

Charting Your Financial Future



Asset Protection

Passing assets through trusts can help protect your family's estate.



As the well-known maxim states, only two things in life are certain, death and taxes. After working most of your life, upon death, you have the ability to do something for your loved ones that none of them can do for themselves—provide an exceptionally strong asset protection vehicle for the estate you leave to them. The risks and costs associated with doing so are minimal, and to paraphrase another often quoted adage, having it and not needing it is fine, but needing it and not having it may prove disastrous.

Control of assets

At the time of death, property held by the decedent passes as he or she directs by the terms of his or her will or by state statute, if no will exists, for probate assets; or by his or her

beneficiary designations for non-probate assets such as insurance policies, retirement assets, or pay-on-death accounts at financial institutions. Specially titled property passes automatically upon his or her death such as property held as joint tenancy with a right of survivorship.

If the decedent's death triggers a trust's distribution or disbursement provisions, those trust assets also will flow as prescribed by that document. Knowing which documents control an asset's disposition is a fundamental, but sometimes overlooked, component of effective estate planning.

Character of assets

There are differing ways of holding title to property, and each has its own unique characteristics, body of

law, and vulnerabilities to creditor claims. The way property is treated for taxation may vary for issues such as a step-up in basis at death or as an available asset for beneficiaries.

Assets held or transferred to a trust typically do not change their title's character unless doing so eliminates a necessary component. Absent an intentional change by the trustee, assets held in trust retain their character, which means community property or separate property contributed remain so. A trust does, however, separate title on a different dimension—by legal and beneficial owner.

Understanding these building block concepts can help immensely in structuring a smooth estate plan that will protect the family treasure you've accumulated over a lifetime.

Protection of assets

Rather than leaving assets outright to loved ones, those exact same assets may pass into a trust for their benefit and provide asset protection from creditors or adverse judgments. In addition, those same assets may carry estate and generation-skipping transfer tax protections that flow from the decedent's death.

If you create a trust for yourself, as both its grantor or donor as well as a beneficiary, it is referred to as a first party or self-settled trust. Very few states extend many asset protection benefits to such trusts, and those that do require the trust to be irrevocable.

In contrast, a third-party trust is created by a donor or grantor, who is not a beneficiary, for others.

Many Americans have enjoyed a short-lived respite from federal estate taxation since the Tax Cuts and Jobs Act of 2017 (TCJA); however, that relief is set to expire at the end of 2025, and many states impose their own separate estate tax on their residents and property. Oregon, as an example, permits as little as \$1 million per person to pass without imposing estate taxation.

But even if you have just a modest retirement savings balance and a home, you still may escape such low estate tax thresholds.

Passing these assets that have already "paid" the estate tax, actually or by exemption, to a trust for loved ones eliminates that tax liability exposure for those assets, unless the beneficiary distributes the assets from the protected shelter of the trust.

Shrewd estate planners who understand this concept will rarely terminate trusts upon the beneficiary reaching financial maturity (age 25 to 40), much less biological maturity



(age 18). Rather, upon the beneficiary attaining the specified age, the trust provides the beneficiary the keys to the vault by permitting him or her to serve as its sole trustee. At that point, a beneficiary/trustee can manage and retain the assets in the trust (like a protective asset fort) or self-distribute and terminate it.

Special needs

Another benefit of leaving assets in a trust for loved ones involves public benefits. Assets held in a third-party trust, if drafted with distinct provisions pertaining only to a beneficiary with special needs, would not affect his or her eligibility for or reduce public benefits that may be received at some point in the future. From a legal perspective, the assets have never been in his or her possession since the trust owns the assets.

Termination alternative

In a trust, the legal title holder is the trustee, and the beneficial or equitable titleholder is the beneficiary. The trustee must

manage and distribute assets according to the trust's terms. Where a beneficiary serves as trustee, the trust document must generally limit his or her ability to make distributions to himself or herself to an "ascertainable standard" (e.g. health, education, maintenance and support) to avoid inclusion of the trust's assets in his or her estate and to protect trust assets from his or her creditors.

A qualifying independent trustee may be given broader discretion to make distributions, such as the ability to make distributions to the beneficiary for any purpose in independent trustee's discretion. Note that asset protection laws vary by state.

For enhanced estate tax and asset protection benefits, the beneficiary's trust should continue for his or her lifetime.

Upon the beneficiary's death, assets may pass to the beneficiary's descendants or others as specified under the trust's terms and be kept in trust, often for multiple generations.

Taxation

Trust tax rates are highly compressed and climb quickly to the highest marginal rates. Even with the favorable TCJA rates, a trust reaches the highest federal income tax level of 37% with only \$15,650 of income. Only income above \$626,350 (for single filers) or \$751,600 (for married filing jointly) falls into the highest federal income tax bracket.

However, if properly managed, the trust may distribute the income and take a deduction for the distribution, and the income can be taxed at the beneficiary's income tax rate.

Also, if the assets are invested in tax advantaged or growth oriented vehicles, the trust may have very little, if any, taxable income.

Dynasties

Some states, such as South Dakota and Nevada, have created very favorable asset protection laws and have greatly increased or eliminated their rules against perpetuities, which limits the number of years a trust may continue in existence. These states have created cottage industries and have attracted large sums of wealth from those familiar with these dynasty concepts.

Conclusion

As beautiful as leaving an inheritance to loved ones is, it is even more appreciated if it does not create an additional tax burden upon its recipients or impede the public or private benefits being received.

Enhancing a gift that must eventually pass, since we can't take it with us, can prove to be a very worthwhile endeavor.

Discussing the possibilities in creating or improving your estate plan with a trusted advisor is a great first step.

Business Planning

Asset protection strategies help protect small businesses and their owners.

By Eva Stark, JD, LL.M.



In today's economy, it is not uncommon for an individual's "gig" or "side hustle" to grow into a full-time business opportunity. Something that starts out as a part-time activity or just a hobby may quickly blossom into a profitable business.

Where a business activity is conducted, limiting liability from that activity is an important consideration. In the absence of planning, an accident, or a dispute with a customer, supplier or an employee, can not only wipe out business profits but also put the business owner's personal assets at risk. Fortunately, proper planning may limit exposure and avoid a nightmare scenario.

CONDUCTING BUSINESS IN A LIMITED LIABILITY ENTITY

One of the first lines of defense from business liabilities is to conduct any business activity in a limited liability

entity. A limited liability entity—such as a corporation, a limited liability company (LLC), a limited partnership (LP), limited liability partnership (LLP), limited liability limited partnership (LLLLP) or similar entity—can create a "firewall" between the business owner's business activity and personal assets.

The specific business activity, management structure, expected growth potential and tax considerations will determine what entity type makes the most sense under the circumstances.

ASSESSING THE NEED FOR MULTIPLE ENTITIES

Just as an entity may create a firewall between business activities and a business owner's personal assets, segregating different business lines and business assets into separate entities may create firewalls between such activities and assets as well. For

example, a manufacturer that owns its warehouses and transports its products may be taking on unnecessary risk if all assets are owned and all activities are conducted inside a single limited liability entity. A single trucking accident and a judgment against the company could put all of the company's assets at risk (warehouses, manufacturing equipment, bank accounts, etc.). However, if the company is divided into several entities (a manufacturing company, a transportation company and a real estate holding company, for example) it may be possible to isolate the liability within the transportation company.

To set up such separation, three entities would typically be created and the entities would execute contracts (e.g., rental agreements and contracts for transportation services) with one another. The manufacturing company could lease the warehouses from the real

estate holding company and hire the transportation company to transport its goods. Proper documentation (contracts, governing documents), capitalization, insurance and governance can help ensure that courts will respect such segregation of one entity from another and from the business owner's personal assets.

LIMITING LIABILITY THROUGH CONTRACT

Written contracts with clients, suppliers, lenders, etc. may help avoid disputes over pricing, payment terms, or quality expectations, and spell out each party's obligations to limit surprises.

Where a dispute does arise, a contract may often limit damages to amounts paid under the contract or provide for liquidated damages (e.g., a set dollar amount). State law varies widely when it comes to the ability to limit liability and damages through contract, so having contracts drafted and reviewed by a competent business attorney is key.

INSURANCE

Carrying adequate insurance is also key to protecting assets of the business and the personal assets of the business owner. Without sufficient insurance

to satisfy liabilities, a creditor will be tempted to explore strategies for accessing a business owner's personal assets. Additionally, a business that is poorly capitalized (given the specific business activity involved) or a business's failure to carry adequate insurance may bolster a creditor's argument for piercing the corporate veil.

Generally, where the corporate veil is pierced, the court or creditor may ignore the firewall between the business and the business owner's personal assets, exposing such personal assets to creditors. For example, a business owner who runs a "transportation company" that leases its trucks from the owner, owns no other assets, and carries no insurance would likely not be respected by a court as a separate entity and a liability from a trucking accident involving the business would likely not be isolated within the business.

PERSONAL ASSET PROTECTION

In addition to limiting business liabilities, business owners should consider positioning personal assets for creditor protection. Various state and federal laws protect certain types of assets from creditors. These "exempt" assets may include home equity, qualified

plan balances, individual retirement accounts, annuities, life insurance death benefits and cash values, as well as some miscellaneous assets (e.g., a personal vehicle, burial plot, gun, livestock, etc.).

What is exempt and the degree to which it may be exempt varies greatly by state. For example, certain states protect an unlimited amount of life insurance cash values as well as death benefits both from the creditors of the insured and the beneficiary.

Other states may limit the protection of cash values to a specific dollar amount and may limit the protection of death benefits based on the relationship of the beneficiary to the insured or other factors.

In addition to taking advantage of exemptions, a business owner may be able to enhance creditor protection of personal assets by placing both exempt and nonexempt assets in a trust for the benefit of the business owner's spouse or children.

An increasing number of jurisdictions also allow protection for certain self-settled trusts (trust created by an individual for the individual's own benefit). Successful asset protection planning requires planning ahead and having a trust in place before the liability exists.

Having a part-time gig or hobby blossom into a great business opportunity can be very exciting. When this happens, it makes sense to take steps to minimize risk both for the business owner as well as for the business itself.

The right professionals (attorneys, financial advisors, accountants) can help spot opportunities to ensure that the business, and the business owner's balance sheet, continue to grow.



Eva Stark, JD, LL.M., joined The Nautilus Group in 2014 to assist with the development of estate and business plans. She also performs advanced tax research. Eva graduated summa cum laude with a BS in economics and finance from The University of Texas at Dallas. She earned her JD, with honors, from Southern Methodist University, where she served as a student attorney and chief counsel at the SMU Federal Taxpayers Clinic. She received her LL.M. in taxation from Georgetown University Law Center. Prior to joining Nautilus, Eva worked in private practice in tax controversy, business law, and litigation.

Estate Planning

Basic estate planning considerations and documentation.

By Eva Stark, JD, LL.M.



A significant number of Americans have no estate plan in place in the event of premature death. However, failing to plan can have consequences that could be very costly both financially and in terms of undesirable distributions, delay, and family disharmony.

Issues and considerations

Many considerations go into developing an effective estate plan:

- Type of assets owned.
- Overall net worth.
- Family structure and dynamics.
- Wishes and goals.

These issues, described below, should be thoroughly discussed with attorneys and financial professionals.

AVOIDING INTESTACY. A basic will can be used to ensure that assets will be distributed as desired. If an individual dies without a will—i.e., dies “intestate”—assets will be distributed as state law specifies. State law default distributions may come as a surprise to many individuals and may provide for drastically fewer or drastically more assets to certain beneficiaries than what may have been desired or anticipated.

SELECTING A GUARDIAN FOR MINOR CHILDREN. A will also can be used to nominate a guardian for minor children or their property. If a minor child has no other living parent or legal guardian at a parent’s death, the court will consider and frequently appoint the person the

parent nominated in the will. In the absence of a will, the court will select a guardian based on what it deems is in the child’s best interest which may be different from the parent’s wishes.

AVOIDING INADVISABLE DISTRIBUTIONS. A will may additionally be used to keep assets in trust for beneficiaries if outright distributions are inadvisable. It may be unwise to distribute assets to a beneficiary who: is too young or immature; is a spendthrift; has outstanding creditors; may undergo a divorce; is disabled and eligible for government benefits; or for other reasons. Keeping assets in a properly structured trust can help protect assets from third parties and help ensure that assets remain available for the benefit of the intended

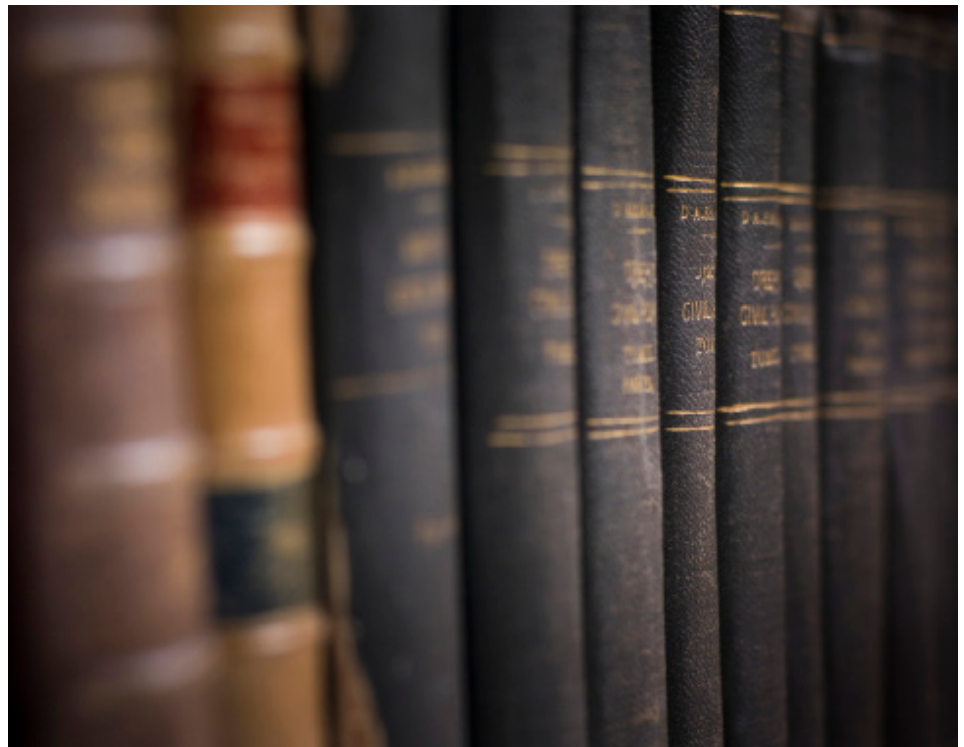
beneficiary and other family members.

CONSIDERING ESTATE TAXES. For most individuals, neither federal nor state estate taxes will be a concern. However, where federal or state estate taxes may be an issue, planning opportunities for lowering or eliminating taxes may be permanently lost in the event of intestacy.

While the federal estate tax lifetime exemption amount is currently \$13.61 million, many states have a much lower state-level estate tax exemption amount. Massachusetts and Oregon—currently the states with the lowest exemption amounts—\$2 million and \$1 million respectively.

REMEMBERING NON-PROBATE ASSETS. Many individuals own a substantial amount of “non-probate” assets that pass outside a will. These typically include retirement accounts and life insurance that pass by beneficiary designation, certain jointly-owned property, pay-on-death accounts and similar assets. These should be reviewed with an individual’s attorney to ensure that they are coordinated with overall objectives and planning.

UTILIZING LIFE INSURANCE. Life insurance can play a critical role in estate planning. It can protect a family’s financial security in the event of the death of a breadwinner or stay-at-home parent. It can help equalize children’s inheritances where a significant portion of the estate is tied up in a business or farmland that may be designated to pass to a child actively involved in running the business or farm operations. Life insurance can also add much-needed liquidity to an estate for the payment



of various obligations, including estate taxes.

Estate plan documents

Once an estate plan is developed, the individual’s attorney will draft documentation that is in accordance with the plan. Documentation in a typical estate plan may include:

WILL. A will may be used to avoid intestacy, name a personal representative and guardian for minor children and to keep assets in trust for children and later descendants if immediate distributions are inadvisable.

REVOCABLE TRUST. For many individuals, a revocable trust (established in addition to a will), can offer additional advantages. A revocable trust can provide for privacy in the disposition of assets. While a will can become public record in certain circumstances, the terms of a revocable trust typically remain private. A revocable trust can also help avoid the need for

ancillary probate in every additional state where the decedent may have owned real property. The trustee also holds and manages assets as soon as the assets are transferred to the revocable trust—not just after death. As a result, the trustee can effectively manage the assets in case of the settlor’s incapacity.

Just like a will, a revocable trust also can include provisions to keep assets in trust for beneficiaries in the event that outright distributions are inadvisable.

DURABLE POWER OF ATTORNEY.

An individual may become unable to manage financial affairs well before death due to old age, disease or injury. A durable power of attorney may be used to appoint a trusted individual (an “agent”) to handle financial affairs under such circumstances. This can avoid a potentially costly guardianship proceeding where a court appoints a guardian it deems will act in the individual’s best interest. Where

the estate includes a business, a separate document may be executed to appoint an agent for making business decisions. The document may be made effective immediately upon execution or only in the event of incapacity.

NOMINATION OF PRE-NEED

GUARDIAN. In many states, it is customary for an individual to nominate a guardian for his or her person or property "pre-need" as part of his or her estate planning documents. If the individual does become incapacitated, and a guardianship proceeding is commenced, the court will consider the nominated agent. Without such a document, the court will likely appoint a close relative it deems can act in the individual's best interest.

HEALTH CARE PROXY. A health care proxy may be used to nominate a trusted family member or friend to make health care decisions if an individual is unable to make or communicate his or her own health care decisions. The document can typically be structured to take effect immediately or upon the individual's incapacity.

ADVANCE DIRECTIVE. An advance directive may be used to express a person's wishes with respect to various types of life-sustaining

treatment in the event he or she becomes terminally ill or permanently unconscious and unable to communicate such wishes to his or her doctor.

HIPAA AUTHORIZATION. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) protects certain health care information. An authorization may be needed to permit medical personnel to discuss such protected health information with agents named under powers of attorney.

RE-EVALUATING PERIODICALLY.

Even if an individual established an effective estate plan and executed proper documentation, changed circumstances or laws may necessitate revisions. Family circumstances may change (a marriage, the death of a spouse, birth of a child, divorce, etc.). Guardians, executors or trustees named in documents may no longer be living or capable of handling duties. Tax

laws may have changed. Financial circumstances and insurance needs may have changed. As a result, estate plans should periodically be re-evaluated with an individual's attorneys, financial advisor and other professionals to determine whether updates may be necessary.

OVERCOMING EXCUSES. Many individuals fail to create an estate plan. This may be due to not making time to address a seemingly far-off problem, avoiding potentially difficult conversations and decisions, not wanting to think of one's mortality and the perceived high cost of working with attorneys and other professionals.

However, the lack of a plan can lead to drastic consequences that may easily be addressed with an appropriate estate plan and the help of competent attorneys and financial professionals.



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As a result of the Tax Cuts and Jobs Act of 2017 (TCJA) the estate, gift and generation skipping transfer (GST) tax exemption amounts increased to approximately \$11.18 million per person (approximately \$22.36 million for a married couple). For assets transfers in excess of the applicable exemption amount and otherwise subject to such taxes, the highest applicable federal tax rate remains at 40 percent. While the exemption amounts are indexed for inflation, current law provides for an automatic sunset of these increased exemption amounts after 2025. As a result, the exemption amounts available in 2026 and beyond could be reduced to a level provided under prior law (\$5.49 million/single and \$10.98 million/couple in 2017, indexed for inflation) absent further action by Congress. In addition, under different rates, rules and exemption amounts (if any), there may be state and local estate, inheritance or gift taxes that apply in your circumstances. Please consult your own tax or legal advisor for advice pertaining to your specific situation. This material includes a discussion of one or more tax related topics. This tax related discussion was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purposes of avoiding any IRS penalties that may be imposed upon the taxpayer. These materials are prepared by The Nautilus Group®, a service of New York Life Insurance Company, and are made available to all Nautilus Group member agents, and, as a courtesy to select agents of New York Life Insurance Company. Nautilus, New York Life Insurance Company, its employees or agents are not in the business of providing tax, legal or accounting advice. Individuals should consult with their own tax, legal or accounting advisors before implementing any planning strategies. SMRU 5016477 Exp. 02/28/2026

Life insurance is a valuable generational wealth-transfer tool.

By R. Matthew Pate, JD, LL.M.



Many people may be familiar with the *rags-to-riches-to-rags* wealth phenomenon. The first generation builds it, the second manages it, and the third squanders it. Fear of this phenomenon motivates many families to develop a generational wealth plan that maximizes incentives for productivity and prudent stewardship of wealth. While today's wealthy seniors are likely to die with far more assets than they'll ever need, this inheritance may be a necessary source of income for their children and grandchildren, especially considering the ever-increasing costs

of fundamental expenses like higher education, homeownership, and health care. Coupled with increased spending, decreased saving, and greater longevity, scant wealth may remain to leave a legacy for future generations.

Enter life insurance

Well-known as a tool for financial security and future income replacement, life insurance is often perceived as unnecessary once one's children are grown. For this reason, term insurance is frequently used by growing families to ensure that they

don't suffer a catastrophic loss of income should a breadwinner die.

However, a wide variety of customizable permanent insurance products are often preferred because they provide both income replacement during one's working years (through a cash value that accumulates over time) and a means for guaranteeing long-term family wealth (through its potential for lifetime coverage).

You may consider using permanent life insurance for generational wealth planning for three primary benefits: leverage, guarantees, and simplicity.

Benefit 1: Leverage

With life insurance, you pay a premium in exchange for what will likely be larger payout in the event of death. This leverage of premium dollars is intended to provide a “positive return” on outlays for the benefit of designated beneficiaries.

The expected performance of a life insurance policy should be viewed in light of desired family wealth goals and can be a complement to other investments in a financial portfolio. Fees, taxes, and risks associated with any financial products should of course always be considered.

EXAMPLE: *Brian and Sofia have saved \$2 million to provide them with income in retirement. They are comfortably budgeted but concerned about preserving a meaningful portion of their nest egg to provide for the education of their many grandchildren (a sum that could approach \$1 million). If they include permanent life insurance in their budget, they can ensure that the money will be available to help pay for their grandchildren's education and other family needs after they've died—regardless of their longevity.*

This may even provide them greater flexibility to spend in retirement and enjoy their golden years as they desire.



Benefit 2: Guarantees

Guarantees are key benefits of permanent life insurance. Depending on the type of insurance, guaranteed annual premiums and guaranteed death benefits can provide certainty regarding the availability and cost of coverage. And while life insurance is largely viewed as a commodity, guarantees are backed by the financial strength of the issuing carrier.

For this reason, financial stability and reputation are important to consider when choosing a life insurance provider.

EXAMPLE: *Alessandro and Melissa have decided to purchase a \$500,000 life insurance policy to ensure that they could provide for their grandchildren's education. Their main goal is finding a solution where the premium will be paid in full, will never change, and the death benefit will be guaranteed. A whole life policy from a well-known and highly stable insurance company may make the most sense.*

In addition to the guaranteed return on their premiums, with a whole life policy, they also benefit from the potential of accruing dividends, which further increases the return on their premiums.



Benefit 3: Simplicity

Life insurance can offer tremendous simplicity in an otherwise complex and often confusing planning environment impacted by taxes, probate, and creditor risks.

Tax benefits

A life insurance death benefit is generally received free of any income tax by the beneficiary. Contrast this with the income tax on accumulated savings that would otherwise be left to heirs.

While life insurance proceeds are included in a taxable estate,

EXAMPLE: *John and Carrie settle on a \$500,000 whole life product they can comfortably afford. They designate their three children as equal beneficiaries of the policy, with the direction to them that funds are to be used for educational costs as needed. They like the idea that they can modify the beneficiary designation in the future and that all proceeds will be paid free of income taxes and also protected from their potential creditors, depending on their state.*

They may consider using a trust in the future depending on changes in tax laws in consultation with their estate planning attorney.



the current federal estate tax exemptions (\$13,990,000 per person in 2025) effectively eliminate the vast majority of people from federal estate taxation. Note that some states impose a state level estate tax at lower thresholds, but trust arrangements can be employed to address this issue.

Probate avoidance

Life insurance proceeds are paid directly to the designated beneficiary of the policy, avoiding probate delays and additional legal expenses. Funds are generally paid after a simple claim form is completed and the death certificate is presented. Beneficiaries can be easily changed to reflect the

insured's changing wishes. Contrast this with the difficulty in updating and properly executing a codicil to a will or other estate planning document.

Asset protection

Depending on state exemption laws, the death benefit received from an insurance policy may be exempt from potential creditor claims against the policyholder, and sometimes outstanding claims against the beneficiaries as well.

Where enhanced protection is desired for long-term wealth management, a trust established during one's life or under one's will can likewise be named as a beneficiary of a policy.

On a final note

Life insurance has attributes that make it a uniquely effective way to create wealth for the next generation. More fundamentally, though, permanent life insurance is a purchase one makes because even if the future cannot be known, you can ensure that family legacy goals are insulated from risks such as taxes, market fluctuations, and changes in personal health.

By providing a very predictable amount in an otherwise unpredictable world, individuals have more freedom to enjoy their wealth, liberated from concerns about the adequacy of support for loved ones.



R. Matthew Pate, JD, LL.M. is the head of Nautilus Plus at The Nautilus Group®, a service of New York Life Insurance Company serving the complex planning needs of New York Life's top select agents and their high net worth clients. Matt has extensive experience in sophisticated estate planning, business succession, closely held businesses, life insurance, asset protection, and charitable planning techniques. He has authored numerous legislative publications and newsletters, including New York Life's "Eye on Washington." Matt received his undergraduate degree from Georgetown University, his JD from the University of Texas School of Law, and his LL.M. from Southern Methodist University.

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IRA distributions to a CRT can provide asset protection and retirement income.

By Robert Ahearn, JD, LL.M., CFP®, CLU®, ChFC®, CRPC®, CTEP®



The Setting Every Community Up for Retirement Enhancement Act (SECURE Act) that took effect in January of 2022 was designed to prevent older taxpayers from outliving their assets by increasing access to certain tax-advantaged accounts. A consequential part of the SECURE Act eliminated an estate planning tool designed to stretch individual retirement account (IRA) payments over the lifetime of the IRA beneficiary, replacing it with the requirement of full distribution of an IRA to its beneficiary (or beneficiaries) within 10 years following the year of the IRA owner's death.

A noteworthy estate planning technique has arisen in response

to this new 10-year distribution requirement that attempts to recreate a "stretch IRA" by using a charitable remainder trust (CRT). Utilizing a CRT can lengthen (or stretch) the time for payments to the beneficiary and provides income tax advantages also. The payment made from the CRT (referred to generically as the "payout") is made instead to the CRT lifetime beneficiary, replacing the distribution that would have been made from the IRA.

There are two basic types of CRTs:

- A charitable remainder annuity trust, or CRAT; and
- A charitable remainder unitrust, or CRUT.

Payments can be structured as either a fixed percentage of the value of the

CRT assets at inception (an annuity trust, or CRAT), or a fixed percentage of the value of the CRT assets on an annual basis (a unitrust, or CRUT). A CRUT is the preferred type of trust due to its innate flexibility regarding both design and payout options.

IRA owners can fund a CRT by distributing either their entire IRA balance at one time or, alternatively, over several years (not to exceed 10). A CRUT is preferred because it allows the owner to make additional contributions following the initial year and the beneficiary is not required to make withdrawals. While the IRA distribution to fund a CRUT is considered taxable income, the IRA owner can offset a portion of the income with a charitable income tax deduction. The proceeds of the trust

can be used to pay income to the IRA owner's beneficiaries.

The CRT beneficiary receives a payout over his/her lifetime with the remainder passing to a charity of the original IRA owner's choice, including a donor advised fund established by the original IRA owner.

Payments made to the CRT lifetime beneficiary are considered taxable income, and furthermore, are subject to the "tiering" rules set forth at Internal Revenue Code §664(b). These rules determine how distributions to the beneficiary are taxed since a CRT will often have a mixture of various types of taxable income.

For example, assume that a CRT has investments that generate ordinary income, capital gains, and tax-free interest income. The tiering rules

determine how the distribution is taxed to the CRT's lifetime beneficiary:

- First, ordinary income;
- Then, income from capital gains;
- Next, tax-free interest income; and
- Last, any tax-free return of basis.

As an enhancement to this plan, two basic strategies using life insurance that can augment CRT assets are available.

First, if all IRA assets are subject to tax, then IRA proceeds (typically, a post-tax amount) can be used to purchase a life insurance policy within the CRT. Life insurance inside of a CRT will boost the assets available to a successor lifetime beneficiary and/or the charitable remainder beneficiary.

Second, payouts to the CRT's lifetime beneficiary can be redirected to a wealth replacement trust (WRT), which is merely another name for an irrevocable life insurance trust. At the death of the lifetime beneficiary, the remainder of the CRT passes to the charity named in the CRT, but since a life insurance policy was funded with part of the CRT distributions (typically, the post-tax amount), the WRT has essentially replaced assets contributed initially to the CRT for the benefit of family members. The life insurance policy distributions will be income tax-free.

By designating a CRT as recipient of IRA distributions, the SECURE Act's 10-year payout can be altered effectively for asset protection, estate planning, retirement income, and charitable planning purposes.



Robert Ahearn, JD, LL.M., CFP®, CLU®, ChFC®, CRPC®, CTEP®, has been with The Nautilus Group since 2016, applying his substantial business, legal, and tax experience to support Nautilus member agents with the development of advanced planning strategies for their clients. As an estate and business planning attorney, Robert worked extensively with high net worth individuals, closely held businesses, farmers and ranchers, private foundations, and public charities. He earned a B.S. in Business Administration from the Boston University School of Management, a J.D. from the Suffolk University Law School, and a LL.M. in Taxation from the Boston University School of Law. Robert is a member of the state bars of Arizona, California, and Massachusetts and the Estate Planning Council of North Texas. He holds FINRA Series 7 and 66 licenses.

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Adding flexibility to irrevocable trusts can help address tax law uncertainty.



Attorneys across the country have been, and will continue, drafting irrevocable trusts for a multitude of clients who are anxious to capture the increased estate and gift tax exclusion amounts provided in the Tax Cuts and Jobs Act (TCJA).

As originally enacted, the TCJA sunsets on its own at the end of 2025; however, due to the ever-shifting political winds, these increased exemptions could always be terminated or extended.

This article is provided to describe some helpful provisions that can be added to irrevocable trusts to provide greater flexibility in relation to anticipated changes in the law.

In the event changes or modifications are needed, trusts that miss or misstate some provision may find judicial reformation costly and may not always achieve the full extent of

the change needed, especially if a not-so-loved one decides to oppose it for some concession or advantage.

Trust protector provisions

The first of the suggested provisions that may assist grantors to achieve the irrevocable trust's purpose are trust protector provisions. Trust protector provisions create a non-fiduciary office or role for an independent third-party, preferably with legal and business acumen, that typically would require a judge in a court of law to perform. Just as parties to a contract may opt to subject the agreement to arbitration or mediation, in essence choosing their own dispute resolution mechanism, a trust protector may serve a similar role by determining if and how a trust may be amended or modified to achieve its stated

purposes. The trust protector may act as a failsafe mechanism, providing an independent party to change the trust's situs or terms to address unexpected changes that inevitably come to pass after an irrevocable trust is executed and administered.

Decanting the trust

A second suggested provision is to grant either the trustee or trust protector authority to follow any appropriate decanting statute to transfer assets from the existing trust into a newly formed successor trust. Such provisions may be exceedingly important as the trust ages. Anyone who has administered or been a beneficiary under a trust drafted before major tax law revisions existed will readily understand the importance of such a provision.

An irrevocable trust may easily exist

for fifty years or longer while changes naturally occur in tax and trust laws, product developments in financial instruments and services, long-term economic cycle fluctuations, and sociopolitical environments.

As the trust ages, there eventually may come a point that administration under the trust's antiquated language becomes impossible or unbearable. By invoking such statutory decanting provisions, the trustee or trust protector could transfer the trust assets into an updated trust with language specifically addressing the unforeseen changes or events that could have adverse effects on the trust's taxation, assets, or beneficiaries.

Powers of appointment

Third, powers of appointment may permit trust beneficiaries to direct their trust assets during their life or at their death to charity, to anyone in general, or to a narrowly defined class of people. The power of appointment provides the beneficiaries the ability to direct the trust assets directly to beneficiaries outright or on certain

conditions, or indirectly to them by directing assets into updated and legally current trusts for remaining loved ones, similar to the decanting provisions referenced above.

Even when the aging trust contains provisions that would retain the assets in trusts for the intended successor beneficiary, consideration should be given to utilize an available power of appointment to direct assets into an updated trust based upon current tax and trust laws and contemporary trust planning strategies.

Reciprocal trusts

Finally, for spouses contemplating using their enhanced life-time gift tax exemption by creating irrevocable trusts for one another, a note of caution: Beware of the reciprocal trust doctrine. If the net result of the two nearly identical trusts created in close proximity to one another leaves the parties in the same or a substantially similar position as before the trusts were created, the trusts will be disregarded, and each spouse will be deemed a grantor

of the other's trust—making the gifts pointless from an estate tax perspective.

Trust differentiating strategies do exist to counter such a characterization and attorneys familiar with this area of the law should utilize them.

Conclusion

Whether the TCJA sunsets in 2025 or extended, it's time for clients to have a conversation with their trusted legal or tax advisors about existing estate planning opportunities and strategies that may vanish very soon.