Tulsa Estate Planning Forum

A Case Study: Estate, Business & Zero Estate Tax using Philanthropic Planning Techniques

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Case overview

- John (66) and Betty (65) Arnold:
  - Met through personal introduction.
  - Recently retired CFO of public company.
  - CPA and MBA credentials.
  - Very knowledgeable and savvy in tax planning matters.
    - Tax averse and planning tolerant.

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Case overview

- John (66) and Betty (65) Arnold:
  - Residents of Oklahoma.
  - Children:
    - Robert (45) - Partner in architectural firm, married with 3 children.
    - Cindy (43) - OB/GYN, married with 2 children.

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Financial overview

	Co-owned	John	Betty	Total
ASSETS				
Cash and Securities				
Cash	$2,864,660	-	-	$2,864,660
Securities accounts	-	-	$4,373,050	4,373,050
401(k) plan with Co. stock	-	$1,842,520	-	1,842,520
Real Estate				
Personal residence	500,000	-	-	500,000
Vacation home	300,000	-	-	300,000
Business Interests				
50% Undivided ranch	-	3,715,750	-	3,715,750
50% Minerals and leases	-	4,375,000	-	4,375,000
Other Assets	-	-	-	
Personal property	255,000	-	-	255,000
TOTAL ASSETS	$3,919,660	$9,933,270	$4,373,050	$18,225,980
LIABIITIES				
None	-	-	-	-
Life insurance	-	-	-	-
TOTAL ESTATE VALUE	$3,919,660	$9,933,270	$4,373,050	$18,225,980
LIFE INSURANCE OUTSIDE ESTATE			$0	

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Financial overview

- 3rd Generation Family Ranch
  - John inherited:
    - 50% undivided interest in property – includes mineral interests.
    - John's sister owns other half.
  - Longtime ranch manager runs ranch with his son.
  - John's sister not interested in ranching or using the property.
    - But does like the income she receives from the mineral interests.

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Financial overview

* Can fluctuate.
** Does not include $500,000 bonus or future RMDs

- Annual income sources:
  - Social Security - $35,000
  - 20-year non-qualified plan - $150,000
  - Defined benefit pension - $200,000
  - Interest / Dividends - $130,000*
  - Oil and gas revenue - $900,000*
  - Total annual income: $1,415,000**
  - Final performance bonus from company next tax year - $500,000

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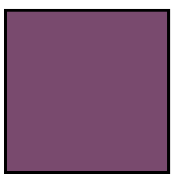
What color is the box?



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The Arnold Family Mission Statement

- *Vision, Values, & Purpose*
- *Philosophy & Responsibility of Wealth*
- *Primary Planning Goals*
- *Financial Independence*
- *Family Legacy*
- *Social Capital Legacy*
- *Statement of Investment Policy*

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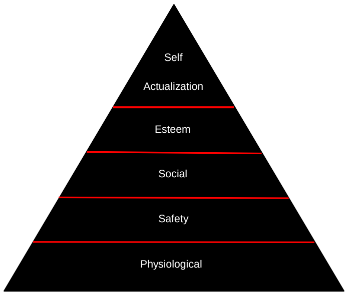

(Abraham Maslow, Motivation and Personality, 1954)

Maslow's Hierarchy of Needs

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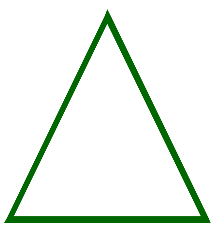

100% of the estate

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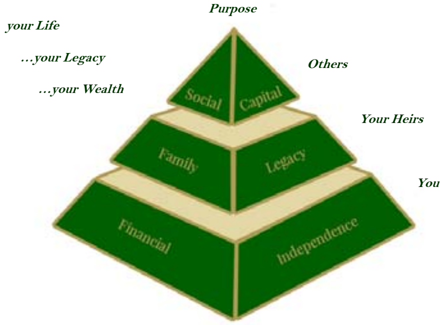
Vision, Values, & Goals

Purpose



…your Unique Journey

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Goals and objectives

- Maintain personal financial security.
  - $300K after tax with annual inflation adjustments.
- Pass full value of estate to the family.
- Reduce estate taxes to extent possible.
- Reduce impact of income taxes.
- Preserve family ranch for multiple generations.
  - Acquire sister's 50% interest.

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Goals and objectives (Continued)

- Protect assets from creditors.
- Maintain and enhance charitable giving.
  - Current gifting of $75K annually to various charities.
  - Wish to provide significant legacy to charity at death.
- At the end of goals and objectives meeting:
  - "Would you if you could?"

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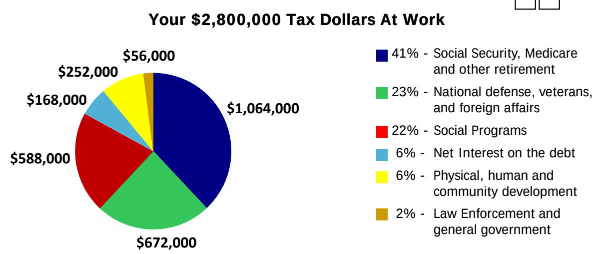
Current planning

- Pour over wills and revocable trusts:
  - A-B trusts.
- Powers of attorney in place.
- Asset ownership had been reviewed.
  - Securities account in Betty's name.
- No asset shifting; no ILIT.
  - Full applicable exclusions available.

Client presentation overview

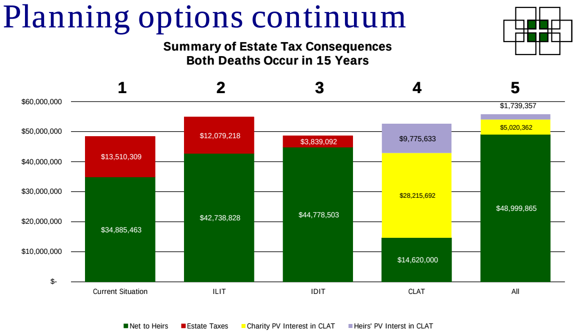
- Current estate tax exposure was approximately $2.8 million.
- Future estate tax planning was necessary.
- When factoring in growth on respective assets and surplus income reinvested, future estate may be sizable.

Your tax dollars at work



Source: IRS Pub 1040 (Jan. 26, 2015)

Planning options continuum



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Zero estate tax plan with CLAT

- Testamentary Charitable Lead Annuity Trust:
  – Step 1: Lifetime exemptions in long-term trust for heirs.
  – Step 2: Taxable estate balance to 20-year CLAT.
    - Zeroed out for estate tax purposes.
    - CLAT payable to Donor Advised Fund (DAF).
  – Lending taxable estate to charity versus leaving outright to charity.
    - Split-interest gift.

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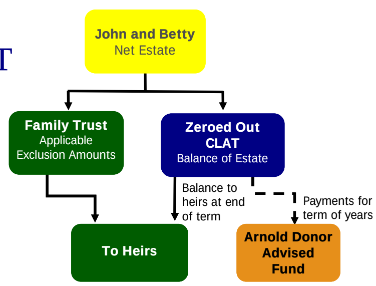
Zero estate tax plan with CLAT



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GST & CLAT's

Heet

- One problem with CLAT arrangement:
  - At end of term, most probable beneficiaries will be skip persons (grandchildren).
  - Due to 2642(e), cannot allocate GST exemption to CLAT until end of annuity term (similar to ETIP rule for GRATs).
  - Distributions to grandchildren would therefore trigger GST tax (or CLAT would be inefficient tool for allocation).
- Solution: HEET as remainder beneficiary of CLAT.

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Health and Education Exemption Trust

- Trust that can provide for direct payments to health care provider or educational institution.
  - Exempt from GST tax under IRC 2642(c)(3).
- No taxable termination for trust at death of last surviving non-skip beneficiary, so long as trust names charity as beneficiary as well (charity is considered a non-skip person).
  - Interest must be mandatory and significant (e.g., unitrust interest).

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Health and Education Exemption Trust

- Preserve long-term benefit for family over multiple generations.
  - Significant family growth and wealth division on generational basis.
  - Costs of education; family scholarship fund.
  - Concerns about healthcare, insurance and medical marketplace.
  - Special medical needs of certain family members.
  - Charity along with family as a beneficiary.

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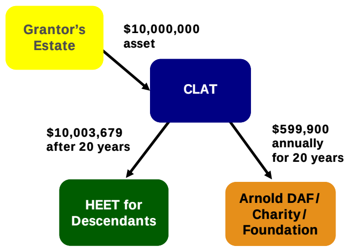
Health and Education Exemption Trust



Growth rates assumed are hypothetical for illustrative purposes only and not a guarantee of performance or indicative of any particular product.

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Ranch planning

- Step 1:
  - Bifurcate surface rights from mineral interests.
    - Separate LLC for each interest.

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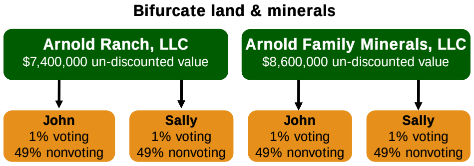
Ranch planning

Step 1

Arnold Ranch & Cattle
6,000 acre ranch includes mineral rights
Producing oil & gas wells
$16,000,000
Inherited from father; ½ undivided interest
John Arnold / Sally Roberts (John's sister)

Bifurcate land & minerals



John is managing member of both.

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Ranch planning

- Step 2:
  - Gift of mineral interests under lifetime exemption to intentionally defective irrevocable trust (IDIT).
  - Sale of surface interests to trust.
  - Purchase of survivorship universal life insurance in trust.
    - Return of premium
    - GST tax exemption leverage

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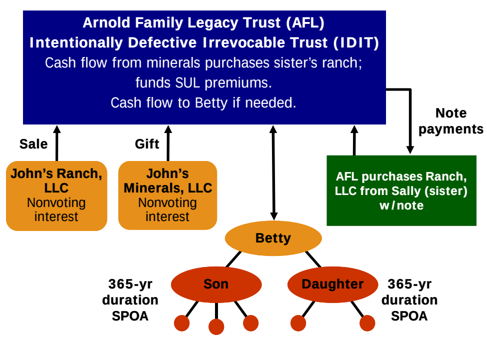
Ranch planning

Step 2



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Ranch planning

- Step 3:
  - Ranch is now in a 365-year dynasty trust.
  - Problem is how to resolve conflicts.
    - Use, expense, upkeep of family compound, etc.
  - Family Constitution is created to govern those matters.
  - Ranch management:
    - Ranch manager and his son retained as part of the "ranch management continuity" plan.

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Other Planning Opportunities

- Enhance Current Charitable Giving
- 401(k) Plan
- Income Taxable Bonus Next Year
- Appreciated Securities in Their Portfolio

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Final Planning Considerations

- Took advantage of favorable tax treatment of company stock in 401(k) by exercising a Net Unrealized Appreciation (NUA).
- Established Donor Advised Fund
- Donated $500K of appreciated stock to DAF to offset $500K bonus from company.

Questions?

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