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The Trump Effect: Practical Drafting Tips for Estate Planners in Uncertain Times

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When Donald J. Trump won the presidency and the Republican Party fared better than most pundits expected in the 2016 elections, many experts predicted that major tax reform, including a repeal of the federal estate tax, would pass prior to the August 2017 congressional recess. The August 2017 congressional recess has since come and gone, and the Trump administration has had to deal with internal and external issues that have made it difficult for its tax reform agenda to gain momentum.

Nevertheless, President Trump, administration officials, and House and Senate Republicans have publicly and repeatedly confirmed that tax reform remains a top priority. Following their inability to bring about healthcare reform, they are arguably now under even more pressure to pass meaningful tax reform. Given the potential for federal estate tax repeal as part of broader tax reform, it is important for the estate planning community to take stock of where we are today and consider how to address this uncertainty in our clients' estate plans.

This article briefly summarizes what we know about the proposed repeal of the federal estate tax, discusses what practitioners should be considering when preparing or updating clients' estate plans, and offers practical approaches planners can take to help ensure that clients' goals are met in light of the uncertainty surrounding the federal estate tax.

Estate Tax Repeal—Will It Happen, and What Would It Look Like?

President Trump stated during his campaign that he would repeal the "death tax," a position that his administration has reiterated on multiple occasions. The administration, the House Committee on Ways and Means, and the Senate Committee on Finance also jointly released an outline of tax reform principles toward the end of September of this year that calls for a repeal of the "death tax" and the generation-skipping transfer (GST) tax.[1] While this contemplates repeal of the federal estate and generation-skipping transfer taxes, it does not appear to cover the gift tax. In addition to the likely resistance that the proposal will receive, President Trump's commitment to repealing the "death tax" (in whatever form that may take) may also be wavering; shortly before the issuance of the tax reform principles in late September, there had been unconfirmed reports that the admin-

istration was considering ultimately abandoning its promise to repeal the "death tax" in an effort to garner more widespread support for its very ambitious tax reform agenda.[2]

There continues to be great uncertainty as to whether there will be "death tax" repeal, what that would encompass, and what, if anything, would replace the tax, but that has not stopped commentators from speculating on each of these points. In particular, based on comments that President Trump made during his campaign, many pundits have suggested that if the federal estate tax is repealed, it could be replaced with a "mark-to-market" capital gains tax on death. This is

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based on a statement from Trump's campaign website, which noted that under the Trump tax plan, "capital gains held until death and valued over $10 million will be subject to tax to exempt small businesses and family farms."[3] However, subsequent proposals by the Trump administration have been silent on this question. As an alternative, some commentators have suggested that the federal estate tax could be replaced with a carryover basis regime, under which the recipients of property on the death of a decedent would simply inherit the decedent's basis in the assets. In either of these cases, income tax planning and planning for cost basis would take on increased importance.[4]

Another area of uncertainty is whether a repeal of the federal estate tax would be temporary or permanent. Due to congressional procedural rules, it may be difficult to enact permanent estate tax repeal by vote of a simple majority of the Senate (which is all the Republicans can do at this point, without Democratic support). This may seem familiar to many seasoned estate planners who dealt with a similar question with the 2001 Bush-era tax cuts under the Economic Growth Tax Relief Reconciliation Act of 2001 (EGTRRA). Under EGTRRA, instead of permanent outright estate tax repeal, due to these procedural rules, all the Bush administration could accomplish was a gradual increase to the federal

estate tax exemption amount from 2001 through 2009, followed by temporary repeal of the federal estate tax in 2010, and then reinstatement of the tax in 2011 at pre-EGTRRA exemption levels.

So with all of this uncertainty, what should a prudent estate planner advise his or her clients to do?

What Do We Do Now?

All of the uncertainty surrounding federal estate tax repeal provides a good justification for practitioners to reach out to their clients to ensure that their estate plans will be well positioned to respond to potential changes to the estate and gift tax systems. Regardless of the uncertainty, it is generally a good idea to periodically review existing documents, especially after a life-changing event such as a birth, death, marriage, divorce, change of residence, or significant change of assets, or after a change in the law.

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When presented with the current uncertainty regarding the prospects of estate tax repeal, many clients may justifiably prefer to take a "wait and see" approach before spending the time and money updating or formulating their plans.

While this may make sense for some, it should not necessarily be the default approach. If the existing estate planning documents no longer meet the client's wishes and objectives for whatever reason, or if it is anticipated that the client may not be able to make changes to his or her estate planning documents in the near future, it is generally advisable to move forward with updating the client's existing estate plans. Of course, clients should think critically before making transfers or entering into transactions that would subject them to payment of gift tax once they have run out of exemption—nobody wants to pay a gift tax the day before it is repealed.

Even for those without an urgently impending need, if a client is waiting for total certainty when it comes to the federal estate tax system, he or she may be waiting a long time. First, the prospect of meaningful tax reform in the near term seems to be less likely than it was at the beginning of the year, as the Trump administration has thus far had a difficult time making progress on other major agenda items. Even if the Trump administration is able to bring about tax reform, and even putting aside the fact that it's not totally clear what that reform would look like in the estate tax context, further changes in the near term are always a possibility (perhaps when the next administration takes office).

For clients inclined to take the "wait and see" approach, it may be helpful to briefly remind them of the roller coaster ride that the transfer tax regime has endured over just the last twenty years. For example, back in 1998, the estate tax exemption amount was $625,000 under The Taxpayer Relief Act of 1997 and was set to increase gradually to $1 million in 2006.[5] As mentioned above, a few years later, EGTRRA scheduled increases to the federal estate tax exemption through 2009, with a temporary repeal of the federal estate tax in 2010, followed by a reinstatement of the estate tax in 2011 at pre-EGTRRA exemption levels. Under EGTRRA, the gift tax exemption amount did not increase and was kept at $1 million during that entire period. Then, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Act) was passed, which reunified the federal estate and gift tax systems and increased the exemption amount to $5 million, indexed annually for inflation. The 2010 Act also provided for portability of the deceased spouse's unused exemption amount.[6] Despite serious concerns that pre-2010 Act exemption amounts would be reinstated, the exemption amounts from the 2010 Act were made permanent by the American Taxpayer Relief Act of 2012,[7] though politicians and voters have repeatedly called for repeal and other changes since then. From just 1998 to the present, the federal estate and gift tax rates have fluctuated significantly, ranging from 35% to 55% (not counting the 0% federal estate tax rate applicable to certain decedents dying in 2010).

Bottom line: a client who decided to postpone addressing his or her estate plan in 1997 until there was certainty regarding the federal transfer tax regime might still be waiting.

The good news for individuals who may want or need to prepare or update their estate plans today is that practitioners have the tools to account for changes

to the client's family dynamics or changes in the tax laws (such as the possibility of federal estate tax repeal) by crafting documents that have sufficient flexibility to deal with changing circumstances. Some of the ways in which practitioners can build this flexibility into clients' documents are discussed below, together with sample language.

Planning for Repeal

Once client and attorney have decided to move forward—either with an update of the existing estate planning documents or entirely new estate planning—the prospect of federal estate tax repeal, and the general desirability for flexibility to account for changing circumstances, should be kept in mind. The following is a discussion of examples of some of the provisions in existing documents that should be carefully reviewed and potentially updated in light of potential estate tax repeal, as well as a discussion of specific provisions, types of trusts, and other planning methods that may be advisable to include to further these objectives.

WILLS AND REVOCABLE TRUSTS

With the looming prospect of estate tax repeal, it may be advisable for practitioners to revisit existing wills and revocable trusts with their clients. For new documents, practitioners should build in the flexibility to achieve their client's goals whether or not there is a federal estate tax in place at the client's death. A discussion of key considerations, issues, and potential solutions follows.

Funding Formulas

If repeal were to occur, practitioners would need to consider whether any formula clauses in their clients' documents still make sense. Although clients with existing plans in place may be hesitant to incur the cost of reviewing and updating their documents, a failure to review these provisions could subvert their intent.

Credit Shelter Trusts

For example, married couples who might be subject to federal and/or state estate tax often fund credit shelter trusts (also referred to as bypass trusts) by a fixed formula in the will or revocable trust. The formula typically provides that

the credit shelter trust is to be funded with an amount equal to the largest share of the decedent's estate that can pass free of federal estate tax. With several states having estate tax exemption amounts at or below the federal level, formulas for residents of those states often limit the amount passing to the credit shelter trust to the state exemption amount so as not to trigger a state estate tax.

Depending on the exact wording of the mandatory credit shelter funding clause, if the federal (and any applicable state) estate tax is repealed, this could result in all of the estate assets passing to the credit shelter trust. This may not be desirable, as the client may not want all of his or her assets tied up in a credit shelter trust if there is no estate tax benefit.[8] In fact, depending on the applicable rules at that time, there may actually be an income tax disadvantage to this approach; under current law, assets in the credit shelter trust would generally not receive a "step-up" in basis at the death of the surviving spouse.

In addition, if the formula clause is based on the federal estate tax, and as a result of federal estate tax repeal all estate assets pass to a credit shelter trust, then to the extent there is a separate state estate tax, the formula could inadvertently trigger state estate tax, which could have otherwise been avoided or minimized. This is because funding the credit shelter trust with an amount in excess of the state estate tax exemption will expose the assets to that state's separate estate tax. This is even more problematic for decedents subject to New York State estate tax. New York law provides for a phase-out of the New York estate tax exemption available to a decedent when his or her New York taxable estate exceeds the exemption amount. In fact, the New York estate tax exemption is completely lost if the taxable estate exceeds the exemption amount by more than 5%.[9] So, an overfunded credit shelter trust for a New York State resident decedent can have serious consequences, as it could subject the entire amount to New York estate tax, without the benefit of a New York exemption.

The following provision to be included in the will addresses this problem by limiting the application of the formula clause to situations where a federal or state estate tax is in existence, and has the added benefit of protecting the client against a future reinstatement of the federal or state estate tax:

> If my spouse survives me, and there is a Federal [or State] estate tax in effect as of the date of my death, my Executors shall distribute a sum equal to the maximum amount, if any, that can pass free of Federal

> [and State] estate tax payable by reason of my death, after taking into account all credits available against such taxes, to the Trustees of the trust created under the Article hereunder entitled Credit Shelter Trust. If there is no applicable Federal estate tax [and there is no applicable State estate tax] in effect as of the date of my death, then the bequest to the Trustees of the trust created under the Article hereunder entitled Credit Shelter Trust shall lapse.

Practitioners should of course tailor this and the other sample provisions contained throughout this article to their clients' unique facts and circumstances and the nuances of any applicable state estate tax laws. This clause, in particular, could also be further modified depending on the nature and form of estate tax repeal (for example, further modification may be desired if a capital gains tax were implemented to replace the federal estate tax).

Marital Trusts

Conversely, the funding formula sometimes applies to the amount passing to the surviving spouse or marital trust. The balance not passing to the surviving spouse or marital trust would then pass to the credit shelter or bypass trust. Many of the same considerations discussed above apply, and the following is a sample clause to be included in the will to address this scenario:

> If my spouse survives me, and there is a Federal [or State] estate tax in effect as of the date of my death, I give my spouse the smallest amount that will minimize the Federal [and State] estate tax payable with respect to my estate. If there is no applicable Federal estate tax [and there is no applicable State estate tax] in effect as of the date of my death, then I give my spouse, if my spouse survives me: [my entire residuary estate].

GST Trusts

Additionally, if the GST tax is repealed, bequests to grandchildren or more remote descendants, or trusts for their benefit that were designed to use GST exemption, should be revisited. Similar to the formula bequests to a credit shelter trust or marital trust, discussed above, a GST bequest may have a funding formula that may no longer be appropriate. In addition, the bequest itself may have

only been included for GST tax savings reasons, and with no GST tax, the client may no longer wish to make such a bequest at all. The decision to remove such a bequest should also factor in the possibility that the federal estate or GST tax could be reinstated in the future.

Disclaimer to Credit Shelter Trusts

As noted above, credit shelter trusts are commonly used in estate planning documents. An advantage of the credit shelter trust under current law is that it permits the surviving spouse to make use of the deceased spouse's unused federal (and/or state) estate tax exemption amount. This benefit became somewhat less important with the ability of a surviving spouse to effectively inherit his or her deceased spouse's unused estate tax exemption via portability. However, because (i) there are a number of nuances to the portability rules, (ii) a deceased spouse's GST exemption is not portable, and (iii) many states with separate state estate taxes do not permit portability, there are still benefits to the use of credit shelter trusts under current law.

Amounts passing to the credit shelter trust should not be included in the surviving spouse's estate for estate tax purposes and, thus, would pass free of federal (and/or state) estate tax following the surviving spouse's death. However, if there is no applicable estate tax in effect, this may not actually provide any value.

Given the benefits of the credit shelter trust in a world with an estate tax, and the relative lack thereof in a world without an estate tax,[10] there is option value in deferring the decision of whether to fund a credit shelter trust for as long as possible. One way to preserve this optionality is to leave the entire estate to the surviving spouse, while also giving the surviving spouse the ability to disclaim all or any portion of the bequest. If the surviving spouse disclaims some or all of his or her interest in the bequest, the disclaimed property could pass to a credit shelter trust. An example of a provision to be included in a will that would allow for a disclaimer to a credit shelter trust follows:

> I leave my residuary estate to my spouse, if my spouse survives me. If my spouse renounces and disclaims all or any portion of the gift made under this paragraph, then such disclaimed property instead shall be distributed to the Trustees of the trust created under the Article hereunder entitled Credit Shelter Trust. Any renunciation and

> disclaimer made under this paragraph may also be made by such person, acting on my spouse's behalf, as permitted under applicable law. To be effective under this paragraph, any renunciation and disclaimer must meet the requirements of a "qualified disclaimer" under Sections 2518 and 2046 of the Internal Revenue Code or any successor thereto, if applicable, and the requirements for a valid renunciation and disclaimer under applicable state law.

Including such a provision in the will would provide significant flexibility for the surviving spouse, who could make the appropriate decision in light of more complete information about the federal and state estate tax laws in effect at that time.

When determining whether or not to disclaim all or a portion of the bequest to a credit shelter trust, the surviving spouse or his or her advisors should also consider the income tax consequences. Assets passing to a credit shelter trust generally do not receive a second step-up in basis on the surviving spouse's death (at least under current law). Thus, appreciation in the value of the assets passing to the credit shelter trust between the death of the first and second spouses will eventually be subject to capital gains tax on disposition, absent additional planning. By contrast, under current law, if the assets passed outright to the surviving spouse, those assets would ultimately receive an additional step-up in basis on the surviving spouse's death. In a scenario with no estate tax, this second step-up in basis would likely be more valuable than keeping the assets out of the surviving spouse's estate altogether. If, on the other hand, a carryover basis regime were implemented in place of the estate tax, the second step-up in basis would not be applicable even if the assets were to pass outright to the surviving spouse.

Although the disclaimer method provides flexibility, vesting the decision in the surviving spouse gives the surviving spouse a significant amount of power and responsibility, which may not be appropriate in all situations. For example, granting the surviving spouse this level of discretion may not be advisable in the case of a second marriage with children from the first relationship.

Clayton Provisions

"Clayton" provisions, so named after the case that confirmed their viability,[11] are similar to disclaimer clauses, except that they give the decision-making power

to a fiduciary. In this scenario, assets passing to the martial trust for which a qualified terminal interest property (QTIP) election is not made would instead pass to a credit shelter trust. An example of such a provision follows:

> If my spouse survives me, I direct that my residuary estate shall be distributed to the Trustees of the trust created under the Article hereunder entitled Marital Trust; provided, however, that if the Federal estate tax is in existence at the time of my death, and if any portion of the gift is not elected to qualify for the Federal estate tax marital deduction, such portion shall instead be distributed to the Trustees of the trust created under the Article hereunder entitled Credit Shelter Trust.

The "Clayton" approach is similar to the use of a disclaimer clause in the sense that it maintains the flexibility to adjust the disposition of assets on the first spouse's death in light of the federal and state estate tax law in effect at that time. An added benefit of the Clayton provision is that the complex tax considerations can be left in the hands of an independent fiduciary who is an expert on the subject.

For practitioners with clients who may be subject to a separate state estate tax, it may be advisable to modify the above clause to also address those state estate tax considerations. For example, if there is no federal estate tax in existence but there is a separate state estate tax, it still may make sense in certain situations to fund a credit shelter trust to absorb the state estate tax exemption of the decedent spouse (or to shelter assets from a federal estate tax if it is later reinstated). One complication is that depending on the laws of the applicable state, there may be limitations on the ability to make a separate state QTIP election if no federal QTIP election is made (which may be the case if there is no federal estate tax). Below is a further discussion on considerations relating to QTIP trusts.

QTIP Trusts

Marital trusts (and QTIP trusts in particular) are commonly used in estate plans as a mechanism to obtain the benefits of a trust (as opposed to an outright disposition), while also not jeopardizing the marital deduction and the resulting deferral of the payment of estate taxes until the death of the surviving spouse. Presumably, if the federal estate tax is repealed, it will no longer be possible (or

necessary) to make a QTIP election for federal purposes. However, while the need to defer federal estate tax may become irrelevant, deferring state estate tax until the death of the surviving spouse by use of a marital trust may still be desirable. It would thus be important to confirm whether the applicable state will allow for a separate state QTIP election. Alternatively, use of a general power of appointment trust (GPA Trust), as opposed to a QTIP trust, should be considered to address this issue. A GPA Trust is one in which the surviving spouse retains a general power of appointment on his or her subsequent death, thus resulting in the same estate tax deferral as a QTIP trust.

Inclusion of a provision in the will such as the following would grant the surviving spouse a general power of appointment:

> I give my spouse power to appoint the entire principal of the marital trust, exercisable in favor of my spouse or in favor of my spouse's estate or in favor of both, as well as in favor of others. Such power to my spouse to appoint the principal in favor of [himself/herself] may be exercised in whole or in part at any time or from time to time, any such exercise to be by instrument signed by my spouse and delivered to my Trustees. Such power of my spouse to appoint the principal in favor of my spouse's estate, as well as in favor of others, shall be exercised by my spouse's last will and testament, and in so far as my spouse exercises such power by such will, my spouse may appoint the principal in any shares and manner, outright or in lesser estates, or in trust or otherwise. In default of such appointment by my spouse, my Trustees shall upon my spouse's death pay over to the principal of the marital trust (or if my spouse shall not effectually appoint all of such principal, then my Trustees shall upon my spouse's death pay over such part of the principal as my spouse shall not effectually appoint) as follows: [insert alternative disposition].

Despite its advantages, this approach may not be appropriate for all clients. Similar to the issues discussed above with use of a disclaimer into a credit shelter trust, giving the surviving spouse a general power of appointment vests significant discretion to the surviving spouse. This discretion could be troublesome where the client is not entirely comfortable that the surviving spouse will follow through with the desires of the predeceased spouse (for example, where there are children from prior marriages).

Qualified Domestic Trusts

Thought must also be given to marital trust planning for surviving spouses who are not U.S. citizens. Under current law, the federal estate tax marital deduction is only available for transfers to surviving non-citizen spouses if the assets passing to the non-citizen spouse are held by a qualified domestic trust (QDOT). QDOTs are similar to QTIP trusts, although principal distributions to the surviving spouse, as well as final distributions following the surviving non-citizen spouse's death, are subject to a deferred federal estate tax as though the assets had been included in the deceased spouse's estate. Assets passing to QDOTs are subject to strict requirements, which are set forth in the Internal Revenue Code (the Code) and corresponding Treasury regulations.[12] If the federal estate tax is repealed, use of such trusts may no longer be desirable. While again not appropriate for all clients, if provisions are made for non-citizen spouses, it may be preferable to leave the assets to the non-citizen spouse outright. Unlike the funding of most trusts on death, there is a window of time following the decedent's death in which the surviving spouse can create and fund the QDOT trust.[13] This approach may be preferable, as it provides flexibility to determine whether a QDOT trust is appropriate, based on the status of the federal estate tax at that time.

Apportionment Clauses

Apportionment clauses in wills and revocable trusts can provide for the allocation of taxes, debts, and expenses attributable to the decedent's estate and can have a significant impact on the net amounts that the beneficiaries actually receive.

Even if the federal estate tax is repealed, given the long history of changes in this area, it is conceivable that it will be reinstated at some point in the near future. In addition, even if it is repealed, it is not totally clear what replacement tax, if any, would result. One way of dealing with this uncertainty as it relates to the apportionment clause would be for practitioners to retain their standard apportionment clauses and simply modify the description of what taxes are included to account for potential replacement regimes.

An example of a definition of "Death Taxes" to be used in the apportionment clause follows:

> Death Taxes. "Death Taxes" means all estate, inheritance, succession, capital gains or other transfer taxes and any similar taxes on appreciation, including interest, penalties and any excise or supplemental taxes, imposed by any domestic or foreign jurisdiction by reason of a person's death, but shall not include generation-skipping transfer taxes imposed by Chapter 13 of the Code, other than such taxes attributable to a direct skip of which I am the transferor, unless such direct skip is caused by a qualified disclaimer by a non-skip person (as those terms are defined in the Code).

Given the current uncertainty as to what system would replace the federal estate tax, this solution is merely a temporary one, and if a new system is enacted, these provisions should be carefully reviewed to make sure they are still appropriate. As is currently the case, it is important to also consider which beneficiaries bear the tax burden in the apportionment clause.

Finally, as is also currently the case, to the extent a client establishes a "pour-over" will coupled with a revocable trust, practitioners should ensure that the apportionment clauses in each document are coordinated and work together in a consistent manner.

LIFETIME TRUSTS

Some commentators have speculated that if President Trump's tax reform goes into effect, it will reduce the number of lifetime trusts that are established. The rationale for this is that a primary motivator behind the creation of most trusts is reduction of estate taxes, which would no longer be relevant under President Trump's tax plan (as there would be no federal estate tax to reduce). However, those commentators are not focusing on the many other benefits that trusts offer. Those benefits include the following:

- Serving as a "testamentary substitute." By putting dispositive provisions in a trust, as opposed to a will, this may help to limit expense, delay, and administrative hassle involved with probate or surrogate's court proceedings.
- Creditor protection for the donor and/or the beneficiaries.

- Protection from matrimonial claims against beneficiaries. Trusts can work in conjunction with, or to some extent serve as a substitute for, matrimonial agreements.
- Relieving the beneficiaries from responsibility associated with managing the assets by appointing a separate trustee. This is especially advantageous for young beneficiaries or beneficiaries who lack business or investment experience.
- Addressing the concern that outright ownership may serve as a disincentive for the beneficiary to work, go to school, or become a productive member of society.
- Providing other tax benefits, beyond federal estate tax. For example, state estate tax can potentially be saved, and there may also be opportunities to avoid state income taxation in certain situations.[14]

In addition, if transfer tax considerations are removed by tax reform (for example, if the gift tax is also repealed), then lifetime trust creation may actually increase as a result. This is because transfer taxes serve, to some extent, as a limitation on what can be transferred into a trust to achieve most of the above non-tax objectives. For example, gifts to a trust may be limited to the annual exclusion amount or unified credit. Those limitations effectively disappear if there is no transfer tax system to worry about.

Of course, many of the same drawbacks to the use of trusts would still apply. From a tax perspective, one of the main trade-offs to the establishment of a lifetime trust that is a completed gift for gift tax purposes is the probable loss of a step-up in basis for the assets in the trust on the death of the grantor. With the increased importance of income tax planning due to the rise of income tax rates, and the somewhat decreased importance of estate tax considerations due to high estate tax exemptions and estate tax rates that are off of their highest amounts, this trade-off needs to be seriously considered and analyzed. In addition, assuming transfer tax considerations are no longer relevant due to tax reform (a major assumption, indeed), then one of the primary remaining downsides to

Flexibility is key with the looming prospect of tax reform.

the use and funding of lifetime trusts is the donor's loss of control and ability to enjoy the trust funds. While complete control often undermines the objectives of the trust, the donor, trusted friends, family members, or advisors can still be given significant authority. This concern can also be ameliorated, somewhat, by building in flexible trust provisions.

As discussed above, a flexible structure is particularly key with the looming prospect of tax reform. With flexibility built into a trust, clients can move forward with traditional estate planning to make use of the estate and gift tax exemption and benefit from some of the other non-tax advantages to the use of trusts, while providing mechanisms to deal with changing circumstances, including the ability to unwind the entire structure if it no longer makes sense.

Below are several strategies and options to provide this flexibility for a client who is looking to make use of the exemption now by making lifetime gifts to trusts.

Spousal Limited Access Trust

The Spousal Limited Access Trust (SLAT) is one way in which clients who wish to make gifts now can do so, while retaining an "escape valve" if the structure is no longer desirable, such as in the event the federal estate tax is repealed.

The SLAT was a particularly popular planning device in 2012, when the prospect of a steep reduction in the federal estate tax exemption loomed and there was a rush to make year-end gifts. That same strategy is also attractive with the current uncertainty surrounding the prospects of federal estate tax repeal. In the typical SLAT, a married grantor uses some or all of his or her gift tax exemption to make a completed gift to a trust of which the grantor's spouse is one of the discretionary beneficiaries (often, together with descendants). If, at a later time, there is a desire to unwind the trust, the trustee (who should not be the grantor or spouse) could simply distribute the assets to the grantor's spouse. Depending on the relationship between the grantor and the grantor's spouse, a distribution back to the spouse could effectively be the same as a distribution back to the grantor.

To maximize the exemption from both spouses, it was common to establish reciprocal SLATs, where each spouse would set up a SLAT to benefit the other. In that plan, however, it was (and still is) important to be mindful of the reciprocal trust doctrine, under which the IRS could treat the trusts as so interrelated that

"the arrangement, to the extent of mutual value, leaves the settlors in approximately the same economic position as if they had created trusts naming them as life beneficiaries," and therefore the trusts and their assets would be included in the settlor's estate for estate tax purposes.[15]

While there is not a bright-line test to assess whether the reciprocal trust doctrine will apply, it is important to draft substantive differences into the terms of both SLATs to avoid this treatment. For example, granting one spouse, but not the other, a power to appoint the property in the trust of which he or she is a beneficiary may counter the potential application of the reciprocal trust doctrine.[16] Varying the distribution standards and the classes of beneficiaries in the two trusts may also lower the chances of the IRS applying the reciprocal trust doctrine.[17]

Self-Settled Asset Protection Trust

A "self-settled asset protection trust" is another example of a flexible structure that could enable clients to advance their trust and tax planning today, while preserving their flexibility to deal with changes to applicable estate tax laws. Donors who establish a self-settled asset protection trust can, for example, retain the possibility of receiving back trust assets if it is later determined that unwinding the trust is advisable.

Under traditional common law principles, a creditor of a settlor can generally reach the trust property to the maximum extent that the trustee can distribute property to the settlor. This results in the assets of the trust being includable in the settlor's taxable estate for estate tax purposes.[18] However, several states have enacted statutes that reverse this traditional common law approach and allow for individuals to create irrevocable trusts in which they retain the ability to receive distributions at the discretion of an independent trustee, while seeking to preserve the creditor and estate tax protection that would have been afforded to the trust had the settlor not been named as a discretionary beneficiary. These trusts are often referred to as "self-settled spendthrift trusts," or "self-settled asset protection trusts."

Statutes permitting asset protection trusts generally include requirements that the trust (i) be irrevocable, (ii) invoke the law of the resident state, (iii) have a resident trustee, (iv) have at least some of the assets located in the state, and (v) have certain administrative activities with respect to the trust occur within the state.

If the statutory requirements are met, most actions commenced within the state by the settlor's creditors against the trust property are prohibited. There are, however, exceptions for fraudulent conveyances and tort injuries occurring on or before the date of transfer to the trust, and in certain asset protection jurisdictions, for claims for marital and child support depending on the timing of the funding of the trust or the date of the claim.

Estate planners who are interested in exploring the flexible nature of self-settled asset protection trust laws are advised to pay careful attention to the requirements of the statutes and other pertinent local laws and to work closely with local counsel. Additionally, practitioners should flag for clients in states that have not enacted self-settled asset protection legislation the possible conflict-of-law concern that a creditor's claim in that non-self-settled asset protection jurisdiction may be successful in spite of the purported creditor protection of such a trust.[19]

If such planning is pursued, it may be beneficial to include provisions in a spendthrift clause that specifically refer to the particular asset protection statute. For example, the following is sample language for a self-settled asset protection trust created under Nevada law:

> It is the Grantor's intent that during the Grantor's lifetime this trust shall qualify as a spendthrift trust for the benefit of the Grantor pursuant to NRS § 166.010 et seq. Notwithstanding anything in this Agreement to the contrary, any power, duty or discretionary authority granted to the Trustees, Trust Protectors, the Grantor or any other person shall be absolutely void to the extent the right to exercise such power, duty or authority would in any way jeopardize the trust's status under NRS § 166.010 et seq., or otherwise cause the assets of the trust to become subject to the claims of the creditors of the Grantor (other than creditors whose claims are permitted under the timing requirements set forth in NRS § 166.170).

Additional suggested language, plus the contemporaneous execution of an affidavit as to the solvency of the donor, may be advisable. So again, consultation with local counsel is strongly encouraged.

Other Reserved Powers

There are myriad other powers that a settlor (or other trusted family members or friends) can retain that can allow an element of control over an irrevocable trust, while still preserving the intended tax treatment of the trust. These powers, coupled with some of the techniques discussed above, can further give comfort to a settlor that he or she will be able to account and adjust for later changes of circumstances, such as the potential repeal of the federal estate tax.

For example, a settlor can have the power to remove the trustee and appoint a successor in such removed trustee's place. In order not to jeopardize the estate tax treatment of the trust, the settlor should not have the power to appoint a "related or subordinate" person as successor to the removed trustee.[20] With that relatively narrow limitation, this power would allow the settlor to change the trustee for any reason, including, for example, if the trustee refused to make a distribution that the settlor believed to be advisable. This would include a distribution of the entirety of the trust to effectively unwind the trust if it no longer makes sense in light of changes to the tax laws. If an existing trustee were not willing to take such an action, the settlor could then appoint a successor trustee who the settlor believed would be more likely to take the requested action.

It may also be beneficial to provide mechanisms for modifying the terms of a trust, even if it is an "irrevocable" one. For example, it may be advantageous to include a clause in the trust that allows for administrative or other amendments, so long as they do not impact the beneficial interests in the trust. The following is sample language that can be included in a trust:

> The Trustee may amend any portion of this Agreement in writing from time to time to state expressly any such additional powers and authority or otherwise to change the provisions of this Agreement in any manner that the Trustee deems necessary or advisable, including for tax purposes. Nevertheless, no power granted to the Trustee in this paragraph grants any implied power to change beneficial interests under any trust. In exercising these powers and in amending the provisions of this Agreement, the Trustee shall observe the general fiduciary duties of loyalty, good faith, fairness and due care and shall act in a manner consistent with the Settlor's intent as expressed in this Agreement.

Another increasingly popular way to effectively amend an otherwise irrevocable trust would be to grant the trustee the ability to “pour” trust assets into a new trust with different (more favorable) terms. This is known as a trust “decanting,” and while several states have statutorily enabled trustees to distribute trust assets to a new trust for the benefit of the beneficiaries of the existing trust, it may be advisable to specifically authorize a decanting in the trust itself.[21]

There are multiple ways to establish a lifetime trust in a way that allows for flexibility to account for later changes, including changes to the tax law. It is important for practitioners to work closely with their clients and build in the flexibility that is best suited for the clients and their particular facts and circumstances.

Conclusion

With so much uncertainty surrounding whether we will see tax reform, what it will look like, and what the timing will be for enactment, estate planning advisors and their clients are left in a state of limbo. However, for many practitioners, this should be a familiar feeling, given the many changes and proposals that we have encountered in the U.S. transfer tax system, even in just the last twenty or so years. If nothing is certain except for death and taxes—and now we can’t even count on death taxes—it is becoming more important than ever before for planners to consider adding flexibility, including some of the suggestions made in this article, to their clients’ estate planning documents.

Robert W. Sheehan and Michael S. Schwartz are authors of PLI’s Stocker on Drawing Wills and Trusts.

NOTES

1. White House, United Framework for Fixing Our Broken Tax Code (Sept. 27, 2017), www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf; *see also* Press Release, U.S. Dep't of Treasury, Unified Framework for Fixing Our Broken Tax Code (Sept. 27, 2017), www.treasury.gov/press-center/press-releases/Pages/sm0166.aspx.
2. Amanda Becker, *White House Weighs Abandoning Estate Tax Repeal in Republican Tax Push*, Reuters (Sept. 19, 2017), www.reuters.com/article/us-usa-tax-estate/white-house-weighs-abandoning-estate-tax-repeal-in-republican-tax-push-idUSKCN1BU2YS (last visited Sept. 25, 2017).
3. *Tax Plan*, Donald J. Trump (Nov. 5, 2016), www.donaldjtrump.com/policies/tax-plan [https://web.archive.org/web/20161105190533/https://www.donaldjtrump.com/policies/tax-plan].
4. This has been a trend over the last several years, regardless of the prospect of estate tax repeal, due to a combination of factors including rising income tax rates, increasing estate tax exemption amounts, and estate tax rates that have come down from their highs.
5. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (effective for gifts made, and the estates of decedents dying, after December 31, 1997).
6. Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296.
7. American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, H.R. 8, 126 Stat. 2313.
8. Although it may be beneficial if the estate tax is later reinstated.
9. N.Y. Tax Law § 951(a), as amended by 2014 A.B. 8559/S.B. 6359 (N.Y.) (effective Apr. 1, 2014).
10. Note that there still may be some advantages to the use of a credit shelter trust even if there is no estate tax. Some of the non-tax advantages to the use of trusts are discussed below in this article. In addition, there still may be a benefit to a credit shelter trust if the estate tax is reinstated.
11. Estate of Clayton v. Comm'r, 97 T.C. 327 (1991), *rev'd*, 976 F.2d 1486 (5th Cir. 1992).
12. 26 U.S.C. § 2056(A); 26 C.F.R. § 20.2056A-4.
13. 26 U.S.C. § 2056(A)(d).
14. For example, an "incomplete non-grantor trust" such as a DING, NING, or SDING trust may be used by grantors in high-income-tax states to try to avoid the applicable state income tax. However, such planning is no longer viable for residents of states such as New York, which have statutorily eliminated the benefit of using such trusts.
15. United States v. Estate of Grace, 395 U.S. 316 (1969).
16. Estate of Levy v. Comm'r, T.C. Memo 1983-453 (1983).
17. I.R.S. Priv. Ltr. Rul. 200426008 (Mar. 10, 2004).
18. 26 C.F.R. § 25.2511-2; Rev. Rul. 76-103, 1976-1 C.B. 293(1976).
19. For a discussion of the conflict-of-law issues, see David G. Shaftel, Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes (Aug. 2017),

www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf.

20. Rev. Rul. 95-58, 1995-2 C.B. 191.
21. Including decanting language in the trust itself may have the benefit of allowing for a decanting without having to strictly adhere to the statutory requirements. *See, e.g.*, *In re* Hoppenstein, No. 2015-2918/A, 2017 NY Slip Op. 30940(U), 2017 WL 1969401, NYLJ 1202784244139, at *1 (N.Y. Sur. Ct., N.Y. Cty., Mar. 31, 2017).