BACK TO BASICS

Session 3 - Estate Tax Considerations for Estate Lawyers

trustate

About me

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Founder and CEO, trustate

- Settled hundreds of estates, nationwide.
- Administered over $50B via estate administrations.
- 12+ years experience as estate attorney (JD & LLM) with multi-jurisdictional estate/trust admin practice.
- Learn more: trustate.com

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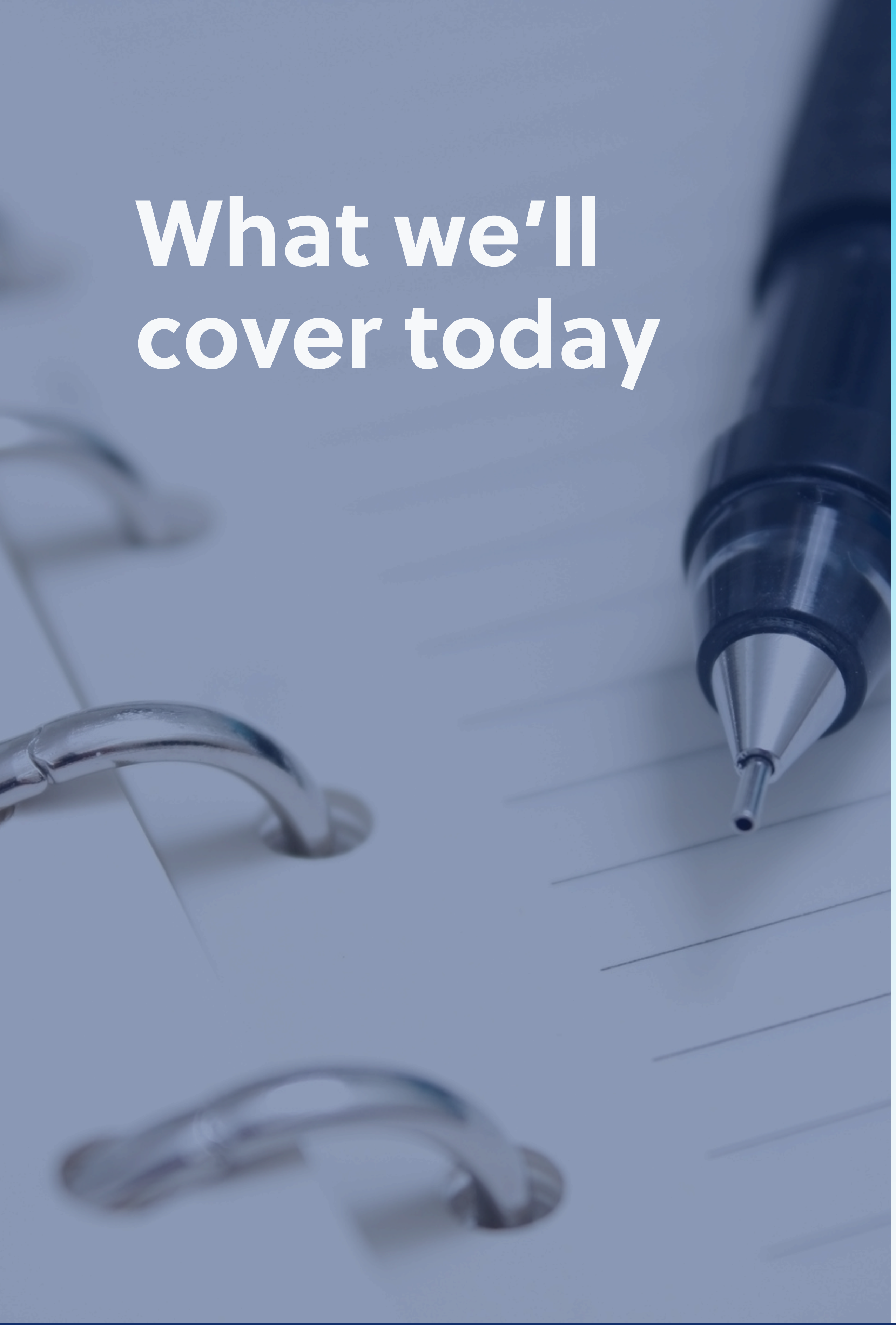


What we'll cover today

Agenda:

- When to Prepare and File Form 706
- Reasons to File Form 706 for Non-Taxable Estates
- Preparation and Filing Process for Form 706
- QTIP Elections: Benefits and Procedures
- Situations for Making Clayton QTIP Elections
- Portability

Overview

Definition of Trust Administration: Estate Administration and Revocable Trust Administration - used synonymously here as both are "post-death administration"

Importance for Estate Lawyers

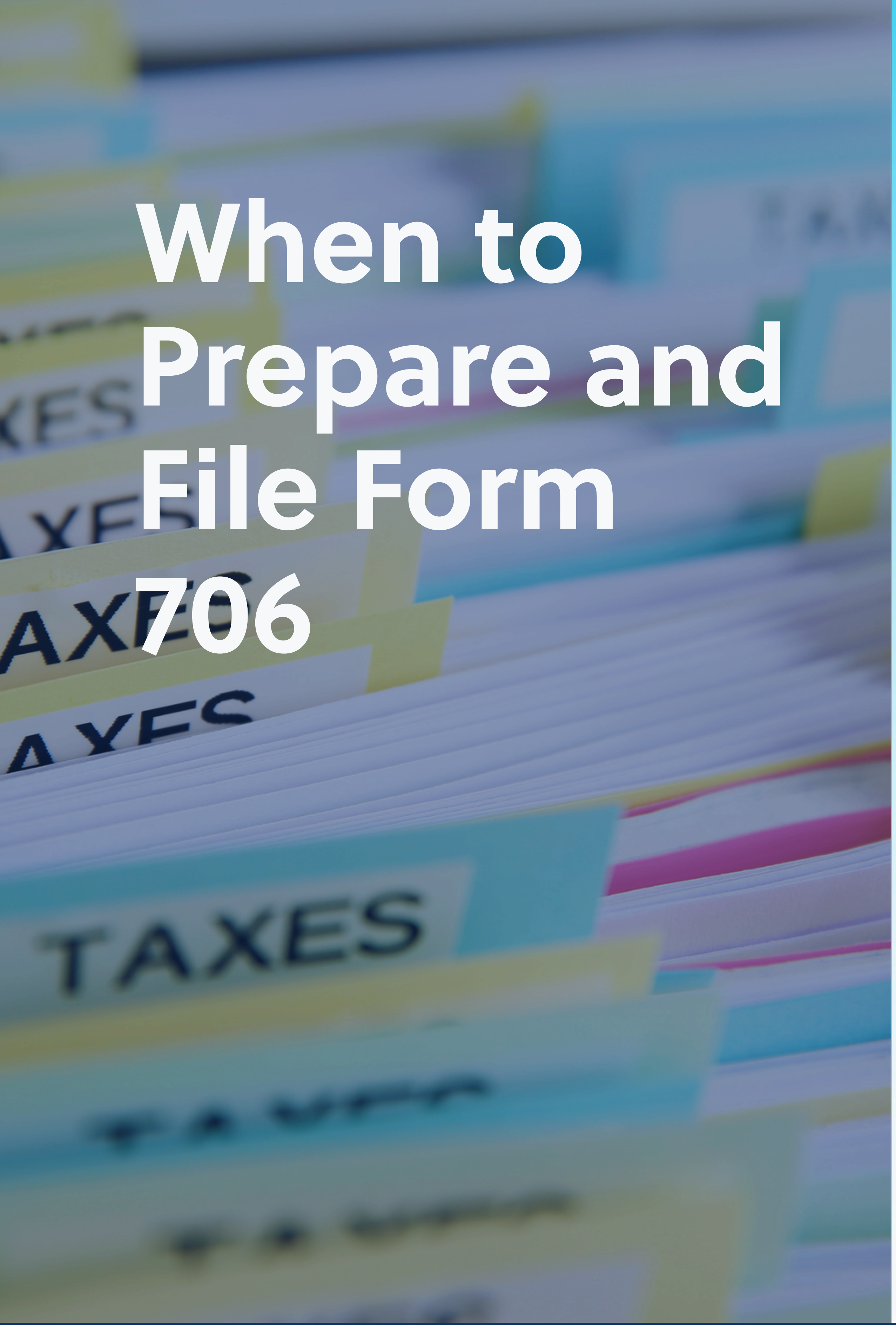
- Where the majority of revenue comes from in a mature practice
- Makes you a better planner
- Not chasing estate plans for the rest of time

Key Responsibilities and Tasks

6 Phases of Estate Administration

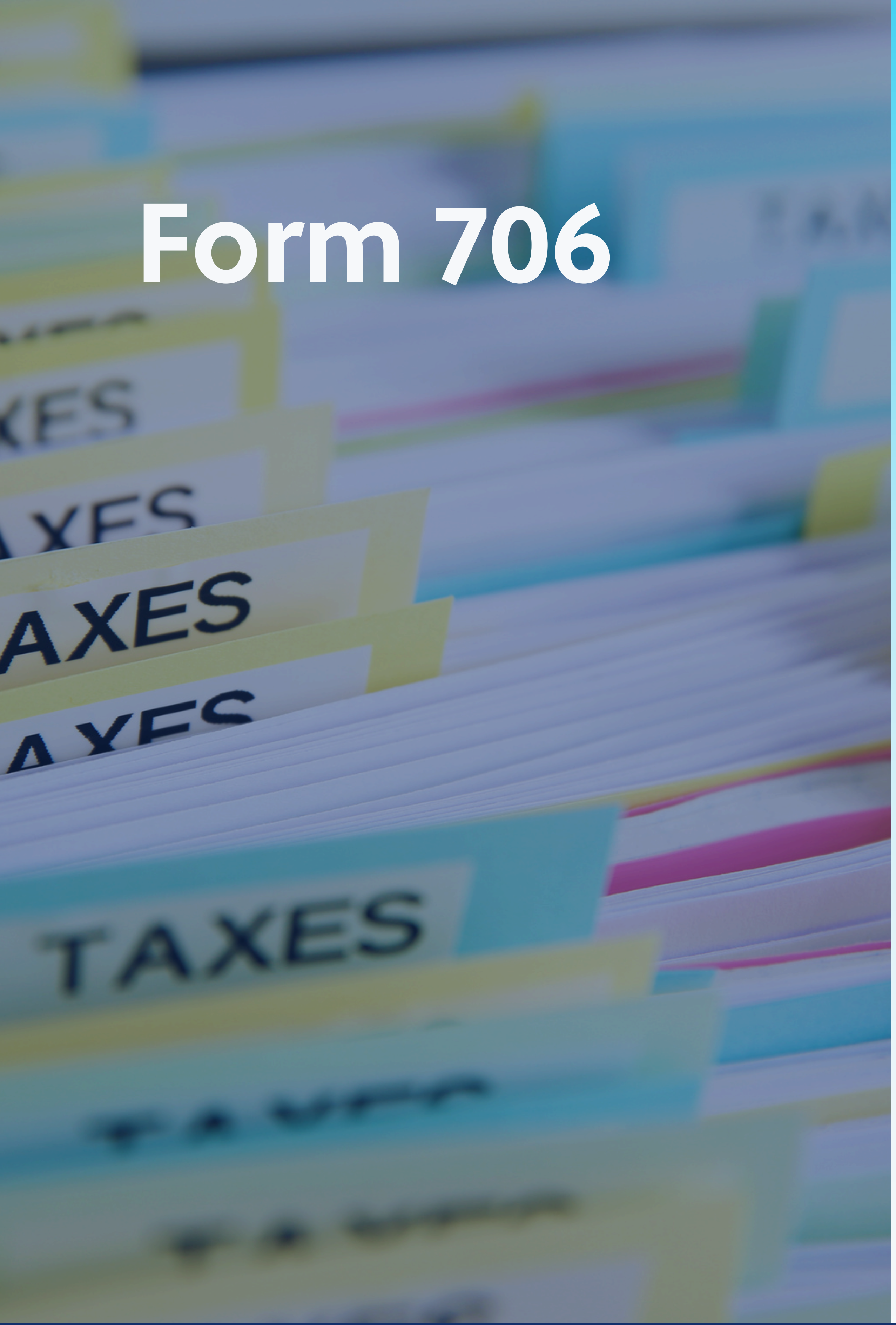
1. Estate Opening
2. Asset and Liability Discovery
3. Asset and Liability Management
4. Payment and Taxes
5. Distributions
6. Estate Closure, Settlement, and Final Distributions

When to Prepare and File Form 706



- What is an Estate Tax Return?
- What is a Taxable Estate?
- Key Deadlines

Form 706



- What is an Estate Tax Return?
  - A snapshot of someone's net worth as of their date of death
- Why do they seem so scary?
  - Questionable valuations are where there are typically issues.

Pro-Tip

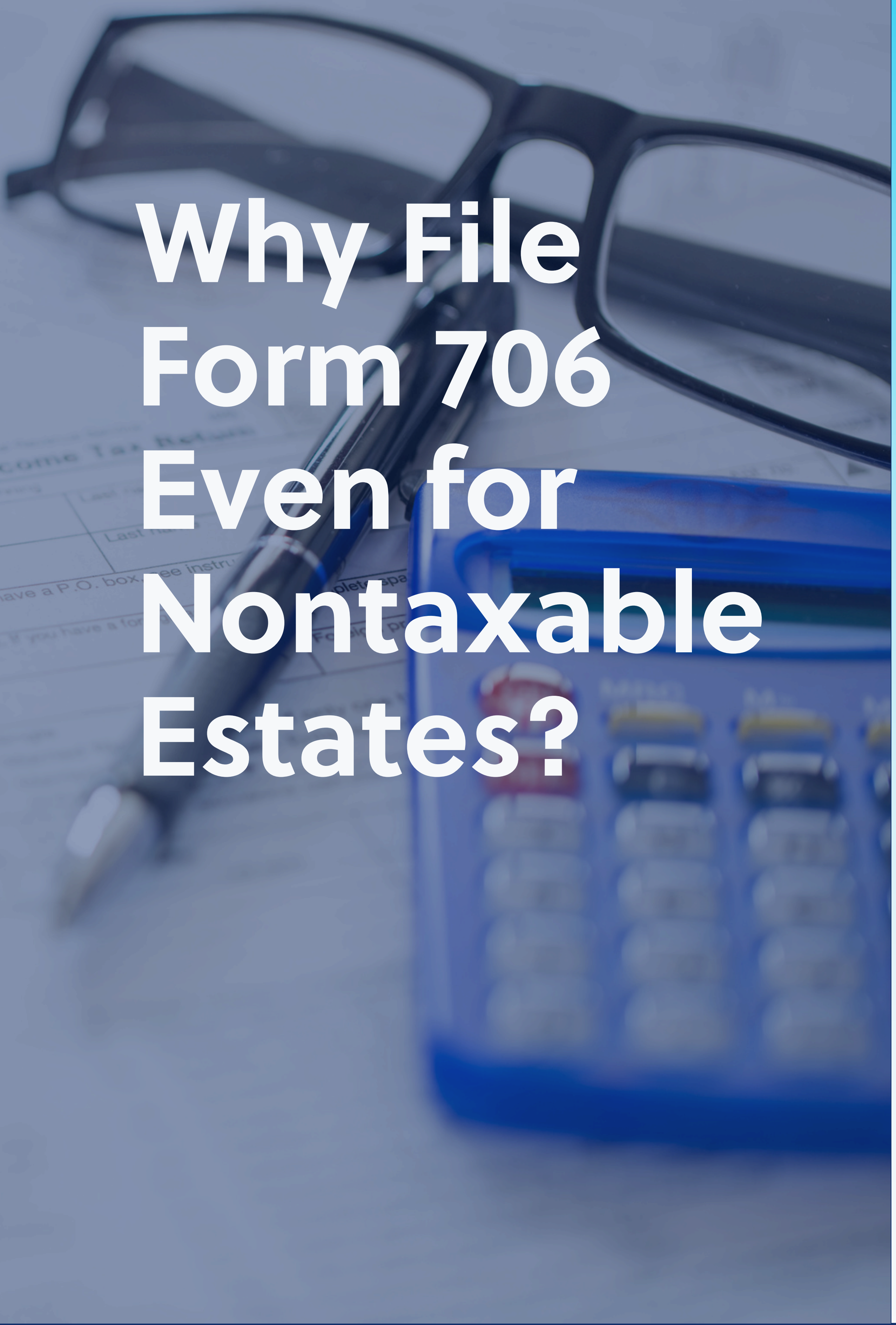
When it comes to appraisers- make sure the executor hires good people and obtain qualified appraisals.

What is a qualified appraisal?

- Requiring a qualified appraiser who specializes in "hard to value" assets is a must for an estate with non-traditional assets.
- The appraiser must conduct a qualified appraisal that meets the criteria outlined by the IRS.
- Multiple appraisers with different specialties may be needed for an estate with a variety of assets.

Technology can help!
With respect to certain types of artwork and assets, there are now appraisers who can work with you remotely, even on tangible assets.

Tools like EVP or Yahoo Finance can be used for stock.



Why File Form 706 Even for Nontaxable Estates?

Reasons to file for nontaxable estates:

- To Make Elections
  - QTIP
  - Portability of Deceased Spousal Unused Exclusion (DSUE)
- Audit Protection
- Documentation and Record-Keeping Benefits
- Potential Future Tax Law Changes

What is a QTIP Election?

A process under the U.S. tax code that allows a person to leave assets (“QTIP property”) to their spouse in a trust that qualifies for the marital deduction (“QTIP Trust”), thereby deferring estate taxes until the death of the surviving spouse.

For the QTIP trust to qualify and the election be properly made, certain requirements must be met.

(1) Trust Terms: The surviving spouse must have the right to receive all the income from the trust annually, and no one else can have access to the principal during the spouse's lifetime.

(2) The executor of the estate must make an election to treat the trust as a QTIP trust on the estate tax return.

What is a QTIP Election?

How to make it:

Schedule M

- The QTIP election is made on Schedule M of IRS Form 706, which is dedicated to the "Bequests, etc., to Surviving Spouse."

Identify QTIP Property:

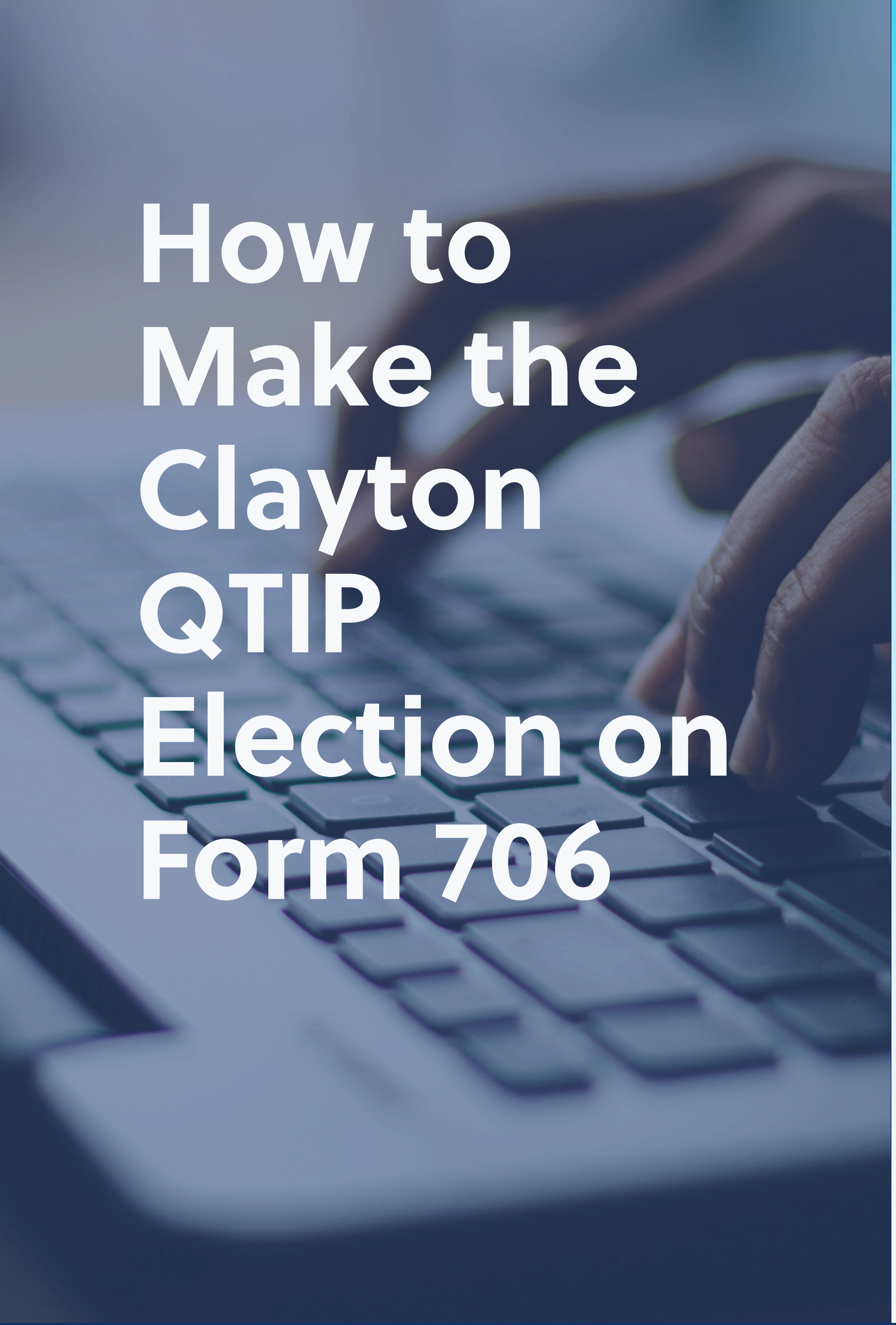
- On Schedule M, list the property for which you are making the QTIP election.
- Ensure that each piece of property is clearly identified and valued.
  - This includes cash, securities, real estate, and other assets.

Indicate QTIP Election:

- For each item listed on Schedule M, there is a column where you must indicate if the QTIP election is being made.
- Place a checkmark or "X" in the "QTIP election" column for each property for which you want to make the election.

Required Statement:

- Attach a written statement to Form 706 indicating that the executor is making a QTIP election under Section 2056(b)(7) of the Internal Revenue Code.
- This statement must <u>clearly specify</u> the property for which the election is being made.



How to Make the Clayton QTIP Election on Form 706

Step-by-Step Guide

SAME AS a regular QTIP election – EXCEPT the language in the written statement. Two examples of the written statement:
(For illustration purposes only)

Example 1: Regular QTIP Election Statement

- "The executor elects to treat the property listed on Schedule M, specifically items 1, 2, and 3, as Qualified Terminable Interest Property (QTIP) under Section 2056(b)(7) of the Internal Revenue Code. This election is intended to qualify the property for the marital deduction."

Example 2: Clayton QTIP Election Statement

- "The executor elects to treat $600,000 of the trust listed on Schedule M, item 1, as Qualified Terminable Interest Property (QTIP) under Section 2056(b)(7) of the Internal Revenue Code. This election is intended to qualify this portion of the property for the marital deduction. The remaining $400,000 of the trust is not subject to the QTIP election and will be directed to a bypass trust."

What is a QTIP Election?

Cheat sheet

- Complete IRS Form 706.
- List QTIP property on Schedule M.
- Indicate the QTIP election for each item.
- Attach the required written statement.
- File the form by the deadline.

Clayton QTIP Election

An Overview

Allows for a partial QTIP election, where part of a trust can be treated as QTIP property and the remaining part can be directed elsewhere, often to a bypass trust or family trust.

Reasons to Make a Clayton QTIP Election

- Flexibility in Estate Planning
- Deferring Estate Taxes
- Optimizing Marital and Family Trust Benefits
- Case Studies and Examples

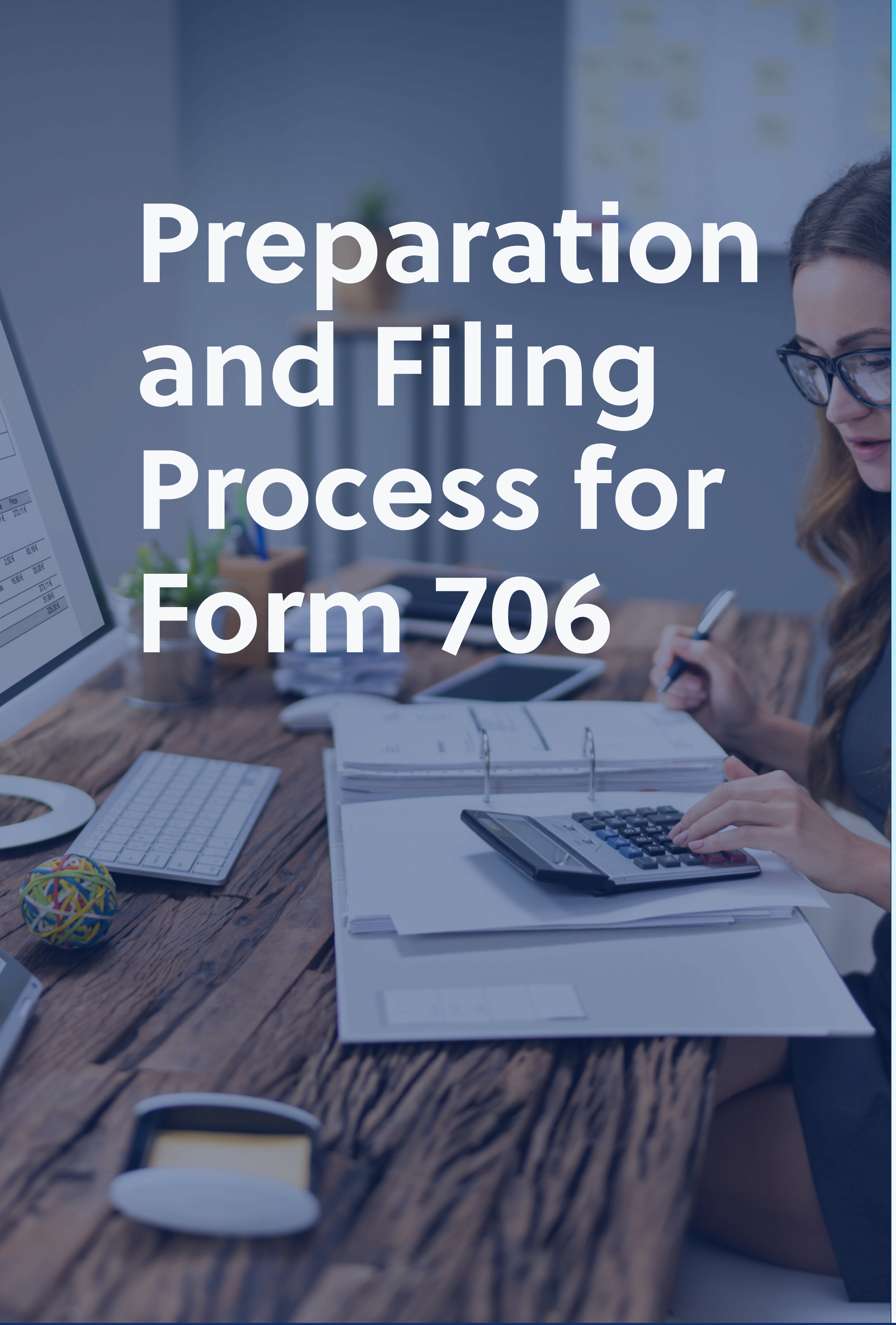
Feature	Normal QTIP Election	Clayton QTIP Election
Decision Timing	At death of the first spouse	After death of the first spouse
Flexibility	Limited once made	High flexibility for executor
Tax Planning	Defers estate tax until surviving spouse's death	Optimizes estate tax planning
Suitability	Standard marital deduction use	Complex estates, uncertain tax future

Situations Appropriate for Making a Clayton QTIP Election

- **High Net-Worth Estates**
- **Complex Family Dynamics**
    - When it doesn’t make sense to split trusts up and allocate one thing to one trust and another asset to another (think family businesses and rental real estate)

Allocation of assets to different trusts

Feature	QTIP Trust Allocation	Bypass Trust Allocation
Tax Optimization	Income-producing assets to defer taxes **Examples of income producing assets that don't typically appreciate in value at the same rate as they produce income:** Rental Properties, Real Estate Investment Trusts (REITs), Bonds, Certificates of Deposit (CDs), Dividend Stocks, Franchises, Savings and Annuities, Royalties, Loans and Lending	Appreciating assets to avoid future estate taxes **Examples of appreciating assets:** Vacant Land, Growth Stocks, Alternative investment funds (private equity, RE funds, hedge funds, VC), Fine Art, Antiques, Classic Cars, Rare Coins and Stamps, Gold and Silver, Luxury Residential Properties, direct interest in private companies, Cryptocurrencies, Certain Intellectual Property, Development Land
Asset Protection	Stable assets for income	High risk assets for creditor protection
Estate Planning Goals	Ensure income for spouse	Specific needs of other beneficiaries
Flexibility	Fixed once elected	Adaptable based on current needs and laws



Preparation and Filing Process for Form 706

- ☐ Required Documentation
- ☐ Valuation of Assets Obtaining DOD values
- ☐ Completing the Form
- ☐ Filing Deadlines 9 months from date of death - 6 month extension available (AND ALMOST ALWAYS TAKEN)
- **Common Pitfalls and Mistakes - Valuation Errors and Disputes**

Portability

DSUE: Deceased Spousal Unused Exemption

To take the first-to-die spouse's unused estate/gift tax exemption and TRANSFER (i.e. "port") it to the surviving spouse.

Example:

- A dies at age 41 with a taxable estate of $2,610,000, all passing to his surviving spouse, B in a QTIP trust. B (age 40) has $500,000 in her retirement, a home in her name worth $1,000,000, and a $2,000,000 term life insurance policy that names her children as beneficiaries ($3,500,000 total).
- B is a young physician and has a lot of future earning potential.
  - We also don't know what the estate tax exemption will look like (could drop to $5mm) in 2026, let alone when B is at death's door which will hopefully be many years from now.
- Since 2024 is A's year of death, he has $11,000,000 of UNUSED Exemption (Current exemption is $13.61mm).
- B is already at 3.5mm (+2.61mm she inherited and all appreciation in value) – if we do a "portability return" for A, we can GIVE A B's $11mm DSUE in addition to whatever exemption is available at her time of death (could be a lot, could be a little, depending on her future year of death).

Portability

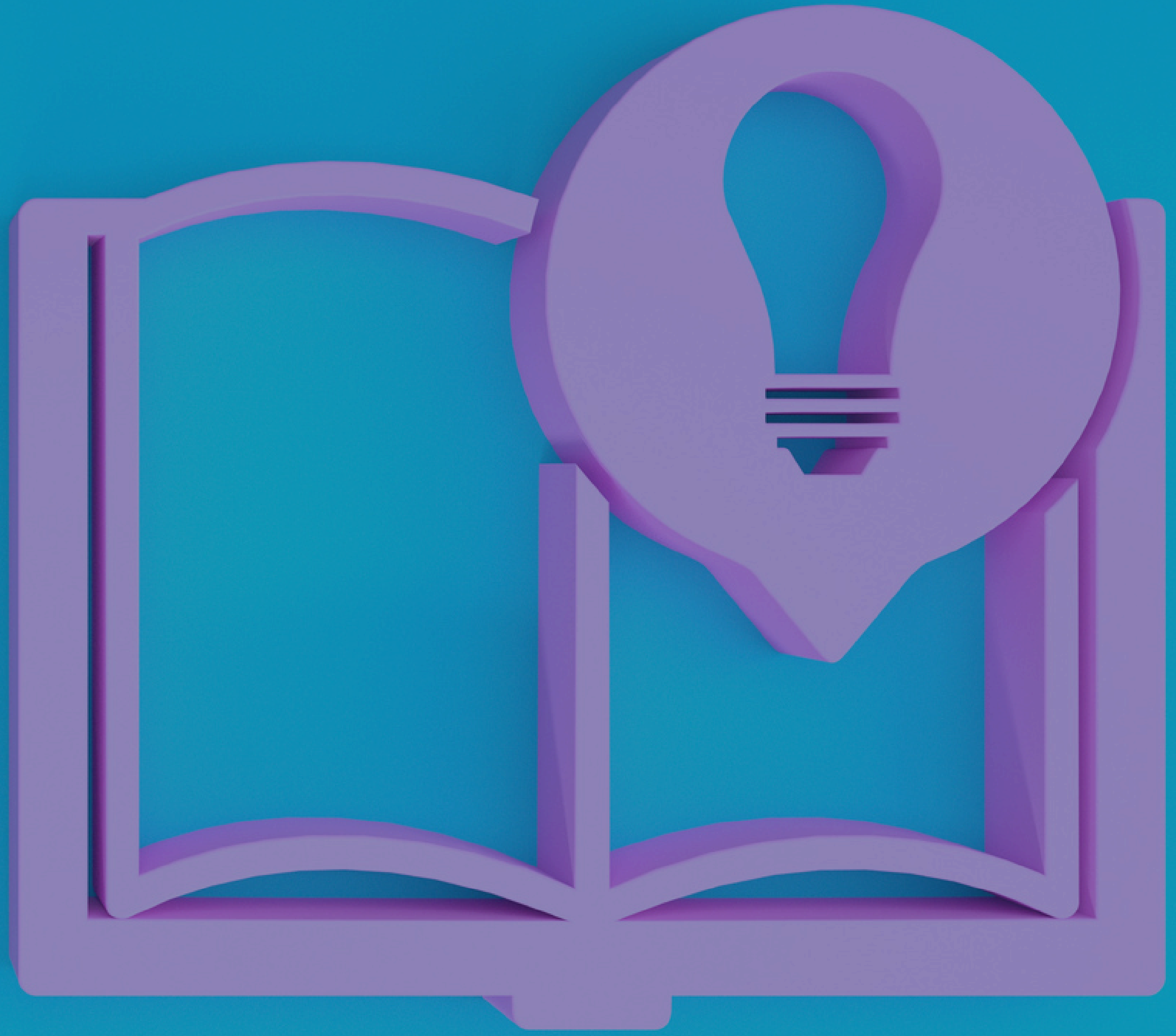
Portability Return

An informational IRS Form 706 for the decedent to record the leftover exemption and memorialize it's transfer to the surviving spouse.

Informational return = that snapshot of all values of A's taxable estate on his date of death, including those passing in in the QTIP trust.

- NO TAX IS DUE since there was leftover exemption
- There is an election made on this return - which involves completing the following sections:
  - Part 6, Section A: Indicate that you are making the portability election by checking the box in Section A, which is the "Portability of Deceased Spousal Unused Exclusion" section.
  - Part 6, Section C: Report the DSUE amount in Section C.
- Due date: On or before the fifth anniversary of the decedent's date of death. (Rev proc 2022-32)

Portability



Fun stuff

- If the surviving spouse remarries, and the new spouse dies, that spouse cannot "stack" DSUE, they would then lose the earlier DSUE.
- <u>Loophole:</u> DSUE from first spouse can be used by the surviving spouse for gifts until spouse 2 dies.
- What about where SS and Executor are different people, and possibly in conflict? Can SS sue and win for breach of fiduc duty if Exec doesn't prepare/file a portabilty return?
- Who pays for the portability return?

Best Practices

- Regular Reviews and Updates of Estate Plans
- Collaboration with Financial Advisors and Accountants
- Client Communication and Education
- Staying Informed on Legal and Tax Changes

Resources

Follow Trustate on LinkedIn for tips and updates.

Email info@trustate.com with questions.

Visit Trustate's website to see what subscription works for you so you can start streamlining and automating trust and estate administration for all your estates today.