BASIC PLANNING STRATEGIES FOR U.S. PERSONS

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Basic Planning Strategies for U.S. Persons

The following discussion highlights several strategies that a US Person might adopt in considering long-term planning.

Any strategies discussed here would need to be analyzed for compliance and consistency with Swiss Federal as well as any cantonal property laws and taxation regime.

Estate Tax System

- **Exemption Amounts**
  - Under current federal law a US person may give away during lifetime, or at death, the federal exemption amount of $12.92 million to anyone she wishes (this amount will be increased annually for inflation). However, the law is scheduled to "sunset" in 2026 resulting in the decrease of the federal estate tax exemption to $5.6 million, as adjusted for inflation.

1. Basic Documents

- **Will**
  - A will accomplishes a variety of functions (both tax and non-tax) to transfer individually owned property to designated beneficiaries. It is the basic instrument for transferring property at death.
    - Personal Property Memorandum
    - Choice of Fiduciary
    - Guardianship Provisions for Minors

1. Basic Documents (Cont'd)

- **Revocable Grantor Trust**

  - A Revocable Trust is essentially a will substitute. While it can hold title to property—including income producing property, during the grantor' lifetime it uses the individual's own social security number and is transparent or disregarded for income tax purposes. The grantor may modify, amend or revoke the trust at any time. If she were to decide to fund the trust during her lifetime, to avoid probate and to provide a centralized investment management vehicle, she would arrange for those assets to be retitled to the name of the trust.

    - During Grantor's Lifetime
    - Debts, Expenses and Taxes
    - At Death
    - Provisions for children and more remote descendants

Tax Treatment: As noted, during her lifetime, as grantor of a revocable trust all activities in the trust pass-through to the grantor and the trust is a disregarded entity for income tax purposes. Following her death, the tax status of the trust changes to nongrantor. If the (nongrantor) trust accumulates income it pays its own taxes at a rate of 37%; income distributed from the trust is taxable to the beneficiary at his or her appropriate marginal rate.

2. Exemption Planning

Exemption planning involves transfers in gift aimed at reducing or eliminating federal gift and estate tax. Noting that the current exemption of $12.92M is scheduled to be reduced to around $5.6M in 2026, such strategies aim to 'lock-in' the higher exemption amounts while it is still possible to make such transfers without incurring gift tax. Discussions around exemption planning often follow parallel tracks. One focus is the choice of asset and most efficient mechanism for maximizing the value of the gift. The other pressing issue is how to structure the transaction - who receives the gift and in what form.

Exemption Planning (Cont’d)

- **Outright Gifts**
  - The simplest form of gifting is a straight transfer. Subsequent appreciation of any such asset occurs outside of the estate, and so the leverage gained is (i) the amount by which the gift tax –free asset exceeds the lowered exemptions anticipated in 2026 and beyond; and (ii) the growth of the asset following the transfer.
- **Discounting Techniques**
  - Discounting usually arises where an appraisal can establish that the value of the asset actually transferred is less than the apparent fair market value; this is usually found in the context of discounts for illiquidity, lack of marketability, lack of control or minority holder status. Non-control shares in a private company, for example, or fractional interests in real estate, can receive discounts as great as 50% from face market value, allowing for transfer of greater wealth within the available exemptions.

Tax consequences: The taxpayer would be required to file a gift tax return documenting the value of the gift; this is informational only-- no gift tax liability unless the value of the transfer exceeds the available exemption;

Exemption Planning (Cont'd)

- **Gifts in Trust**

  - **Grantor/nongrantor**

    The discussion concerning trusts above pertained to grantor revocable trusts, which during the lifetime of the grantor are disregarded entities for both income tax and estate and gift tax purposes. There are alternative forms of trusts, however, some of which can be useful in exemption planning.

    The irrevocable grantor trust, or so called "defective grantor trust" is one such vehicle. A transfer to an irrevocable grantor trust where the grantor is not a beneficiary, is considered a completed gift for gift tax purposes, but is taxed as a pass-through entity to the grantor for income tax purposes. This hybrid status allows the grantor flexibility in several different areas. By retaining the income tax liability for the earnings inside the trust, for example, the grantor can add substantial value to the trust without incurring any additional gift tax exposure (note that the trustee can also be authorized to distribute to the grantor the funds needed to cover the tax liability). Grantor trust status also permits the grantor to exchange assets held in the trust with other assets from outside the trust of equivalent value with no gain recognition or other tax consequences.

Exemption Planning (Cont'd)

- **Sale to a Defective Grantor Trust**

  The defective grantor trust can also engage in tax-advantaged transactions with the grantor. For example, the trust can purchase assets from the grantor in exchange for a promissory note detailing installment payments. Such an arrangement is disregarded for income tax reporting purposes since the grantor is acting as both buyer and seller, and the interest on the note payments can be satisfied by income generated within the trust without double taxation of the income. If the assets that are the subject of the sale are discounted at the time of transfer, this strategy can be effective at moving substantial sums without using available exemption; and any subsequent appreciation of value that occurs inside the trust is not subject to estate taxation.

Tax consequences: In the event of a sale to a defective grantor trust, there may be a gift tax filing if the trust is originally unfunded as the IRS requires that the purchasing trust be capitalized with at least 10% of the value of the asset purchased; the income tax status is neutral as the transaction is disregarded. The tax basis (for capital gains purposes) of the grantor, as with any gift, is assumed by the transferee.

Exemption Planning (Cont'd)

- **Irrevocable Life Insurance Trust**

  US law permits the sale or transfer of ownership of life insurance policies to irrevocable grantor trusts and the death benefit is subsequently excluded from estate tax. There is a 3 year look back period where the asset is still included in the grantor's estate if the policy is transferred as a gift. The estate tax exclusion is immediately effective however if the policy is transferred via a sale for value. Income earned inside the trust is taxed to the grantor as a flow-through since the entity is disregarded. The death benefit is income tax free.

Tax consequences: A gift tax return reporting the cash surrender value of the policy must be filed in the event of a gift; there are no income tax consequences in the event of a sale for value; the death benefit proceeds are exempt from income and (subject to the 3 year look back period if applicable), estate taxation.

Exemption Planning (Cont'd)

- **Grantor Retained Annuity Trust**

The concept behind a Grantor Retained Annuity Trust ("GRAT") is that the grantor gifts only appreciation. A GRAT is an irrevocable grantor trust with a minimum of a two year term. The trust must provide that the grantor receive an annuity payment that is equal in the aggregate (over the lifetime of the trust) to the value of assets contributed plus a reasonable rate of return. Reasonable rate of return is defined as the then-current 7520 rate (an index published monthly by the US Treasury); the 7520 is 5% for September 2023; it is highly interest rate sensitive and will fluctuate with market conditions and Federal Reserve policy.

Exemption Planning (Cont'd)

If the assets inside the GRAT appreciate at a rate greater than the annuity amount that difference is transferrable without gift tax consequences either in trust or outright. This technique is suitable for volatile assets; note that because of the grantor trust status, a holding that spikes in value can be locked in or frozen by the grantor in a tax free swap with a more stable asset of equivalent value.

Tax consequences: Income tax neutral (the GRAT is a disregarded entity); gift tax neutral (although it is prudent to file an informational gift tax return in order to trigger the three year statute of limitations and preclude further IRS review).

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Thank You!

Merci!

Danke!

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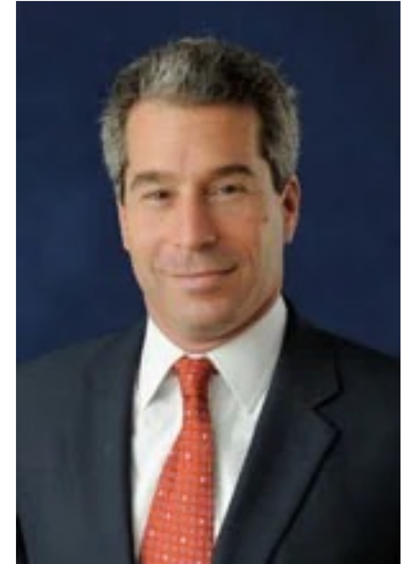
About the Presenter

Matthew Berlin (he/him/his) is a Partner in the Trusts and Estates Department of Rubin and Rudman LLP, a U.S. law firm headquartered in Boston, MA. Matt focuses his practice on all aspects of estate planning, trust administration and related tax matters, including FATCA compliance and offshore informational reporting. His clients consist of individuals and families living throughout the U.S. and abroad, as well as the offshore and onshore entities they create or control to manage and pass on wealth.

As a fiduciary for scores of trusts, estates and charitable foundations, Matthew has extensive experience managing and administering assets, including disposition of or investment in commercial and residential real estate, fine art, intellectual property and marketable securities in the U.S. and abroad

He received his J.D. from the University of Oregon and B.A. from Harvard University. Matthew is an accomplished jazz and blues bassist, having released multiple albums.



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