Fundamentals of Wealth Transfer Planning

Establishing Control Entities

For most individuals – even though individuals who have significant net worth – they will not part with a significant asset unless there is some means of control established in the transfer.

What do we mean by this?

First of all, it is important to understand that for most of us we can control assets via any number of entities that have been established over time to own and control those assets. Within those entities in and of themselves there can be a designation as to a portion of the ownership which contains the management control of those assets. Within that entity, there can be a non-control portion, which can be transferred to someone or something else, and then a control portion, which will be retained by the individual client.

Control and not ownership is the important aspect of having access and use over assets. You can own an asset yet not have control of the asset. For example, if you own an asset and you have a liability claim against you, someone else could actually have control over that asset due the liability claim if they get a judgment. However, if you control the management aspect of the entity and give away or sell the non-controlling portion of the entity you can continue to control the assets that are within the entity.

That is a real secret of wealth transfer planning. Don't lose control of the assets and maintain control of them via control entities.

- Use of Entities with which to Maintain Control over Assets without having to Own the Assets
- Control and not Ownership is the Important Aspect of Having Jurisdiction over the Assets
- Positioning Assets to Remove them from the Taxable Estate

Discounting the Current Taxable Value of Your Assets

The tax for both the estate and tax is calculated by taking the market value of the assets and applying the tax rate which will be transferred. For example, you might have an investment of $1 million in a piece of property, but that property has appreciated over time and is now worth $5 million. The value at which it will be taxed if you transfer it is $5 million and not your original investment.

That is why it's so important when you're doing wealth transfer planning to position your assets in such a way to be able to maximize the valuation discounting that has been available to individuals in the United States since the early 60s.

In this scenario, you can take that same asset that that you have $1 million invested in that is now become worth $5 million and with some strategic valuation discounting you can probably discount the value of that asset to $2.5 million and then transfer it at that value. In any event, you have reduced the estate or gift tax by half by the use of valuation discounting, and you have maintained control of the asset.

How do you do this?

In short, you use entities to create tier discounts on assets what you held by the entities. Those include asset class discounts, entity class discounts, which would include both voting and nonvoting shares, lack of marketability discounts for those entities which are privately held, and a lack of management control discount, which would be tied to the ability of the owner of the share to either vote or not vote the shares.

Overall, the discounts would add up to a point where you could take the overall discount in the transfer of the asset thus saving substantial taxes.

- Use of Entities to Create Tiered Discounts
- Asset Class Discounts
- Entity Class Discounts
- Lack of Marketability Discounts
- Lack of Management Control Discounts
- Overall Discounts by Design of Assets within the Master Entity

Freeze of Discounted Values of Taxable Estate

One of the really key areas is that assets tend to appreciate over time which are held by high net worth individuals. As they appreciate that same tax on the market value of the asset itself will apply if it's transferred at a later date.

How do you freeze the discounted value in the taxable estate? Well, what you can do is to make a gift of the asset, which would then freeze the value at whatever value you transferred it with the credit that you had left in your taxable estate or you could sell the asset for the discounted value and take back a note which would be a low interest rate note for the sale of that asset. In this manner, you have frozen the value of that asset in your taxable estate at a much lower value and the appreciation of the underlying asset would move to possibly a trust which has been set up for the benefit of your heirs. But in this manner, you can avoid having the appreciation be taxable in your own estate.

- Transfers of Assets to Dynasty Trusts on a Low Interest Note
- Removing any Highly Appreciating Assets from Taxable Estate

Removing the Appreciation from the Taxable Estate

By utilizing a sale of the discounted entity to a Dynasty trust or a generation-skipping trust of some kind, you can allow those assets to appreciate for at least two generations without having been taxed in the estate and gift tax system. By utilizing a sale, you can avoid an application of the generation-skipping tax and you can move the appreciate of that underlying asset for about 100 years depending upon the age of your grandchildren and that would be if you chose to use a state jurisdiction that did not allow for a longer period.

- Sale of Discounted Entities to Dynasty Trusts to have Assets Appreciate inside the Trust and Outside the Taxable Estate
- Utilizing the Master Control Entities and Trusts to do Future Deals which might Appreciate

Leveraged Gifting of Assets

Just in the same manner that you can utilize valuation discounting as we have discussed above, you can utilize it for both annual and lifetime gifts, which are leveraged up by virtue of the valuation discount that's taken on the asset that's given.

The fact of the matter is that your annual exclusion gift is a use it or lose it credit. If you don't use it on an annual basis, then it simply goes by the wayside. If you take an asset and then leverage it up by the use of valuation discounting, you can then might be making gifts on an annual basis to a wide number of beneficiaries, possibly in trust and then you have the benefit of being able to maximize your annual gifting.

The same concept applies to a lifetime gift where you use your lifetime unified credit. Matter fact, if you use your lifetime unified credit as quickly as possible, you can maximize the leverage of gifting the assets by taking into account the valuation discount that you get currently, and then the movement of the appreciation of the underlying assets.

- Current Use of Annual Gift Tax exclusions on regular basis without losing control – Use it or Lose It
- Current Use of Lifetime Unified Credit to remove Appreciation of Assets
- Making Gifts of Discounted Assets to Leverage Gifts 2 to 1
- Use of Income Tax Liabilities to make Additional Gifts

Use of Life Insurance as Discount Mechanism to Provide Liquidity

For most of us, we understand that life insurance pays a death benefit. What we often times don't understand is just how good of mechanism it is to pay that death benefit. Life insurance in and of itself is both income and estate tax free if it's owned properly. And if it's designed in a manner that will lever up the death benefit of the life insurance policy overtime, the rate of return on the death benefit will be in the neighborhood of 8 to 14% depending on the manner in which it is designed.

And this rate of return is free of tax. Because of that, and the fact that you do not have to apply both income and estate taxes to this rate of return it leverages up the overall rate of return of the insurance contract and thus it is used as a discount mechanism to provide liquidity in well transfer cases.

The leverage is typically used to fund the life insurance which enhances the overall value to the overall estate.

- Life insurance provides a funding tool which is both income and estate tax free (assuming proper planning) which will provide liquidity upon the death of the insured.
- Leverage is typically used to fund the life insurance which enhances the overall value to the estate.

Use of Unlimited Charitable Deductions to Zero Out the Taxable Estate through Leverage Gifting Techniques

When you make charitable gifts at death, there is no limitation as to what that gift and deduction for estate taxes might be. And if you utilize the techniques and strategies that have been mentioned above, you can significantly reduce the overall taxable estate that you have overtime. This might mean that you can move as much as 80 to 90% of your taxable estate over in the trust for the benefit of your heirs over time. And then you were left with a small taxable estate, which then will be taxed at the prevailing tax rate.

Because of this, you can utilize the same life insurance that you were depending upon to provide liquidity to your estate, as a means of making a charitable bequest that will completely zero out your taxable estate thus leaving no tax to be paid.

The manner that you do this is to have the life insurance contract paid outside of your taxable estate and then it will loan money to or purchase assets from your taxable estate and then subsequently be used as a charitable bequest to a charitable organization. And doing so, you reduce the taxable estate down to zero after all the other credits are left and thus you're able to have a zero out estate plan in which you pay no tax to the treasury department.

- Charitable Gifts are made at death and not during Lifetime
- Asset used to fund the Charitable Bequest is designed utilizing substantial leverage that is available
- Creation of an Estate Tax deduction through the use of an Asset which is both Income and Estate Tax free