Establishing a Strategic Gifting Plan – Preparation for Pre-2026 Gifting

1) **Discerning Objectives and Values of the Client**
   a) Developing a Mindset for Strategic Gifting
      i) What is the client's vision (what difference does the client want to make) and what are the client's values?
      ii) Does the proposed plan accomplish the client's objectives?
      iii) Does the proposed plan optimize tax and non-tax opportunities?
   b) Values and Vision (developing the foundation of the plan)
      i) Start the conference at 40,000 feet
         (1) What stage of planning are the clients at?
            (a) Is this their first time engaging in comprehensive, long-term planning? Or has prior extensive planning already established a foundation for framing the gifting discussion?
         (2) What role does the client want inheritance to have in the beneficiaries' lives?
         (3) What values does the client want emphasized in the plan?
            (a) Extent of Safety net
               (i) Limited safety net to supplement other resources and income.
               (ii) Comprehensive safety net to provide comfortable standard of living.
            (b) Guardrails (i.e., protection from immaturity or claims)
            (c) Maximum flexibility and benefit
            (d) Efficiency
               (i) Administrative efficiency vs. tax efficiency

1. A plan that maximizes utilization of various tax minimization strategies will be more complex to administer.

(e) Succession of legacy assets

(i) Maximum economic benefit related to family legacy assets.

1. Should the distribution standard be broad or narrow?

(ii) Protection of legacy assets for children and more remote descendants

c) <u>Understanding the Client – The Five Factors</u>

i) Optimization of Simplicity and Benefit

(1) Simplicity

(a) Every client wants the planning to be simple.

(b) How much complexity is the client willing to tolerate?

(2) Benefit

(a) Every client wants maximum benefit.

(3) Optimization Scale

(a) Simplicity and benefit are not "absolute" values – they each operate on a sliding scale.

(i) Simple to complex

(ii) No benefit to high benefit

(b) There is often tension between the factors of simplicity and benefit

(4) Finding the "Sweet Spot"

(a) The planner's objective is to discern the client's tolerance for complexity and the value the client puts on achieving maximum benefit:

(i) How much complexity is the client willing to tolerate to achieve benefit?

2) Evaluating the "Five Factors"

i) Benefit

(1) Who does client want to receive the benefit of their estate?

(a) Children/descendants?

(b) More remote family members?

(c) Friends

(d) Charities

(i) Does charity "start (and end) at the home" or is charitable giving important to clients?

(2) How should the benefit be received?

(a) For Individuals – should guardrails be placed on benefits received?

(i) Does the beneficiary have a good financial track record?

(ii) Are there standards the client's want to promote (and tie distributions to)?

1. Financial Acumen

a. Saving money

b. Earning money

c. Investing money

2. Stable and productive personal life

3. Good relationships with other family members

(iii) Should the trustee need to take into account the beneficiary's other (e.g., independently earned) resources?

1. If so, to what age?

(b) For Charities

(i) Timing and manner of distributions

1. Does client want to consider "split-interest" gifts (e.g., Charitable Remainder Trusts, Charitable Lead Trusts, Charitable Gift Annuity)

(3) Economic sustainability: how much can the clients "afford" to gift?

(a) Determine extent of gifting after receiving a cash flow analysis (financial advisor, wealth management company, institutional/professional trustee)

(b) How much benefit will client's need to retain from their assets during lifetime?

(i) Once an appropriate amount to gift has been determined, an analysis of what assets to gift (and how they should be gifted) can be made.

(4) Administrative sustainability

(a) Can the gifting plan realistically be implemented and maintained in a simple manner?

(b) Is an appropriate team of professional advisors involved to maintain the plan?

(i) Trust officer, CPA, financial advisor, attorney

ii) Control (retained by the client or an independent third party)

(1) How much control does client wish to retain over assets subject to the gifting plan?

(a) This is important in discerning the manner and extent to which an independent third-party will be integrated into the plan.

(2) Protection for beneficiary

(a) Protection may or may not dovetail with control, that is:

(i) Clients may want to retain maximum control for their own personal reasons; or

(ii) Clients may want guardrails placed on legacy gifts because their children need protection from:

1. Potential claimants
2. Failed marriage
3. Immaturity
4. Inclusion in gross estate/transfer tax costs (i.e., estate, gift, and generation skipping tax minimization)

iii) <u>Timing – time and manner of gifts</u>

(1) Strategic Gifting Phases

(a) While both spouses are living

(b) Upon the death of the first spouse

(i) After reset of income tax basis on community property of the decedent and the survivor.

(c) Upon the death of both spouses

iv) <u>Taxes</u>

(1) The tax benefits afforded by the proposed gifting plan.

(2) Tax planning opportunities related to strategic gifting:

(a) Avoidance of WA estate tax (because no WA gift tax)

(b) Shift in appreciation

(c) Utilization of valuation discounts

(d) Utilization of exemptions available under current federal law

(3) Counterbalance:

(a) Loss of step-up in basis at death

(b) Loss of control

(c) Loss of benefit

v) Flexibility

(1) Is the plan sufficiently flexible?

(a) Independent trustee discretion involving irrevocable trusts

(b) Trust protector for removal and replacement of trustee

(2) Is the client emotionally ready to commit to the plan?

3) Strategies and Strategy Layering

a) Valuation discounts

i) Establishing an entity to gift interests in real property:

(1) Lack of marketability

(2) Lack of control

ii) If gifting real property without an entity structure:

(1) Undivided interest (simple to implement; complex to administer)

b) Trusts

i) Legacy Trust

(1) Assets placed in trust for children and more remote lineal descendants.

(2) Provide beneficiaries with high level of protection (see section 2.ii.2 above)

(3) Utilize Trustors' GST exemption (no transfer tax for permissible distributee beneficiary for the rule against perpetuities period – 150 years)

(4) Can ensure that benefit of the trust assets remains in the family line.

ii) Grantor trust

(1) Allows trustor to pay the taxes on income attributable to the trust assets without such payment being deemed a gift to the beneficiaries.

(a) *strategy layering with Legacy Trust/ILIT

iii) Life Insurance – if additional liquidity is needed

(1) ILIT

(a) Policy purchased by trustee of trust on life of one spouse or second to die

(i) Policy proceeds in trust can provide liquidity to estate of surviving spouse while not being includible in gross estate of surviving spouse.

(b) Spouse(s) can pay premiums on ILIT through periodic gifts to the trust.

(c) Grantor Trust ILIT (*strategy layering)

iv) SLATs – if utilization of lifetime gift tax exclusion is a high priority

(1) Can be helpful if:

(a) Long term, stable marriage:

(i) One or both clients' will be making an irrevocable, $13,620,000 (in 2024) gift to a trust for the benefit of their spouse.

(b) Clients are willing to hedge against the following risks (that could lead to the IRS deeming SLAT assets includible in trustor spouse's gross estate):

(i) Avoiding satisfaction of spousal duty of support

1. Limiting distributions to "best interests" or "all income" and prohibiting distributions that satisfy spousal support obligations.

(ii) Avoiding reciprocal trust doctrine

1. If a trust is established by each spouse, the trusts should be drafted differently in terms of trustee, distribution standard and remainder beneficiaries.

(2) If the clients have a stable marriage, are comfortable with the risks, and can afford to make the proposed gift(s) (and sign a thorough, custom engagement letter that outlines these factors in detail), SLATs can be an excellent option.

4) Gifting Pitfalls

a) <u>Over-gifting (see section 2.i.3 above)</u>

b) <u>Federal Estate Tax Issues</u>

i) Retaining too much control and/or benefit (and causing inclusion in gross estate)

(1) 2035 – three-year rule (relating to life insurance and fixing any retained interest power)

(2) 2036(a)(1)-(2) – transfers with retained life estate

(a) 2036(a)(1) – retained income benefit

(b) 2036(a)(2) – retained control

(3) 2036(b) – direct or indirect retention of voting control

(4) 2038 – revocable transfers

(a) Authority to change timing or amount of distribution

(b) Authority to amend or revoke provisions

(5) 2041 – powers of appointment

(6) 2042 – life insurance

ii) Step transaction

(1) A series of steps can be "collapsed" to disallow a tax benefit and be deemed a step-transaction if the only reason for engaging in the transaction was a tax benefit

(2) However, this result can be avoided if there is a non-tax reason for taking certain steps (e.g., forming and funding LLCs to hold real property) or sufficient time passes between steps

iii) Adequate disclosure rules (section 6501)[1]

(1) If there is no adequate disclosure of the value of the gift on the Form 709 (particularly if valuation discounts are utilized), there is no statute of limitations to restrict when the IRS can attack the value of the gift

(2) Best Practice: follow the "safe harbor" rules in Treasury Regulation § 301.6501(c)-1

(3) Example: always include appraisal with Form 709

c) <u>Federal Income Tax Issues</u>

i) Gifting property where mortgage is greater than basis

(1) Can trigger federal income tax

d) <u>Washington Real Estate Excise Tax Issue</u>

i) Gifting of more than a 49% interest in real property subject to a mortgage in under 3 years

(1) Will trigger real estate excise tax on the value of the property (gift recipient's assumption of loan is deemed consideration by WA Dept. of Revenue)[2]

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[1] Treas. Reg. § 301.6501(c)-1
[2] Washington Administrative Code § 458-61A-101