TDC LIFE

HOW ESTATE & ASSET PROTECTION CAN SAVE MILLIONS

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You should consider creating an Intentionally Defective Irrevocable Trust ("IDIT") and gifting assets to the IDIT to fully utilize your gift tax exemption. Below is a brief summary of the IDIT concept and the potential benefits of this type of planning.

Brief Description of an IDIT

- An IDIT is an irrevocable trust drafted so that assets transferred to the IDIT should not be subject to estate taxes upon your death.
- The assets of a properly crafted IDIT should not be subject to creditor or divorce claims of a beneficiary.
- An IDIT is designed to receive gifts from you or to borrow funds from you to make investments on behalf of the trust beneficiaries. The Trustee will use the trust assets for the benefit of the beneficiaries during their lifetimes.
- An IDIT contains special provisions that qualify it as a "grantor trust" for income tax purposes without causing its assets to be included in your taxable estate at death.
- As a result, although assets transferred to the IDIT, and all appreciation of those assets, should be removed from your estate for estate tax purposes, you should still be taxed on the income generated by the IDIT's assets.

An example of a His and Her IDIT is on the next page.

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WIFE

Contributes $12.06MM of separate property to IDIT for the benefit of the spouse

$12.06MM

HER IDIT

Grantor: Wife
Trustee: Husband and/or Advisor
Beneficiary: Husband and/or Children

ASSETS

Up to $12.06MM* contributed from Grantor and Life Insurance policy on Wife

HUSBAND

Contributes $12.06MM of separate property to IDIT for the benefit of the spouse

$12.06MM

HIS IDIT

Grantor: Husband
Trustee: Wife and/or Advisor
Beneficiary: Wife and/or Children

ASSETS

Up to $12.06MM* contributed from Grantor and Life Insurance policy on Husband

ADVANTAGES

Taxes
No estate tax on trust assets (or appreciation there on)

Creditor Protection
Assets inside the trust are no longer owned by Grantor

Simplicity
Reduces need for loans or split-dollar arrangements

RISKS

Death
If spouse dies, remaining assets pass in trust to beneficiary (e.g. - children)

Divorce
Assets gifted away are unlikely to be reacquired and each IDIT may grow and/or decrease in value at a different rate

Reciprocal Trust Doctrine
Trusts must leave each Grantor in a different economic position or IRS could unwind the trusts

RISK MANAGEMENT SOLUTIONS

Death
Life Insurance on Grantor is used to create liquidity/asset replacement in the IDITs

Divorce
Depending on length of marriage, may be a non-issue

Reciprocal Trust Doctrine
Add children to one trust as permissible beneficiaries, vary lifetime powers, vary trustees, vary special trustees, etc.

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**Technique can be leveraged if spouses gift assets that qualify for a valuation discount; however, this may involve additional gift tax risk and an estate and gift tax attorney should be consulted.*

Potential Benefits of an IDIT

Assets of the IDIT Appreciate Outside of Your Estate on an After-Tax Basis

- **NOTE:** Appreciating assets are attractive candidates to be gifted to an IDIT. The assets transferred and all appreciation of those assets should pass free of transfer taxes.
- In addition, the Trustee can use the IDIT and cash generated by the assets transferred to it (or funds lent to the IDIT by you in the future) to make investments in new ventures on behalf of trust beneficiaries.

Spouse May be Beneficiary of IDIT

Depending on the assets transferred to the IDIT, the non-grantor spouse may be a beneficiary of the IDIT. The non-grantor spouse may also serve as the Trustee or Co-Trustee of the IDIT, so long as distributions are restricted to those needed for the spouse's health, education, maintenance and support in his or her accustomed manner of living.

Spouse May Create Similar IDIT

In addition to an IDIT established for the benefit of your spouse and descendants, your spouse may create a similar IDIT for the benefit of you and your descendants and fund this IDIT with a portion of his or her remaining gift tax exemption. Many clients prefer to establish two IDITs (one for each spouse). This structure allows each spouse access to the assets of his or her respective IDIT while providing the benefits explained in this memorandum.

Correlate with Revocable Trust

The IDIT can be drafted with provisions to match or complement your Revocable Trust.

Income Tax Payments Should Not Constitute Gifts

As the "grantor" of the IDIT for income tax purposes, you will pay the income taxes related to the income generated by the assets of the IDIT. Your income tax payments:

- Should not constitute gifts by you for gift tax purposes; and
- Should reduce the amount of wealth subject to estate taxes when you die.

Grantor Trust Status May Be "Turned Off"

A "Trust Protector" may be given the power to amend the IDIT so that you are no longer taxed on the income from the assets of the IDIT.

- **NOTE:** The Special Trustee provisions also provide flexibility to accommodate certain changes in the tax laws and family circumstances.

Risks of Using an IDIT

There are several risks you should be aware of while contemplating this planning technique. These include the following:

An IDIT is an Irrevocable Trust, And as Such, Any Gift to it is Irrevocable

- Gifts to the IDIT will likely not be reacquired in the event of divorce.
- The assets in each IDIT may grow and/or decrease in value at different rates.
- Each spouse should consider obtaining separate counsel with experience in family and divorce law to advise each spouse individually with respect to his or her rights under any proposed plan, before executing any documents.
- When a spouse dies, that spouse's trust would become for the benefit of the children (or other named remainder beneficiaries).
- To hedge against this and to provide additional liquidity for the surviving spouse, life insurance could be purchased on the non-beneficiary spouse to create an infusion of cash at the first death.
- Husband establishes trust for the benefit of wife and wife establishes trust for the benefit of husband. They each transfer $12.06 million of assets to the respective trusts. Inside the trust for the benefit of the wife, a $12.06 million policy is purchased on the life of the husband (and vice versa). If the husband were to prematurely die, wife's trust would have the original $12.06 million of assets (plus any appreciation) and would also receive $12.06 million of cash.

Reciprocal Trusts

- Care must be taken to be certain that the trusts do not violate the "reciprocal trust" doctrine.
- In other words, the trusts must not be mirror images of one another and must have differences that would allow the IRS to determine that your economic positions were different before and after the gifts.