Three Current Considerations in Estate Planning

Executive summary
After you finalize your estate plan and work out the complicated details, it’s human nature to want to file away the documents and never have to think about them again. But the world changes at a rapid pace. It may be wise to keep on top of the latest planning development trends so that your estate documents continue to be relevant.

Several recent scientific, political and governmental developments—in particular, U.S. Supreme Court striking down Section 3 of the Defense of Marriage Act (DOMA), Assisted Reproductive Technology, and more favorable transfer tax rules—have revised the way we look at some established estate planning assumptions.

In this paper, we provide relevant information on these three estate planning trends. You may gain a better understanding of the potential opportunities to work with your tax and legal advisors to update and strengthen estate plans as a result of these changes.

Same-sex estate planning
In light of recent judicial action—specifically, the Supreme Court’s overturning of Section 3 of DOMA—couples should understand how federal benefits may be applied in their state. Previously, same-sex couples were treated as non-spouse beneficiaries where estate, tax and retirement planning were concerned.

As a result of new rules, a person may be able to pass assets on to his or her same-sex spouse, in most cases, without a federal tax. The ability to roll over estate plans and individual retirement accounts upon the death of the first spouse is a new potential opportunity for same-sex married couples.

What the ruling may mean
The new Supreme Court ruling means same-sex couples may have the same rights and responsibilities as a heterosexual couple, which can have a tremendous impact on estate planning.

Rather than be treated as domestic partners, same-sex couples can be treated as spouses with the ability to be recognized as legally married from a federal standpoint. Previously, the DOMA ruling meant a couple married in a state that had legalized same-sex marriage could not collect federal benefits.
In late August 2013, even more clarification was provided when the IRS and Treasury Department announced they would treat legal same-sex marriages the same as heterosexual marriages regardless of jurisdiction. That means same-sex couples married in a state that recognizes same-sex marriage must file federal income tax returns as either married filing jointly or married filing separately, regardless of whether they live in a state that recognizes their marriage.

Couples married prior to DOMA being overturned can go back two or three years and amend returns to file as married couples. That could be beneficial if gift taxes were filed for money given to a spouse over the exclusion amount. Since the money now can be exchanged freely without tax, it might be worthwhile to amend the tax return.

Same-sex married couples also may be able to transfer assets to surviving spouses in a more tax-favored manner. For example, a same-sex couple is married in a state that recognizes same-sex marriage but moves to a state that does not. If the first spouse owns an IRA, he or she could list the second spouse as the beneficiary. When the IRA owner passes away, the spouse can treat that IRA as his or her own as opposed to being treated as a non-spouse. The 401(k) benefits, employee benefit plans, Employee Retirement Income Security Act (ERISA) benefits and other qualified retirement benefits may be allowed to pass to the surviving spouse as well.

Unanswered questions

Indeed, plenty of questions remain unanswered. That’s because the overturning of DOMA doesn’t necessarily require states to do anything; it leaves matters up to the individual states. From a federal standpoint, the government will recognize the validity of a same-sex marriage if the couple’s state does. But if the state doesn’t, the couple may not be eligible for various tax and wealth transfer benefits. Adding to the complexity is that some states don’t recognize marriage from other jurisdictions.

The 2013 IRS/Treasury Department announcement is significant because it potentially impacts all same-sex couples in the United States. Other federal agencies have announced similar decisions: for example, allowing benefits for same-sex spouses of federal workers and military personnel. But these decisions only impact portions of the population.

When constructing their estate plans, same-sex couples should work with their tax and legal advisors and ask these questions and others:

- If a same-sex couple is married in New York (a state in which same-sex marriage is legal) but moves to Texas (a state in which same-sex marriage is banned), what federal benefits might they lose?
- If a spouse in a same-sex marriage works for a large company that operates in many different states, how will benefits for same-sex spouses be coordinated?

Looking ahead, if the Supreme Court were to strike down Section 2 of DOMA, individual states would have to recognize same-sex marriages from other jurisdictions. Section 2 currently makes an exception to the Full Faith and Credit Clause of the U.S. Constitution, which requires states to give “full faith and credit” to the laws of other states. Until the court tackles Section 2, however, same-sex couples should be mindful of how their estates deal with the possibility of moving to a state where same-sex marriage remains banned.

How states treat same-sex marriage

<table>
<thead>
<tr>
<th>Same-sex marriage is legal in:</th>
<th>Same-sex marriage is banned by constitutional amendment or state law in:*</th>
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<tbody>
<tr>
<td>California, Connecticut, Delaware, Hawaii, Illinois,</td>
<td>Alabama, Alaska, Arizona, Arkansas, Colorado, Florida, Georgia, Idaho,</td>
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<tr>
<td>Iowa, Maine, Maryland, Massachusetts, Minnesota,</td>
<td>Indiana, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri,</td>
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<tr>
<td>New Hampshire, New Jersey, New Mexico, New York,</td>
<td>Montana, Nebraska, Nevada, North Carolina, North Dakota, Ohio, Oklahoma,</td>
</tr>
<tr>
<td>Oregon, Pennsylvania, Rhode Island, Vermont,</td>
<td>South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, West</td>
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<tr>
<td>Washington state and Washington D.C.</td>
<td>Virginia, Wisconsin and Wyoming</td>
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*Of the number of states where same-sex marriage is banned, many of these states have pending court cases that could rule these state laws as unconstitutional. Couples may wish to check the status of these remaining states often for marriage equality updates. Petitions for writ of certiorari have been filed with the U.S. Supreme Court regarding the marriage laws of Indiana, Utah, Wisconsin, Oklahoma and Virginia.
Assisted reproductive technology

Assisted Reproductive Technology (ART) traditionally has been used by couples that had problems conceiving a child on their own. Today, same-sex couples, single parents and many others may find ART a viable family planning option, as well.

The field of ART has evolved to such an extent that it is forcing some families to ask tough questions about the very nature of what constitutes a child or heir. For some people, scientific breakthroughs, such as the use of gestational carriers/surrogates and cryogenic preservation, have presented alternative parenting options beyond adoption of unrelated children.

Children conceived after a parent’s death

One advancement in the field of Assisted Reproductive Technology is the ability to indefinitely freeze the sperm or embryos of a genetic parent, allowing conception of a child even after death.

For purposes of certain entitlement programs such as Social Security, a child conceived after the death of a parent may not be able to claim Social Security benefits of the deceased parent. For example, in Astrue v. Capato, a case decided by the Supreme Court in 2012, the Court looked to Social Security Administration rules and state law in determining that only children conceived prior to death qualified for the benefits in question.

Couples utilizing stored reproductive matter to be used in the future should review the arrangement with an attorney. They should discuss:

- Whether traditional ownership principles can be applied to the preserved material. For example, do a state’s joint tenancy concepts apply, or does the contract signed by the parents involving the genetic material apply?
- If the preserved genetic material is received from a donor who is not a parent, what are the parental rights of the donor? Has the donor consented to postmortem use of the material?
- How was parental status obtained? Did one or more parent adopt, or was an order of parentage obtained? Will the order of parentage be recognized in the state where the parent now lives?

While many states have addressed the issue of inheritance rights with regard to children conceived before death, the law is less settled regarding children conceived postmortem through cryogenic freezing of reproductive matter. As of August 2013, just seven states have addressed postmortem conception through the Uniform Parentage Act, which was introduced in 1973 to help determine parentage, paternity actions and child support. Eighteen states have enacted the Uniform Probate Code, which does contain provisions regarding whether a cryogenically conceived child conceived after the death of a parent is entitled to benefits under specified circumstances.

Using a gestational carrier

Estate planning considerations around using a gestational carrier can be complex, especially when both an embryo and sperm come from unrelated third parties.

Some states require parents to adopt the child to make it official, while other states may allow a person or a couple to utilize an order of parentage to treat a child as their own. Additionally, some state codes contain provisions to allow the carrier—if the genetic material is hers—to be the legal parent. That could introduce complications if the carrier decides she doesn’t want to give up the child or asserts parental or inheritance rights. Rights established by contract may or may not be honored by various states in establishing parental privileges.

Whether a child will be considered an heir or descendant for the purposes of inheritance by intestacy and for class gift purposes in pre-existing documents is an important consideration in a wealth planning review.

Incorporating a “by any means” clause

Of the many tools available to address ART, the so-called “by any means” clause—language recognizing a child conceived by any means of conception—can be added by attorneys to estate planning documents to help ensure a child becomes an heir.

Including a sentence in an estate plan that recognizes children conceived by any means also can help ensure an adoption remains effective after a divorce. For example, two women in a same-sex marriage both might be artificially inseminated by the same man so their children could be related. Each mother might adopt the other child. Including a “by any means” clause could eliminate questions arising if the couple divorced.
Addressing family members’ opinions and concerns

Parents planning to use ART to have a child likely will want to ensure their child can inherit their estate. But some grandparents and other family members may have difficulty in considering children born from third-party genetic material to be bona fide descendants.

Parents who decide to utilize assisted reproductive techniques—or even if there is a slight possibility that reproductive issues could arise down the line—should try to get everyone’s feelings out in the open as soon as possible.

As difficult as these conversations might be, they are vitally important. These conversations can potentially tackle sensitive issues early on. People planning to utilize assisted reproductive techniques should ask their parents and other key family members if such moves are in line with their beliefs, especially if they affect a dynasty trust.

As such, establishing an estate planning checklist may be beneficial. For example, are the overall plans in line with family members’ religious and/or personal beliefs? Do family members want to restrict inheritance rights of a child who is carrying someone else’s DNA?

Transfer tax rules

When President Obama signed into law the American Taxpayer Relief Act of 2012 (ATRA) on January 2, 2013, more favorable transfer tax exemptions became permanent. The federal estate tax exemption, the lifetime gift tax exemption and the generation-skipping transfer tax exemption have been unified, indexed for inflation and increased to $5.34 million in 2014 from $5.25 million in 2013. These exemptions will continue to be indexed for inflation beyond 2014. The portability of these exemptions to a surviving spouse is preserved.

However, the maximum rate for all three taxes increased to 40 percent in 2013 from 35 percent in 2012 and remains at 40 percent in 2014.

These larger exemptions necessitate a review of many current estate plans.

Rethinking trust strategies

Back when the estate tax exemption was $1 million, many estate plans utilized two trusts—marital and credit shelter—in tandem to reduce the tax burden. For the average taxpayer, now that the exemption amount has risen to $5.34 million, that strategy may not work. For estates of $5.34 million or less, using the old credit shelter and marital trust formulas, only a credit shelter may be funded. A review of pre-ATRA documents is in order to determine if the trust funding is still in line with your goals.

Even though it might not be necessary, many taxpayers may still choose the use of a credit shelter/marital trust structure. For example, if an individual is concerned that her spouse might remarry after her death, she might put a portion or all of her $5.34 million estate into a credit shelter trust to attempt to protect it. This amount can be preserved for her children, not the new spouse or the children of the second marriage. A marital trust could also be funded, and would still be exempt from taxes and less restrictive for the surviving spouse to use. For larger estates, the protections provided by a credit shelter trust are still an important consideration. Individuals should work with their advisors to review the objectives of their trusts.

For individuals with estates worth more than $5.34 million, or couples with estates worth more than $10.68 million, the higher exemption amount opens the door for a stronger focus on achieving legacy goals. That’s because with the higher exemption threshold, there might be more money that can be utilized—after what’s been set aside for beneficiaries, for charitable giving and other tax-exempt strategies that can carry on one’s legacy. Individuals and couples might choose to set up a private foundation, or opt for a Grantor Retained Annuity Trust (GRAT) or other popular planning strategies typically used by clients with estates greater than $10.68 million. In addition, they may want to consider setting up a dynasty trust that could last in perpetuity if created in a state that allows them. See our Insights paper “Straying from Home—The Search for Situs” for more information.

The ability to utilize the portability of exemptions between spouses is significant. Portability allows a surviving spouse to use his or her deceased spouse’s exemption to shelter his or her retirement benefits from taxes. Plus, portability provides an additional “step up” in basis. In other words, when an individual’s property passes through his or her estate after death, a long-held portfolio of stocks, for example, would be valued at the date of death value. It’s important to note that the protections of a credit shelter trust won’t be provided when portability is utilized; and generation-skipping transfer tax exemptions are not portable.
**Considering state taxes and domicile**

Even though federal taxes are greater, states can still provide a substantial transfer tax burden. Considering domicile options might be worthwhile, particularly in cases where an irrevocable trust must file its own tax return.

For those with trusts that otherwise would need to file their own tax return, changing domicile to a state without an income tax system might significantly affect estate planning. Currently, Alaska, Florida, Nevada, South Dakota, Texas, Washington (state) and Wyoming have no state income tax. Again, see “Straying from Home—The Search for Situs” for more information.

**Consider flexibility and control**

Today’s more favorable transfer tax exemptions provide grantors with increased flexibility and control when it comes to passing down their assets. Other current estate planning trends are intended to do the same.

For example, the practice of “decanting” a trust has become more widespread in recent years. Rather than go to court to change some aspect of an irrevocable trust, trustees might be able to decant or amend a trust to transfer assets of one trust into another or change the rights of a beneficiary.

An increasing number of states have decanting statutes, and sometimes the language in a trust can prevent decanting.

The bottom line: If some element of an estate plan is especially important to a grantor, and they wish to emphasize certain values or don’t want it easily modified, incorporating these wishes into final documents should be discussed with their advisor and attorney. See our Insights paper “Live Long and Prosper: Creating Trusts with Heart and Soul” for more about drafting with intent.

**Current transfer tax rates and exemptions**

<table>
<thead>
<tr>
<th></th>
<th>Definition</th>
<th>Exemption for 2014 and Beyond</th>
<th>Maximum Rate</th>
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<tbody>
<tr>
<td>Gift Tax</td>
<td>Imposed on the transfer of ownership of property to an individual, either directly or indirectly</td>
<td>After application of any annual exclusions, $5.25 million, indexed for inflation</td>
<td>40 percent</td>
</tr>
<tr>
<td>Estate Tax</td>
<td>Imposed on the transfer of the taxable estate of a deceased person</td>
<td>$5.34 million, indexed for inflation</td>
<td>40 percent</td>
</tr>
<tr>
<td>Generation-Skipping Transfer Tax</td>
<td>Imposed on outright gifts and transfers in trust either to an unrelated person more than 37.5 years younger than the donor, or in the case of related persons more than one generation younger than the donor.</td>
<td>$5.34 million, indexed for inflation</td>
<td>40 percent</td>
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Conclusion

Estate planning conversations aren't always the easiest to have. After all, they involve considering one’s own death and mortality. Some recent developments—particularly advances in ART—may make those conversations even more uncomfortable for some.

The combination of recent developments makes it imperative to take a fresh look at even the most up-to-date estate plan. Now may be the ideal time to revisit your estate plan with your advisors to ensure you’re on the right path to work toward your goals now and far into the future.

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