

# Revocable Trusts and Funding, Disclaimer Plans, and Clayton QTIP Plans



*Travis J. Schroeder*

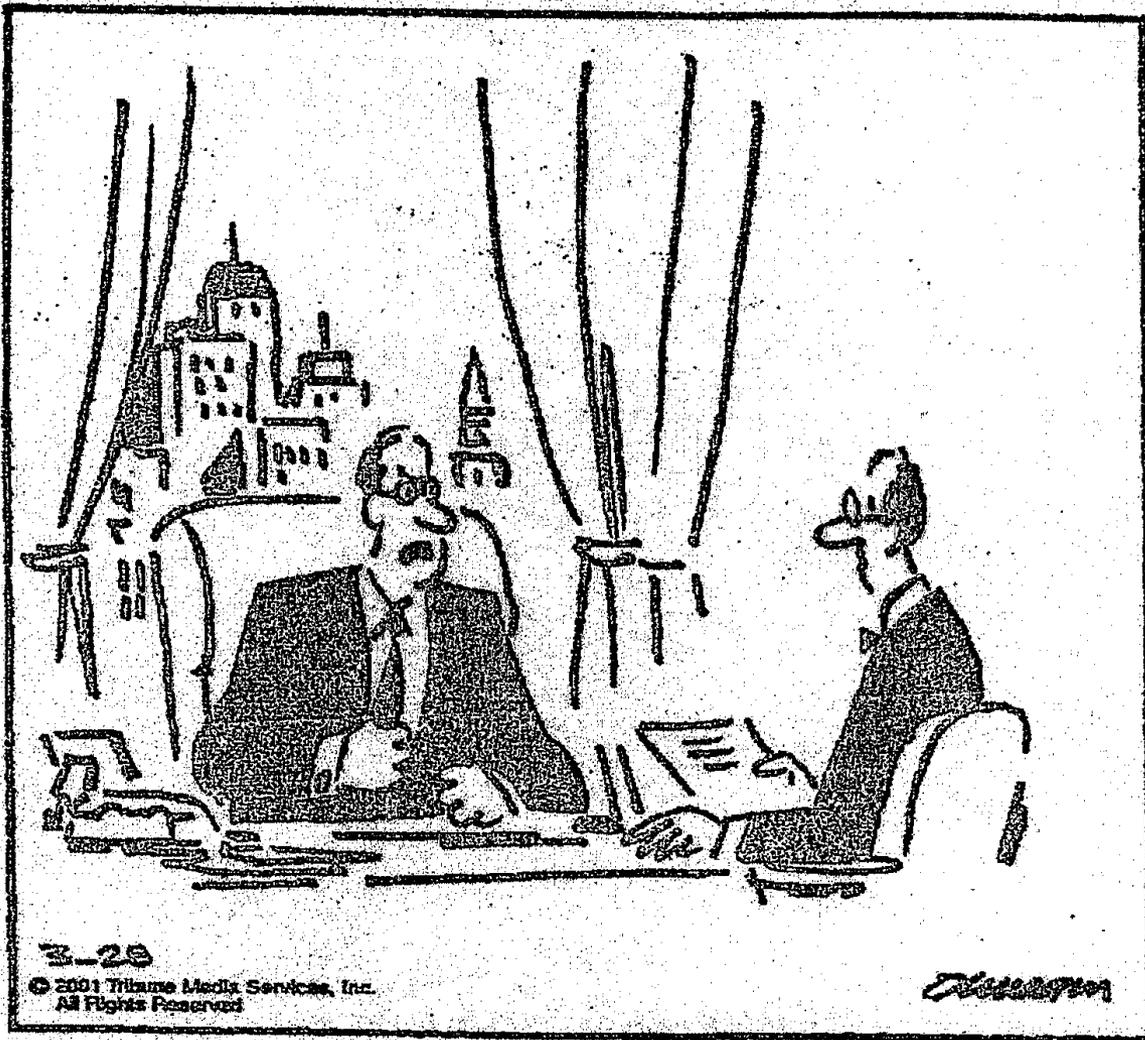
(319) 366-7641

tjs@spmbllaw.com



SIMMONS PERRINE MOYER BERGMAN PLC

[www.spmbllaw.com](http://www.spmbllaw.com)



3-29

© 2001 Titano Media Services, Inc.  
All Rights Reserved

*Tom Swick*

"Darn it! I've spent too much money on ways to avoid the estate tax to have it end now!"

**SPMB**

SIMMONS PERRINE MOYER BERGMAN PLC

[www.spmblaw.com](http://www.spmblaw.com)

# Federal Estate Tax Exemptions 2019 and Beyond

Per Individual

Per Married Couple

2019: \$11,400,000

2019: 22,800,000

2020-2025: \$11,400,000  
plus inflation

2020-2025: \$22,800,000  
plus inflation

2026: \$5,700,000 (plus 8  
years inflation increases)

2026: \$11,400,000 (plus 8  
years inflation increases)



SIMMONS PERRINE MOYER BERGMAN PLC

[www.spmbllaw.com](http://www.spmbllaw.com)

# Important Tax Rates

## Federal Gift/Estate Tax Rate

- 40% (deductions for gifts to spouse & charity)
- GST Tax rate is the same

## Iowa Estate Tax Rate

- 0% on gifts/bequests to spouse, children, grandchildren, etc.
- 10%-15% on gifts/bequests to others

## Federal Income Tax Rates

- 10%, 12%, 22%, 24%, 32%, 35%, and 37%
- Top rate begins at \$612,350 (\$510,300 for single)

## Iowa Income Tax Rates

- 8.53% top rate (income over \$73,710)
- Rates reduced somewhat under new tax law starting in 2019

## Federal QBI Deduction

- 20% of QBI (phase outs begin at \$321,400 joint taxable income and \$160,700 single taxable income)

## Iowa Income Tax Rates

- 25% of Federal QBI Deduction (starting in 2019)

## Federal Tax Law Changes (except corporate tax rate) – Expire 12/31/2025

## Federal LT Capital Gains Tax Rates

- As high as **23.8%**
  - 0% on income below \$78,950 (\$39,475 for single)
  - 15% on income between \$78,950 and \$488,850 (\$39,475 and \$434,550 for single);
  - 20% on income above \$488,850 (\$434,550 for single)
  - Additional 3.8% Medicaid Tax on lesser of (a) net investment income and (b) excess of modified AGI over \$250,000 (\$200,000 for single)

**Kiddie Tax:** Applies to children under age 18 and to young adults 18 or older who are unmarried and a full-time student. Net unearned income allocated to such persons is now taxed at trust and estate rates (rather than parent rates), which hit 37% after \$12,750 of income. Gifting of grain, pass-through entity interests, and other income producing assets to minors is now less tax efficient.

## Iowa Capital Gains Tax Rates

- 8.53% top rate (income over \$73,710)
- Iowa Capital Gains Exclusion

## Federal Corporate Tax Rates

- 21% flat rate (permanent)

## Iowa Corporate Tax Rates

- 12% top rate (income over \$250,000)
- Rates reduced under new tax law starting in 2021



# Overview

1. **Planning Idea #1** - Use of Revocable Trusts (rather than Wills) to Avoid Probate and Funding of Revocable Trusts
2. **Planning Idea #2** - Clayton QTIP or Disclaimer Plan and Other Flexibility to Include in Revocable Trust/Will



# Estate Planning – Idea #1

- What is a “Revocable Trust” a/k/a “Living Trust”
  - Usually the Trustor is the initial Trustee and initial Beneficiary
  - The Trustor Can Amend or Revoke (undo) the Trust at any time
  - The Trust is Not a Separate Taxpayer
  - Gifts to the Trust Have No Tax Implication Whatsoever
  - Upon the Trustor’s Death, Incompetence, or Resignation, the Trust Continues with a Successor Trustee
  - Upon the Trustor’s Death, the Trust Continues With New Beneficiaries, According to the Terms of the Trust, Which at That Point Become a Will Substitute.
  - It is important that every Revocable Trust be Back-stopped with a Valid Will. A “Pour-Over Will” provides that any property owned by the Trustor (and not by the Trustor’s Revocable Trust) at Death pours into the Revocable Trust.



# Estate Planning – Idea #1, *cont.*

- Why Would Somebody Create a Revocable Trust as Opposed to Only Having a Will
  - If Trust owns all of the Trustor's property at his death (other than property passing by beneficiary designation or joint tenancy arrangement), then court-supervised probate is avoided. Avoiding probate:
    - Reduces attorney fees at death (court involvement complicates things)
    - Executor fees avoided (trustee fees are oftentimes less)
    - No court costs (0.2% of gross estate value)
    - If real estate is owned in multiple states, avoids court-supervised probate in multiple jurisdictions, which is expensive
    - No court file so privacy is enhanced. Nosy persons can't go to the court to see what you owned, what it was worth, or who you left it to. (Heirs and creditors and beneficiaries still have rights to certain notice)
    - Streamlines decision making during incapacity prior to death.
  - When is it worth the effort and complexity, and why?
    - The wealthier you are, the more beneficial it is (greater savings at death)
    - The more that privacy matters to you, the more beneficial it is
    - If you own property in multiple states or may move between states, it may be worth considering



# Estate Planning – Idea #1, *cont.*

- **Funding Revocable Trusts:** The benefits provided by revocable trusts can only be realized if the client is able to transfer all of his/her property into the revocable trust during his/her life.
  - Real Estate – Transferred to revocable trust by deed.
  - Structures on Leased Land – Transferred to revocable trust by bill of sale.
  - Ownership in Business Entities – Stock/units transferred to revocable trust by irrevocable stock/unit power (or signing back of stock/unit certificate). Need to confirm entity organizational documents and ownership agreements permit such a transfer (and if not then obtain written consent of other owners) prior to having client execute transfer documents.
  - Tangible Personal Property – Transferred to revocable trust by bill of sale or general assignment. However, vehicles, boats, and other tangible personal property that can be titled can be re-titled into the name of the revocable trust if desired, but such property should be covered by the bill of sale or general assignment in any event.
  - Assets Passing by Beneficiary Designation (life insurance, IRAs, 401Ks, etc) – Do not need to transfer ownership into the revocable trust, as such assets pass outside of probate to the designated beneficiary by contract. However, we will uncross life insurance that is cross owned by spouses if estate tax will not be an issue for the family. The beneficiary designations should be reviewed regularly to ensure they are consistent with the rest of the estate plan the client has implemented.



# Estate Planning – Idea #1, *cont.*

- We will oftentimes have retirement accounts and annuities pass outright to beneficiary (i.e., spouse as primary beneficiary and children, per stirpes, as contingent beneficiaries) for income tax reasons, unless the children are young (or there are other non-tax reasons to use a trust) in which case we would name the family trust created under the revocable trust as the contingent beneficiary. Need to ensure trust is structured as a “see-through trust” (trust beneficiaries must be identifiable, only individuals are trust beneficiaries, and oldest trust beneficiary is identifiable as such beneficiary’s life expectancy is used to calculate the permitted stretch) in order for the trust to qualify for a payment stretch. “Conduit trusts” (the greater of RMD or all trust income is distributed to beneficiaries – then no need to look at contingent or remainder beneficiaries) and “accumulation trusts” (requires careful drafting to ensure beneficiaries are identifiable (particularly the oldest beneficiary) and only individuals can be beneficiaries) are safe harbors under the regulations. If a trust qualifies as a “see-through” trust, then RMD can be taken over life expectancy of oldest trust beneficiary.
  - We will often times name the insured’s revocable trust as the contingent beneficiary of life insurance, particularly if the insurance is needed to fund estate taxes, to pay debts, or to equalize children’s inheritances (as the trust better manages deaths out of order and contains young beneficiary provisions). However, if the deceased client has potential creditor issues, you need to be aware that this may potentially subject the proceeds to trust estate creditors. For second to die policy, primary beneficiary should be ½ to one spouse’s revocable trust and ½ to other spouse’s revocable trust to protect against simultaneous death with the intent being to update the beneficiary to the surviving spouse’s revocable trust after death of first spouse.
  - For policies owned on another person’s life, need to consider naming the owner’s revocable trust as a contingent owner and contingent beneficiary of the policy.
- Notes Receivable / Mortgage – Transferred to revocable trust by an assignment.



# Estate Planning – Idea #1, *cont.*

- **Types of financial accounts:**
  - Accumulation Accounts (brokerage accounts, investment accounts, CDs, etc.) – accounts clients do not need to access on a regular basis, but rather are meant to accumulate wealth.
  - Transaction Accounts (checking accounts, savings accounts, etc.) – accounts clients do need to access on a regular basis to make deposits into and to pay bills from.
- **Options for titling of financial accounts when funding revocable trusts:**
  - Title account in the name of one spouse’s revocable trust.
    - Pros: clean, controlled by trustee of revocable trust, and financial institutions usually allow. Cons: only one spouse can access the account unless both spouses are named as co-trustees of the revocable trust, may make life harder for transaction accounts, and financial institutions may require new account to be opened.
  - Title account as tenants-in-common in the names of both spouse’s revocable trusts
    - Pros: controlled by trustee of revocable trusts, and both spouses can access some or all of the account (particularly if both spouses are named as co-trustees of both revocable trusts). Cons: financial institutions sometimes will not allow this, may make life harder for transaction accounts, and financial institutions may require new account to be opened.
  - Title the account as tenants-in-common in the names of the individual spouses and have a POD designation on the account directing that upon the death of a spouse that spouse’s share of the account will be paid to that spouse’s revocable trust.



# Estate Planning – Idea #1, *cont.*

- Pros: makes life easy for transaction accounts, and both spouses can access some or all of the account (particularly if spouse is named as attorney-in-fact for other spouse and trustee of other spouse's revocable trusts). Cons: financial institutions sometimes will not allow this, partially controlled by attorney-in-fact upon incapacity, requires extra step to get account into revocable trust upon incapacity (if desired).
- Title the account as a joint account in the names of the individual spouses and have a POD designation on the account directing that upon the death of the surviving spouse the funds of the account will be paid to the surviving spouse's revocable trust. If a financial institution is hesitant to include such a POD designation, the POD designation could alternatively provide that upon the death of the surviving spouse the funds of the account will be paid ½ to one spouses revocable trust and ½ to the other spouse's revocable trust. This protects against a simultaneous death with the intent being to update the ownership of the account to the surviving spouse's revocable trust after the death of the first spouse.
  - Pros: makes life easy for transaction accounts, and both spouses can access the account. Cons: financial institutions sometimes will not allow this, and partially controlled by attorney-in-fact upon incapacity.



# Estate Planning – Idea #1, *cont.*

- **Other Issues with Funding Revocable Trusts:**
  - Debts Encumbering Assets – We always have client discuss proposed transfer with lenders before executing and filing deeds and other transfer documents.
  - Property, Casualty, Liability Insurance – We always have client talk with insurance agents to update the policies to include the revocable trust names as “additional insureds” under such policies (property/liability insurance policy for real estate and other assets, homeowners insurance policy, auto insurance policy, personal umbrella policy).
  - FSA Issues for Farm Clients – We always have client talk with FSA office to notify them of farm entity and land ownership changes to the revocable trusts. CRP payments should be updated from personal names to revocable trust names and the “operator” should be updated from personal names to revocable trust names. If updates are made at the FSA office, the client will also want to update crop insurance to revocable trust names.



# Estate Planning – Idea #1, *cont.*

- **Use of Joint Revocable Trusts:**

- Will generally only consider using for clients with no more than a couple million of net worth and who want a fairly simple estate plan. In cases where the use of a joint revocable trust is appropriate, it is simpler to fund and oftentimes simpler for client to understand. The more complicated the assets and the more complicated the desired estate plan, the less useful a joint revocable trust will be to carry out the estate plan.
- In cases where the use of a joint revocable trust is appropriate, the trust can be drafted in a manner that requires only a limited administration process at the death of the first spouse (still will want to provide required notices, value assets to determine basis, and file federal estate tax return if determined prudent).
- Problems with joint revocable trusts – (1) complicated to administer (and draft) unless limited assets and simple estate plan, (2) sometimes difficult to determine which spouse contributed which assets when a death occurs, (3) sometimes difficult to determine basis step-up at death, and (4) added complexity with plans that attempt to provide significant estate/GST tax planning or plans that attempt to provide significant creditor protection for surviving spouse.



# Estate Planning – Idea #2

With current higher gift/estate tax exemption amounts, availability of portability (ability to have unused gift/estate tax exemption of first spouse to die to be added to exemption of surviving spouse), and continuously changing tax laws, estate plans should be drafted to have maximum flexibility.

- **Disclaimer Plan (Contingent-Tax Plan):**

- Assets are left to surviving spouse, with surviving spouse having ability to disclaim (within 9 months of deceased spouse’s death – hard deadline) assets to the Family (Bypass) Trust created by deceased spouse (surviving spouse would be trustee and primary beneficiary of such Trust).
- Allows Flexibility for Post-Mortem Planning: Disclaim to Fund the Trust and Get an Estate Tax Freeze? Or Spouse to Receive Assets and Get a Second Step-up? Either way, no estate tax exemption is wasted. Assets passing to Family Trust by way of disclaimer by surviving spouse cannot be subject to a spousal second look power over the Family Trust.
- Optimal Plan for Many or Most “First Marriage” Clients Well Below the \$22,800,000 Threshold (as Second Step-Up in Basis will often be Optimal) and who have no non-tax reasons for utilizing a Trust.
- Not Optimal Plan For (a) folks approaching or above the \$22,800,000 Threshold, where the estate tax freeze may be more attractive than the possibility of a Second Step-Up (especially with appreciating assets (farms) that are not likely to be sold by heirs but rather retained as legacy assets), (b) folks that have non-tax reasons for utilizing a Trust, or (c) folks who desire to do generation skipping transfer (“GST”) Tax Planning.



# Estate Planning – Idea #2, *cont.*

- **Clayton QTIP:**
  - Assets are allocated between a Family (Bypass) Trust and Marital Trust based on the extent to which the Trustee makes a QTIP election. Portion of assets for which QTIP is elected will be allocated to Marital Trust and remaining portion of assets will be allocated to Family Trust. Marital Trust and Family Trust can provide for the same or different dispositive terms. This type of plan may provide additional post-mortem planning opportunities than traditional Marital Deduction Formula Plan.
  - Optimal Plan For (a) folks approaching or above the \$22,400,000 Threshold where availability of valuation discounts will be important, (b) folks that have non-tax reasons for utilizing a Trust, or (c) folks who desire to do GST Tax Planning.
- **Income Tax Considerations When Developing Marital Plan:**
  - Stepped-Up Basis, Avoiding Trust Income Tax Rates, S-Corporation Income, Phantom Income Issues, Etc.



# Estate Planning – Idea #2, *cont.*

- **Clayton QTIP Plan**

- Trustee (and sometimes an Independent Trustee) decides what portion of Trust is elected as QTIP. This decision can be based on family wealth situation, tax law in place at the time the first spouse has died, and other factors.
- QTIP portion will get second step-up in basis at death of surviving spouse, but will be included in taxable estate of surviving spouse. These assets will be held in trust for the sole benefit of surviving spouse during surviving spouse's life.
- Non-QTIP portion will not be included in taxable estate of surviving spouse and will not get second basis step-up. These assets will be held in trust for the benefit of surviving spouse (and, if desired, simultaneously for the benefit of children and grandchildren) during surviving spouse's life.
- The Trustee would likely make a QTIP election under two circumstances:
  - **If estate taxes turn out to be an issue for you.** If deceased spouse's assets exceed deceased spouse's available tax-free amount (currently \$11,400,000 less taxable lifetime gifts made by deceased spouse), then an election would be made as to the excess assets (*i.e.*, those assets in excess of the available tax-free amount) to avoid estate taxation at deceased spouse's death.



# Estate Planning – Idea #2, cont.

- **To obtain a second basis step-up on assets at surviving spouse's subsequent death.** Even if estate taxes are not an issue for you, the Trustee may want to make an election as to a portion of the Residual Trust assets in order to obtain a second basis step-up on such assets at surviving spouse's subsequent death in order to re-depreciate such assets or minimize the taxable gain that may occur on the subsequent sale of such assets by your children (*i.e.*, facilitates the ability of the trustee to engage in post-mortem income tax planning) However, the Trustee would not want such assets to appreciate so much that an otherwise avoidable estate tax problem is created at surviving spouse's subsequent death. The opportunity for a second basis step-up is possible because the assets with respect to which the QTIP election is made will pass to the Marital Trust, and the assets of the Marital Trust will be included in surviving spouse's taxable estate at his/her subsequent death and receive a second step-up in basis. In Rev. Proc. 2016-49, the IRS clarified that a QTIP election will be respected where it is coupled with a portability election, even if it was not necessary to reduce or avoid federal estate taxation upon the first spouse's death.
- At least if the QTIP Trust is different from the Non-QTIP Trust, it appears that a QTIP election would have to be made by an independent executor/trustee (such as a bank). Surviving spouse and the children (as executor/trustee) would not be able to make the election under such circumstances for tax reasons.

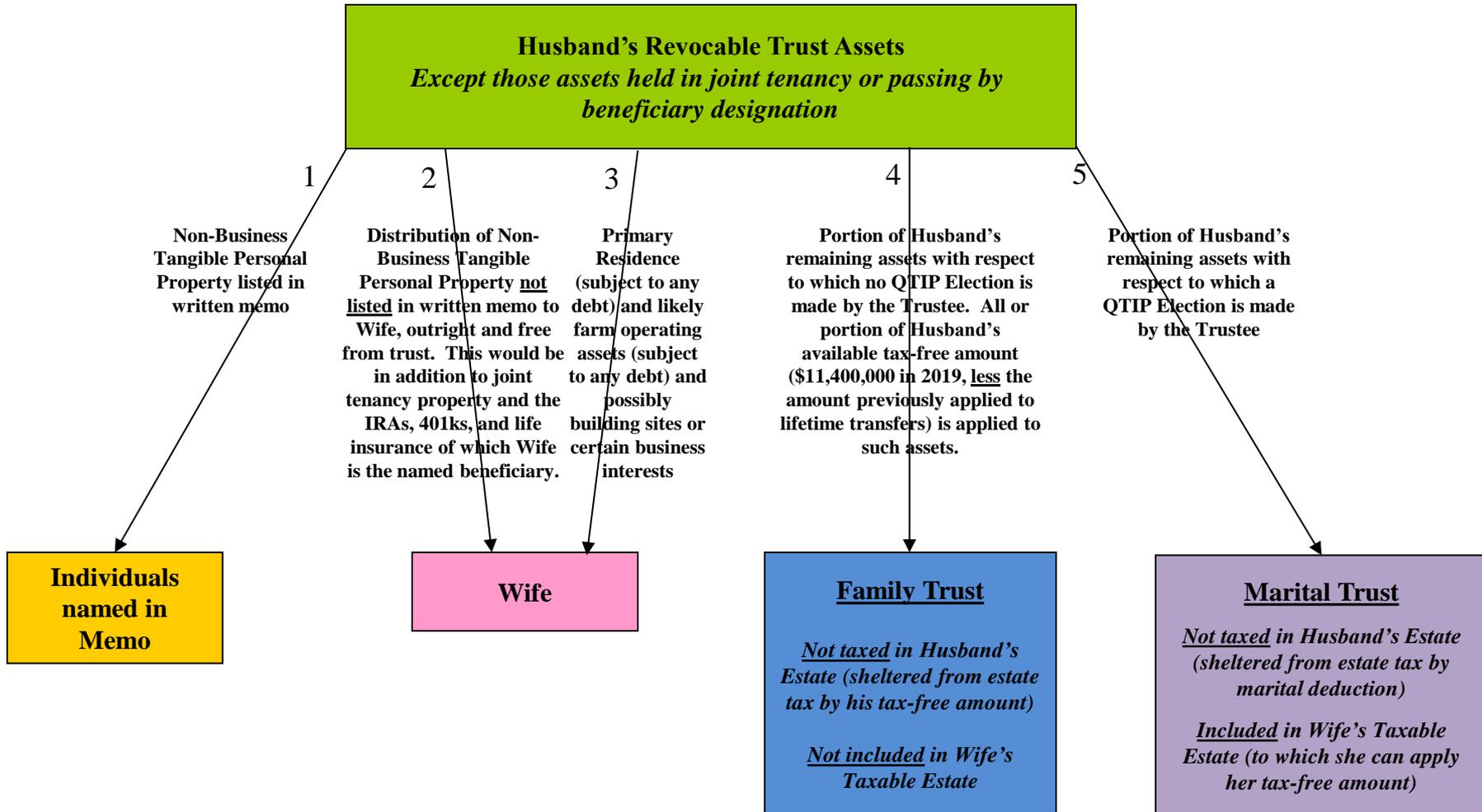
# Estate Planning – Idea #2, *cont.*

- Additional Provisions to Maintain Flexibility:
  - Trustee’s Power to “Sprinkle” or “Spray” income and/or principal of Family Trust among a specified class of beneficiaries during surviving spouse’s life – provides flexibility for Trustee to manage taxes and direct funds to persons who need them
  - Surviving Spouse’s Second Look Power (Limited Power of Appointment) – provides surviving spouse with flexibility to change the distribution of trust assets that will occur after death of surviving spouse (can be narrow or broad).
  - Power to remove and replace Trustees given to beneficiaries.
  - Power to Amend Trust given to Independent Trustee or Trust Protector (for tax reasons, to carry out grantor’s intent, to corrects errors, etc.).
  - If assets will remain in trust for multiple generations, give each generation power of appointment to create some flexibility (for tax reasons, for changes in family, etc.).

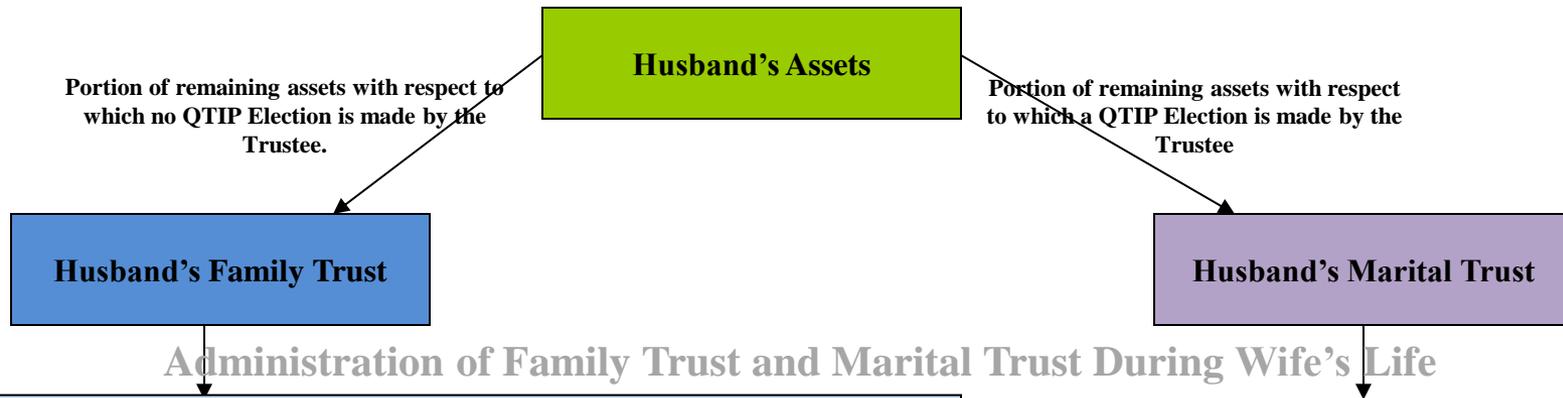


# CLAYTON QTIP PLAN

## Operation of Husband's Revocable Trust Following Husband's Death (Assuming Husband Dies First)



# Operation of Husband's Revocable Trust Following Husband's Death (Assuming Husband Dies First)



## Administration of Family Trust During Wife's Life:

- Trustee shall distribute all or such portion of the income of the Family Trust to Wife as is necessary (after considering all other funds and resources available to her) to provide for her health, education, maintenance, and support. If Wife is serving as Trustee of the Family Trust, the Trustee (i.e., Wife) shall distribute to or for the benefit of your descendants all or as much of the net income not distributed to Wife in a given year as is necessary (after considering all other funds and resources available to them) to provide for their health, education, maintenance, and support (distributions need not be equal as among your descendants). If Wife is not serving as Trustee of the Family Trust (i.e., one or more of the children), any net income not distributed to Wife in a given year shall be distributed to or for the benefit of your children, per stirpes. The needs of Wife (both short-term and long-term) should take precedence in the Trustee's calculus over the needs of the other beneficiaries. Additional restrictions apply to assets passing to the Family Trust as a result of a disclaimer by Wife and to distributions from s-corporation stock held by the Family Trust.
- Trustee shall also distribute as much of the principal of the Family Trust as necessary (after considering all other funds and resources available to Wife) to provide for Wife's health, education, maintenance, and support, provided that farm assets/business assets shall not be distributed. Wife's access to principal distributions from the Family Trust will cease if she gets remarried without first obtaining a valid prenuptial agreement containing certain required provisions protecting the family assets.
- Wife will have right to use and enjoy residences held by Family Trust and the authority to direct the Trustee to sell any residence and to reinvest the sale proceeds in a new residence or other investment.
- All minimum distributions from a Deferrable Retirement Benefit (IRA, 401k) held by the Family Trust are paid to Wife each year.

## Administration of Family Trust After Wife's Death:

- All remaining assets of the Trust (including assets pouring in from the Marital Trust) will be distributed as provided on the subsequent pages of this summary.

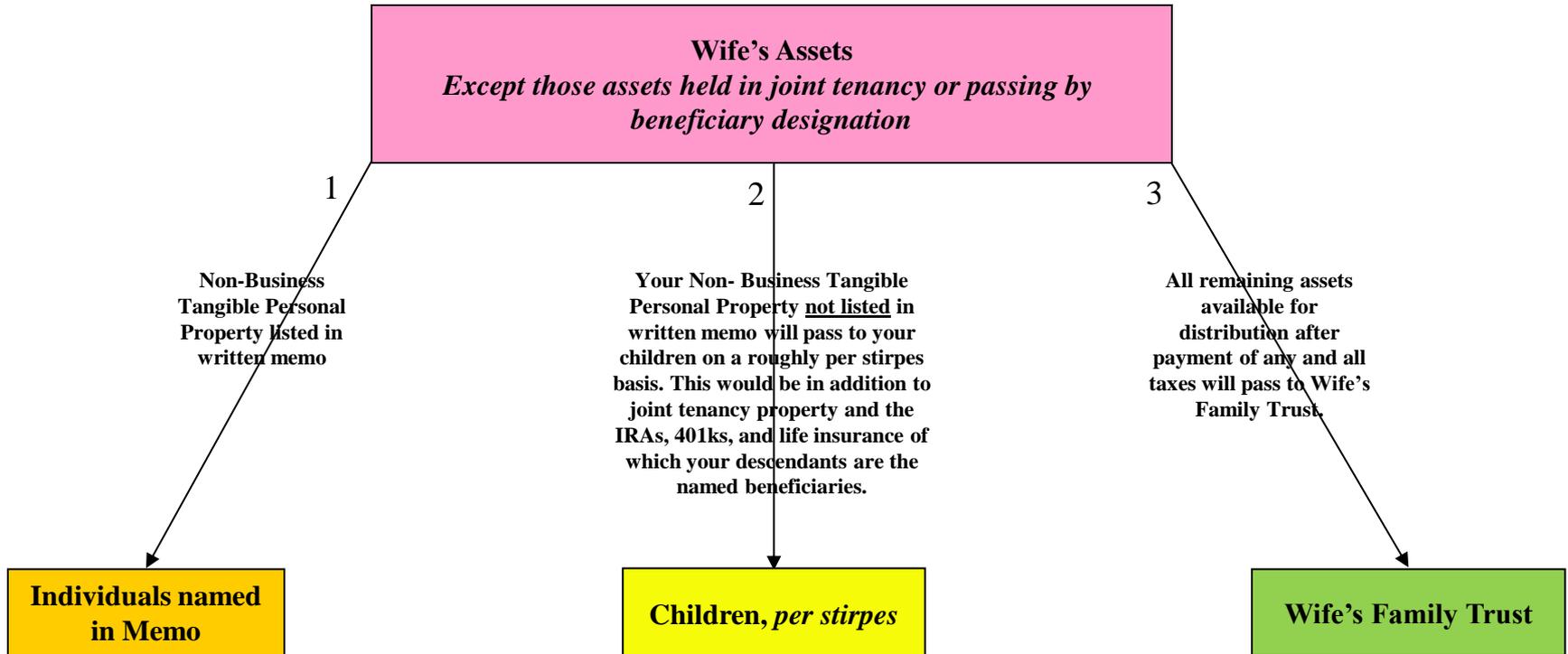
## Administration of Marital Trust During Wife's Life:

- Trustee annually distributes all income generated by the assets of the Marital Trust to Wife (required for marital deduction).
- Trustee may also make distributions of the principal of the Marital Trust as necessary (after considering all other funds and resources available to Wife) to provide for Wife's health, education, maintenance, and support, provided that farm assets/business assets shall not be distributed. Wife's access to principal distributions from the Marital Trust will cease if she gets remarried without first obtaining a valid prenuptial agreement containing certain required provisions protecting the family assets.
- Wife will have right to use and enjoy residences held by Marital Trust and the authority to direct the Trustee to sell any residence and to reinvest the sale proceeds in a new residence or other investment.
- All minimum distributions from a Deferrable Retirement Benefit (IRA, 401k) held by the Marital Trust are paid to Wife each year.

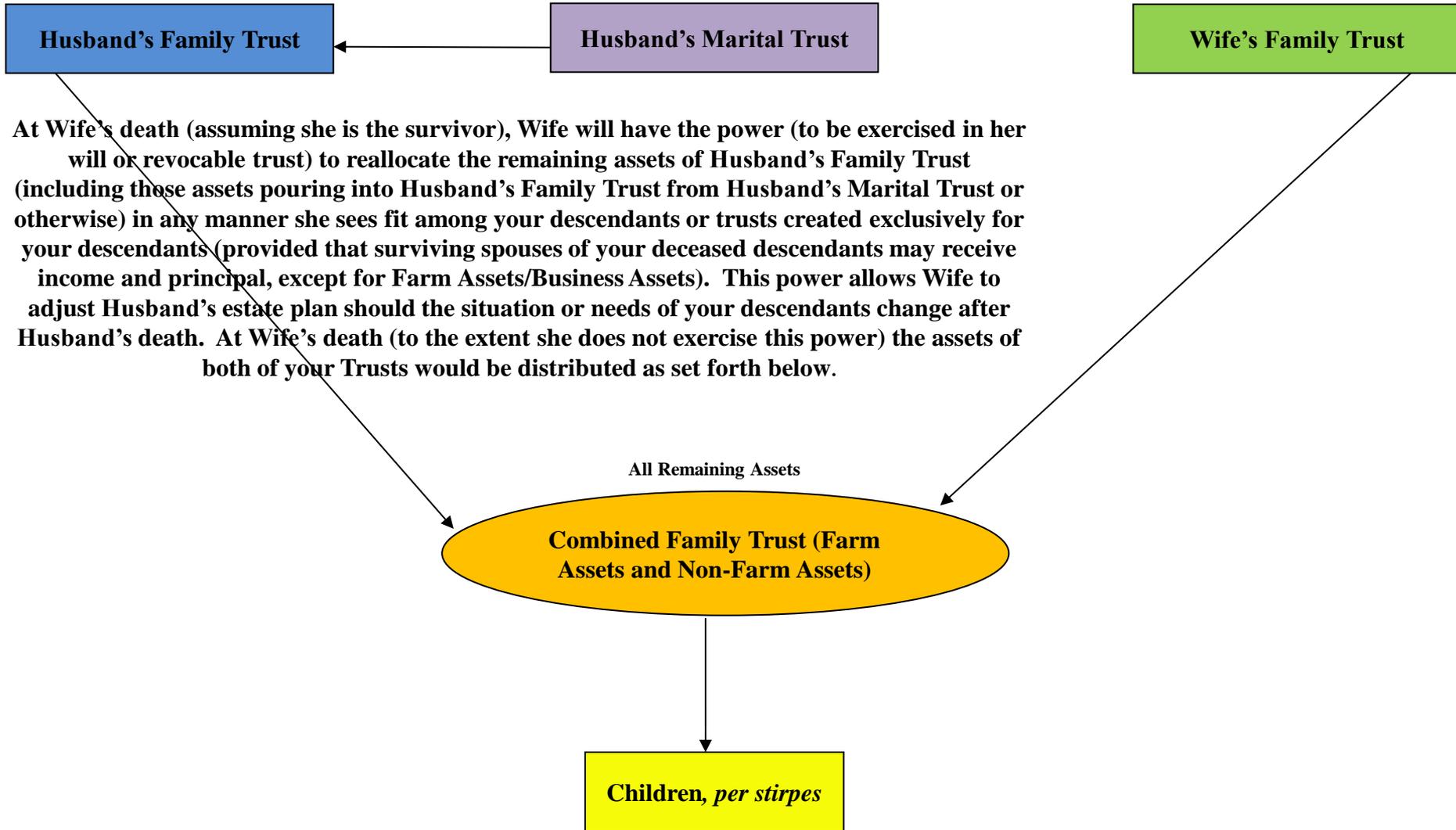
## Administration of Marital Trust After Wife's Death:

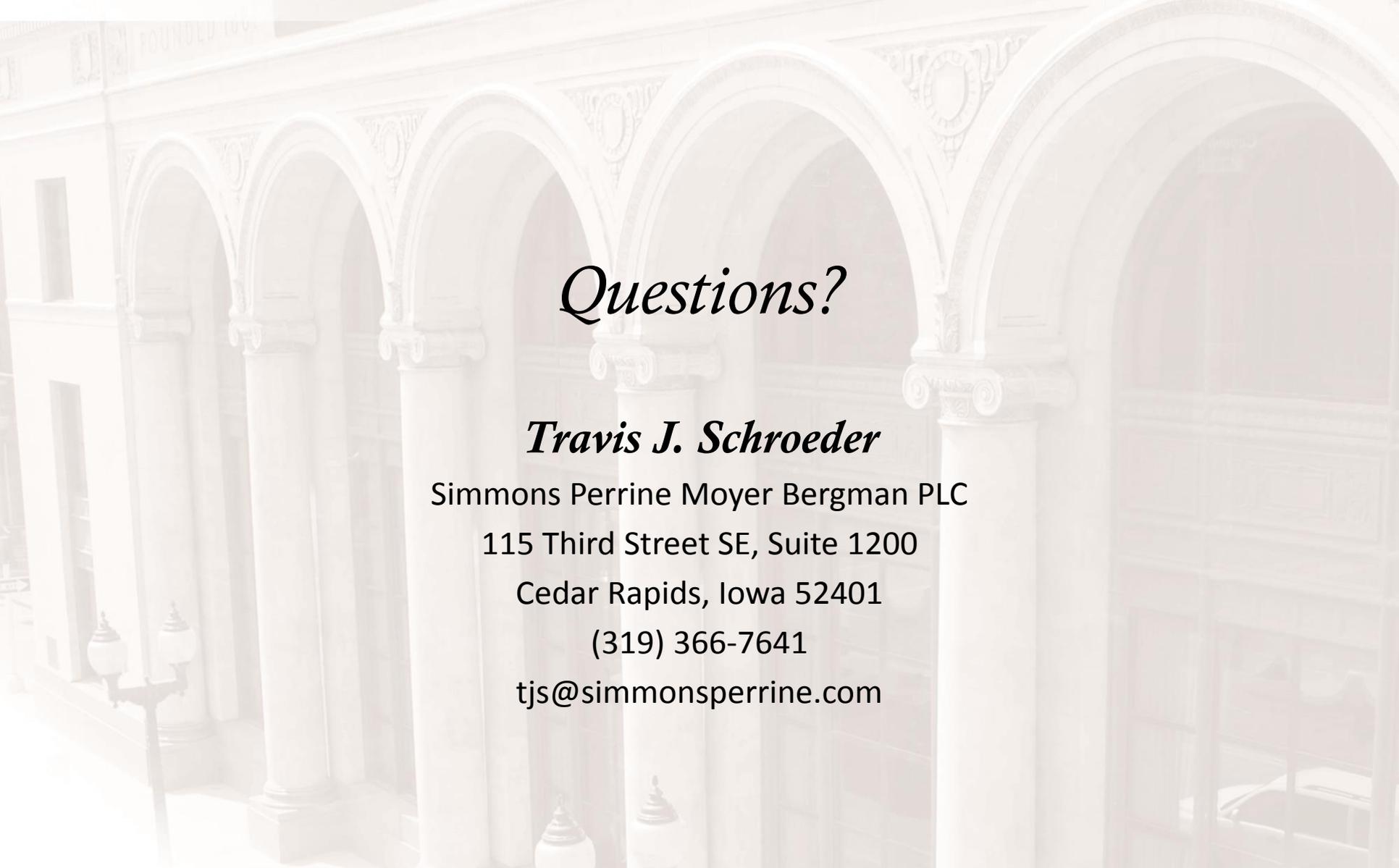
- The assets of the Marital Trust will pour into the Family Trust.

# Operation of Wife's Revocable Trust Following Wife's Death (Assuming Husband Dies First)



# Operation of Revocable Trusts at Death of Second of You (For purposes of this illustration assume that Wife is the second to die)





# *Questions?*

***Travis J. Schroeder***

Simmons Perrine Moyer Bergman PLC

115 Third Street SE, Suite 1200

Cedar Rapids, Iowa 52401

(319) 366-7641

[tjs@simmonsperine.com](mailto:tjs@simmonsperine.com)



SIMMONS PERRINE MOYER BERGMAN PLC

[www.spmblaw.com](http://www.spmblaw.com)