers and/or avoids paying tax on the $500,000 of

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capital gain that the CRUT recognizes (but is not taxed on) when it sells the appreciated securities. The CRUT will be included in the donor's taxable estate at his death with a fully offsetting estate tax deduction.

CAN I CHANGE THE CHARITABLE REMAINDER BENEFICIARY AFTER I FUND THE CRUT?

If you are the beneficiary of the CRUT, you may retain the right to change the charitable remainder beneficiaries by adding and removing charities, restricting how they will use the property to be distributed to them, and changing their relative shares in the remainder interest. If you are not the beneficiary of the CRUT and you do not want to risk having the CRUT included in your taxable estate, you should not retain the right to change the charities, but you may give that right to the beneficiary of the CRUT.

CAN MY PRIVATE FOUNDATION BE THE CHARITABLE REMAINDER BENEFICIARY?

If you are a beneficiary of the CRUT, you can name your foundation as the charitable remainder beneficiary without adverse transfer tax consequences. However, doing so may reduce the benefit of your income tax deduction for funding the CRUT. The percentage limitation rules that determine how much of your adjusted gross income can be offset with a charitable deduction in any year are less favorable for gifts to private foundations, and unless your appreciated property gifts to the CRUT are limited to "qualified appreciated stock," your income tax deduction for those gifts will be determined using your basis in the property rather than its fair market value.

If you are not a beneficiary of the CRUT and want to avoid having the CRUT included in your taxable estate, you should be cautious about naming your foundation as a remainder beneficiary unless you do not serve as a trustee, officer or director of your foundation or your foundation has adopted procedures that prohibit you from participating in decisions regarding the foundation's use of funds received from the CRUT.

DOES A CRUT HAVE TO PAY ME A UNITRUST AMOUNT? WHAT OTHER PAYMENT OPTIONS ARE THERE?

A CRUT distributes to the beneficiary a set percentage of the fair market value of the trust's assets, as revalued each year (a "unitrust amount").

A charitable remainder annuity trust ("CRAT") pays a fixed amount (a stated dollar amount or a percentage of the initial value of the CRAT) to the beneficiary each year.

A CRUT also may pay the beneficiary the lesser of the trust's income and the unitrust amount (an "income CRUT"). Since a CRUT must make each payment to the beneficiary in a timely manner, an income CRUT can be useful when the property that will be used to fund the CRUT is illiquid and does not produce sufficient income to pay the unitrust amount as it comes due. An income

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CRUT also may convert to a regular CRUT upon the happening of a stated event, such as the sale of the illiquid asset, thereafter paying the beneficiary a fixed percentage of the value of the trust's assets, without regard to the amount of income produced by the trust.

CAN I MAKE ADDITIONAL CONTRIBUTIONS TO THE CRUT?

You may make additional contributions to a CRUT. You will be entitled to an income tax deduction for the value of the charitable remainder interest in the additional assets contributed, and to an increased unitrust payment based on the amount added. Before funding the CRUT or making any additional contribution, you need to confirm that the value of the charitable remainder interest will be at least 10% of the value of the assets being contributed to the trust.

You may not make additional contributions to a CRAT.

IS THERE A WAY FOR ME TO USE A CRUT TO DIVERSIFY MY LOW BASIS ASSETS IN A TAX-EFFICIENT MANNER WITHOUT "DISINHERITING" MY FAMILY?

If you and/or your spouse are insurable, you can create an irrevocable trust to purchase and own a policy of insurance on your life or on the joint lives of you and your spouse. You would use a portion of the CRUT distributions to fund the premium payments for the trust. On your death or on the death of the survivor of you and your spouse, the assets remaining in the CRUT would pass to charity and the insurance would be paid to the trust for the benefit of your descendants. If properly structured, the insurance trust and policy would not be included in your taxable estate.

WHAT ARE THE COSTS OF ADMINISTERING A CRUT?

Depending on who serves as trustee and handles the investment of the trust's assets, the CRUT might have to pay trustee fees and/or investment management fees. The trustee must file an information return for the trust each year, and must prepare a Schedule K-1 informing the beneficiary how to report the unitrust payments for income tax purposes. Usually no court costs or court supervision are involved during the beneficiary's life. Some states (for example, New York) require a court accounting to be filed after the interests of the non-charitable beneficiaries expire. There also are costs involved in establishing the trust, such as fees to prepare the trust agreement and gift tax return.

WHAT PROPERTY SHOULD I USE TO FUND A CRUT DURING LIFE? WHAT PROPERTY SHOULD I USE TO FUND A CRUT AT DEATH? WHAT PROPERTY SHOULD I NOT USE?

Generally, funding a CRUT during life with low basis assets that if sold would produce a long-term capital gain will produce the greatest benefit for the donor. If the CRUT will benefit a

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private foundation, it is generally preferable to fund the CRUT with qualified appreciated stock (unrestricted publicly traded securities that if sold would produce a long-term capital gain).

When funding a CRUT at death, it may be advantageous to use assets that are subject to income tax, such as a retirement account.

You should avoid funding a CRUT with mortgaged property, property in which you will continue to own an interest (property that you would own with the CRUT as tenants in common), interests in partnerships that hold debt-financed property or that operate an active trade or business, S corporation stock, assets that are subject to a binding sales contract or any agreement or understanding under which the trustees of the CRUT would be obligated to sell the property to a third party, and during your life, retirement accounts and other assets that would cause you to recognize ordinary income if you transferred them to the trust. Illiquid assets, life insurance policies, options, and tangible personal property also may present issues.

It is advisable to work with your attorney and your accountant to confirm that your plans for funding a CRUT will produce the desired results both with respect to the income tax consequences of your gift and with respect to the administration of and tax consequences to the CRUT.

WHAT ARE THE GENERAL ADMINISTRATION CONCERNS INVOLVED WITH ADMINISTERING A CHARITABLE REMAINDER UNITRUST?

Administration of a Charitable Remainder Unitrust (the "CRUT" or "trust") involves investing the trust's assets, revaluing them annually, making timely unitrust payments to the beneficiaries, preparing and filing returns in a timely manner, providing the beneficiaries with tax information regarding their unitrust payments, and accounting for the trust's administration.

WHAT TYPE OF ASSETS SHOULD BE USED TO FUND THE CRUT?

Funding a CRUT with appreciated property generally produces the greatest income tax benefit for the donor. A donor does not recognize capital gain, for regular income tax, AMT or net investment income tax purposes, when he or she funds a CRUT with long-term capital gain property (appreciated property that, if sold by the donor, would have produced a long-term capital gain). Since the CRUT is a tax-exempt trust, the trustee can sell the appreciated property without incurring any tax liability and re-invest the entire proceeds. The beneficiary of the CRUT will be taxed on the capital gain from the trust's sale only when and to the extent that such gain is received by the beneficiary as part of a unitrust payment. This deferral, and possibly avoidance, of tax on the capital gain makes it advantageous for income tax purposes to fund a CRUT with highly appreciated long-term capital gain property during life.

HOW DOES THE CRUT QUALIFY AS TAX-EXEMPT?

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In order for the trust to qualify as a tax-exempt CRUT and for contributions to the trust to qualify for income, gift and estate tax charitable deductions, the value of the charitable remainder interest in the assets transferred to the CRUT must be at least 10% of the value of those assets at the time of transfer. It is the charitable remainder interest that gives rise to a charitable deduction for income, gift and estate tax purposes.

Before funding a CRUT and before making any additions, the donor (and the trustee) should confirm that the 10% minimum charitable remainder interest test will be satisfied. The IRS discount rate used to value the remainder interest (the "AFR") is adjusted each month. When determining whether the 10% test has been satisfied, the donor should use the AFR in effect in the month the contribution to the trust is made (not the rate for either of the two months preceding the gift).

WHAT ARE THE LIMITATIONS ON THE CHARITABLE INCOME TAX DEDUCTION?

In order for the trust to qualify as a tax-exempt CRUT to which tax-deductible contributions may be made, the charitable remainder organization must be a domestic charity (one formed in the U.S.). In order to secure the most favorable income tax deduction treatment for lifetime gifts to the CRUT, the trust's description of the organizations qualified to receive the remainder interest must exclude private non-operating foundations.

If the CRUT prohibits the distribution of the remainder interest to a private non-operating foundation, then the deduction for contributions of cash or short-term capital gain property to the CRUT can be used to offset a certain amount of the donor's AGI. The deduction for contributions of long-term capital gain property can be used to offset a lesser amount of the donor's AGI. The deduction for long-term capital gain property gifts is determined using the fair market value of the property contributed. The deduction for all other property gifts is based on the lesser of fair market value and the donor's basis. The donor may also elect to have that certain limitation apply to gifts of long-term capital gain property, but only if the donor's deduction for all such gifts is determined using the donor's basis instead of the property's fair market value.

If a private non-operating foundation is named or can be added or substituted as a charitable remainder beneficiary, then the above limitations on current deductibility of gifts to the CRUT will be reduced. In addition, the deduction for all property gifts will be based on the lesser of fair market value and the donor's basis unless the property contributed is unrestricted publicly traded stock which, if sold on the date of the gift, would have produced a long-term capital gain ("qualified appreciated stock"). A fair market value deduction will be allowed for contributions of qualified appreciated stock to a CRUT that benefits or may benefit a private non-operating foundation until the combined qualified appreciated stock gifts of the donor and the donor's family members in a particular corporation total 10% of that corporation's outstanding stock.

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A donor does not need to obtain a "written acknowledgment" of a contribution to a CRUT in order to substantiate the income tax deduction, but must retain a copy of the calculation of the value of the charitable remainder interest in the donor's gift with his or her income tax records.

If the donor contributes assets other than cash to the CRUT, the donor must file a Form 8283 with his or her income tax return in order to claim an income tax deduction for those gifts. Gifts of unrestricted publicly traded securities are reported in Section A of Form 8283; other property gifts must be reported in Section B. A "qualified appraisal" from a "qualified appraiser" is required in order to substantiate the deduction for any property gifts reported in Section B. Without an appraisal, no deduction will be allowed. The date of the appraisal cannot precede the date of the gift by more than 60 days. If within 3 years of the date of contribution, the trustees sell contributed property that was reported in Section B of Form 8283, the trustees must report the sale on Form 8282.

MUST THE TRUSTEES BE SENSITIVE TO CERTAIN REQUIREMENTS?

A CRUT is exempt from federal income tax. However, the trustees must file an information return, Form 5227, with the Internal Revenue Service each year. This return (other than Schedule A) is open for public inspection. Schedule A reports the contributions made to the CRUT during the year, the income accumulated by the CRUT, and the distributions made to the beneficiary. The trustees of a CRUT may be required to file state information returns or register the trust depending on the situs of the CRUT.

Although a CRUT is exempt from federal income tax, if it has any "unrelated business taxable income," including any "debt-financed income," that income is subject to an "excise tax" at a 100% tax rate. If the CRUT conducts an active trade or business or invests in or receives an interest in any partnership or other pass-through entity (a joint venture or an LLC taxed as a partnership) that conducts an active trade or business, the CRUT will have unrelated business income. If the CRUT borrows funds (including use of a margin account to buy securities) or holds mortgaged property, or if the CRUT has an interest in a partnership or other pass-through entity that borrows funds or holds mortgaged property (such as a partnership that owns leveraged real estate investments or debt-financed gas pipelines), then unless an exception applies, the CRUT will have debt-financed income. A CRUT's unrelated business taxable income, including its debt-financed income, is subject to a 100% excise tax and must be reported on Form 4720. The trustees must also include the CRUT's unrelated business taxable income when determining the character for income tax purposes of the unitrust amount paid to the beneficiary. So, notwithstanding that the CRUT has already paid an "excise" tax in an amount equal to this income, to the extent the unitrust payment is deemed to include some or all of this income, it will also be subject to income tax in the hands of the beneficiary.

Unitrust payments must be made each year in a timely manner and in accordance with the provisions in the trust document regarding frequency of payments. Failure to make the payments in a timely manner can disqualify the trust as a CRUT and / or give rise to excise (penalty) taxes. Payment of the unitrust amount can be deferred only in the case of payments attributable to property passing to a CRUT by reason of a donor's death. Payment of the unitrust

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amount attributable to such property may be deferred until all of the funding attributable to the donor's death has been completed.

The trustees may wish to prepare informal accountings and request that the unitrust beneficiary or that all of the beneficiaries release them from personal liability in connection with the trust's administration. The trust document describes the information to be provided in an informal account. Since it is not clear whether a named charity's release of the trustees would be effective to protect the trustees from personal liability if other charities are later added or substituted for the releasing charity, the trustees may prefer to file periodic court accountings, with notice to the Attorney General's office (which would represent all charitable remainder beneficiaries) in order to ensure that the trustees are effectively released from personal liability in connection with their administration of the trust.

When investing a CRUT, the Trustees (and investment counsel) should keep in mind: (a) any applicable state prudent investor law, (b) the private foundation self-dealing rules, and (c) the 100% excise tax on unrelated business taxable income and debt-financed income.

A trust will not qualify as a CRUT if it restricts the Trustees from investing the trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets -- for example, a direction in the trust to retain donated securities or to invest the trust only in the securities of a particular issuer, or to invest only in a particular kind of financial instrument, such as double tax-exempt bonds.

Whether or not Code section 4944 (jeopardizing investments) is applicable to a CRUT, the trust's governing state law may impose its own prudent investor standard and require that the trustees diversify the CRUT's investments, including those contributed to the trust by gift. If a trustee invests the CRUT's assets in a balanced, diversified portfolio designed to meet both the CRUT's current and future needs, neither Code section 4944 nor state prudent investor law should be a concern.

A trust will not qualify as a tax-exempt CRUT if it is a "grantor trust" for income tax purposes. The trustees should review the grantor trust rules before accepting a gift of or investing the CRUT's assets in stock of a donor-controlled corporation, stock subject to a voting trust, policies of insurance on the life of a donor and/or a donor's spouse, or property subject to a mortgage. A gift of mortgaged property may also be a prohibited act of self-dealing, and even if it falls within a self-dealing exception permitting its transfer to the CRUT, may give rise to debt-financed income in the CRUT that is subject to a 100% excise tax.

A CRUT does not qualify as a shareholder of S corporation stock.

If property contributed to a CRUT is transferred subject to a binding sales contract or any agreement or understanding under which the trustees are obligated to sell the property to a third party, the donor will recognize gain on his or her personal income tax return when the trust sells the property. Caution should also be exercised if a donor transfers stock in a closely-held corporation during an ongoing tender offer and pending merger if the donor takes part in negotiating and planning the tender offer and merger, as the donor could be deemed to have

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already converted the stock into a fixed right to receive cash at the time the stock is contributed to the CRUT.

TAX-FREE IRA DISTRIBUTIONS TO CHARITY

For individuals 70½ or older, there is yet another way to make charitable contributions in a tax efficient manner. These donors may make direct charitable gifts from an IRA, including required minimum distributions, of up to $100,000 annually to public charities. This distribution to charity would not be reported as taxable income on the donor's federal income tax return. Donor advised funds, supporting organizations and most private foundations are ineligible donees, but private-operating and pass through (conduit) foundations are allowed. While there is no charitable deduction for IRA distributions, this method avoids tax on otherwise taxable income.

Donors must be mindful of several rules to ensure their distribution is not taxed as income. While all distributions that are made from an IRA during the year in which a person turns 70½ can be applied toward satisfying the minimum distribution requirement, only distributions made on or after reaching age 70½ will avoid taxation as income, so donors should make sure to wait until they have actually reached 70½ before making the distribution. Distributions from most qualify for this tax-free treatment. Distributions from employer-sponsored retirement plans (like SIMPLE IRAs and simplified employee pensions (SEPs)), profit sharing plans, 403(b) plans, 401(k) plans or Keoghs do not qualify for this tax-free treatment. In addition, any charitable distribution from an IRA must be made directly by the IRA's administrator or trustee to a qualified charity and cannot be distributed to the donor first.

WHAT IS A PRIVATE FOUNDATION?

A private foundation is a type of charitable organization. Both tax-exempt private foundations and public charities are both known as "501(c)(3)s" (because they are both exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code), and both qualify to receive contributions that are deductible for income, gift and estate tax purposes. However, a private foundation usually receives its funding from one or a few private sources, while most public charities receive on-going public support for their programs and activities. The principal activity of a private foundation tends to be making grants to public charities and awarding scholarships to individuals. It may, however, operate a direct charitable program, such as a museum, arboretum, homeless shelter, or Meals on Wheels program, in which case it may be appropriate for the foundation to seek recognition from the Internal Revenue Service as a "private operating foundation."

HOW DO I CREATE A FOUNDATION?

A foundation can be created as a corporation or as a trust. Generally, it is easier to form and administer a trust than a corporation. If you establish the foundation as a trust, then certain powers (such as termination and amendment powers) should be included in the trust

agreement to make the trust as flexible as possible. The trustees should also be given the power to incorporate the foundation in case that later becomes desirable.

Normally, the corporate form is chosen when a foundation is expected to engage in activities that expose its managers to a greater risk of liability, such as providing services or goods to or holding facilities open to the public. The trust form is often used when a foundation will carry out its tax-exempt purposes by making grants to other charitable organizations. However, the choice between a trust or corporation may depend on how comfortable you are with corporate governance procedures and, possibly, also on the number of individuals you wish to have participate in governing the foundation.

WHO MAY MANAGE THE FOUNDATION?

There are few restrictions on who may serve as a trustee, director or officer of a foundation (a "foundation manager").

If a foundation is incorporated under Connecticut, Florida or New York law, it must have at least three directors. An individual may serve as both a director and an officer and may hold multiple offices. However, New York law requires, and it is generally better practice for, different individuals to serve as president and as secretary.

If a foundation is formed as a charitable trust, an individual, including the individual who formed the trust, may serve as the sole trustee and control all functions of the foundation, including distributions.

However, there may be advantages to naming several trustees. Consider the following:

- Would you like to have your children or other family members become involved in the process of philanthropy? This is an opportunity for you to involve them in the joys of participatory philanthropy while you are still alive and able to guide them.
- Would the process of selecting charitable recipients of foundation grants benefit from the involvement of persons with different backgrounds and areas of expertise?
- Do your professional advisers share your interest in the foundation? If so, would their professional expertise coupled with their knowledge of your family's goals and objectives be helpful in guiding the foundation?
- If you plan to focus the foundation's grants on one or two charities, would it be helpful to have members of their boards serve as trustees of your foundation?

CAN I RESTRICT THE ACTIVITIES OF FUTURE FOUNDATION MANAGERS?

Yes. If you want to limit the ability of future foundation managers to change your foundation's focus, you can restrict the foundation's charitable purposes in its organizational documents and restrict the power of future foundation managers to amend those purposes. You can also impose legally binding restrictions on the foundation's use of your contributions at the time you make your gifts.

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If you intend to benefit a particular public charity or charities, then you might want to consider creating a supporting organization instead of a private foundation. A supporting organization is organized and operated exclusively to benefit certain identified public charities. It is itself classified as a public charity (rather than as a private foundation) because of its relationship with and responsiveness to the public charities it was created to support. However, a supporting organization cannot be controlled, directly or indirectly, by the persons who create and fund it or their family members. Since a supporting organization is a public charity, contributions you make to it qualify for more favorable treatment under the income tax charitable deduction rules. In addition, most of the so-called "excise tax" rules (discussed below), which are applicable to private foundations, do not apply to supporting organizations. However, the organizational and operational requirements for a supporting organization can be as or more cumbersome to deal with, and certain excise tax rules applicable to supporting organizations are actually more restrictive, than the private foundation excise tax rules.

ARE THERE ANY TAXES PAYABLE BY A FOUNDATION?

Yes. A foundation's annual net investment income (such as, interest, dividends and capital gains) is subject to a 2% excise tax that is, in effect, a tax on the foundation's income. Each year (other than its initial tax year) in which a foundation's charitable distributions equal or exceed its average historic giving ratio plus 1% of its net investment income for the year, this 2% tax on income is reduced to 1%.

If a foundation has unrelated business taxable income, it must pay tax on that income at regular trust or corporate income tax rates. Unrelated business taxable income is income from the conduct of an active trade or business that is not directly and substantially related to carrying out the foundation's charitable purposes (other than by producing revenue for the foundation). A foundation can have unrelated business taxable income if it holds an interest in a partnership or limited liability company that conducts or owns an interest in other pass-through entities that conduct an active trade or business. If a foundation owns stock in an S corporation, all of its share of the S corporation's income and gains, and any gain the foundation recognizes when it disposes of the S corporation stock, will be subject to unrelated business income tax. A foundation's debt-financed income also is subject to unrelated business income tax. The tax applies to the debt-financed portion of the foundation's income and gains from holding or disposing of the debt-financed property, whether the foundation holds property directly (e.g., a margined securities account or mortgaged real property) or indirectly (through a partnership or limited liability company in which the foundation holds an interest).

Other very significant excise (penalty) taxes may be assessed if a foundation fails to make certain required distributions or engages in certain prohibited transactions.

MUST A FOUNDATION MAKE DISTRIBUTIONS?

Yes. Federal law requires a foundation to distribute an amount equal to roughly 5% of the average fair market value of its investment assets to other charitable organizations or to expend

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that amount directly for charitable purposes each year. This requirement is satisfied as long as the amount required to be distributed or expended for any year is distributed or expended by the end of the following tax year. With advance approval from the Internal Revenue Service, the distribution requirement can be satisfied by setting aside an amount for a future project for which immediate expenditure is not feasible (for example, if a foundation plans to build a museum within 5 years). There are substantial penalties for failure to make timely distributions.

ARE THERE OTHER RESTRICTIONS ON HOW A FOUNDATION IS OPERATED?

Yes. A foundation must be operated as the charitable organization that it is and not for private benefit. In addition, certain transactions, investments and expenditures can give rise to excise (penalty) tax liability for a foundation, the "disqualified persons" involved in the transaction, and sometimes also for the foundation's managers (its trustees, directors, officers and certain employees). A foundation's "disqualified persons" include its substantial donors and their family members, its managers and their family members, and certain trusts, partnerships and corporations in which the foregoing hold a significant interest. The transactions that can result in the imposition of penalties include the following:

SELF-DEALING

The following transactions and arrangements between a foundation and a disqualified person are prohibited: any sale, exchange or leasing of property, any loan or extension of credit, and any furnishing of goods, services or facilities. A foundation is also prohibited from paying compensation to a disqualified person or reimbursing a disqualified person for expenses. In addition, any transfer to or use by a disqualified person of a foundation's assets or income is also prohibited. Such transactions and arrangements are prohibited without regard to whether they are fair and beneficial to the foundation.

EXCESS BUSINESS HOLDINGS

Generally, a foundation and its disqualified persons cannot co-own a business. The excess business holdings rules prohibit a foundation and its disqualified persons from holding, in the aggregate, more than 20% of the voting stock of a corporation or the profits interests in a partnership ("permitted holdings"). The permitted holdings are increased to 35% if one or more persons who are not disqualified persons have effective control of the business. Under a safe harbor rule, a foundation will not be treated as having excess business holdings, regardless of how much of the business is owned by disqualified persons, if the foundation owns no more than 2% of the voting stock and no more than 2% in value of all outstanding shares of all classes of stock (voting and non-voting). In determining whether a foundation's interest falls within the safe harbor, the foundation will be treated as owning any interest in the business that is held by a related foundation.

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The excess business holdings tax does not apply to a foundation's interest in an entity if at least 95% of the entity's income is derived from passive sources (for example, a family-owned investment fund holding publicly traded securities).

If the excess business holdings rules apply, then a foundation must dispose of its excess holdings in a timely manner to avoid incurring a penalty tax. Excess holdings received by gift or bequest must be disposed of within 5 years of their receipt. Excess holdings created when a disqualified person purchases additional holdings must be disposed of by the foundation within 90 days. There is no grace period when a foundation purchases excess business holdings.

When disposing of excess business holdings, a foundation must be cognizant of the self-dealing rules that prohibit sales to disqualified persons. A narrow exception to the self-dealing rules permits a business entity that is a disqualified person to redeem a foundation's excess business holdings as part of a general redemption offer, but the business entity may not issue a note to the foundation to pay for the shares it redeems.

INVESTMENTS WHICH JEOPARDIZE CHARITABLE PURPOSE

A foundation is prohibited from investing its assets in a manner that jeopardizes its ability to carry out its exempt function. The statute does not prohibit any particular investment. Rather, it imposes a duty to use ordinary business care and prudence to provide for a foundation's long-term and short-term needs. Diversification is prudent; speculation must be avoided.

TAXABLE EXPENDITURES

A foundation is prohibited from lobbying or otherwise attempting to influence legislation, from participating in or intervening in any political campaign on behalf of or in opposition to any candidate for public office, and from making any expenditure that is not for one or more of its exempt purposes. Unless certain requirements are satisfied, a foundation is also prohibited from operating a voter registration drive, making scholarship or similar types of grants to individuals or making grants to entities other than U.S. publicly supported charities. Although public charities are permitted to engage in a limited amount of lobbying and private foundations are prohibited from engaging in any amount, a private foundation may make a general support grant to a public charity that engages in lobbying without having the public charity's lobbying attributed to it.

WHAT ARE THE ALTERNATIVES TO A FOUNDATION?

We have mentioned above some circumstances that indicate when a private operating foundation or a supporting organization might be an appropriate alternative to a grant making private foundation.

Another alternative to consider is establishing a donor-advised fund (a "DAF") with an existing public charity that sponsors a DAF program. Since the sponsoring charity owns the assets in its

DAFs, it is responsible for all investment decisions, administrative duties and reporting obligations. As the grant adviser for the DAF you establish, you would have the right to recommend, but not to direct, grants to be made from your DAF. Although the grant adviser can only make recommendations, the charities that sponsor DAF programs generally give full and careful consideration to the grant adviser's recommendations. A sponsoring charity will not, however, make grants that are prohibited by law or offensive to its charitable purpose or mission, and it may have a grant making policy that prevents it from accepting certain grant recommendations.

When choosing a sponsoring charity, you should read the description of its DAF program carefully to determine whether the program's terms and restrictions are acceptable to you. Some charities allow each then serving grant adviser to name successor advisers for the DAF, in perpetuity. Others limit the number of successor advisers. Some charities operate national DAF programs, while others, such as community foundations, tend to focus their grant making on a particular geographic area. A sponsoring charity may also require that its DAFs be used primarily or solely to make grants that support its own programs or the programs of its affiliates.

In addition to sponsoring DAF programs, many community foundations operate "donor-designated fund" programs that allow a donor to create a fund that will provide a permanent source of support for a particular charity or charities selected by the donor when establishing the fund. Community foundations may also offer to establish a "field of interest fund" to benefit organizations that operate programs within a donor's selected field of interest (such as, arts and culture, or youth and families). Each year, the community foundation selects the charities that will receive distributions from its field-of-interest funds. When you establish a DAF, you may also require the community foundation to distribute the assets remaining at your death to a designated fund or field-of-interest fund.

Contributions made to a public charity to establish a DAF or other restricted fund are treated more favorably for purposes of the income tax charitable deduction than are contributions made to a grant making private foundation. Using a DAF can also be helpful for individuals who "bunch" their charitable contributions to beat the newly increased standard deduction amount and maximize their tax savings through itemization. With the standard deduction at $12,000 for individuals and $24,000 for married couples, many taxpayers may no longer see tax savings from their giving. One strategy is to pool or "bunch" multiple years of charitable contributions in one year and itemize deductions in that year. A donor may not want to actually contribute more assets to any certain charity in one year, so that donor may wish to contribute several years of charitable gifts to a DAF at one time. The DAF can then be used to distribute grants to various charities over time as the donor desires.

Even if you create your own foundation, your local community foundation can still be a source of important information regarding organizations and programs in your community that need your foundation's support. By working with your local community foundation, you can help ensure that your private foundation's efforts and activities are efficiently coordinated with the philanthropic activities of other organizations in your community.

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This white paper is for general educational purposes and is not intended as legal advice. Our objective is to convey to you the principal characteristics involved with trusts and estates planning as they apply to common situations. For this reason, we have deliberately simplified technical aspects of the law in the interest of clear communication. Cummings & Lockwood's private clients attorneys would be pleased to consult with clients, prospective clients and/or their professional advisors with regard to their specific estate planning needs.

In accordance with IRS Circular 230, we are required to disclose that: (i) this white paper was not intended or written by Cummings & Lockwood to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer; (ii) this white paper was written to support the promotion or marketing of the transaction(s) or matter(s) addressed by the white paper; and (iii) each taxpayer should seek advice on his or her particular circumstances from an independent tax advisor.

CUMMINGS & LOCKWOOD CONTRIBUTORS

MARY BETH CRAWFORD

Mary Beth Crawford is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Bonita Springs, Florida, office. She focuses her practice on estate planning, tax planning and probate and trust administration. Mary Beth brings a caring and comprehensive approach to estate planning and provides her clients and their families with both the technical and personal guidance they need in developing the proper plan.

She received her LL.M. in Taxation and J.D., with *honors*, from the University of Florida, Levin College of Law, and received her B.A. from the University of Florida.

Mary Beth can be reached at (239) 390-8062 or via email at mcrawford@cl-law.com.

DANIEL P. FITZGERALD

Daniel P. Fitzgerald is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Firm's Greenwich, Connecticut, office. His practice focuses on estate planning, estate administration, taxation, partnerships, probate litigation and defending tax audits. Dan's extensive estate administration experience allows him to develop estate plans that address issues and concerns before they become problematic.

He has worked with a broad range of finance, accounting, hedge fund and private equity professionals, as well as artists and entrepreneurs. Dan has developed comprehensive estate plans to assist members of many generations in their wealth planning, protection and protection. Dan is the principal in charge of the Firm's Continuing Legal Education Program and the Private Clients Group Associate Training Program.

Dan received his B.A. from Lafayette College, his J.D. from Syracuse University College of Law, and his LL.M. in Taxation from New York University School of Law.

Dan can be reached at (203) 863-6511 or via email at dfitzgerald@cl-law.com.

JESSIE A. GILBERT

Jessie A. Gilbert is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Firm's Greenwich, Connecticut, office. Jessie advises high net worth individuals on estate and tax issues, helping them with succession, generation-skipping and asset protection planning. She also represents executors and trustees with respect to probate, estate and trust administration matters, as well as with estate and fiduciary income taxes.

Jessie is a frequent writer and lecturer on estate planning and administration topics, including business succession planning, fiduciary income tax, and the Principal and Income Act. She has also served as a law clerk with the United States Tax Court in Washington, D.C.

Jessie received her A.B. from Hamilton College, her J.D. from Case Western Reserve University School of Law, and her LL.M. in Taxation from New York University School of Law.

Jessie can be reached at (203) 863-6503 or via email at jgilbert@cl-law.com.

DAVID M. HALPEN

David M. Halpen is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Palm Beach Gardens, Florida, office. David has over 20 years of broad-based legal experience in trusts and estates planning, estate settlement, trust administration, business succession planning, and U.S. and international tax planning for a variety of high net worth clients. Prior to joining Cummings & Lockwood, he was a shareholder with Dunwody, White & Landon in their Naples and Palm Beach, Florida, offices.

David received his LL.M. in Taxation from the University of Florida, Levin College of Law, his Certificate in International Law from the Paris Institute of International Law, his Certificate in International Tax Law from Leiden University, the Netherlands, his J.D., with honors, from the University of Florida, Levin College of Law, and his B.A. from the University of Florida.

David can be reached at (561) 214-8508 or via email at dhalpen@cl-law.com.

DANIEL G. JOHNSON

Daniel G. Johnson is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Stamford, Connecticut, office. Dan is Principal-in-Charge of the Stamford office where he has practiced since joining the Firm in 1997. He practices primarily in the areas of estate planning, family business succession planning, estate administration and trust administration. Dan frequently lectures on estate and tax planning topics before both lawyer and non-lawyer audiences.

Dan received his A.B., *cum laude* from Georgetown University and his J.D. from University of Virginia School of Law.

Dan can be reached at (203) 351-4317 or via email at djohnson@cl-law.com.

ROBERT L. LANCASTER

Robert L. Lancaster is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Naples, Florida, office. Rob focuses his practice on the areas of estate planning and business succession planning. He also helps clients with wealth preservation planning, which involves maximizing the benefits offered under Florida law, as well as considering the implementation of sophisticated foreign or domestic structures.

Rob received his LL.M. in Taxation and J.D., with *honors*, from the University of Florida, Levin College of Law, and his B.S. in Business Management, *cum laude*, from Florida State University.

Rob can be reached at (239) 649-3178 or via email at rlancaster@cl-law.com.

RANI NEWMAN MATHURA

Rani Newman Mathura is the Principal-in-Charge of the Palm Beach Gardens, Florida, office of Cummings & Lockwood where she focuses her practice on estate planning, estate and trust administration, charitable planning. Rani also represents guardians and conservators.
She frequently speaks on estate and tax planning topics to attorney and community

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audiences. Prior to joining the Firm, Rani was the probate staff attorney for the 15th Judicial Circuit Court in Palm Beach, Florida. In addition to the Firm's Florida offices, Rani has been resident in the Firm's Greenwich, Connecticut office.

Rani received her LL.M. in Estate Planning from the University of Miami School of Law, her J.D. from Nova Southeastern University Shepard Broad Law Center, and her B.A. from the University of Michigan.

Rani can be reached at (561) 214-8503 or via email at mathura@cl-law.com.

DOUGLAS H. OLIN

Douglas H. Olin is a Principal in Cummings & Lockwood's Private Clients Group and is based in the Greenwich, Connecticut, office where he serves as Principal-in-Charge. Doug joined Cummings & Lockwood in 1999 and became a Principal in 2001. His practice focuses on estate planning, family business succession planning, and estate and trust administration. Doug speaks frequently on estate and tax planning topics before both lawyer and non-lawyer audiences.

Doug received his B.A., *with honors* from Emory University, his J.D. from New York University School of Law, and his LL.M. in Taxation from New York University School of Law.

Doug can be reached at (203) 863-6504 or via email at dolin@cl-law.com.

HEATHER J. RHOADES

Heather J. Rhoades is a Principal in Cummings & Lockwood's Private Clients Group and is based in the West Hartford, Connecticut, office. Heather joined the Firm in 1999 and she practices in the areas of estate planning, estate settlement, trust administration and charitable planning. Heather is a member of the Firm's National Charitable Planning Group.

Heather received her J.D. from the University of Connecticut School of Law and her B.A. from the University of Connecticut.

Heather can be reached at (860) 313-4933 or via email at hrhoades@cl-law.com.

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ABOUT CUMMINGS & LOCKWOOD LLC

OVERVIEW

Founded in 1909, Cummings & Lockwood provides sophisticated legal counsel to both private clients and commercial enterprises. Our clients include individuals and families with inherited and newly created wealth, as well as emerging, middle market and Fortune 500 companies.

With over 100 attorneys and fiduciary accountants located in Stamford, Greenwich and West Hartford, Connecticut, and in Naples, Bonita Springs and Palm Beach Gardens, Florida, we have the experience, technology and resources to provide a broad range of trusts and estates, corporate and finance, litigation and dispute resolution, and commercial and residential real estate services to our clients.

PRIVATE CLIENTS PRACTICE

Cummings & Lockwood has one of the largest trusts and estates practices in the United States, with a significant private client base of high net worth individuals and families, family offices, closely-held businesses, and national charities and foundations with very complex and sophisticated legal needs. Our clients reside in nearly all 50 U.S. states and in over 25 countries around the world.

Our private clients attorneys, many of whom have been elected to the prestigious American College of Trust and Estate Counsel (ACTEC), are experienced in the areas of estate planning and administration; estate, income and gift tax; trust formation and management; executor and trustee services; charitable giving and foundations; international estate and tax planning; estate planning for hedge fund and private equity principals; special needs planning; probate law; and residential real estate.

Whether dealing with recently acquired assets or family fortunes that span generations, the Firm provides innovative strategies and solutions to preserve, enhance and transition our clients' wealth in the most tax-efficient manner possible, as well as meet their varied legal needs and personal goals.

Cummings & Lockwood's private client attorneys regularly collaborate with other professional advisors, including investment managers, accountants, insurance agents, financial planners and trust officers among others, to ensure that our clients achieve their estate planning objectives.

COMMERCIAL PRACTICE

Cummings & Lockwood has an elite commercial practice with numerous, professionally-recognized lawyers who are experienced in the areas of litigation and dispute resolution; real estate investment and development; banking, lending and credit transactions; corporate acquisitions and divestitures; and partnership, limited liability company and tax matters.

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Our clients include entrepreneurs, closely-held companies, regional, national and international corporations, hedge funds, private equity firms, financial institutions and not-for-profit organizations.

In addition, Cummings & Lockwood's commercial and private clients lawyers regularly work together to provide entity planning, business succession planning, tax guidance and litigation to privately-owned businesses of all sizes and industries.

For additional information about our Firm, practice areas, capabilities and attorneys, please visit our website at www.cl-law.com.

ABOUT THE FAMILY OFFICE ASSOCIATION

The Family Office Association is a global membership community of successful families and single family offices. We are committed to creating value for each family/SFO that we serve; value that enhances wealth, strengthens legacy, and unites multiple generations by speaking to shared interests and passions. The Family Office Association provides the resources to solve your most difficult challenges and help you achieve your collective goals: to invest intelligently, give strategically, and learn exponentially.

The Family Office Association is the community leader in serving all the key imperatives for successful families, respecting your privacy but enabling an intimate community of global families like yours. Our organization delivers education, content and programming opportunities, proprietary research, and access to salient thought leadership that will interest all generations of your family.

In addition to the deepest and most unique content in the community, throughout the year, we host a variety of exclusive events for those qualified and accepted into our highest level of membership including seasonal summits, investment forums and family retreats, all with carefully selected speakers and presenters. In these intimate face-to-face settings, you will be able to truly engage experts and get personal advice and opinions on the best way to capture opportunity.

Our content and programming led by top professionals and thought leaders across a variety of key economic, family business, philanthropic and social fields, are the best in the community. This rich and diverse content and programming offering insight with thought leadership, yields the optimal combination for enhancing and nurturing successful families.

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