

How the Timing and Source Of Trust Funding Can Save Taxes

Estate planning focuses on transferring your assets as you desire while minimizing your estate tax. When you set up trusts to achieve these goals, don't overlook the tax impact of how and when assets pass to each trust and how actual trust funding affects your goals. Here's an illustrative example.

Case Study: Stuart's Estate Plan

A married couple, Stuart and Elaine, decided to leave some assets directly to their grandchildren because their two children were financially secure. Each heir would receive something on Stuart's death even if he died before Elaine. Stuart's will allocated:

- His \$1.03 million exemption from the generation-skipping transfer (GST) tax to two \$515,000 trusts, one for each grandchild,

- 50% of his gross estate, after debts and expenses, to a marital trust, and
- The remaining estate, after distributions and estate tax, to the children.

The Plan's Execution

When Stuart died July 15, 2000, his estate was valued at \$10.03 million after debts and expenses. Assuming that the entire unified credit is available and Stuart is entitled to a federal estate tax credit equal to the amount of his state estate tax, here's how the estate would be divided:

GST tax exempt trusts:	\$1,030,000
Marital trust:	\$5,000,000
Federal & state estate taxes:	\$2,170,250
Children's share (residue):	\$1,829,750

How Stuart's will was drafted, the timing of funding the distributions under the will, and the change in asset value from the date of

death to the date of funding all could affect the plan and result in the following unexpected or unintended consequences.

Assets	Date of Death Value	Date of Distribution Value
Publicly traded X Corp. stock	\$ 500,000	\$ 1,000,000
Publicly traded Y Corp. stock	\$ 1,030,000	\$ 1,030,000
Interest in closely held Business Z	\$ 5,000,000	\$ 6,500,000
Investment real estate	\$ 3,500,000	\$ 2,000,000
TOTAL	\$10,030,000	\$10,530,000

Capital gains. For example, assume that Stuart had the following assets and the distributions were not funded until Dec. 1, 2001:

If the will specifically stated that the distributions to the GST trusts were to be a pecuniary \$1.03 million, and the executor used the X Corp. stock to satisfy this distribution, the simple act of funding the distributions would produce a capital gain to the estate of \$500,000. This would result in a capital gains tax of approximately \$100,000, leaving less in the estate for the children.

If Stuart had the same assets, but funding occurred closer to the date of death with all the X Corp. stock and one-half the Y Corp. stock, no gain would occur, and significant appreciation would inure to the benefit of the GST trust.

Valuation. If, under the previous example, the executor were required to fund the marital trust with estate assets using the date of death values, waiting to fund might result in serious overfunding of the marital share. This would leave little, if anything, for the

residuary beneficiaries after all taxes and expenses had been paid.

Thus, using the Business Z asset to fund the marital share and the Y corp. stock to fund the GST trust, Elaine would receive \$6.5 million in current assets and the children would be left with \$829,750, minus any tax from having to sell assets to pay estate tax. This not only might be undesirable, but it also might cause a rift between Elaine and the children.

Funding More Effectively

Although you can't always control the post-death appreciation or depreciation of assets, you can avoid the unexpected by closely monitoring the funding situation. A professional can give you more ideas on funding your trusts effectively.