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2014 Inflation-Adjusted Estate and Trust Tax Brackets; Surtax on Investment Income and Gains

Each year, IRS tax figures are adjusted for inflation based on the average Consumer Price Index ("CPI") for the 12-month period ending August 31. The following figures are the adjusted exemption and exclusion amounts, tax rates and estate and trust tax brackets for 2014 based on the August 2013 CPI released by the Labor Department.

The 2014 Rate Brackets for Estates and Trusts are as follows:

- If your taxable income is equal to or less than $2,500, your tax rate is 15% of taxable income;
- If your taxable income is over $ 2,500 but equal to or less than $5,800, your tax rate is $375.00, plus 25% of the excess over $2,500;
- If your taxable income is over $5,800 but equal to or less than $8,900, your tax rate is $1,200.00, plus 28% of the excess over $5,800;
- If your taxable income is over $8,900 but equal to or less than $12,150, your tax rate is $2,068.00, plus 33% of the excess over $8,900;
- If your taxable income is over $12,150, your tax rate is $3,140.00, plus 39.6% of the excess over $12,150.

The following exclusions and exemptions apply:

- The unified estate and gift tax exclusion amount for gifts made and estates of decedent's dying in 2014 will be $5,340,000;
- The generation-skipping transfer tax exemption will be $5,340,000;
- The gift tax annual exclusion will remain $14,000 per donee or a combined $28,000 per donee for married donors;
- The increased annual exclusion for gifts to noncitizen spouses will be $145,000;
- The requirements for reporting foreign gifts will be as follows: If the value of the aggregate "foreign gifts" received by a U.S. person (other than exempt 501(c) organizations) exceeds a threshold amount, the U.S. person must report each "foreign gift" to the IRS. Different reporting thresholds apply for gifts received from nonresident alien individuals or foreign estates and foreign partnerships or foreign corporations. For gifts from a nonresident alien individual or foreign estates, reporting is required if the aggregate amount of the gifts from that person exceeds $100,000 during the tax year. For gifts from foreign corporations and foreign partnerships, the reporting threshold will be $15,358 in 2014.
- The exemption from the kiddie tax for 2014 will remain $2,000. A parent will be able to elect to include a child's income on the parent's return for 2014 if the child's income is more than $1,000 and less than $10,000.
- The AMT exemption for 2014 for a child subject to the kiddie tax will be the lesser of (1) $7,250, plus the child's earned income, or (2) $52,800.
- Beginning taxable year January 1, 2013, certain income of estates, trusts and individuals is subject to a 3.8% surtax (sometimes called the "unearned income Medicare contribution tax"). For estates and trusts, the surtax is 3.8% of the lesser of (a) the estate or trust's undistributed net investment income, or (b) the excess of adjusted gross income at which the highest income tax bracket applicable to an estate or trust begins ($12,150).

Please consult with Gunster's estate planning attorneys to find out how these and other changes affect you.

Choosing a Trustee: Individual or Corporate?

Choosing a trustee is an important decision. A trustee stands in a special relationship to the grantor of a trust and to the trust beneficiaries. At least one trustee must be named when a trust is established. This may be an individual or a corporate entity having trust powers under applicable law. How do you choose?

The primary considerations in choosing a trustee are:

- A trustee must be responsible and reliable.
- A trustee must have relevant expertise and experience based on the type of trust, the assets it holds and the goals of the grantor.
- A trustee must be free of personal or business interests which conflict with the interests of the trust, grantor or beneficiaries.

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- A trustee must have the requisite availability and accessibility.
- The term of the trust and the age and health of the individual candidates should be considered.
- The ability to compensate the trustee from trust assets should also be considered.

Next, you need to decide whether to use an individual or corporate trustee. There are pros and cons to each.

An individual trustee may have better knowledge of family relationships and dynamics than a corporate trustee. An individual may also offer a more personal relationship with the beneficiaries than a corporate trustee. However, individual trustees may have more potential conflicts of interest than a corporate trustee and a higher risk of successor issues triggered by death, disability, or absence. Individual trustees, like family members, may be willing to serve for a lower fee or without compensation. Corporate trustees, on the other hand, agree on fees based on their corporate fee schedules.

Corporate trustees generally have more diverse expertise and can provide related services like investment management, financial advice, legal advice, tax planning, accounting and administrative support, under one roof. Corporate trustees also have more financial resources and insurance coverage in the event of malfeasance. Generally speaking, there are no successor issues with corporate trustees. Corporate trustees also may have, or have access to, more sophisticated record keeping methods and procedures. However, corporate trustees may have less flexible investment philosophies, a higher risk of personnel changes, and bureaucratic delays.

All of these considerations should be carefully weighed with the interests and goals of the grantor, trust and beneficiaries in mind. Additionally, the needs of the beneficiaries and the types of assets being administered are likely to change over time. The choice of trustee should consider these eventualities as well.

If you have any questions, Gunster's team of experienced trust and estate attorneys are here to guide you through the process.

Do You Know Where Your Assets Are Going?

Properly completed beneficiary designation forms are an important part of your comprehensive estate plan. Beneficiary designation forms document your selection of the person(s) or charity(ies) to be the recipients of the benefits of your assets under life insurance policies, retirement accounts, certain bank accounts, annuities and certain brokerage accounts, in the event of your death. These forms generally trump the provisions of your last will and testament or revocable trust.

A properly completed beneficiary designation form may serve to protect your assets from creditors upon your death. When choosing your beneficiaries you should consider, among other things, the effect the designation will have on the beneficiaries' eligibility for government benefits and the age of the beneficiaries. For minors, you may want to create an inter vivos trust or testamentary irrevocable trust for the benefit of the minor child and name the trust as the beneficiary of the designated asset. It is also important to update beneficiary designations in cases involving second or later marriages.

If you fail to designate beneficiaries, or name primary beneficiaries but not contingent beneficiaries, institutional guidelines may determine the hierarchy of proposed beneficiaries that may conflict with your estate plan. In the absence of a properly completed designation form, the assets may pass to your estate. This is not always desirable especially if the asset is a qualified plan because naming your estate as beneficiary will accelerate the recognition of income.

Consult with your estate lawyer to ensure proper completion of all beneficiary forms.

Protect Your Deceased Loved One From Identity Theft

Identity thieves are targeting the deceased at increasing rates. The deceased are vulnerable for many reasons, but primarily because information about their death is readily available through public death notices and obituaries in the newspaper. It is not as difficult as one might think to use that information to obtain the deceased's social security number and other personal information. The thieves then use that information to open credit card accounts, apply for loans, file tax returns and obtain goods and services like cellphones.

You can protect your deceased loved ones from identity thieves. The surviving spouse or personal representative of the deceased's estate can do the following:

1. Obtain and keep copies of the official death certificate. Do not include the deceased's birth date, mother's maiden name or home address in obituaries.
2. Send a copy of the death certificate (by certified mail-return receipt requested) to the three national credit reporting agencies (Equifax, Experian and Transunion) and request that a "Deceased Alert" be place on the deceased credit report.
3. Notify the deceased's credit card companies, banks, loan and lien holders, mortgage companies, and stock brokers of the deceased's passing.
4. Notify the Social Security Administration, insurance companies, the Department of Motor Vehicles and all professional and recreational membership holders of the deceased's passing.

Be sure to follow up. Check the deceased's credit report for suspicious activity. If you suspect your deceased loved one has been the victim of identity theft, file a police report and notify the companies involved that the individual is deceased. Make sure that you request a "Letter of Clearance" for any fraudulent debts.

Gunster's attorneys are available to assist you and answer any questions you may have.

Best Practices for Administration of Insurance Trusts

Failure to properly administer an irrevocable life insurance trust ("ILIT") can result in scrutiny by the IRS and unintended tax consequences. In particular, improperly reported gifts to ILITs can result in the imposition of additional federal and state gift taxes upon audit by the IRS. Moreover, failing to comply with trust ownership and administration rules can trigger possible income tax consequences, as well as the inclusion of insurance death benefits for estate tax purposes. Adhering to the following best practices in the administration of ILITs will put you in the best position to defend against an IRS challenge:

1. Obtain a tax identification number ("TIN") for the ILIT. The TIN will be used to apply for new or to facilitate the transfer of existing life insurance policies in the name of the ILIT. It will also be used to open a bank account in the name of the ILIT's trustee and file fiduciary income tax returns to report trust income when required. Your attorney or accountant can help you obtain a TIN.
2. If new coverage is being acquired, the ILIT trustee should submit the insurance application and designate the ILIT as the original owner and beneficiary of the policy. This should avoid a rule which requires the estate tax inclusion of insurance policies transferred within three years of death. If you plan to transfer an existing policy to an ILIT, consult with your estate planning attorney to evaluate ownership prior to completing transfer documents. The gift tax consequences of transferring an existing policy should also be evaluated.
3. The trustee of the ILIT should obtain and hold the original contract for each insurance policy owned by the ILIT and, unless relieved of the responsibility, evaluate the policy on a regular basis.
4. Make sure that premium notices are sent to you and the trustee.
5. After obtaining a TIN, the trustee should open a checking account in the ILIT's name. The trustee should be the sole signatory on the ILIT account.
6. When funding premiums with respect to an ILIT policy, you should not pay the insurance premiums directly. Rather, you should write a check payable to the ILIT for deposit into the ILIT account. If there are joint grantors of the ILIT, checks should be issued from an account jointly owned by the grantors. The gifts should be made well in advance of the premium due date. Whether the gift is made by check or wire transfer, you may formally document the transfer with a "deed of gift" or "gift letter" countersigned by the trustee (to acknowledge receipt).
7. Make sure the trustee deposits your checks immediately and retains the original transfer receipts.
8. The trustee should immediately notify any trust beneficiaries entitled to notice of the gift. When notice is required, the trustee must provide each beneficiary: (i) with the amount subject to withdrawal rights, if any; (2) the expiration date for the withdrawal right; and (3) the manner in which the withdrawal right may be exercised. Although it is not required, the beneficiaries may be asked to sign and date a copy of the notice and return it to the trustee to acknowledge receipt.
9. Confirm that the trustee has issued a check to timely pay policy premiums upon expiration of the withdrawal period, if any.
10. Provide your tax return preparer with copies of all ILIT bank statements and account information and details of annual gifts, including gifts to the ILIT. Your tax return preparer will need to determine whether to file federal and/or state income tax returns and federal and state gift tax returns. Your tax preparer will also need to determine whether to allocate the donor's generation-skipping transfer tax exemption to the reported gifts.
11. You and the trustee should periodically review all policies owned by the ILIT to monitor performance, market changes, product options and the insured's health. Your accountant, attorney, investment advisors and/or medical professionals should be consulted as part of this review.

When lapses or oversights in administration occur, corrective action should be taken immediately. Gunster's estate planning attorneys are here to help you.

Net, Net Gift Reduction Upheld!

You may already know that making gifts during your lifetime reduces the value of your estate for estate tax purposes upon your death. However, some of those gifts may be subject to gift taxes that are normally paid by the donor. It is possible for the donee to agree to pay the applicable gift taxes. In such case, the donor is making a "net gift," where the donee assumes responsibility for gift taxes attributable to the gift. Net gifts can reduce the amount of gift tax payable upon making a gift, but do not result in any overall transfer tax savings because the amount of the gift tax paid by the donee instead of the donor will remain part of the donor's assets subject to estate taxes at death. A net gift of property will be treated as a part gift – part sale and could result in the donor's recognition of gain for income tax purposes.

A transfer tax reduction can be accomplished, however, when the donor makes a "net, net gift." A net, net gift occurs when the donee also agrees to pay the increased estate tax on the donor's estate related to the inclusion of the gift tax paid on the gift if the donor dies within three years of making the gift. The gift tax paid is included in the donor's gross estate to take away the tax-exclusive computational advantage of gift tax compared to the estate tax for trusts made within 3 years of death.

For the first time on September 30, 2013, the Tax Court in *Steinberg v. Commissioner, 141 TC 8 (2013)*, allowed for a reduction in the value of a taxable gift both for the gift taxes assumed by the donee (under a net gift) and the value of the contingent liability assumed by the donee (under a net, net gift) for any increase in estate taxes if the donor dies within three years of making the gift. Thus, a net, net gift results in an overall transfer tax savings, even if the donor dies within three years of making the gift. The dissent in *Steinberg* argued that this reduction diminishes the value of the add-back under the Internal Revenue Code so that even a death bed gift is beneficial.

Keep in mind that it may be difficult to calculate the actuarial value of the assumption of the contingent liability related to a net, net gift. If contingencies other than the possibility of survivorship are added, their value may be deemed too speculative to calculate. Additionally, a relatively large gift is needed to obtain a material reduction or benefit from a net, net gift. Finally, the Court did not address the possibility that the obligation to pay the increased estate tax attributable to inclusion of the gift tax paid could be an asset included in the gross estate and itself be subject to estate tax.

Gunster's estate planning attorneys are here to help you evaluate whether net, net gifts will work for you.

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1. All references to available/allowable estate tax exemptions and credits relate only to persons who are U.S. citizens; references to gift tax exemptions/exclusions generally apply to U.S. citizens and U.S. Lawful Permanent Residents (i.e., "green card" holders). While most transfer tax savings techniques discussed can be fine-tuned to benefit non-U.S. citizens, the results will differ and must be addressed on a case-by-case basis.

2. **The 2014 Annual Exclusion** is an aggregate of $14,000 per donee, from each donor; or $28,000 per couple, if a husband and wife file a "split gift" Gift Tax Return on gifts made from either of their assets this year. **Medical/Tuition ["ed/med"] Exclusion Gifts** allow a donor to pay an unlimited amount for anyone's medical or tuition expenses (including health insurance premiums), <u>if paid directly to the service provider,</u> without incurring any gift tax or use of their unified credit; and, if properly structured, ed/med gifts should not reduce the $14,000 amount available to be given to the same person by a donor each year.

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