A Newsletter from the Law Offices of Boyd & Boyd, P.C.

YOU CAN HAVE YOUR ESTATE PLANNING "CAKE" AND EAT IT TOO!

- Are you a Florida Resident owning Massachusetts Real Estate?
- Do you have a taxable estate?
- Is a child or grandchild starting a business?
- Will you make significant gifts to your children or grandchildren?
- Are you considering a QPRT?
- Do you want future appreciation of assets to be excluded from your taxable estate without losing control over your assets?

If you answered "Yes" to ***any*** of these questions, then this article will show you how to achieve each of those goals.

Irrevocable Trusts with a Back Door

Most of you are aware that Irrevocable Trusts are great in certain instances ~ e.g. when coupled with Life Insurance (Irrevocable Life Insurance Trust - ILIT) or when used for a Capital Gains Avoidance Trust (CRT). The negative about Irrevocable Trusts has been that once you create the trust it can not be changed and once you give an asset to the trust it can not be returned. The irrevocable nature of the instrument is what is beneficial to planning. Once transferred, the asset is no longer a part of the estate. That's great for taxes, but what happens if you need the asset back? Wouldn't is be nice if there was a back door that allowed to transfer the asset back to yourself, if it were needed? Well, we have developed just such a trust!

"Defective" Is Good?

Years ago Congress passed several tax rules that have become known as the "Grantor Trust" rules. Among those rules is Internal Revenue Code Section 678 which provides that if certain conditions are met, a particular beneficiary of the trust will be considered the *income* tax owner of the trust assets. Consequently the beneficiary will be taxed on the income and gains of the trust. However, if other conditions are met (which generally require

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the passage of an amount of time, which may be as brief as a year or as long as several years or more, depending upon the amount of the initial gift to the trust and the growth of the trust assets), the assets of the trust will not be included in the beneficiary's taxable *estate*. Furthermore, with proper planning, the trust assets will remain outside of the reach of wealth transfer taxation (gift, estate and generation-skipping transfer tax) for as long as the trust lasts.

These trusts are commonly called *defective trusts*. The 'defective' label is an carryover from a few decades ago when it was often desirable to have a trust taxed as a separate entity. Before these rules were established, trust income tax brackets were the same as the individual tax income brackets. So it used to be that if a trust drafter inadvertently tripped one of these rules, the trust would be termed 'defective.' But, having a trust's income taxed to an individual today is desirable because trusts reach the highest tax brackets very quickly.

With proper planning, intentionally breaking the Grantor Trust rules and creating an "Intentionally Defective" Trust opens up a whole new realm of planning opportunities.

Beneficiary Taxed Residence Trust ™ (BTRT™)

A Beneficiary Taxed Residence Trust™ (BTRT™) is an alternative for anyone:

- with a taxable estate;
- who is a resident of a state with no estate tax who owns real estate in a state with an estate tax (e.g. MA);
- whose real estate is likely to appreciate; or
- who is considering a Qualified Personal Residence Trust (QPRT).

As an alternative to the QPRT, the BTRT™ may have greater and more definite benefits. The BTRT™ does not attempt to does not attempt to qualify under the IRS guidance relating to QPRTs. Instead the BTRT™ accomplishes many of the same objectives as a QPRT, by the sale of the personal residence to a specially-drafted irrevocable trust taxed as a grantor trust to you, the homeowner.

The BTRT™ compared to the traditional QPRT is shown by the following chart:

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BTRT	Traditional QPRT
Home is sold to the trust	Home is gifted to the trust
Because sale is for reasonably equivalent value, a fraudulent transfer claim is much more difficult for creditors to make	Gift is subject to fraudulent transfer claim made within four years of the date of the transfer
Trust is not self-settled	Trust is self-settled, and susceptible to being set aside as a self-settled spendthrift trust at least to the retained interest in most states
House passes outside the your estate without regard to any period	House passes outside the your estate if they live past the period
House passes outside the your estate without regard to any period	QPRT fails and house stays inside the your estate if they do not live past the period
You may live in home without regard to period	You lose the right to live in the home past the retention period

How the BTRT™ Works

We have a third party establish a trust on the client's behalf. The third party should ideally be a friend or a family member, but not a spouse or a child. After the trust is created the client, who is the trustee and the beneficiary of the trust does the following:

Step 1: Clients make gift of cash or investment assets of at least 10% of Fair Market Value (FMV) of home.

Step 2: Clients sell home & perhaps other assets to BTRT™ at fair market value. Because this is a "defective" trust, there is no *income* (capital gains) tax on this sale.

Step 3: Clients take back:

1. Down Payment of 10% of FMV of home;

2. Interest Only Demand Note at AFR with Mortgage.

Step 4: Clients pay Fair Market (FM) rent to BTRT each month

Step 5: Trust uses rent to pay interest on note plus prepays any principal with available cash.

The result is the home is out of the estate for *estate* tax purposes. This means that the Massachusetts real estate of a Florida Resident is no longer a part of the taxable estate. This can result in substantial tax savings.

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Additionally, the real estate is out of the estate for federal estate tax purposes as well. This means that the appreciation in the real estate will not create an increased estate tax liability. And if the promissory note is paid off over time, the entire value of the real property passes estate tax free.

Since the BTRT™ contains Personal Asset Trust™ provisions the real property will also be protected from the clients creditors as well as protected from claims by the children's creditors or a divorcing spouse after the client's death.

Call us for a detailed explanation of how this could help you.

Gifting with Beneficiary Taxed Trusts

Also, if you plan to gift to a child or a grandchild, another instrument, called the Beneficiary Taxed Trust (BTT), provides a great mechanism to give tremendous flexibility and strong asset protection.

Your gifts might include shares of a Family Limited Partnership, seed money for a business venture or gifts of cash or other assets up to the annual exclusion amount.

The BTT works like the Personal Asset Trust™. But instead of waiting for the death of the Donor (and the Donor's spouse if the Donor is married) the heir is immediately vested as beneficiary and trustee in the trust property. This gives the heir immediate access to the trust property during the Donor's lifetime, provides asset protection and allows the heir the ability to sell assets to the trust at fair market value to obtain added asset protection. And remember, everything in the BTT passes free of estate tax at the heir's death. This allows the assets to appreciate free of death tax for as several generations if you wish.

For More Information Contact
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"You create the legacy. We create the plan."

Estate & Trust: Planning, Administration & Management, Wealth Preservation, Asset Protection, Elder Law, Tax Law, Business & Succession Planning

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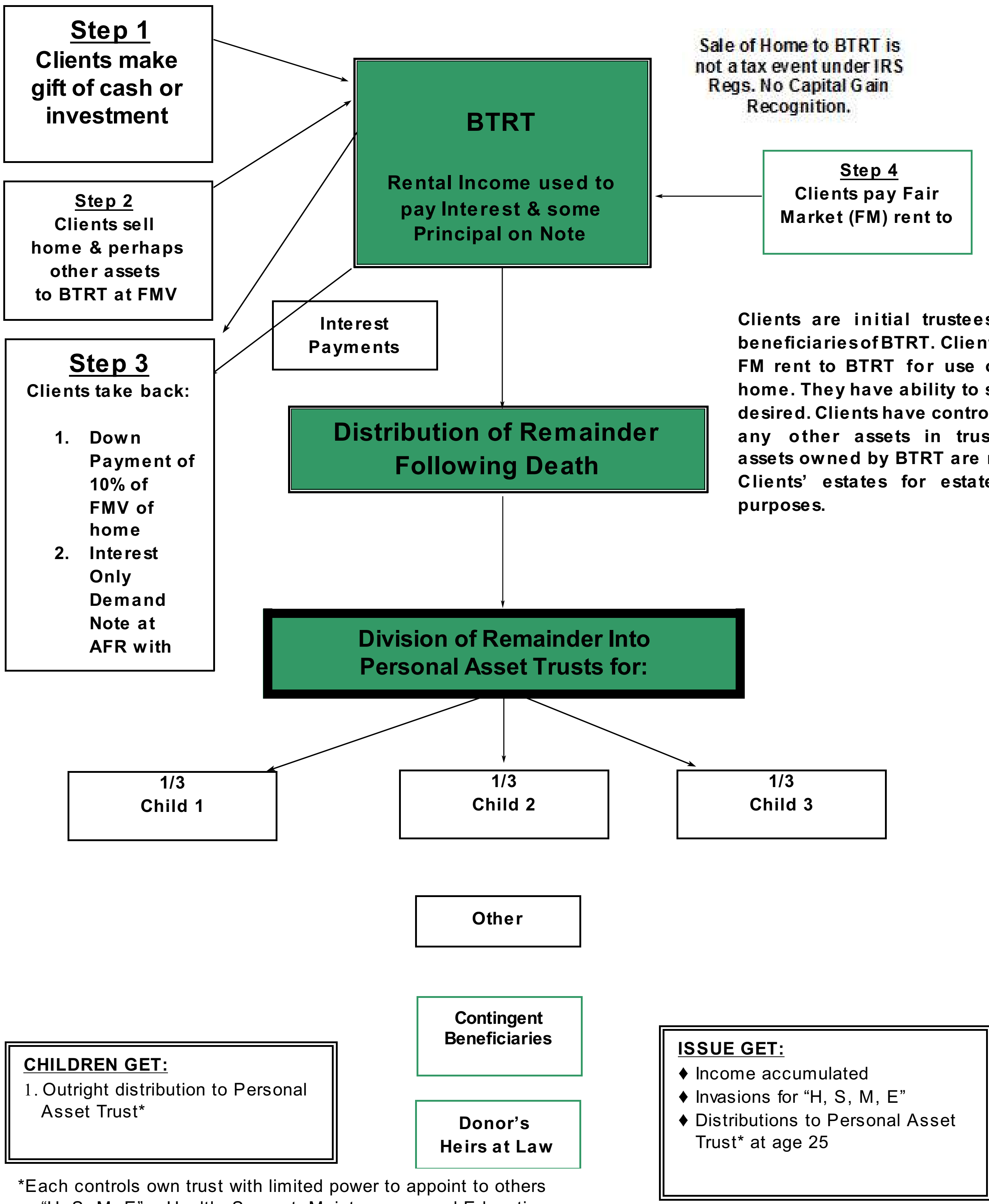

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