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The Washington Report

Wealth Transfer Edition

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From the Desk of An Estate Planning Attorney: Discussions We're Having with Clients about 2025 Estate Planning and Beyond.

MAJOR REFERENCE: Washington Report 07.25.24 - A Head-On...Spousal Lifetime Access Trusts (SLATs) Meet Matrimonial Law

MARKET TREND: 2024 election outcomes have changed 2025 planning dynamics, potentially reducing planning urgency and shifting the way we view and implement transfer tax-based plans. Yet, fundamental tax and non-tax planning objectives remain critical and timely to discuss and implement.

SYNOPSIS: Favorable tax relief from the approaching 2026 sunset is expected, but whether and how that relief will apply to current transfer tax provisions is unclear. Regardless, ultra-high net worth (**UHNW**) clients are more likely to move forward with planning, as they generally have the resources needed to maintain their lifestyle while accomplishing all their tax and non-tax planning goals. Although high net worth clients under the $50 million threshold (**HNW clients**) may continue to implement planning, we're seeing some hesitancy now, since they have less total gifting capacity than UHNW clients and greater concerns about giving away too much. Many HNW clients prioritize control and flexibility, often viewed by them as the ability to "undo" planning if circumstances or laws change.

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TAKE AWAYS:

- For now, little has fundamentally changed in the motivations for UHNW planning, as these clients generally have sufficient assets and are familiar with sophisticated tax planning and the potential benefits. All traditional wealth transfer planning options remain on the table, and additional opportunities may arise, depending on the specifics of any new tax legislation.
- HNW clients, however, may perceive little benefit to planning if they expect limited or no wealth transfer tax exposure. In these cases, we've found that (i) starting with a simple trust, like a crummey trust, a spousal lifetime access trust (SLAT) or an irrevocable life insurance trust (ILIT), (ii) initially targeting planning to just one specific issue or asset, such as liquidity or business succession planning, and/or (iii) enhancing the client's accessibility to transferred assets motivates additional planning discussions and implementation.
- ALL clients still need to implement and regularly review their estate plans to confirm or refine: (i) dispositive provisions (who inherits what, when, and how (outright or in trust)); (ii) the selection of trustees and other fiduciaries to control and manage assets; and (iii) non-tax planning (asset preservation and creditor protection for beneficiaries, special needs planning for disabled beneficiaries, promotion of philanthropic goals, etc.).

TAX REFLIEF IS ANTICIPATED BUT THE SPECIFICS ARE UNCERTAIN

Current law provides for the "sunset" of several beneficial tax provisions on January 1, 2026, including the federal gift/estate and GST tax exemptions (reverting from $13.99 million in 2025 to approximately $7.0 million in 2026). With a Republican-controlled White House and Congress, many expect intervening tax legislation to forestall several aspects of the sunset, but whether that will include extensions of current transfer tax provisions is unclear. Congressional procedural rules may restrict the Republicans' ability to pass desired tax legislation and/or limit the duration of any enacted tax relief. Political realities also may favor extending certain tax provisions that benefit more people than the extension of the transfer tax provisions would.

UHNW CLIENTS SHOULD KEEP MOVING FORWARD

Most UHNW families ($50 million+) have ample resources and liquidity to maintain their desired lifestyle while fully using their available transfer tax exemptions and accomplishing all of their tax and non-tax planning objectives. Since the tax laws also remain fluid depending on the prevailing political party, any expected 2025 tax relief may be temporary in nature. In this regard, little has changed in the *motivations* for UHNW planning, although new opportunities may arise depending on specific tax law changes. This environment also should foster continued use of all traditional planning methods for wealth transfer and tax minimization, such as: (1) large gifts to dynasty trusts to leverage both gift and generation-skipping transfer (**GST**) tax exemptions, (2) seed gifts to new trusts to support later wealth transfers or estate freeze transactions (e.g., installment sales or private annuities, (3) grantor retained annuity trusts (**GRATs**) and charitable split interest trusts (charitable lead or remainder trusts), (4) transfers using any available and defensible valuation discounts, and (4) grantor trusts for life insurance planning (potentially coordinated with private split dollar, premium financing and/or buy-sell planning) and/or tax basis management (i.e., through exercises of substitution powers).

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As most UHNW clients will continue to own substantial assets after the implementation of any wealth transfer planning, they can limit estate tax inclusion risk by minimizing their retained rights or control over the assets transferred. As the second Trump administration may usher in a more favorable regulatory environment, some families may seek to implement more aggressive planning and be willing to litigate potential tax challenges, which could result in favorable legal precedents for taxpayers. Other UHNW clients may look to leverage the repeal of *Chevron* deference, pursuant to *Loper-Bright*, and challenge adverse IRS regulations and rulings (for example, those involving conservation easements and charitable deductions).

A brief comment regarding questions we're hearing from UHNW clients who have or are exploring private placement life insurance (**PPLI**). Sen. Ron Wyden's (D-Ore) recently proposed legislation targeting PPLI. We note that, while Sen. Wyden has continually focused on PPLI, he is not part of the Senate Republican majority and will not remain Chairman of the Senate Finance Committee under the new administration. Also, PPLI policies issued by U.S. insurers are already highly regulated and appropriately taxed *as life insurance products*, and both existing case law and the tax code impose numerous requirements on PPLI policies that already address the perceived issues expressed by Sen. Wyden. Many UHNW clients fit the profile for acquiring PPLI policies, as they have the net worth and necessary liquidity to fund large annual premiums and the desire for significant, long-term alternative investments in a tax-managed environment. That said, as PPLI is a long-range planning tool, critical care must be employed in understanding the potential benefits and risks associated with its structuring and implementation.

OTHER CLIENTS CAN BENEFITS FROM INCREMENTAL OR ASSET/ISSUE-SPECIFIC PLANNING TO ADDRESS TAX AND NON-TAX CONCERNS

We are seeing some hesitancy now from HNW clients under the $50 million threshold. These clients generally have less total gifting capacity (based on their comfort level) than UHNW clients and greater concerns about losing control and giving away too much. Most HNW clients prioritize access to funds and the flexibility or ability to "undo" planning if they change their minds or need additional resources in the future. In that respect, we have successfully moved HNW clients forward with planning after the following discussions. *Although advisors are likely familiar with these concepts, most HNW clients are not, which is why these conversations remain productive and beneficial to start now.*

Incremental Planning. Planning in discrete steps is generally easier for these clients to navigate, which can help initiate (or maintain) the planning process. For example, as a first step, we may discuss the client's creation of an irrevocable grantor trust as a "crummey" trust, which they *minimally* fund with annual exclusion gifts (increased to $19,000 in 2025). This concept can be introduced in tandem with the suggested creation or update of the client's basic estate plan. The initial trust setup can be simplified by having the client name individual trustees who are willing to act without compensation (preferably independent, but also can include a spouse[1] as a co-trustee) and using the client's social security number as the trust's tax identification number to streamline trust account creation and income tax reporting. The client can later appoint independent/professional trustees and obtain a TIN for the trust if needed or recommended. The trust can name the client's spouse as an initial beneficiary (as in a SLAT) or permit an independent trust protector to add the spouse as a beneficiary later. Further, the trust should: (i) *maximize flexibility*, including giving the client a substitution power over trust assets, (ii) specifically

[1] References to "spouse" herein also include a domestic partner.

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authorize various life insurance acquisition powers and discretionary tax reimbursement for the grantor's tax liability, and (iii) give an independent trust protector the powers to decant, change the trust's jurisdiction or governing law, modify trust provisions to change the trust's tax status or adapt to future tax changes, and (if desired) remove or add beneficiaries. The trustee will provide beneficiaries with withdrawal notices for any annual exclusion gifts to the trust, but timely-filed federal gift tax returns to report these gifts are not required unless the client makes other reportable gifts in the same tax year.

With relatively minimal cost and asset commitment, the client will have set up an irrevocable grantor trust that can "season" over time with proper administration. If nothing else, the client has an annual gifting vehicle that can support their descendants' education, health care, etc., while providing the client with indirect access (through the exercise of trustee discretion) if a spouse is a trust beneficiary. Yet the trust's availability and built-in flexibility also will permit the client to pivot quickly to the next phase of planning. We find that it's easier for a client to take the next step and implement a large gift, an installment sale or a life insurance purchase/split-dollar arrangement when they already have an existing trust and have been sensitized to the potential planning benefits and administration requirements.

Plan by Asset. Proposals expressed in terms of large exemption amounts do not necessarily motivate HNW clients who have concerns about parting with access to or control of significant wealth. Targeted planning based on a unique or single asset, *rather than a dollar value*, is more tangible and often has important non-tax motivators for these clients. Our review of a HNW client's asset composition also typically creates critical entry points for coordinated life insurance planning to solve tax and non-tax needs. We frequently encounter clients with illiquid assets like real estate and closely-held businesses who will need estate liquidity in the event of the client's premature death, which leads us to a discussion about the merits of life insurance as a mortality hedge. Closely-held business owners typically need to implement or update succession plans, which starts a dialogue regarding buy-sell funding upon the client's death or disability.

By opening these discussions, we proactively engage the client in the planning process and can also start to identify and quantify the opportunities for transferring a particular asset, potentially to a dynasty trust for descendants, a charitable split-interest trust to achieve income tax and philanthropic goals, etc. We review the client's portfolio for assets with significant growth potential that can be combined with a transfer to a GRAT or sold to a grantor trust (perhaps one previously implemented, as discussed above) so that the client can retain access to the future flow of funds from the required annuity and/or interest payments, but still shift the appreciation in excess of the applicable hurdle rate (the 7520 rate or AFR). Since the last few years have demonstrated how sensitive these techniques are to rising inflation and interest rates, we also review how clients can manage this volatility, including through "rolling" GRATs, exercises of substitution powers to swap out assets to mitigate losses and/or lock in favorable gains, and if interest rates drop, the potential re-finances of existing loans and prior installment sales.

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Consider Use of Accessible Trusts. The *flexibility and accessibility* of a proposed wealth transfer plan is highly correlated to the likelihood that an HNW client will implement that plan. Hence the popularity of SLATs, which, as noted, can be set up relatively simply. We are also having more discussions about domestic asset protection trust (**DAPTs**) or hybrid DAPTs, which are irrevocable trusts that provide the client with potentially *direct* access as a trust beneficiary. With DAPTs, the client is a beneficiary from trust inception (i.e., it is self-settled), whereas a hybrid DAPT allows an independent trustee/trust protector to add the client as a beneficiary at a later date. DAPTS and hybrid DAPTs avoid the potential loss of a client's access to a SLAT in the event of divorce or if the beneficiary-spouse dies. The trade-offs are (1) additional cost and complexity in implementation and administration (the trusts need to navigate the existence of potential creditor claims and be established in a self-settled trust jurisdiction, which will likely require the use of a local corporate/professional trustee) and (2) increased estate tax inclusion risk, particularly if the client receives regular trust distributions. In our experience, DAPT alternatives will be a better fit for clients who *prioritize* access over simplicity or cost-efficiency in implementation and administration.

Plan for State and Local Taxes. With the possible extension of higher transfer tax exemptions, discussions with HNW clients continue to shift more toward income and state and local tax planning. Non-grantor trusts, both completed gift and incomplete gift trusts, feature heavily in our asset-based planning discussions for closely held business owners that anticipate liquidity events in the next few years.

Take Advantage of Life Insurance Versatility. In the above situations, we routinely discuss using life insurance held through an ILIT as a versatile planning solution to many tax and non-tax needs, such as (1) generating liquidity for potential estate or other tax exposure and administration expenses, (2) permitting varying distributions of estate assets and cash among family members, (3) minimizing conflict among blended family beneficiaries, and/or (4) funding business succession planning.

In terms of policy selection, the client conversation targets three main issues: (1) the client's desire for cash value growth and access versus the desire/need for death benefit protection, (2) their ability and available liquidity to fund required premiums, and (3) their investment risk tolerance. These questions are fairly straightforward for clients to answer and they help narrow the focus to a general category of coverage, where we can work with advisors to further refine the product design and selection. For example, clients that prioritize cash value access will certainly avoid MEC status and many no-lapse guaranteed universal life policies (depending on their design), and a client's investment risk tolerance will suggest whether variable universal life policies should even be on the planning table. Further, not all available product features or riders will be appropriate for a particular plan, depending on its goals. A client may like the concept of a long-term care rider, but it typically will not make sense (or requires additional planning considerations and likely not reimbursement type riders) if the policy is held by an ILIT from inception.

Based on discussions with allied advisors, the option of PPLI also appears to have expanded beyond the UHNW client base. However, given the unique features of PPLI, including limited access to cash value and a longer-term investment horizon, coupled with the desire of most HNW clients to be able to access transferred assets or unwind prior planning, more "conventional" cash value life insurance products may remain the better fit for these clients. In any case, communications between clients and advisors will be critical to analyze and make informed and educated business and investment decisions regarding any policy selection.

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Review Existing Planning. Clients should regularly review and, if needed, update their existing core estate plans, particularly when there are expected changes in tax laws (like now). These reviews are an important opportunity to identify additional planning needs. We also carefully review the terms and administration of existing irrevocable trusts -- whether SLATs, ILIT, DAPTs, nongrantor trusts, etc. -- especially if the plan involves using them for additional wealth transfers. Many existing trusts need refinement because their terms may lack desired flexibility, they may not have been properly structured and/or administered, or family circumstances may have changed (such as due to death of a spouse or divorce).

PLANNING IN REAL TIME – THE HYBRID CLIENT

A current case illustrates some of the foregoing in action. A 46 year-old client is the founder, CEO, and super majority holder of a closely-held business that just received a business valuation of $500 million and expects even greater growth in the next 1-2 years as it obtains additional venture capital funding. Despite falling into the UHNW category, the client's net worth is concentrated in the business interests and various real estate holdings, with less than $10 million in *readily-available* liquidity. The client also wants to keep as much control over the business and liquid assets as possible. Since both UHNW and HNW challenges are in play for this client, the plan design needs to meet the client's control objectives, generate estate liquidity and implement and fund a business succession structure while also minimizing overall tax exposure and planning for the shift of potential appreciation in the business interests.

Using an asset-based approach, the initial priority is planning for the closely-held business, which involves numerous entry points for life insurance (as a mortality hedge and related liquidity strategy). The initial succession structure will most likely entail a trusteed, insurance-funded buy-out arrangement that permits the minority owners to purchase the client's interests at death. Additional personal life insurance held through an ILIT will be recommended to supplement this succession plan, to permit the ILIT to acquire business interests that are *not* purchased by the minority owners. To alleviate pressures on the client's personal liquidity, split-dollar loans from the business can be used to fund the buy-sell and perhaps even the personal insurance premiums. Based on existing investor agreements, the business also will need to acquire certain key person insurance to satisfy investor requirements and mitigate business continuity risks from the client's death, given the client's critical role in business operations.

As a first step, this insurance plan not only addresses the client's main areas of exposure but also establishes a trust structure that can support future planning. The ILIT may be created as a SLAT to enhance flexibility and potential accessibility. As a grantor trust, it can serve as the vehicle for later gifts or installment sales of the business interests (transferred with applicable valuation adjustments), when the client is ready to move forward with additional transfers. Alternatively, to segregate the insurance and asset based planning, a duplicate irrevocable grantor trust may be created and minimally funded at the same time as the ILIT, so both will have time to season before any subsequent round of wealth transfer planning. The client also can serve as a business and an investment advisor that directs the trustee regarding the trust's investments and business interests. Separately the client will continue to hold powers of substitution over the trust assets so they can swap in other assets for the business interests, if later desired or needed.

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