Home Is Where the Tax Exemption Is: Placing Property in Trust Now

By Tom Olchon

More than ever, home is where our hearts are. Home may also be a cornerstone in our wealth transfer planning, allowing families to utilize the still high lifetime estate tax exemption, without sacrificing liquidity.

Let's back up. The estate tax exemption, as discussed on page 14, is scheduled to sunset in 2025, with talk of cuts to previous levels indexed for inflation or even less from the current $11.7 million per individual. There has also been some discussion about eliminating the step-up in basis at death. Not surprisingly, many families are exploring wealth transfer options now. But tapping liquid assets can mean compromising lifestyle and other considerations, as well as the risk of generating significant taxes. Placing primary and secondary (or other) residences in trust could provide a tidy solution.

Consider two recent residents of New York who are making some big and potentially very tax-efficient changes in their lives. Their Florida vacation home will soon be their main residence, and their home in Long Island, where they raised their children and still have many friends, will become their summer place. (As discussed in *Florida Bound: Moving to a Warmer [Tax] Climate* by Helena Jonassen *(click here)*, changing domicile can be tricky; we recommend working very closely with advisors.)

> *This approach could work at least as well for other illiquid assets.*

In this couple's case, changing domicile has been well worth the effort; their income tax and estate tax situation is obviously improving (as Florida imposes neither) and they are flexing new muscles at work and play, exploring their new neighborhood by bike and photographing local birdlife. To utilize their exemption, the couple created two trusts: one a Spousal Limited Access Trust, or SLAT, for the lifetime benefit of the other and then on to their children, grandchildren, and future lineal descendants; and the other a Generation-Skipping Tax-Exempt Trust, or GST trust, also for the benefit of their children, grandchildren, and future lineal descendants.

More to our point here, the couple also retitled their New York property to tenants in common from joint name. This allows one partner to use half of the property to fund the SLAT, while the other can fund the GST-exempt trust. Like many of those implementing similar strategies, the couple and their advisors created an LLC structure to own the property before gifting it. This makes transferring the property easier and provides some efficiencies related to its ongoing management. A subsequent valuation took into account a 25% discount for their relative lack of control over the property, minimizing the amount of exemption used in each transaction while funding both trusts.

The two trusts are now paying the insurance, taxes, and maintenance on the New York (and now vacation) property, amounts that are offset by the couple's payment of a fair market value rent to use the property as they like. (These grantor trusts do not have to pay income taxes on the rental income.) The couple is aware that the fair market value of the rent may be in excess of the cost of carrying the property, but the potential hit to their liquidity is marginal compared with the one they would have incurred had they transferred other assets. There is an additional benefit to rent above expenses in that it serves as another tax-free transfer to heirs and can put a real yield on the property.

It's worth noting that if the residence gains significantly in value, the couple could swap inclusion in the trust for other assets of equal value but with a higher cost basis. The house would then be included in the estate and the heirs would benefit from the step-up in cost basis (a readjustment of the value of an appreciated asset for tax purposes upon inheritance). This assumes that the step-up remains in effect.

0%

Florida income and estate tax

It's also worth noting that this couple's entire approach could work at least as well for other types of illiquid assets with appreciation potential. These and other related issues, including family governance, are matters for discussions with family members and advisors, including corporate fiduciaries. (In this case, the couple works with Evercore Trust Company.)

Ironically, this couple remains relatively liquid, thanks to what many of us consider our most illiquid asset – the family home. It sounds like a lot of planning – and it was – but they are pleased to be wrapping it up and are looking forward to the next stage of their lives.

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