THE ESTATE PLANNER

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## ESTATE PLANNING FOR THE HAPPILY MARRIED

Hedge your bets with a SLAT

Pros and cons of custodial accounts for minors

Addressing an art collection in an estate plan can be tricky

Estate Planning Red Flag

Your spouse's estate didn't make a portability election

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# Estate planning for the happily married

*Hedge your bets with a SLAT*

One of the biggest challenges of estate planning is dealing with uncertainty. For 2022, for example, the federal gift and estate tax exemption is $12.06 million, but it's scheduled to be cut in half after 2025. And some lawmakers would like to shrink it even more. Given this uncertainty over the exemption's future, it's wise to take steps now to lock in the current exemption amount by transferring assets to your children or other heirs — either directly or in a trust — before the exemption is reduced.

At the same time, there's growing economic uncertainty. If you give away substantial amounts of wealth now, what happens if financial circumstances change for the worse at some point and you're in need of additional funds? If you find yourself in this position, and you're happily married, one potential strategy for hedging your bets is a spousal limited access trust, sometimes referred to as a spousal lifetime access trust (in either case, abbreviated as SLAT). Properly designed, a SLAT allows you to transfer assets up to your unused exemption amount tax-free, while providing a financial safety net if you need access to those assets down the road.

## Lose direct access to assets, but gain indirect access

To take advantage of a SLAT, you transfer assets to an irrevocable trust that benefits your spouse during his or her lifetime, with any remaining assets passing to your children or other heirs. Because the trust is irrevocable, the assets you transfer to it are completed gifts for estate tax purposes. That means their value, together with any future appreciation or earnings, are removed from your taxable estate. Most important, your gifts are shielded from gift tax up to your current unused exemption, protecting you from possible future reductions in the exemption amount.

Here's how a SLAT allows you to hedge your bets: Although you must give up your assets to gain the tax benefits described above, you continue to have *indirect* access to your wealth through your spouse, who's a beneficiary of the trust. Usually, the

## Two SLATs are better than one

One way to reduce the risk of losing a spousal lifetime access trust's (SLAT's) benefits if your spouse predeceases you is for each spouse to establish a SLAT for the benefit of the other. For this to work, of course, each spouse must fund their SLAT with separate property. Thus, you may need to retitle or transfer assets to ensure that each spouse has sufficient separate property to fund each SLAT.

If you use two SLATs, be sure the trusts aren't "mirror images" of each other. If they're too similar, the IRS may invoke the reciprocal trust doctrine. Under that doctrine, if the IRS concludes that the two trusts place you and your spouse in roughly the same economic position as if you each created a trust for your own benefit, it can undo the arrangement and bring the assets back into your respective taxable estates.

To avoid this result, be sure that the two SLATs are sufficiently different that they can't be viewed as a quid pro quo for each other. For example, you might establish the trusts at different times or include terms in one trust (a special power of appointment, for instance) that aren't included in the other.

best way to accomplish this is by appointing an independent trustee with full discretion to make distributions to your spouse or, alternatively, with the power to make distributions to your spouse under specified conditions.

### Control of assets is critical

To ensure that a SLAT achieves your objectives, it's important that it's drafted carefully. For example, you must avoid retaining too much control over the trust assets. Otherwise, they may be pulled back into your taxable estate. That means you shouldn't act as trustee or otherwise wield power over the trust, and the trust should prohibit distributions that would satisfy your legal support obligations to your spouse.

Care must be taken to keep the trust assets out of your spouse's estate as well. So, it's best not to name your spouse as trustee or, if that's unavoidable, consider limiting distributions to those necessary for his or her health, education or support.

Also, gifts to the trust must be made with your separate property. Gifts of jointly owned or community property may be included in your spouse's taxable estate. After the trust has been funded, be sure that its assets aren't commingled with marital assets.

### Understand the risks

The advantage of a SLAT is that even though it's irrevocable, it provides you with indirect access to the trust assets through your spouse. Thus, to preserve this advantage, your marriage must remain strong.

If you get divorced, you risk losing the safety net provided by a SLAT. You also risk losing a SLAT's benefits if your spouse dies before you do. One strategy for mitigating this risk is for each spouse to set up a SLAT. (See "Two SLATs are better than one" above.)

### Have your cake and eat it too

Under the right circumstances, and with careful planning, a SLAT can enable you to "have your cake and eat it too." It allows you to enjoy the tax benefits associated with irrevocable gifts, while retaining indirect access to your wealth in case your financial circumstances change. ▮

# Pros and cons of custodial accounts for minors

Setting up an investment account for your minor child can be a tax-efficient way of saving for college or other expenses. And one of the simplest ways to invest on your child's behalf is to open a custodial account under the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA).

These accounts — which are available through banks, brokerage firms, mutual fund companies and other financial institutions — are owned by the child but managed by the parent or another adult until the child reaches the age of majority (usually age 18 or 21).

Custodial accounts can be a convenient way to transfer assets to a minor without the expense and time involved in setting up a trust, but bear in mind that they have downsides too. Let's take a closer look at the pros and cons.

## Pros

**Convenience and efficiency.** Establishing a custodial account is like opening a bank account, so it's quicker, easier and cheaper to set up and maintain than more complex vehicles, such as trusts.

> *Custodial accounts can be a convenient way to transfer assets to a minor without the expense and time involved in setting up a trust.*

**Flexibility.** Unlike some savings vehicles, such as Coverdell Education Savings Accounts (ESAs), anyone can contribute to a custodial account, regardless of their income level, and there are no contribution limits. Also, there are no restrictions on how the money is spent. In contrast, funds invested in ESAs and 529 plans must be spent on qualified education expenses, subject to stiff penalties on unqualified expenditures.

**Variety of investment options.** Custodial accounts typically offer a broad range of investment options, including most stocks, bonds, mutual funds and insurance-related investments. UTMA accounts may offer even more options, such as real estate or collectibles. ESAs and 529 plans often have more limited investment options.

**Tax benefits.** Gifts to a custodial account reduce the size of your taxable estate. Keep in mind, however, that gifts in excess of the $16,000 annual exclusion ($32,000 for married couples) may trigger gift taxes or tap some of your lifetime gift and estate tax exemption. Contributions to custodial accounts can also save income taxes: A child's unearned income up to $2,300 per year is usually taxed at low rates (income above that threshold is taxed at the parents' marginal rate).

### Cons

**Other vehicles offer greater tax benefits.** Although custodial accounts can reduce taxes, ESAs and 529 plans allow earnings to grow on a tax-deferred basis, and withdrawals are tax-free provided they're spent on qualified education expenses. In addition, 529 plans allow you to accelerate five years of annual exclusion gifts and make a single tax-free contribution of up to $80,000 ($160,000 for married couples).

**Impact on financial aid.** As the child's property, a custodial account can have a negative impact on financial aid eligibility. ESAs and 529 plans are usually treated as the parents' assets, which have less impact on financial aid eligibility.

**Loss of control.** After the child reaches the age of majority, he or she gains full control over the assets and can use them as he or she sees fit. If you wish to retain control longer, you're better off with an ESA, a 529 plan or a trust.

**Inability to change beneficiaries.** Once you've established a custodial account for a child, you can't change beneficiaries down the road. With an ESA or parent-owned 529 plan, however, you can name a new beneficiary if your needs change and certain requirements are met.

### Weigh your options

A custodial account can be an effective savings tool, but it's important to understand its pros and cons. Your advisor can help you determine which tool or combination of tools are right for you given your financial circumstances and investment goals. ▮

# Addressing an art collection in an estate plan can be tricky

Some assets pose more of a challenge than others when it comes to valuing and accounting for them in an estate plan. Take, for instance, your art collection. If you possess paintings, sculptures or other pieces of art, they likely represent a significant portion of your estate. Here are a few options available to address your art collection in your estate plan.

### Seek a professional appraisal

It's vitally important to have your collection appraised periodically by a professional. The frequency depends in part on the type of art you collect, but generally it's advisable to obtain an appraisal at least every three years, if not annually. Regular appraisals give you an idea of how the collection is growing in value and help you anticipate tax consequences down the road. Also, most art donations, gifts or bequests require a "qualified appraisal" by a "qualified appraiser" for tax purposes.

> *Generally, there are three options for handling your art collection in your estate plan: Sell it, bequest it, or donate it to a museum or charity.*

In addition, catalog and photograph your collection and gather all appraisals, bills of sale, insurance policies and other provenance documents. These items will be necessary for the recipient or recipients of your collection to carry out your wishes.

## Sell it, bequest it or donate it

Generally, there are three options for handling your art collection in your estate plan: Sell it, bequest it to your loved ones, or donate it to a museum or charity. Let's take a closer look at each option:

1. If you opt to sell, keep in mind that long-term capital gains on artwork and other "collectibles" are taxed at a top rate of 28%, compared with 20% for other types of assets. Rather than selling the collection during your lifetime, it may be preferable to include it in your estate to take advantage of the stepped-up basis. That higher basis will allow your heirs to reduce or even eliminate the 28% tax. For example, you might leave the collection to a trust and instruct the trustee to sell it and invest or distribute the proceeds for the benefit of your loved ones.

2. If you prefer to keep your collection in the family, you may opt to leave it to your heirs. You could make specific bequests of individual artworks to various family members, but there are no guarantees that the recipients will keep the pieces and treat them properly. A better approach may be to leave the collection to a trust, LLC or other entity — with detailed instructions on its care and handling — and appoint a qualified trustee or manager to oversee maintenance and display of the collection and make sale and purchasing decisions.

3. Donating your collection can be an effective way to avoid capital gains and estate taxes and to ensure that your collection becomes part of your legacy. It also entitles you or your estate to claim a charitable tax deduction. To achieve these goals, however, the process must be handled carefully. For example, to maximize the charitable deduction, the artwork must be donated to a *public* charity rather than a private foundation. And the recipient's use of the artwork must be related to its tax-exempt purpose. Also, if you wish to place any conditions on the donation, you'll need to negotiate the terms with the recipient before you deliver the items.

If you plan to leave your collection to loved ones or donate it to charity, it's critical to discuss your plans with the intended recipients. If your family isn't interested in receiving or managing your collection or if your charitable beneficiary has no use for it, it's best to learn of this during your

lifetime so you have an opportunity to make alternative arrangements.

## Enjoy your collection

A primary goal of estate planning is to remove appreciating assets from your estate as early as possible to minimize gift and estate taxes. But for many, works of art are more than just assets. Indeed, collectors want to enjoy displaying these works in their homes and may be reluctant to part with them. Your estate planning advisor can help you properly address your art in your estate plan. ▮

ESTATE PLANNING RED FLAG

## Your spouse's estate didn't make a portability election

Portability helps minimize federal gift and estate taxes by allowing a surviving spouse to use a deceased spouse's unused gift and estate tax exemption amount. Currently, the exemption is $12.06 million, but it's scheduled to return to an inflation-adjusted $5 million on January 1, 2026. Some lawmakers have proposed lowering the amount even further.

Portability isn't automatically available; it requires the deceased spouse's executor to make a portability election on a timely filed estate tax return. Unfortunately, many estates fail to make the election because they're not liable for estate tax and, therefore, aren't required to file a return. These estates should consider filing an estate tax return for the sole purpose of electing portability. The benefits can be significant, as the following example illustrates.

Bob and Carol are married. Bob dies in 2022, with an estate valued at $3.06 million, so his unused exemption is $9 million. His estate doesn't owe estate taxes, so it doesn't file an estate tax return. Carol dies in 2026, with an estate valued at $15 million. (For this example, let's say the exemption amount in 2026 is $6 million.) Because the exemption has dropped to $6 million, her federal estate tax liability is $3.6 million [40% x ($15 million – $6 million)].

Had Bob's estate elected portability, Carol could have added his $9 million unused exemption to her own for a total exemption of $15 million, reducing her estate tax liability to zero. Note that by electing portability, Bob's estate would've locked in the unused exemption amount in the year of death, which wouldn't be affected by the reduction in the exemption amount in 2026.

If your spouse died within the last couple of years, and you anticipate that your estate will owe estate tax, consider having your spouse's estate file an estate tax return to elect portability. Ordinarily, an estate tax return is due within nine months after death (15 months with an extension), but a return solely for purposes of making a portability election can usually be filed up to two years after death.

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*We welcome the opportunity to discuss your situation and provide the services required to help you achieve your estate planning goals. Please call us today and let us know how we can be of assistance.*

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