Legacy by Design

Smart Planning for Wealth, Family, and Philanthropy

FAHLMAN LITTLE WHEELER

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Road Map

- Phase I – Core Estate Planning
  - Hypotheticals of various estate sizes
  - Change domicile – Washington Estate Tax
  - Family Trusts / Dynasty Trusts

- Phase II – Reduction of Taxable Estate
  - Gifting & Sales
  - Business Succession
  - Special Needs Trust / Supplemental Income Trust
  - Discounting

- Charitable Planning
  - Life insurance
  - Retirement accounts
  - DAFs vs. Foundations
  - CRUTS

Core Estate Planning Hypotheticals

The Johnson Family

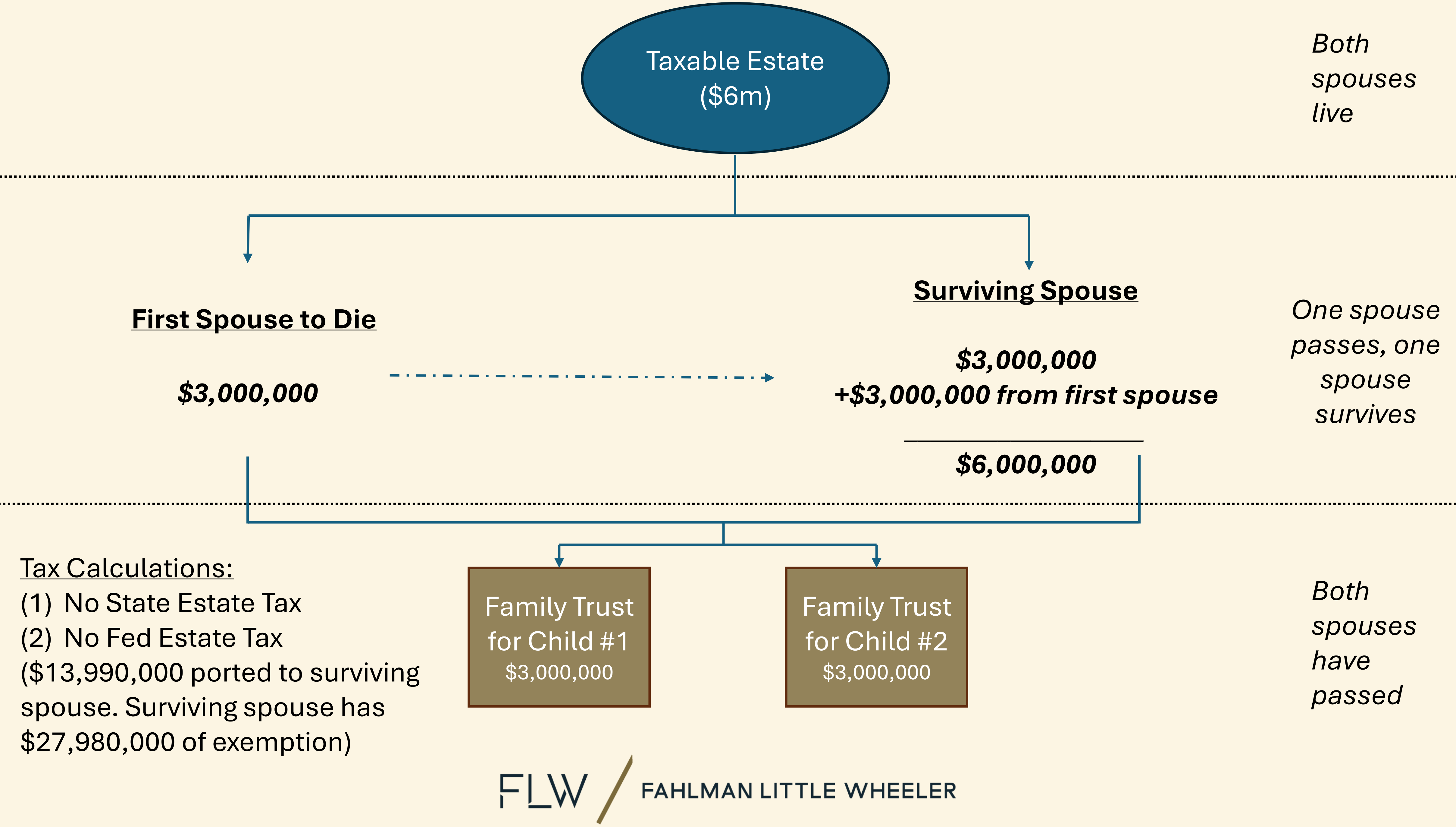
- Varying net worth (hypos)
- All 4 family members are US citizens
- All property located in state of domicile
- All property is community property
- No specific bequests
- No prior gifting

Scenario 1

- $6m net worth
- Domiciled in Arizona

“A good sketch is better than a long speech”

- Napoleon Bonaparte


Taxable Estate
($6m)
Both spouses live
First Spouse to Die
$3,000,000
Surviving Spouse
$3,000,000
+$3,000,000 from first spouse
$6,000,000
One spouse passes, one spouse survives
Tax Calculations:
(1) No State Estate Tax
(2) No Fed Estate Tax
($13,990,000 ported to surviving spouse. Surviving spouse has $27,980,000 of exemption)
Family Trust for Child #1
$3,000,000
Family Trust for Child #2
$3,000,000
Both spouses have passed
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Scenario 2

- $6m net worth
- Domiciled in Washington
- Kept their Arizona estate planning documents

Taxable Estate
($6m)

Both spouses live

First Spouse to Die

$3,000,000

Surviving Spouse

$3,000,000
+$3,000,000 from first spouse

$6,000,000
($3,000,000) WET Exemption
=
$3,000,000 subject to WET

One spouse passes, one spouse survives

Tax Calculations:
(1) Washington Estate Tax:
$420,000
(2) No Fed Estate Tax
($13,990,000 ported to surviving spouse. Surviving spouse has $27,980,000 of exemption)

Family Trust for Child #1
$2,790,000

Family Trust for Child #2
$2,790,000

Both spouses have passed

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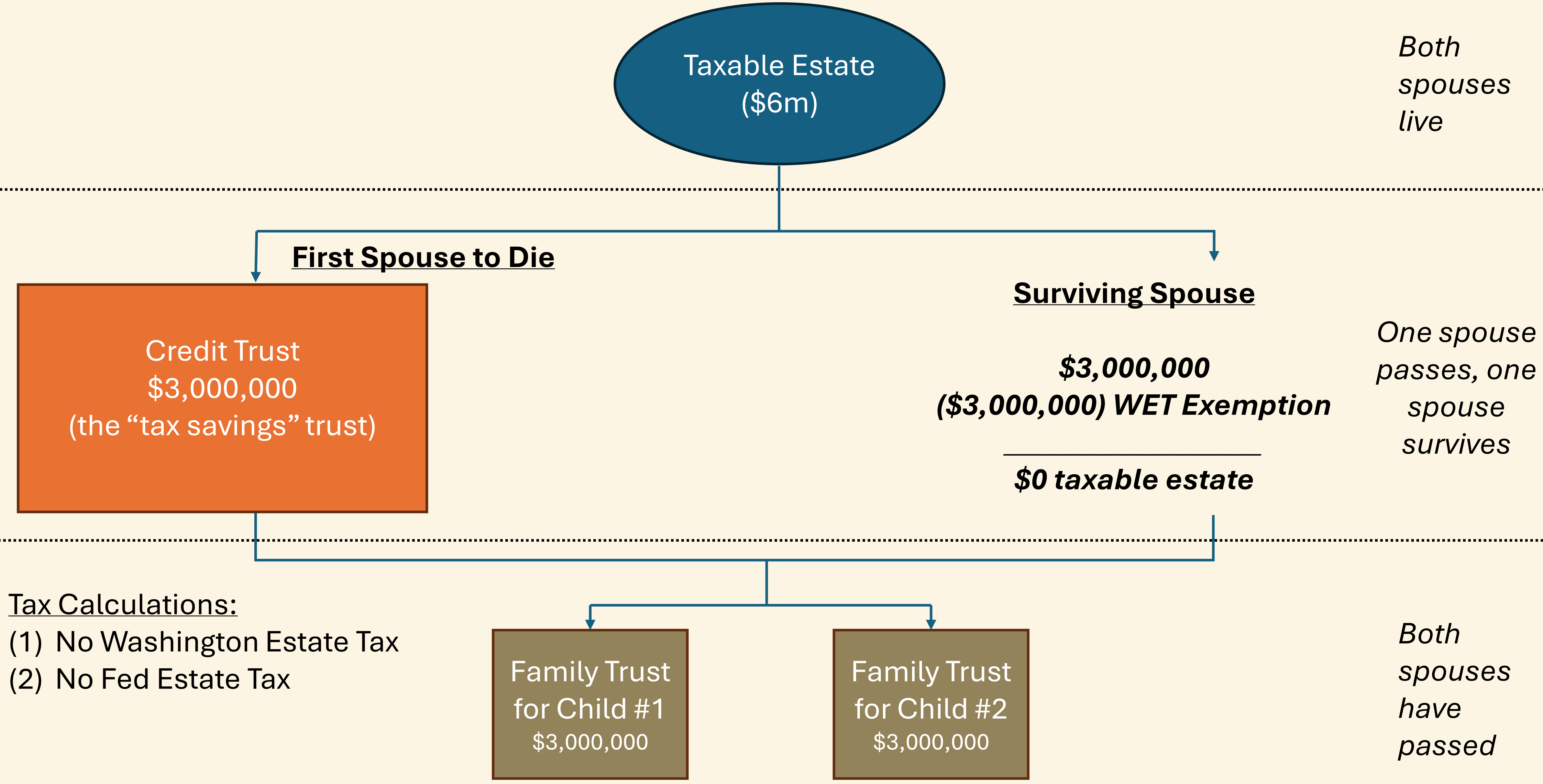
Scenario 3

- $6m net worth
- Updated their estate plan under Washington law
- Use "credit trust" to capture first spouse's Washington Estate Tax exemption



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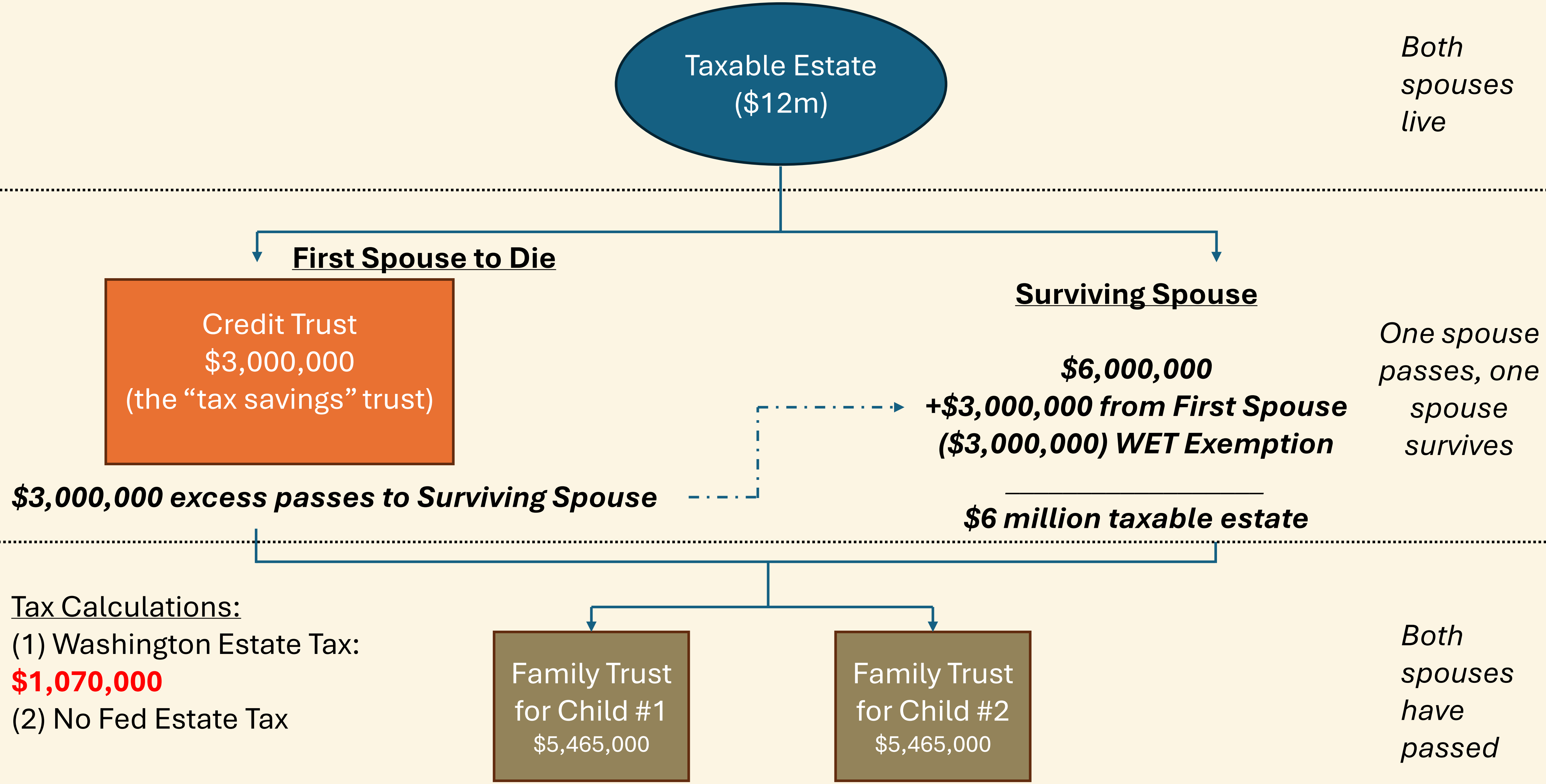
Scenario 3

- $12m net worth
- No utilization of “Marital Trust”



Taxable Estate
($12m)
Both spouses live
First Spouse to Die
Credit Trust
$3,000,000
(the "tax savings" trust)
$3,000,000 excess passes to Surviving Spouse
Surviving Spouse
$6,000,000
+$3,000,000 from First Spouse
($3,000,000) WET Exemption
$6 million taxable estate
One spouse passes, one spouse survives
Tax Calculations:
(1) Washington Estate Tax:
$1,070,000
(2) No Fed Estate Tax
Family Trust for Child #1
$5,465,000
Family Trust for Child #2
$5,465,000
Both spouses have passed

Scenario 3

- $20m net worth
- Utilization of “Marital Trust” to capture GST Exemption

Taxable Estate
($20m)

Both spouses live

First Spouse to Die

Credit Trust
$3,000,000
(WA Exempt & GST Exempt)

Marital Trust
$7,000,000
(GST Exempt, subject to WA Estate Tax)

Surviving Spouse

$10,000,000
+$7,000,000 from Marital Trust
(for Fed Estate Tax Purposes)
($3,000,000) WET Exemption

$14 million taxable estate

One spouse passes, one spouse survives

Tax Calculations:

(1) Washington Estate Tax: **$3,680,000**

(2) No Fed Estate Tax

(3) Beware the GST tax!

Family Trust for Child #1
$8,160,000

Family Trust for Child #2
$8,160,000

Both spouses have passed

Scenario 4

- $40m net worth

Taxable Estate
($40m)

First Spouse to Die

Credit Trust
$3,000,000
(WA Exempt & GST Exempt)

Marital Trust
$10,990,000
(GST Exempt, subject to WA Estate Tax)

Excess amount of $6,010,000 to surviving spouse

Tax Calculations:
(1) Washington Estate Tax:
$10,680,000
(2) Federal Estate Tax:
$536,000

Surviving Spouse

$20,000,000
+$6,010,000 from first spouse
+10,990,000 from Marital Trust
($3,000,000) WET Exemption

$34,000,000 taxable estate

One spouse passes, one spouse survives

GST Exemption is only $13,990,000 per person, so each Family Trust will need to be divided into an exempt and non-exempt share

Family Trust for Child #1
$14,660,000

Family Trust for Child #2
$14,660,000

Both spouses have passed

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Why not just change domicile?

- Washington Estate Tax is *only* levied on (1) estates of decedents who die domiciled in Washington; or (2) the Washington real property of non-domiciliaries
  - RCW 83.100.020(12); WAC 458-57-005(o); RCW 83.100.040(1)

- "Domicile" means a person's true, fixed, and permanent home and place of habitation, and shall be the place where the person intends to remain, and to which the person expects to return when the person leaves without intending to establish a new domicile elsewhere.

Domicile Factors

- Physical presence
- Mailing address
- Size of home
- Furniture and heirlooms
- Voting registration
- Address on file with IRS
- Licenses
- Memberships and organizations
- Investments
- Estate Plan
- Location of Pets

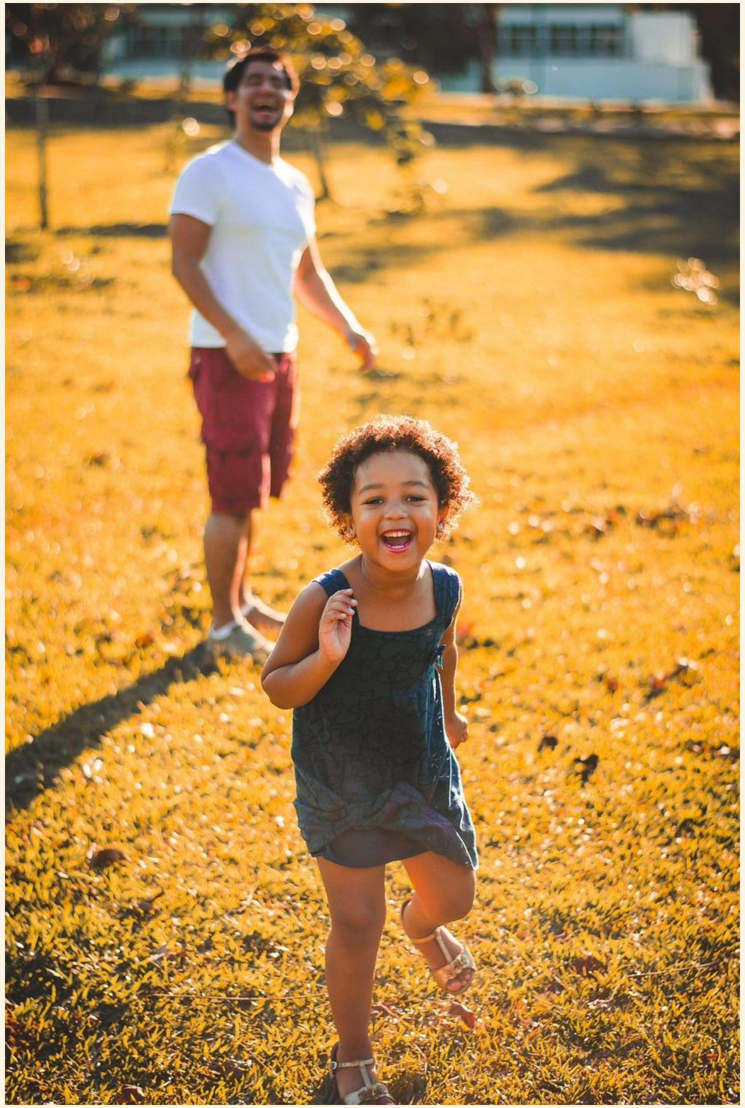
Why *use* a Trust?

Benefits of Trusts vs. Outright Bequests

- Creditor Protection
- Estate Tax Savings – 150 years

Who should serve as trustee of trust?

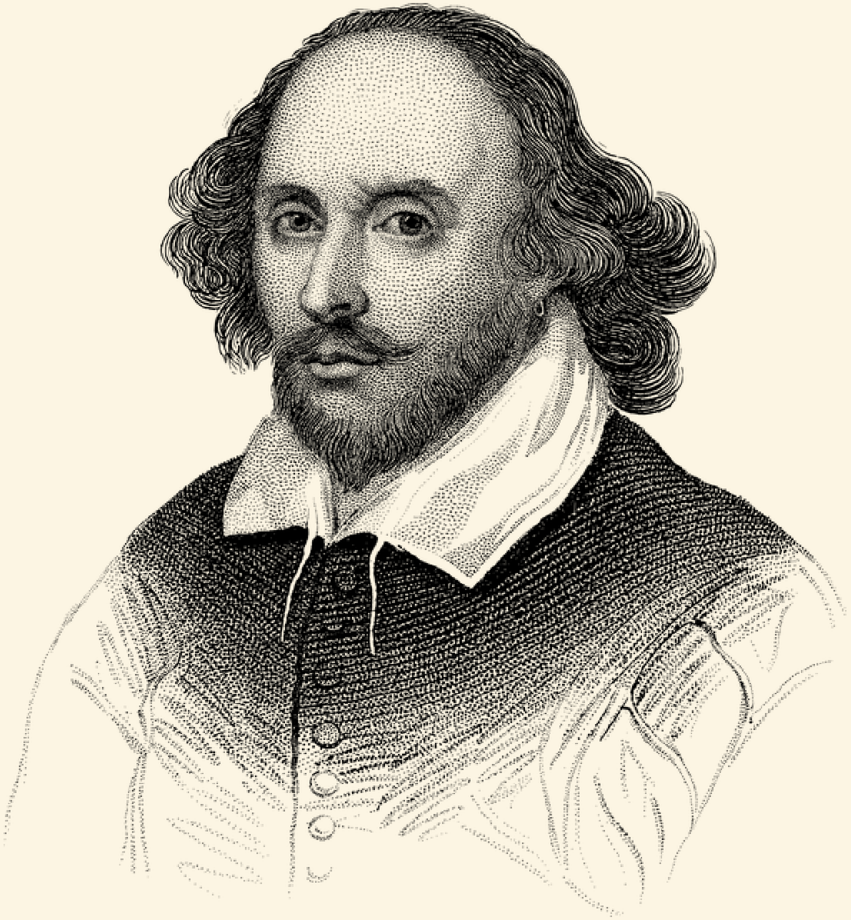
- Children?
- Family friend?
- Third party professional?
- Same person as their guardian?



Family Trusts, Dynasty Trusts, and Legacy Trusts…*Oh My!*

"What's in a name?
That which we call a rose,
By any other word
would smell as sweet."

-*Romeo and Juliet,* Act II, Scene II,
William Shakespeare



Advanced Estate Planning Hypotheticals

The Krueger Family

- $100m net worth
- Founder of XYZ Construction Inc.
- No real liquidity in estate
- All 4 family members are US citizens
- All are domiciled in Washington
- All property located in Washington All property is community property
- The Kruegers are charitably inclined and believe in foster care. Their son is special needs

Estate Tax Calculations for the Kruegers

No estate planning at all

Washington Estate Tax	
Gross Estate	$100,000,000
Less: WA Exemption	($3,000,000)
Net Taxable Estate	$97,000,000
WA Estate Tax	**$32,730,000**

Federal Estate Tax	
Gross Estate	$100,000,000
Less: WA Estate Tax	($32,730,000)
Less: Federal Exemptions	($27,980,000)
Net Taxable Estate	$39,290,000
Fed Estate Tax	**$15,716,000**

Total Estate Tax Burden:
State ($32,730,000) + Fed ($15,716,000) =
$48,446,000

Krueger Family Core Estate Planning

Taxable Estate ($100m)

First Spouse to Die

Credit Trust
$3,000,000
(WA Exempt & GST Exempt)

Marital Trust
$10,990,000
(GST Exempt, subject to WA Estate Tax)

Excess amount of $36,010,000 to surviving spouse

Surviving Spouse
$50,000,000
+10,990,000 from Marital Trust
+$36,010,000 from first spouse
($3,000,000) WET Exemption

$94,000,000 taxable estate

One spouse passes, one spouse survives

GST Exemption is only $13,990,000 per person, so each Family Trust will need to be <u>divided</u> into an exempt and non-exempt share

Family Trust for Child #1
$26,092,000

Family Trust for Child #2
$26,092,000

Both spouses have passed

Estate Tax Calculations for the Kruegers

Proper "Phase 1" Estate Planning

Washington Estate Tax	
Gross Estate	$100,000,000
Less: WA Exemption	($3,000,000)
Less: Credit Trust	($3,000,000)
Net Taxable Estate	$94,000,000
WA Estate Tax	**$31,680,000**

Total Estate Tax Burden:
State ($31,680,000) + Fed ($16,136,000) =
$47,816,000 (net savings of $630,000!)

Federal Estate Tax	
Gross Estate	$100,000,000
Less: WA Estate Tax	($31,680,000)
Less: Federal Exemptions	($27,980,000)
Net Taxable Estate	$40,340,000
Fed Estate Tax	**$16,136,000**

XYZ Construction, Inc.

- Liquidity Issue (estate tax)
  - Section 6166 election
  - Loans
  - Sale and leaseback
  - Life insurance
- Voting vs. non-voting shares
  - Daughter’s irrevocable trust receives voting shares and son’s supplemental income trust receives the non-voting shares
- QSBS Stock

Supplemental Income (Special Needs) Trust

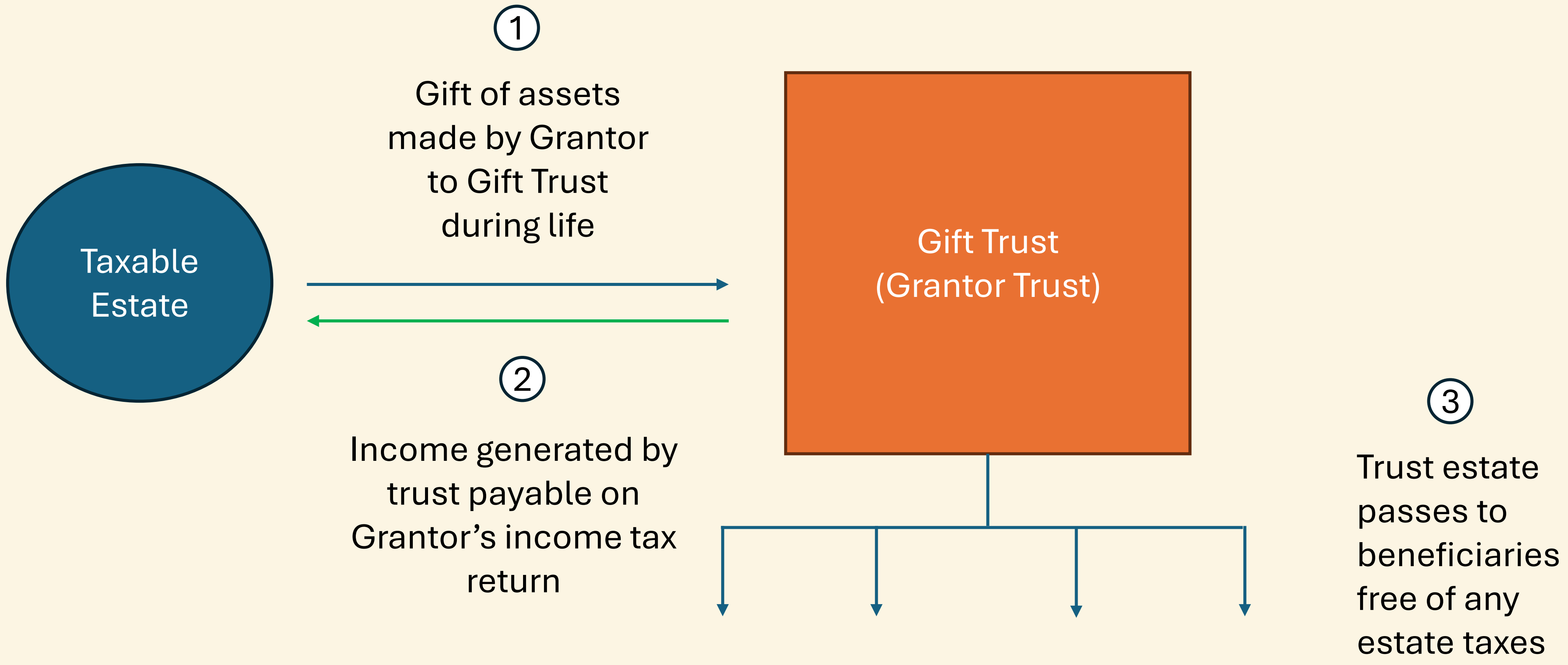
- Beneficiary is son who has special needs
- Purpose of trust is to supplement benefits rather than support
- Pros:
  - ❑Trust is created in a way that will provide for son's needs *above and beyond* what state support is providing
  - ❑State cannot deny support to child
  - ❑State cannot place a lien on the trust
- Cons:
  - ❑Cannot be used for their "basic" health, education, maintenance, and support needs
  - ❑No limited power of appointment
  - ❑Son can never be a trustee

How can we reduce the Krueger family estate tax liability further?

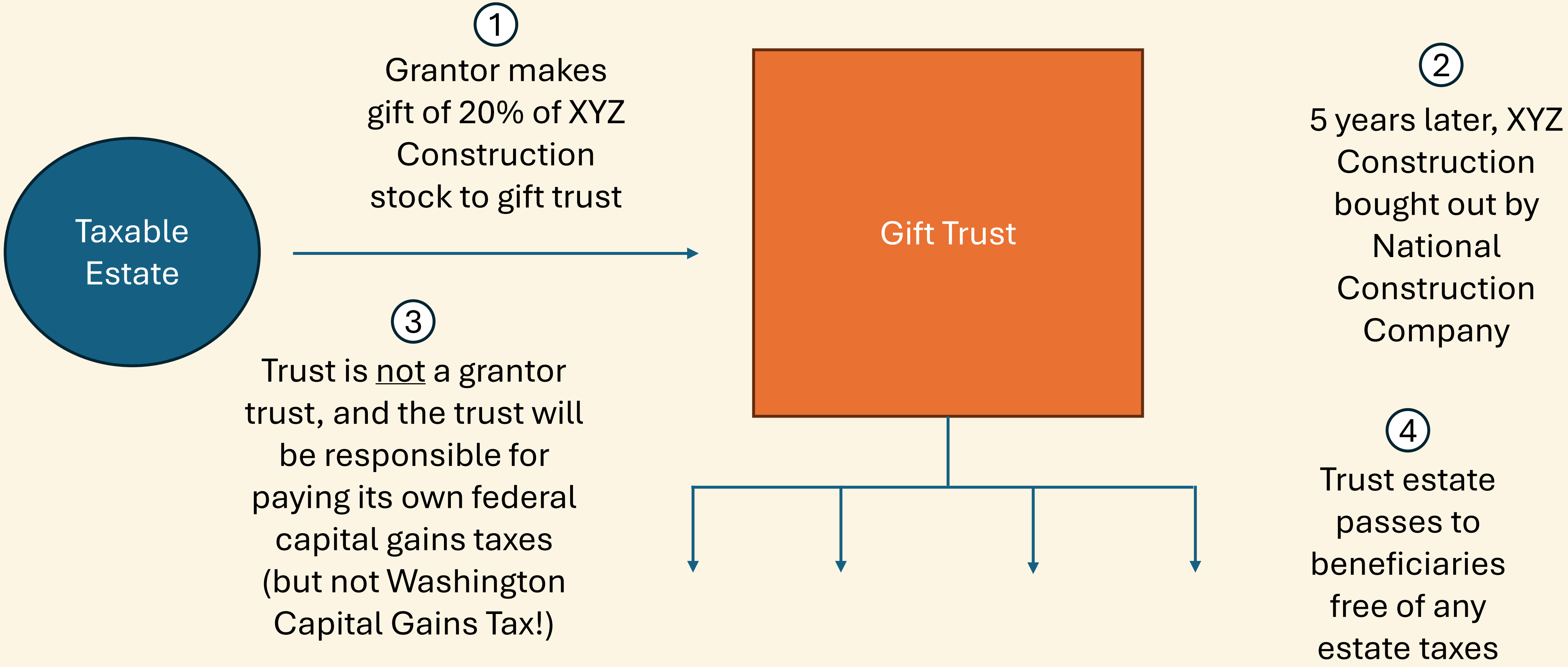
Gifting!

- Washington has no gift tax
- Loss of stepped-up tax basis in gifted asset
- Strategic gifting given limited Federal exemption
- Grantor trusts (& income tax issues)

Gift Trust


1
Gift of assets made by Grantor to Gift Trust during life
Taxable Estate
Gift Trust (Grantor Trust)
2
Income generated by trust payable on Grantor's income tax return
3
Trust estate passes to beneficiaries free of any estate taxes

Gift Trust & XYZ Construction



Discounting (Gifts or Sales)

- Discounts for:
  - ❑Lack of marketability
  - ❑Lack of control
- Kruegers interest in Pacific Star Development LLC ($10m total appraised value of underlying real estate) to their children's irrevocable trusts. 49% is gifted. Discounts for lack of marketability and control amount to 30% as determined by an appraisal.
- Value of gift = (49% of 10m = $4.9m) x .7 (reflecting 30% discount) = <u>$3,430,000 total gift</u> (reflects estate tax exemption saving of $1.5m)

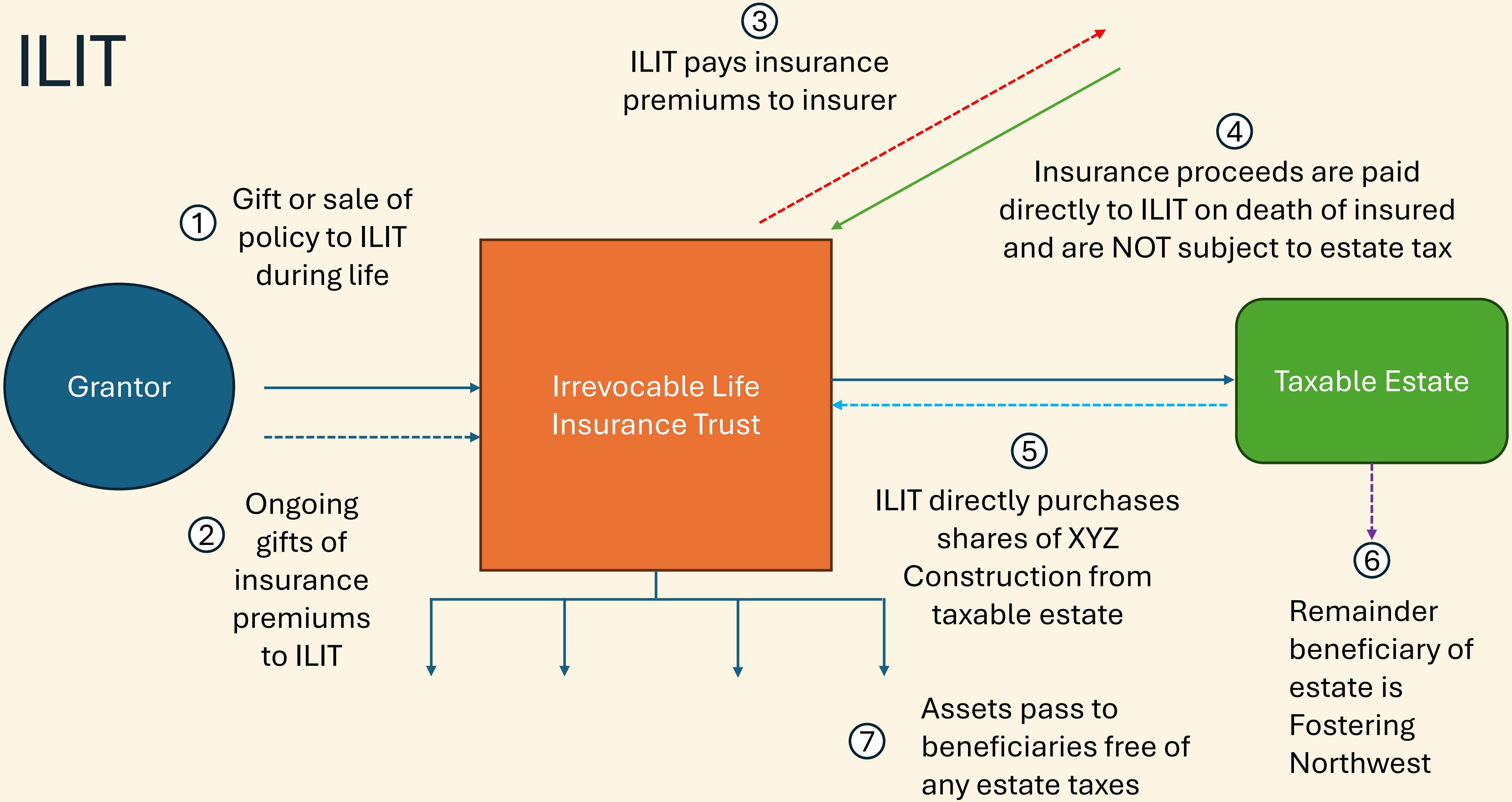
Charitable Planning

- How can we help them fulfill their intent to benefit their favorite charity – Fostering Northwest?
- If no special planning, then assets will need to be sold to provide liquidity, or no charitable planning will be possible!

Charitable Planning (Cont)

- Retirement accounts
- Life Insurance
- Bequest shares to Fostering Northwest

ILIT

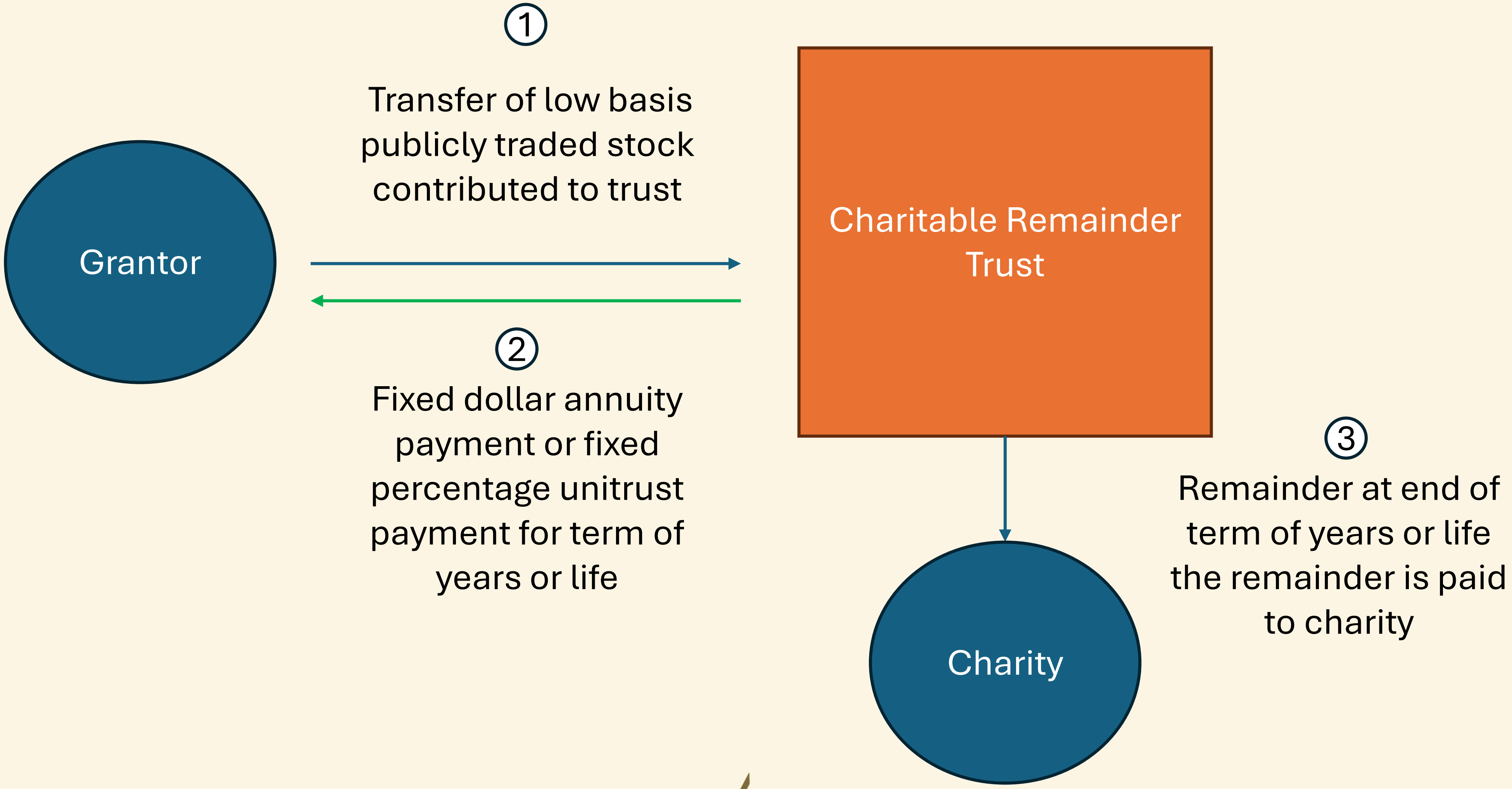


③ ILIT pays insurance premiums to insurer
④ Insurance proceeds are paid directly to ILIT on death of insured and are NOT subject to estate tax
① Gift or sale of policy to ILIT during life
Grantor
Irrevocable Life Insurance Trust
Taxable Estate
② Ongoing gifts of insurance premiums to ILIT
⑤ ILIT directly purchases shares of XYZ Construction from taxable estate
⑥ Remainder beneficiary of estate is Fostering Northwest
⑦ Assets pass to beneficiaries free of any estate taxes

Donor Advised Funds vs. Foundations

- The Kruegers are passionate fans of WWII warbirds and believe they should be preserved for future generations (their daughter would like to be a pilot and fly classic planes)
- Should they utilize a donor advised fund or create their own foundation?
- Kruegers do not believe there is a non-profit in the area that is as committed to WWII warbirds

Charitable Remainder Trust (CRUT/CRAT)



Qualified Charitable Distributions

- Individuals owning retirement accounts must take required minimum distributions at 72.5 years old
- Taxpayers may elect to pay RMD (up to $108,000 for 2025) directly to qualified charity – without taking the payment into income!
- No ability to pay QCD to a Donor Advised Fund

Questions?

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