

2015 ESTATE PLANNING ADVISORY MEMORANDUM

Have Federal Tax Law Changes Affected Your Estate Plan?

While in many cases recent changes to the federal tax laws allow for more favorable outcomes from a federal estate and gift tax perspective, they have fundamentally changed traditional approaches to estate planning. The impact of those changes on your plan will depend on your particular circumstances. The following reflects current tax laws you may wish to consider in connection with your income tax and estate planning. Clients who have not updated their estate plans recently and trustees or beneficiaries of family trusts or other irrevocable trusts are encouraged to contact us to schedule an appointment to discuss the impact of these recent changes on their specific situations.

Federal Income Taxes. Federal income tax planning remains an important focus of every estate plan. The maximum income tax rate of 39.6% and the 3.8% Medicare tax on net investment income that apply to individuals, estates, and trusts result in a combined maximum tax rate of 43.4% on net investment income. Due to the shallower progressive tax rate structure that applies to some irrevocable trusts (including nonmarital trusts discussed below), the maximum tax rate will apply to such trusts with only \$12,301 of undistributed income. Thus, it is important to consider the terms of the trusts created under your estate plan to limit the impact of the maximum tax rate.

Federal Estate and Gift Taxes. The cumulative federal estate and gift tax exemption is now \$5 million per person, indexed for inflation (\$5,430,000 in 2015). The highest estate and gift tax rate is 40%. The portability provisions of federal tax law that allow a surviving spouse to utilize the unused estate tax exemption of the first spouse to die are now permanent. In many cases, the higher exemption, the portability provisions, and other factors eliminate the need for certain structures that were fundamental to estate planning in the past. In fact, those structures may now create unnecessary costs for a surviving spouse (e.g., income taxes, legal fees, and accounting fees).

Before portability, the typically optimal way to leave all of the assets to the surviving spouse and still use both spouses' exemptions was through the use of a nonmarital trust (also known as a bypass trust, a credit shelter trust, or a family trust). In general, at the first spouse's death, a nonmarital trust would be funded with property equal to the amount of the exemption, with the remaining assets funding a marital trust. Both trusts could be held for the benefit of the surviving spouse for life, with the remainder passing to the surviving descendants.

Portability now allows many couples to utilize a variety of fairly simple alternatives for estate planning rather than to use the complex nonmarital trust planning. Nevertheless, there remain many reasons to use the exemption of the first spouse to die with nonmarital trust planning (e.g.,

shelter of post-death appreciation and ability to allocate generation-skipping transfer tax exemption).

These changes encourage flexibility in the structure of estate plans. We recommend that you revisit your estate plan with us in order to determine if changes are advisable.

Existing Irrevocable Trusts

In many cases, the assets of an irrevocable trust are not included in a trust beneficiary's estate and the income tax basis of those assets is not adjusted to fair market value upon the beneficiary's death. There may be circumstances when it would be more beneficial from a tax perspective for the opposite to occur. Thus, whether the trust is more or less beneficial will depend on the particular circumstances of each case.

Same Sex Marriage in Florida

On January 6, 2015, as a result of the *Brenner v. Scott* and *Grimseley v. Scott* decisions, Florida became the 35th state (plus the District of Columbia) to recognize same-sex marriage. In those cases, a federal district court held Florida's constitutional and statutory prohibitions on same-sex marriage to be unconstitutional under the United States Constitution. These decisions mean that all same-sex marriages are now recognized in Florida – both marriages performed within and outside of the state.

Asset Protection Updates for Certain Assets

IRAs and Qualified Plan Accounts. On June 12, 2014, the U.S. Supreme Court unanimously ruled in *Clark v. Rameker* that an inherited IRA is not exempt from the claims of creditors under the Bankruptcy Code provisions that generally exempt "retirement funds" from creditors. This ruling allows bankruptcy creditors in some states to attach inherited IRAs. Fortunately, Florida has its own exemptions for inherited IRAs that protect Florida residents. Nonetheless, it is important to keep in mind that beneficiaries of inherited IRAs may reside in a different state whose laws do not include inherited IRA asset protection. An IRA owner (or a qualified plan account owner) who wants to achieve asset protection for the beneficiary, along with favorable estate and income tax results, will want to consider using a carefully drafted IRA beneficiary trust as the beneficiary of the IRA instead of an individual.

Discretionary Trusts. Trust assets tend to be protected from creditor attacks because trusts typically are structured as "spendthrift trusts" (trusts protected by a spendthrift clause) or "discretionary trusts" (trusts in which distributions are in the discretion of the trustee), or both. As to spendthrift trusts, the Florida Trust Code protects the trust from most creditors but allows certain exception creditors (e.g., alimony, child support, and certain governmental claims) to reach the beneficiary's distributions from a trust. The Florida Trust Code sets out separate rules for discretionary trusts.

Nonetheless, in *Berlinger v. Casselberry* a Florida appellate court upheld a writ of garnishment issued to the trustee of a discretionary trust over any present and future distributions made to or

for the benefit of the trust's beneficiary. The court held that the separate rules for discretionary trusts did not protect the trust from garnishment by a former spouse for unpaid alimony. The Florida Supreme Court refused to exercise its discretionary jurisdiction to review this decision, but work is underway to modify the appellate court's holding through legislation.

Life Insurance Proceeds. In the *Morey v. Everbank* decision, another Florida appellate court held that an insured's life insurance proceeds payable to his revocable trust were not protected from creditors. Prior to that decision, it was thought that life insurance proceeds not payable to the insured or the insured's estate were always protected from creditors under the Florida statutes. Nonetheless, the court held that boilerplate language in the trust agreement instructing the trustee to pay the settlor's "death obligations" was a waiver of such protection. In response, the Florida Legislature passed corrective legislation to require that to waive the protection afforded by the Florida statutes, the settlor must expressly state that the statutory protection does not apply.

The lawyers in our Trusts and Estates Group will be happy to answer any questions you may have or provide additional information concerning the matters discussed in this advisory.

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