

# Special Tax Saving Trusts for Spouses

*Also known as “Buildup Equity Retirement Trusts”*

or

Would you like to save over \$500,000 in Estate Taxes?

By

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# **Buildup Equity Retirement Trusts** ***(Bert & Ernie Trusts)***

## **BENEFITS:**

- Exempt the contributed assets from gift taxes
- Exempt the contributed assets from estate taxes for both spouses
- Earnings (“Ernie”) grow income tax free for retirement
- Provides “nest egg” for donee spouse over which donee has high degree of control
- Upon death of donee spouse, assets pass estate tax free to children/loved ones
- Protect assets from creditors

# **Buildup Equity Retirement Trusts** ***(Bert & Ernie Trusts)***

## **BENEFITS:**

- Donee spouse's interest may terminate if the donor and donee get divorced or separated
- Virtually no downside for clients who are otherwise reluctant to plan due to estate tax uncertainty
- **SUM OF BENEFITS:** Tax free gift to one's spouse in a trust that is accessible to donee, which grows tax free, is creditor protected and removed from both spouse's estates.



# Gifting to Spouses

- **Traditional thinking/conventional wisdom**
  - Can gift unlimited amount to citizen spouses using the unlimited marital deduction I.R.C. §2056
    - Problem – Gifts plus appreciation are included and taxed as part of surviving spouse's estate

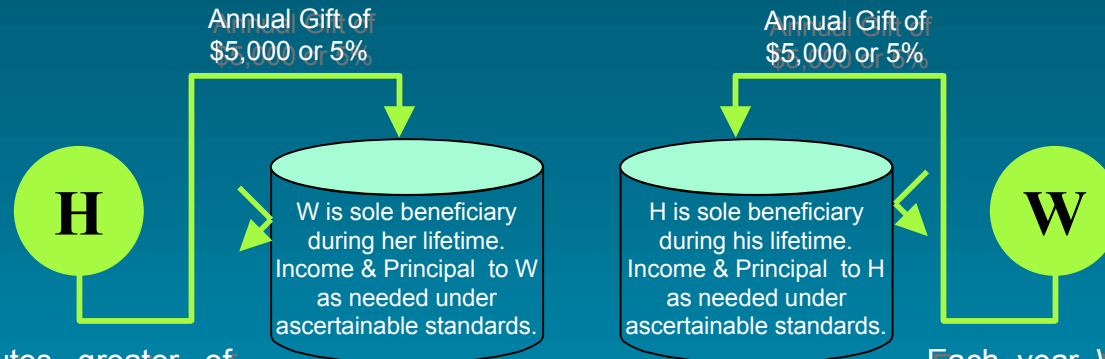
# Gifts to Spouses

- “Out of the Box” thinking
  - Can gift to spouses in trust using the annual gift exclusion
    - There is no prohibition to inter-spouse gifts using the annual gift exclusion
    - Must be present interest gift
      - donee spouse has temporary withdrawal right to qualify as present interest gift
    - Annual gifts limited to \$5,000 or 5% of trust balance to avoid gift tax under IRC 2514(e) and estate tax under 2041(b)(2)
      - Annual exclusion currently \$12,000
      - Lapse of withdrawal right (Crummey notice) creates gift over problem if gift is <\$5,000 or 5%

# How Bert & Ernie Trusts Work

- Spouse creates trust for his/her spouse
- Spouse makes gifts of the greater of 5% of trust balance or \$5,000 limited by A.G.E.
- Donee spouse has high degree of control
  - Donee spouse can access trust for
    - Maintenance, education, support or health needs only which makes balance not subject to estate tax under IRC 2041(b)(1)(A)
- Trust should be drafted such that donee spouse pays any income taxes (Grantor Trust) so earnings grow tax free (“Ernie”)

# Buildup Equity Retirement Trust With Earnings



Each year H contributes greater of \$5,000 or 5% to his Bert & Ernie Trust. After 30 years his trust will likely be worth \$500,000 (saving \$250k in FET).

This trust is designed not to qualify for the marital deduction by being terminal at death or divorce. Gifts to the trust are exempt from gift tax only because the gifts are kept within the 5+5 powers and the annual exclusion.

After H's death, W continues to be the beneficiary for her lifetime.

At W's later death, this \$1,000,000 will pass tax-free to the children.

Each year W contributes greater of \$5,000 or 5% to her Bert & Ernie Trust. After 30 years her trust will likely be worth \$500,000 (saving \$250k in FET).

This trust is designed not to qualify for the marital deduction by being terminal at death or divorce. Gifts to the trust are exempt from gift tax only because the gifts are kept within the 5 + 5 powers and the annual exclusion.

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# **Buildup Equity Retirement Trusts with Earnings**

- **Who can be Trustee**
  - **Generally, anyone the trustmaker desires, other than himself or herself**
  - **The donee spouse can be sole trustee but only if distributions of principal are limited to the ascertainable standard**
  - **Donee spouse can be cotrustee**
  - **Third party or corporate fiduciary for enhanced creditor protection**



# **Buildup Equity Retirement Trusts with Earnings**

- **Effective as retirement account**
  - **creates nest egg account**
    - **Disadvantages compared to QRP**
      - **funded with after-tax dollars**
      - **no income tax deduction**
      - **trust income subject to tax if not a grantor trust**

# **Buildup Equity Retirement Trusts with Earnings**

- **Effective as retirement account**
  - **creates nest egg account**
    - **Advantages compared to QRP**
      - **no complicated rules, MRDs or penalties**
      - **any asset can be held in a BERT**
      - **no administration required**
      - **not subject to estate tax**
      - **if grantor trust, most protected assets inside trust grow income tax free**

# **Buildup Equity Retirement Trusts with Earnings**

- **Flexibility of the BERT**
  - need not comply with the UMD rules
  - Upon divorce or separation, trust assets can flow to children
  - Upon remarriage after donor's death, donee spouse's interest can terminate and trust assets can flow to children
  - GST Exemption may be used to provide for future generations

# Bert & Ernie May Work For You

Husband's "Bert & Ernie" @ 6%			Wife's "Bert & Ernie" at 6%		
Year	Beginning of Yr Contribution	Year End Balance @ 6%	Year	Beginning of Yr Contribution	Year End Balance @ 6%
1	\$ 5,000	\$ 5,300	1	\$ 5,000	\$ 5,300
2	\$ 5,000	\$ 10,918	2	\$ 5,000	\$ 10,918
3	\$ 5,000	\$ 16,873	3	\$ 5,000	\$ 16,873
4	\$ 5,000	\$ 23,185	4	\$ 5,000	\$ 23,185
5	\$ 5,000	\$ 29,877	5	\$ 5,000	\$ 29,877
6	\$ 5,000	\$ 36,969	6	\$ 5,000	\$ 36,969
7	\$ 5,000	\$ 44,487	7	\$ 5,000	\$ 44,487
8	\$ 5,000	\$ 52,457	8	\$ 5,000	\$ 52,457
9	\$ 5,000	\$ 60,904	9	\$ 5,000	\$ 60,904
10	\$ 5,000	\$ 69,858	10	\$ 5,000	\$ 69,858
11	\$ 5,000	\$ 79,350	11	\$ 5,000	\$ 79,350
12	\$ 5,000	\$ 89,411	12	\$ 5,000	\$ 89,411
13	\$ 5,000	\$ 100,075	13	\$ 5,000	\$ 100,075
14	\$ 5,004	\$ 111,384	14	\$ 5,004	\$ 111,384
15	\$ 5,569	\$ 123,970	15	\$ 5,569	\$ 123,970
16	\$ 6,199	\$ 137,979	16	\$ 6,199	\$ 137,979
17	\$ 6,899	\$ 153,570	17	\$ 6,899	\$ 153,570
18	\$ 7,679	\$ 170,924	18	\$ 7,679	\$ 170,924
19	\$ 8,546	\$ 190,238	19	\$ 8,546	\$ 190,238
20	\$ 9,512	\$ 211,735	20	\$ 9,512	\$ 211,735
21	\$ 10,587	\$ 235,661	21	\$ 10,587	\$ 235,661
22	\$ 12,000	\$ 262,521	22	\$ 12,000	\$ 262,521
23	\$ 12,000	\$ 290,992	23	\$ 12,000	\$ 290,992
24	\$ 12,000	\$ 321,172	24	\$ 12,000	\$ 321,172
25	\$ 12,000	\$ 353,162	25	\$ 12,000	\$ 353,162
26	\$ 12,000	\$ 387,072	26	\$ 12,000	\$ 387,072
27	\$ 12,000	\$ 423,016	27	\$ 12,000	\$ 423,016
28	\$ 12,000	\$ 461,117	28	\$ 12,000	\$ 461,117
29	\$ 12,000	\$ 501,504	29	\$ 12,000	\$ 501,504
30	\$ 12,000	\$ 544,314	30	\$ 12,000	\$ 544,314
<b>Total Potential Savings</b>			<b>\$ 1,088,629</b>		
<b>Potential Estate Tax Savings @ 46%</b>			<b>\$ 500,769</b>		



## **Bert & Ernie May Work For You**

- **The Supercharged BERT**
  - If the donor transfers the amount of \$240,000 into the trust, the 5% limit then allows us to put \$12,000 per year into the BERT from the beginning, rather than only \$5000 in per year during the early years without the “supercharge contribution”.

# **Bert & Ernie May Work For You**

- **The Supercharged BERT**
  - The donor utilizes a portion of their lifetime gifting exemption (of \$1,000,000) for the \$240,000 gift
  - Thereafter, the donor can transfer the maximum annual gifting exemption into the trust each year (\$12,000)
  - What does this do to the numbers ?

# Bert & Ernie May Work For You

- **The Supercharged BERT**

## Six Percent Growth

Year 5	\$345,418
Year 10	\$527,975
Year 20	\$1,099,211
Year 30	\$2,122,208

## Ten Percent Growth

Year 5	\$410,468
Year 10	\$734,935
Year 20	\$2,099,075
Year 30	\$5,637,303

Assumptions: Donor makes one \$240,000 supercharged contribution and thereafter makes the maximum contribution each year under the 5 & 5 rule and pays all income taxes; donee makes no withdrawals and lets trust build as much as possible

\* Note: Without supercharge, at yr. 20 = \$211,735

# **Buildup Equity Retirement Trusts with Earnings**

- **Trusts Between Spouses**
  - Spouses may create separate BERTs for each other
  - Doubles the numbers
  - But care must be taken that the terms of each of the trusts differ materially to avoid the reciprocal trust doctrine



# **Buildup Equity Retirement Trusts with Earnings**

- **Clients love BERTS**
  - **The donee spouse (as trustee of his or her respective trust) can retain control over the distribution and investments of the trust**
  - **Rainy day fund**
  - **Good creditor protection**
  - **Allows “extra” estate tax exemption for each spouse’s estate**
  - **Little or no gift tax liability**