

BERT Trust

Overview. Any individual currently may make a tax-free gift of up to \$13,000 each year to anyone he or she wishes. One potential beneficiary of an annual exclusion gift is the donor's spouse. This is often overlooked because the law allows an individual to make unlimited lifetime gifts to a spouse under the unlimited marital deduction. However, upon the donee spouse's death, the assets transferred to the spouse under the unlimited marital deduction will be included in the donee spouse's estate and subject to estate tax.

A Buildup Equity Retirement Trust ("BERT"), also known as a Spousal Limited Access Trust or "SLAT," provides an opportunity to make annual exclusion gifts to a spouse, while giving the spouse indirect access to the trust during his or her lifetime and excluding the trust's assets from the taxable estates of both spouses. With a BERT, assets are removed from the donor spouse's estate, a nest egg is created for the donee spouse's benefit, and the trust assets remaining at the donee spouse's death pass to children or other loved ones—all without adverse gift or estate tax consequences.

The BERT. To take full advantage of the annual gift tax exclusion, the donor creates a specially designed irrevocable trust to benefit the donee spouse during his or her lifetime. The donee spouse is named as the trustee, giving him or her access to the trust assets for needs related to health, education, maintenance and support. As the trustee, the donee spouse decides when those standards apply.

A transfer to a trust is normally considered to be a gift of a future interest, which triggers a gift tax because the gift tax annual exclusion applies only to gifts of present interests. The use of a Crummey withdrawal power in the BERT, however, will qualify the gift for the gift tax annual exclusion. A Crummey power allows the donee spouse to withdraw the gift during the 30 day period beginning when the gift is made to the trust. Because the donee spouse has the ability to reduce the gift to his or her possession, should he or she choose to do so, the gift to the trust will be considered a present interest gift.

Although the gift tax annual exclusion is currently \$13,000, for the first several years of the BERT's existence the annual gift to the trust must be limited to \$5,000. This is because whenever a Crummey power is used in a trust, the Crummey right has the legal effect of granting a general power of appointment to the demand beneficiary. Under the law, all property over which a person has a general power of appointment will be included in his or her taxable estate. There is an exception to this rule, whereby if the right to withdraw does not exceed the greater of \$5,000 or 5% of the trust corpus, no estate tax inclusion results. Since the BERT's objective is to remove property gifted to the trust from the taxable estates of both spouses, annual gifts to the trust should not exceed the greater of \$5,000 or 5% of the trust corpus. This means that until the trust exceeds \$100,000 in value, the donor may make only a gift of \$5,000 per year. Once the value of the trust exceeds \$100,000, the donor may make a gift equal to 5% of the trust value, but not to exceed the gift tax annual exclusion amount.

The most significant estate planning benefit the donor achieves by setting up a BERT is the ability to transfer future appreciation on property placed in trust free of gift and estate tax. Since a transfer to a BERT is a completed gift for gift tax purposes, once the property is placed in the trust the principal amount and all future growth on the property will be excluded from both spouses' taxable estates.

From an income tax standpoint, the BERT is drafted as a "grantor trust" so that income generated by the trust will be treated as income of the donor spouse, not of the trust. The donor thus pays the taxes on the trust income, which, in turn, allows the trust assets to grow "tax free." In other words, the entire trust principal and income remains intact in order to maximize appreciation.

Summary. A BERT achieves all of the following tax and non-tax advantages:

1. Once the trust is funded, the principal and growth is excluded from the donor's estate and the donee spouse's estate, saving estate death taxes.
2. No federal gift taxes are due on the transfer, because a Crummey power is used to qualify the gift for the gift tax annual exclusion.
3. The property is available to the donee spouse during his or her lifetime.
4. The donor spouse reports and pays tax on the trust income, allowing the trust to grow tax-free inside the trust.

A BERT even works effectively as a retirement account that is funded with after-tax dollars. The advantages that a BERT has over qualified plans such as IRAs, 401(k)s, etc., are that there are no penalties for early withdrawal, required minimum distributions or mandatory elections, and no administrator is required to oversee the "plan." And, qualified retirement plans are subject to both income and estate taxes, while the assets in a BERT are not subject to estate taxation at either the spouse's deaths.