

BDIT SCHEMATIC

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- **BDIT Control List**
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- **BDIT – Office of Trusteeship**

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BDIT SCHEMATIC

WEALTH PROTECTION

Solely because assets are placed into an appropriate trust by someone else, and the beneficiary **never** transfers assets to the trust, except in exchange for full value, as long as they are kept in trust, these assets have benefits that do not, and cannot, exist if the same assets were owned outright (or by a trust funded by the beneficiary).

Properly situated and structured

BDITs are forever sheltered:

1. From all estate, gift and GST taxes;
2. From the original and later beneficiary's creditors (including divorcing or dissident spouses);
3. From probate and incapacity headaches and delays; and
4. From certain income taxes after the death of the original beneficiary.

Beneficiary as Income Tax

Owner of the BDIT

Because the original beneficiary is taxed on the trust income, the beneficiary's estate will be "tax burned," i.e., depleted by income tax paid on trust income. This, in effect shifts the beneficiary's personal wealth transfer tax-free into the "BDIT" away from creditors, without gift or GST tax consequences, and with no economic risk because the beneficiary is in control of trust investments.

Insurance Funding

1. Insured beneficiary may not have investment powers over insurance; and
2. Power of appointment cannot extend to insurance on the powerholder.

Parent or Other Third Party creates trust and contributes \$5,000 in cash; no other gifts are made to the trust by anyone
Trust Creator is the Grantor of the Trust for:
Transfer Tax Purposes
Creditor Rights Purposes
But Not Income Tax Purposes

BDIT

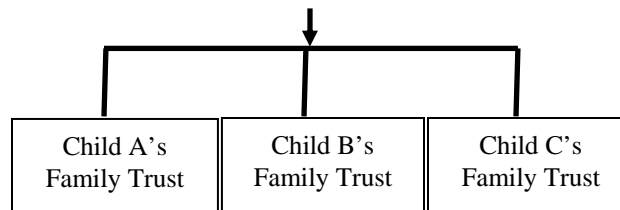
Irrevocable; Fully Discretionary; GST Exempt;
Beneficiary has limited power of appointment
* * * * *

Beneficiary given limited time power to withdraw the original gift; Beneficiary is therefore the "Owner" of the Trust for Income Tax Purposes
* * * * *
Beneficiary – Investment Trustee
Independent Trustee – Distribution Trustee

Unless otherwise directed by exercise of beneficiary's power of appointment ("re-write power") upon death of beneficiary.

Trust for Surviving Spouse (if desired) and Descendants
* * * * *
Surviving Spouse - Investment Trustee
Independent Trustee – Distribution Trustee
* * * * *
Income Taxed to Trust Unless Distributed

Unless otherwise directed by exercise of power of appointment ("re-write power") upon death of surviving Spouse, the trust is divided equally for each family branch and held on similar terms.



These continuing dynastic trusts are protected from creditors, spouses, and the transfer tax system.

CONTROL

Without exposing the trust assets to estate taxes and creditors, the trust beneficiary can have substantial controls. The original primary beneficiary and each successive primary beneficiary is in control (at the proper time) subject to amendment by the exercise of the power of appointment by the preceding generation.

Administrative Control:

1. The original primary beneficiary is the Investment Trustee.
2. The Independent Trustee makes all distributions (if any) and makes other tax sensitive decisions.
3. The primary beneficiary can fire and replace the Independent Trustee with another Independent Trustee, with or without cause. Independent does not require a corporate fiduciary, nor a confrontational relationship; it could be a "best friend".

Beneficiary Control:

1. The right to use the trust-owned assets (rent-free if desired).
2. The primary beneficiary can essentially re-write the trust allowing the primary beneficiary to adjust for changes in tax or trust laws, family dynamics, etc.

AN OUTLINE OF BDIT PLANNING

- (1) A BDIT (a Beneficiary Defective Inheritor's Trust) is a trust created by a parent or other third party who contributes \$5,000 in cash to the trust; no other gifts are made to the trust by anyone, especially the beneficiary.
 - (a) If it is finally determined that a sale to the trust by the beneficiary is partially a gift, the gift would be incomplete (because of his or her limited power of appointment, described below); any such gift would be held in a non-GST exempt share of the trust, under a defined value formula provision.
- (2) The trust creator is the grantor of the trust for transfer tax purposes and creditor rights purposes, but not for income tax purposes.
 - (a) That is, the BDIT is intentionally created as a non-grantor trust from the creator's point of view.
- (3) The trust is irrevocable, fully discretionary, dynastic, and GST exempt (because the creator allocated \$5,000 of his or her GST exemption to the only gift to the trust), and the beneficiary has a limited power of appointment over the trust, exercisable during life or at death.
 - (a) The limited power cannot extend to insurance on the beneficiary's life.
- (4) The beneficiary is given a "Crummey" type power to withdraw the original gift, which right lapses.
 - (a) While the power of withdrawal is outstanding, the beneficiary is treated as the owner of the trust for income tax purposes under Section 678(a)(1).
 - (b) After the withdrawal right has lapsed in accordance with Section 678(a)(2), the beneficiary is thereafter treated as the owner of the trust for income tax purposes.
 - (c) Again, the trust is drafted so that the creator is intentionally not treated as the owner for income tax purposes, so that Section 678(b) doesn't apply to "trump" the application of Section 678(a) to the beneficiary.
 - (d) Because the beneficiary's power to withdraw lapses within the \$5,000/5% lapse protection amount for general powers of appointment, the lapse has no gift or estate tax consequences.
- (5) As a wholly grantor trust from the beneficiary's point of view, the beneficiary pays tax on all trust income (with no gift consequences) – the "tax burn", and transactions between the beneficiary and the trust (such as sales or loans) are ignored for income tax purposes.
- (6) The beneficiary could be the investment trustee, but an independent trustee should be the distribution trustee and must be the insurance trustee with respect to insurance on the life of the beneficiary/trustee.
 - (a) The beneficiary should have no powers over any trust-owned insurance on his or her life, even as a trustee.
- (7) The BDIT can give the beneficiary investment control over the trust (except for insurance on his or her life) and a power of disposition over the trust assets at death (and again, except for insurance on his or her life), but the trust is creditor/predator proof and transfer tax protected from the beneficiary's point of view.
- (8) As a GST-exempt dynastic trust, the BDIT will continue after the beneficiary's death, subject to his or her special power of appointment, for the beneficiary's descendants, for life, with the same protections (though not as a grantor trust from their point of view).

BDIT BENEFITS PROTECTION, USE, CONTROL

➤ **CONTROL**

- This does not apply to life insurance on the life of the beneficiary/power holder.

➤ **FULL USE AND ENJOYMENT OF TRUST ASSETS**

- Except for Life Insurance on the beneficiary's life.
- Life Insurance potentially indirectly accessible through Independent Trustee.

➤ **RE-WRITE POWER**

- Special Power of Appointment.
- Except for Life Insurance on beneficiary's life.

➤ **CREDITOR PROTECTION**

- Including divorcing or dissident spouses.
- Income taxes paid as a result of grantor trust status depletes original beneficiary's otherwise exposed estate.

➤ **TAX SAVINGS**

- Estate, Gift, and GST Tax Exempt - as long and the assets are kept in trust.
- Estate Depletion - of initial primary beneficiary's estate as a result of income tax grantor trust status.
- Trust Beneficiaries can increase and accelerate their estate planning transfers without economic exposure based upon the security of the controlled trust.
- Income Tax – after death of initial primary beneficiary.

BDIT CONTROL LIST

PRIMARY BENEFICIARY/TRUSTEE CONTROLS

➤ ADMINISTRATIVE CONTROLS

- **Full Management/Investment Control Until Death** – as Investment Trustee. This does not apply to life insurance on the life of the beneficiary/trustee.
- **Right to Fire and Replace Independent (Distribution) Trustee** – Within Constraints of IRC §672 (c) and Rev. Rul. 95-58.

➤ BENEFICIARY CONTROLS

- **Full Use and Enjoyment of Trust Owned Assets Until Death** – (with or without rent and for any purpose whatsoever). The beneficiary may also use (or determine who uses) the trust owned property and terminate the use of the property. This does not apply to life insurance on the life of the beneficiary.
- **Re-Write Power** – The ability to essentially revise the trust to adjust for changes in tax laws, trust laws, family dynamics, economics, or for any other reason. This is a Special Power of Appointment and it is permissible as long as the beneficiary does not have the right to exercise this power for him/herself; his/her estate or the creditors of either. This does not apply to life insurance on the life of the beneficiary/power holder.

BDIT

OFFICE OF TRUSTEESHIP

➤ Investment Trustee:

- **Initially Client/Beneficiary**
- **Full Managerial Control** – Except for Life Insurance on the Trustee/Beneficiary's life. Can create entities and invest in new business and investment opportunities.
- **Control of the Identity of the Independent Trustee** – Right to fire and replace, with or without cause, subject to IRC §672 (c) and Rev. Rul. 95-58.
- **Control Over Who Uses the Trust Assets** – Except for life insurance on the Trustee/Beneficiary's life.

➤ Independent Trustee:¹

- **Makes Tax Sensitive Decisions** – Such as distributions.
- **Makes all Decisions Pertaining To Life Insurance on Beneficiary/Trustee's Life**
- **Makes Decisions Regarding the Purchase or Sale of Hard to Value Assets to or from a Beneficiary** – Although not technically required, the independence will add protection.

¹ The position of Independent Trustee can be fragmented into:

◇ A Distribution Trustee – Someone who is an Independent Trustee as provided in IRC §672 (c) and Rev. Rul. 95-58. This does not have to be a confrontational relation – It can be the client/beneficiary's best friend; and

◇ An Administrative Trustee – A person, but most often an entity who/which enables the client to obtain favorable jurisdiction. Caveat – the Administrative Trustee must perform sufficient services to access the superior state laws.

BDIT Flowchart #1

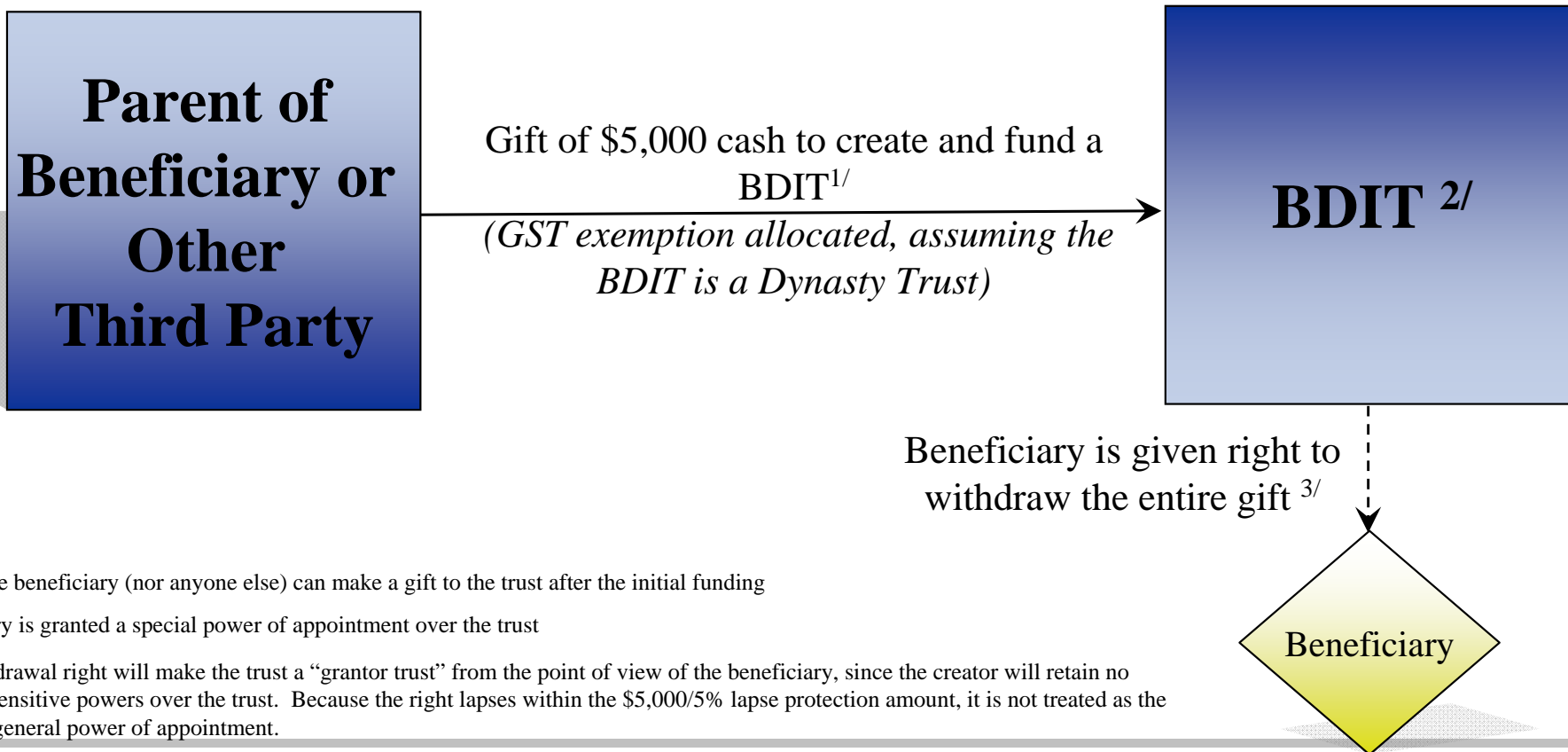
Attached Flowchart of a Sale of Business or Investment Assets to a Beneficiary Defective Inheritor's Trust (a "BDIT") on an Installment Basis

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The attached flowchart depicts a simplified version of the series of steps that would be taken to: 1) have a third party create a BDIT, and 2) have the trust beneficiary sell business or investment assets to the BDIT, on an installment basis.

CREATION OF BDIT FOR SALE OF BUSINESS OR INVESTMENT ASSETS

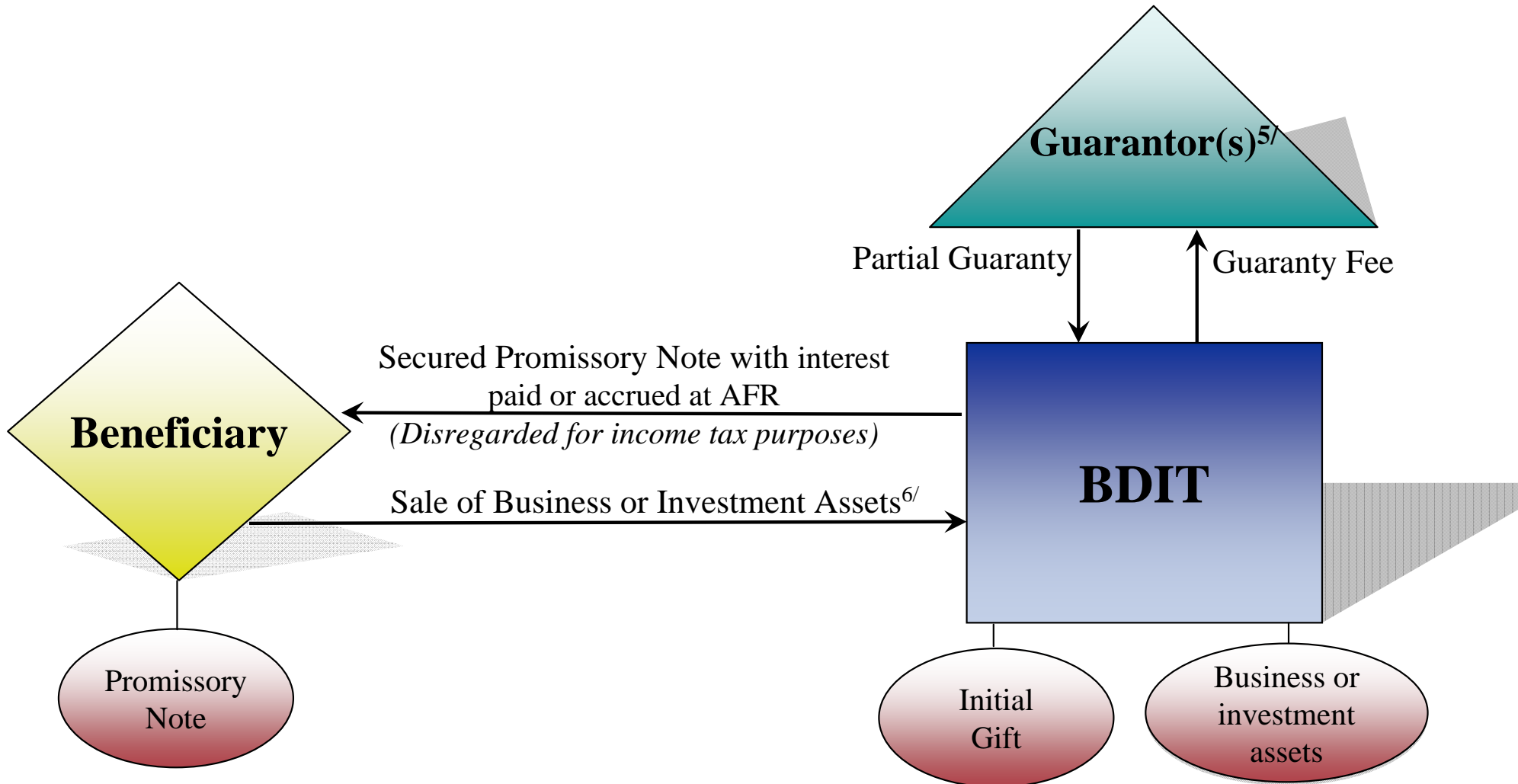


^{1/} Neither the beneficiary (nor anyone else) can make a gift to the trust after the initial funding

^{2/} Beneficiary is granted a special power of appointment over the trust

^{3/} That withdrawal right will make the trust a "grantor trust" from the point of view of the beneficiary, since the creator will retain no income tax sensitive powers over the trust. Because the right lapses within the \$5,000/5% lapse protection amount, it is not treated as the release of a general power of appointment.

SALE OF BUSINESS OR INVESTMENT ASSETS ^{4/}

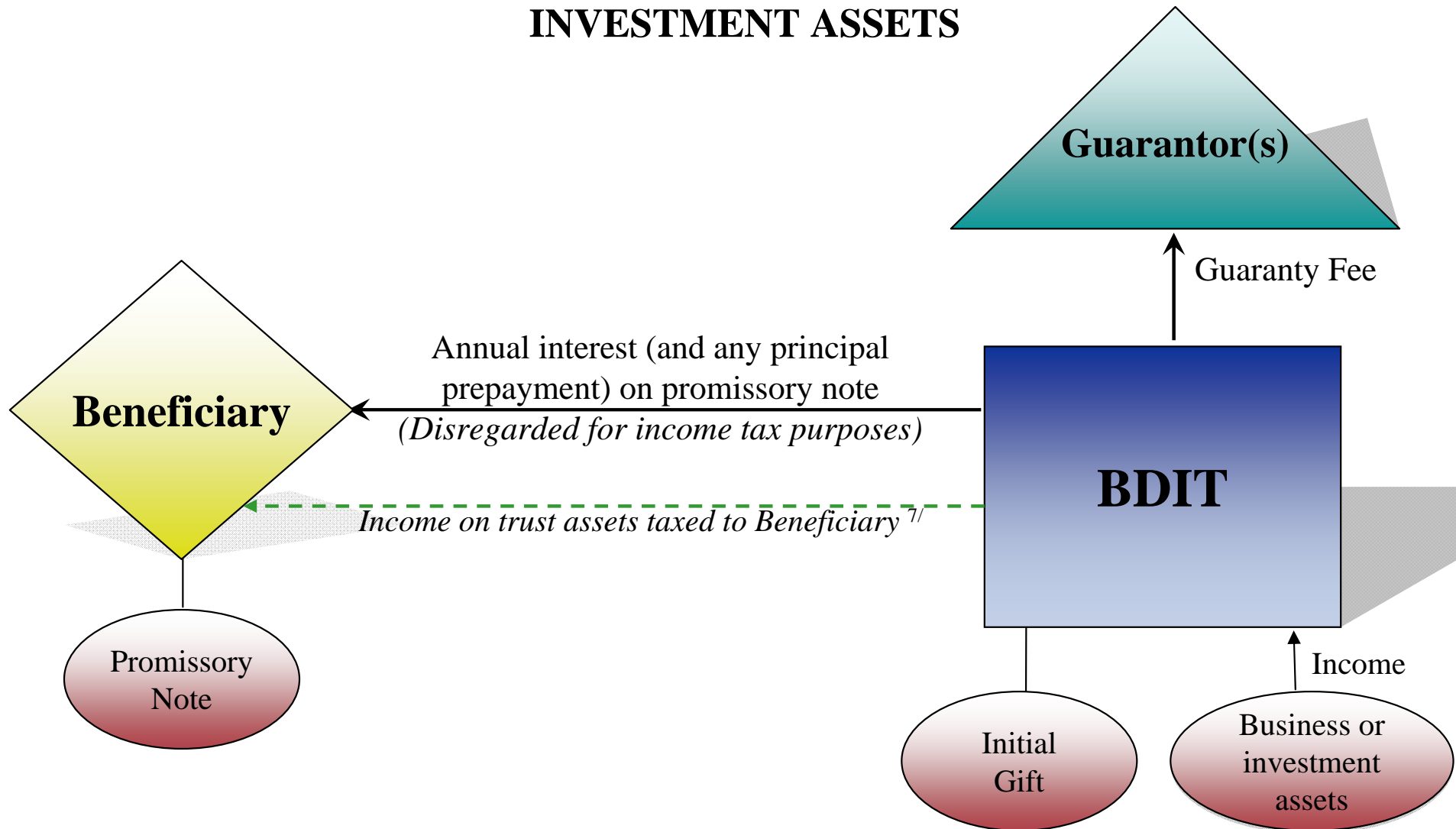


^{4/} The sale would take place after the beneficiary's withdrawal right had lapsed; the sale will be of a defined value and a gift tax return would be filed reporting the transaction as a non-gift

^{5/} May be an existing irrevocable trust, beneficiary's spouse, the creator of the trust, or any other party who or which has sufficient assets to satisfy the guarantee, if necessary

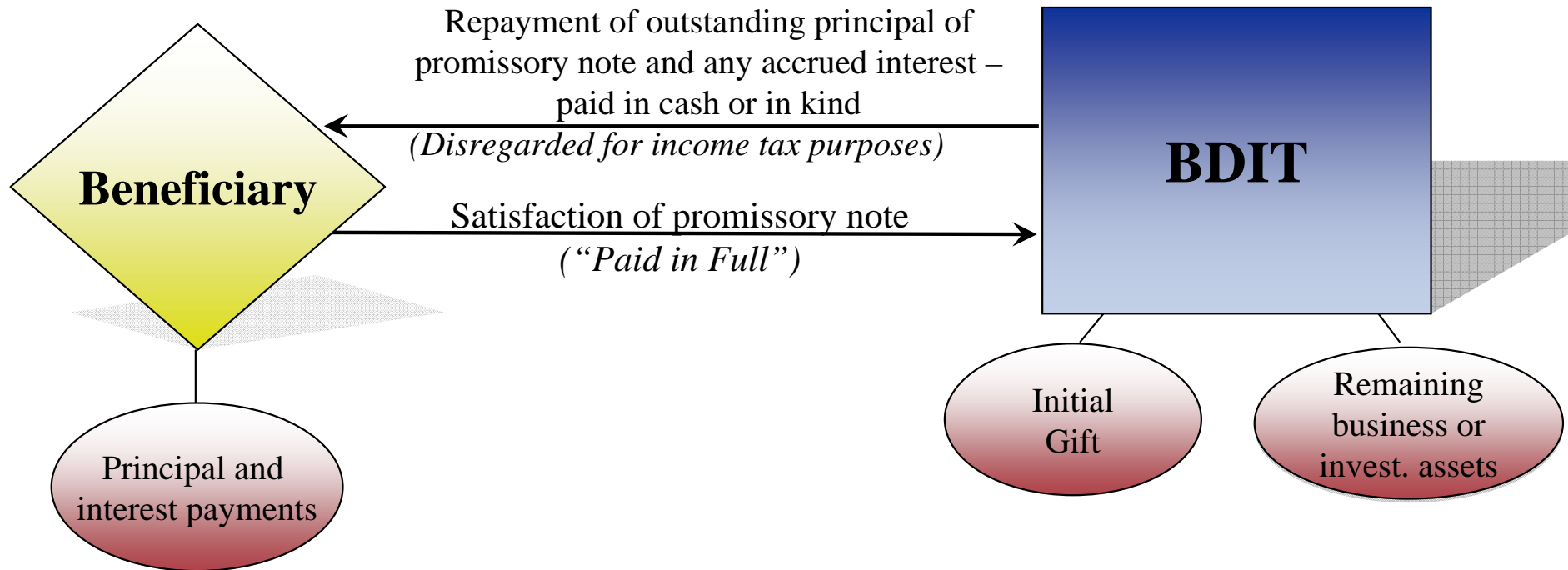
^{6/} If the value of assets sold is adjusted by IRS resulting in an unintentional gift, then the beneficiary's testamentary power of appointment would avoid treating that excess as a completed gift; any excess would be allocated under a formula in the trust to a non-GST exempt share

ANNUAL ADMINISTRATION OF SALE OF BUSINESS OR INVESTMENT ASSETS

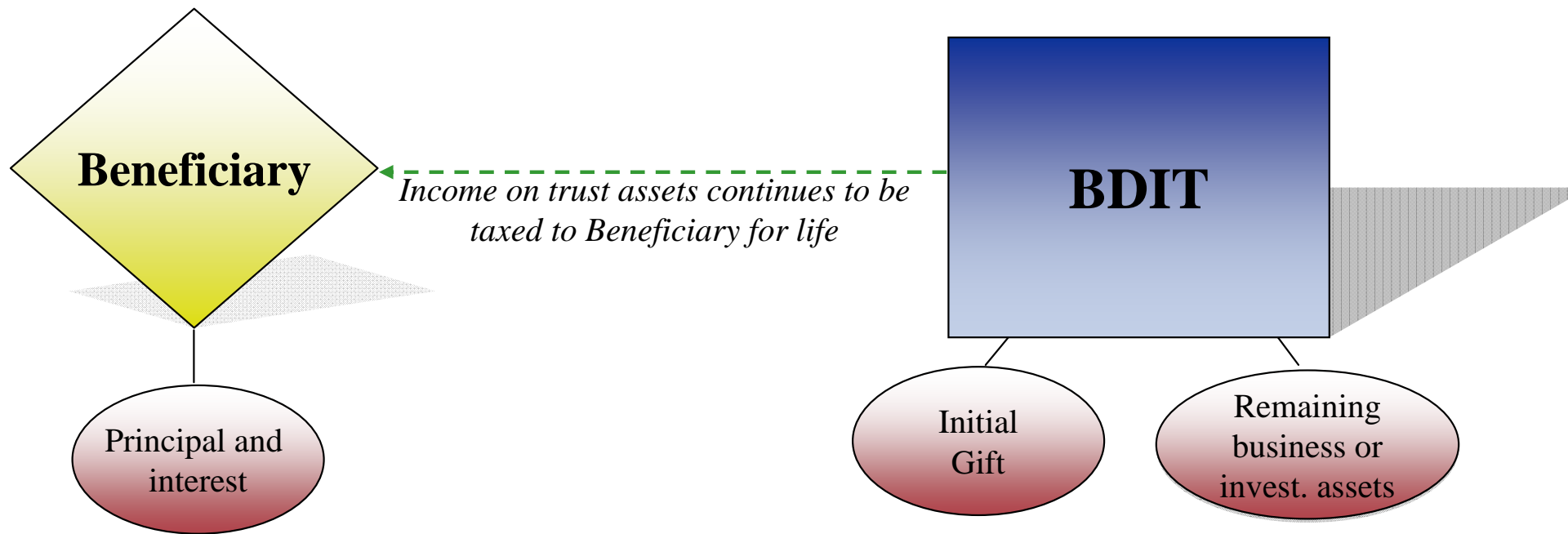


^{7/} Payment of income tax by the beneficiary on trust income is not a gift for gift tax purposes

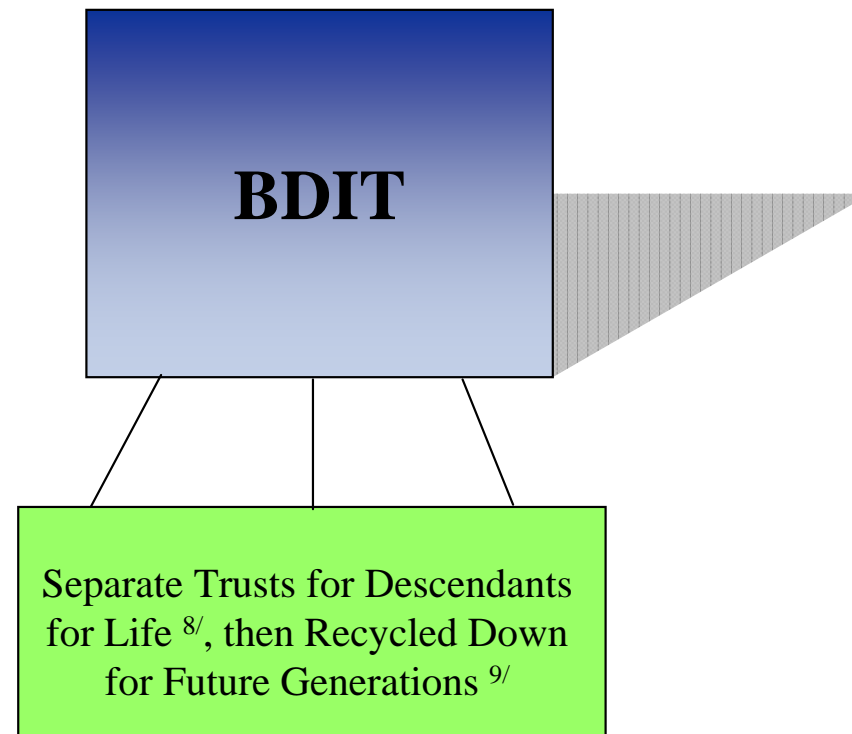
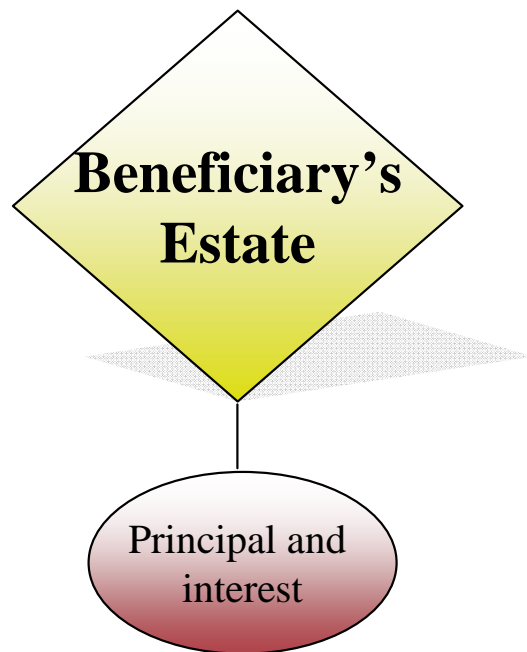
COMPLETION OF SALE OF BUSINESS OR INVESTMENT ASSETS AFTER NOTE TERM



FOLLOWING COMPLETION OF SALE OF ASSETS



FOLLOWING DEATH OF BENEFICIARY



^{8/} Protected from their creditors, spouses, and the transfer tax system

^{9/} Unless modified by the exercise of a limited power of appointment

BDIT Flowchart #2

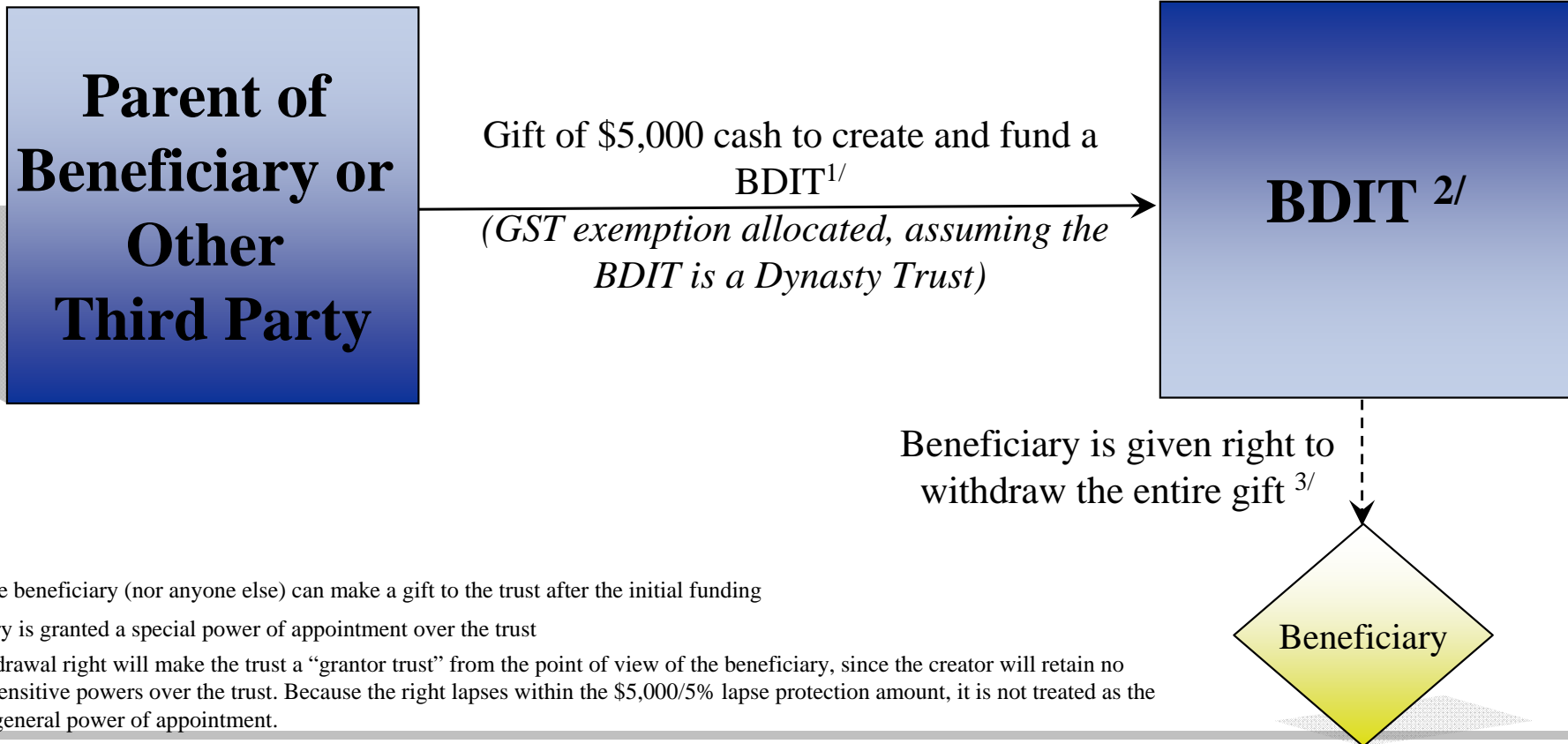
Flowchart of a Sale of Business or Investment Assets to a Beneficiary Defective Inheritor's Trust (a "BDIT") on an Installment Basis and Purchase of a Life Insurance Policy on the Life of the Beneficiary

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The attached flowchart depicts a simplified version of the series of steps that would be taken to: 1) have a third party create a BDIT, 2) have the trust beneficiary sell business or investment assets to the BDIT, on an installment basis and 3) have the BDIT acquire a life insurance policy on the life of the beneficiary.

CREATION OF BDIT FOR SALE OF BUSINESS OR INVESTMENT ASSETS AND PURCHASE OF INSURANCE

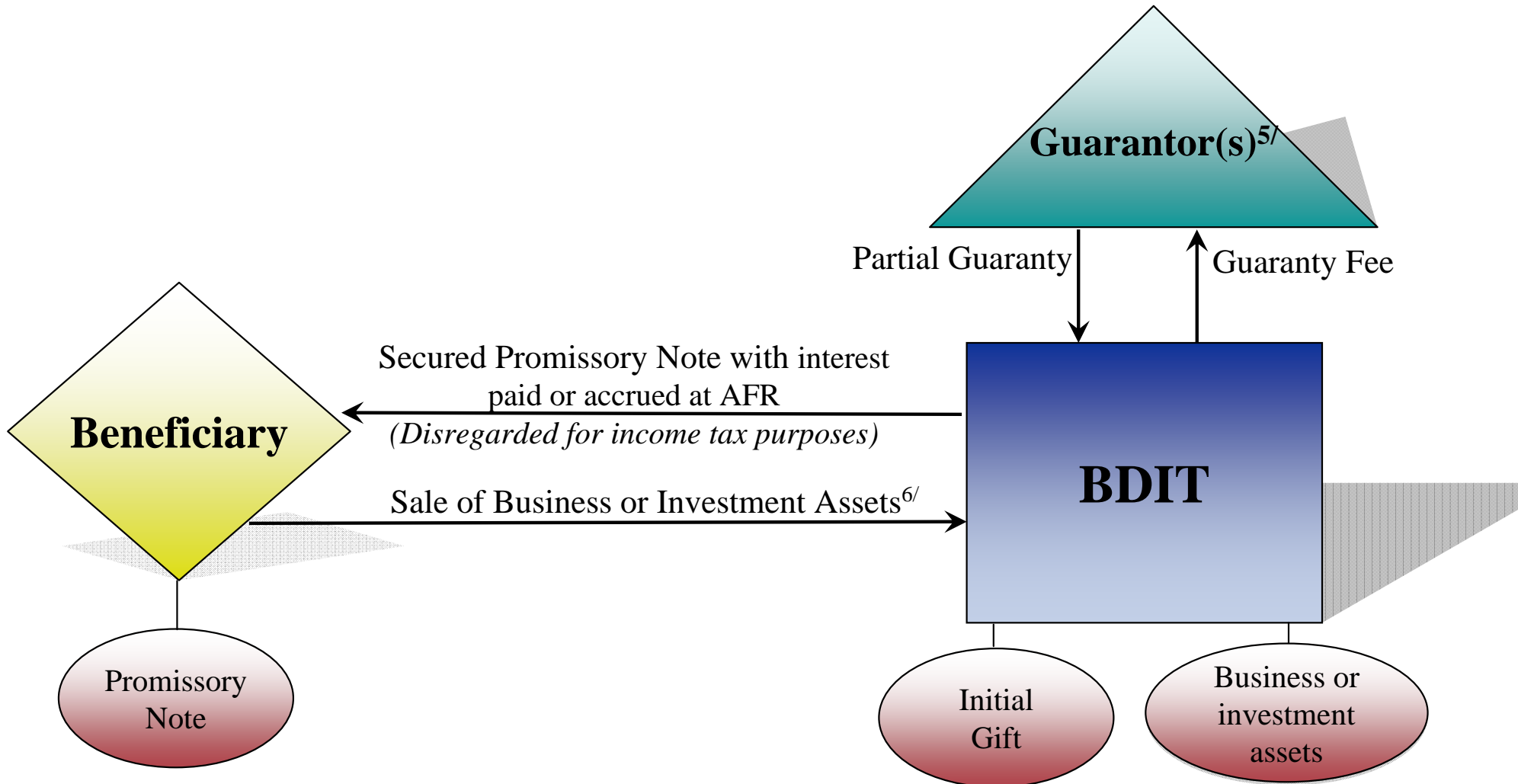


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SALE OF BUSINESS OR INVESTMENT ASSETS ^{4/}

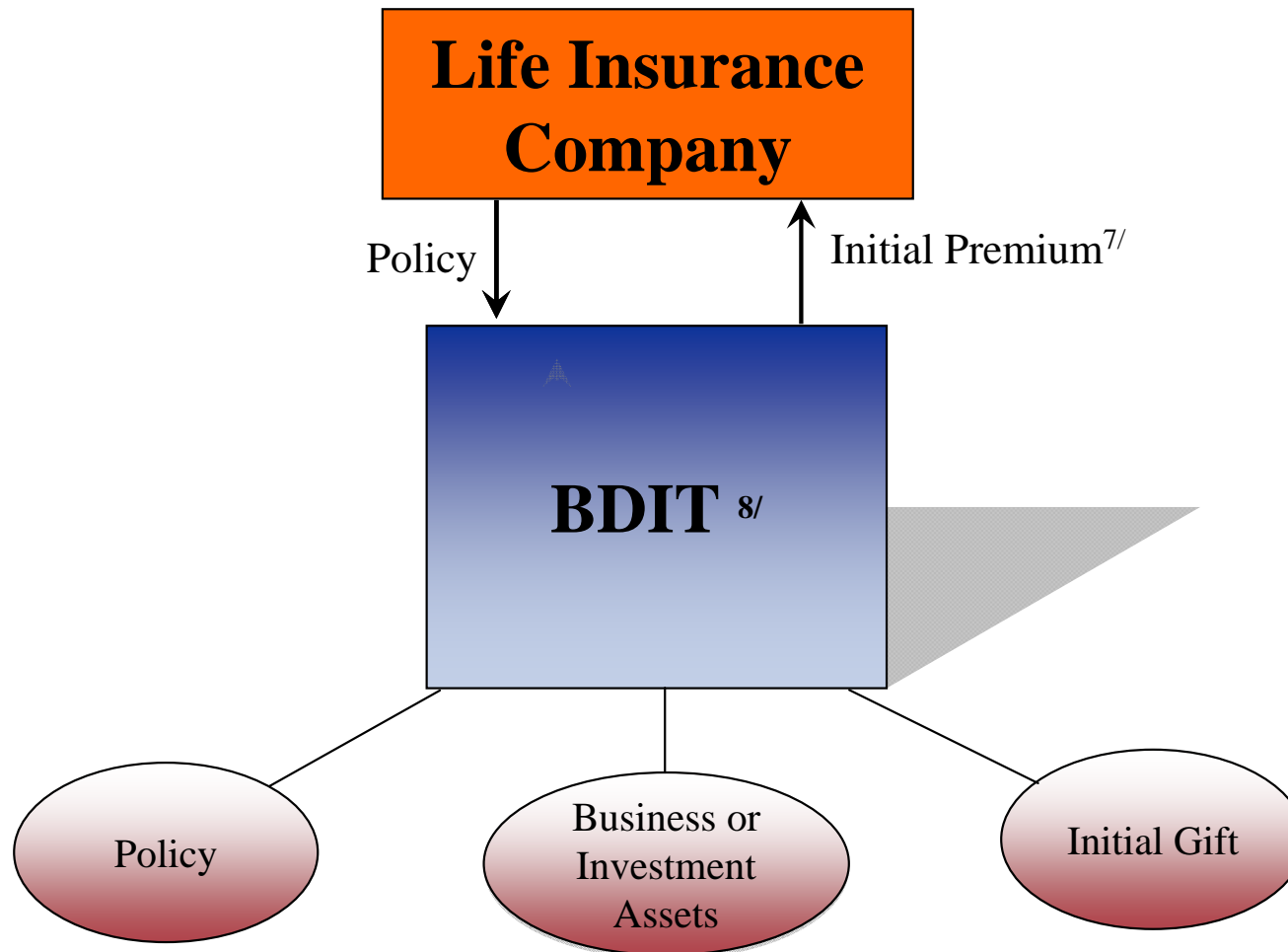


^{4/} The sale would take place after the beneficiary's withdrawal right had lapsed; the sale will be of a defined value and a gift tax return would be filed reporting the transaction as a non-gift

^{5/} May be an existing irrevocable trust, beneficiary's spouse, the creator of the trust, or any other party who or which has sufficient assets to satisfy the guarantee, if necessary

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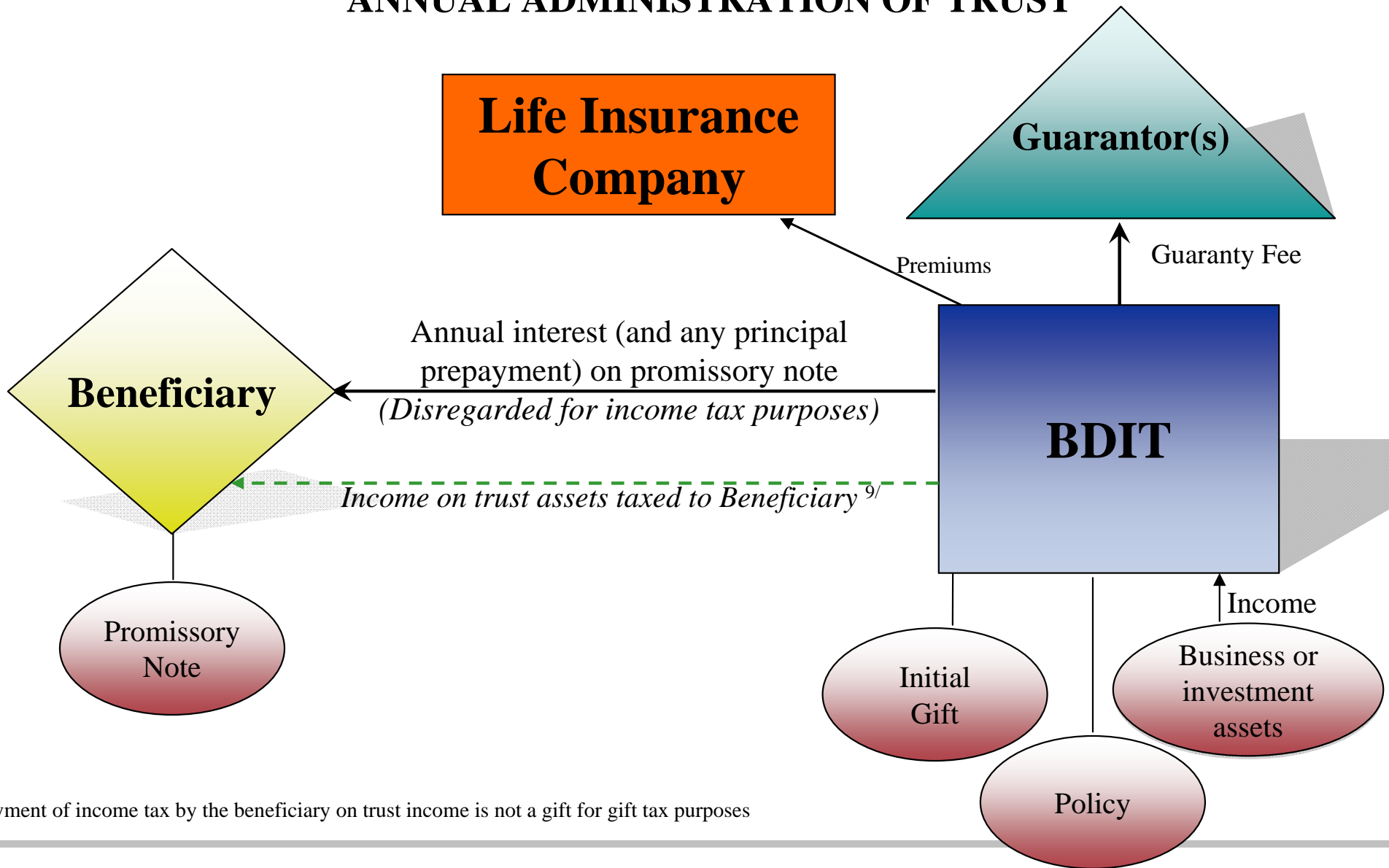
PURCHASE OF INSURANCE



^{7/} If the BDIT did not generate enough cash flow to pay premiums, the beneficiary would enter into a private premium financing split-dollar arrangement with the BDIT

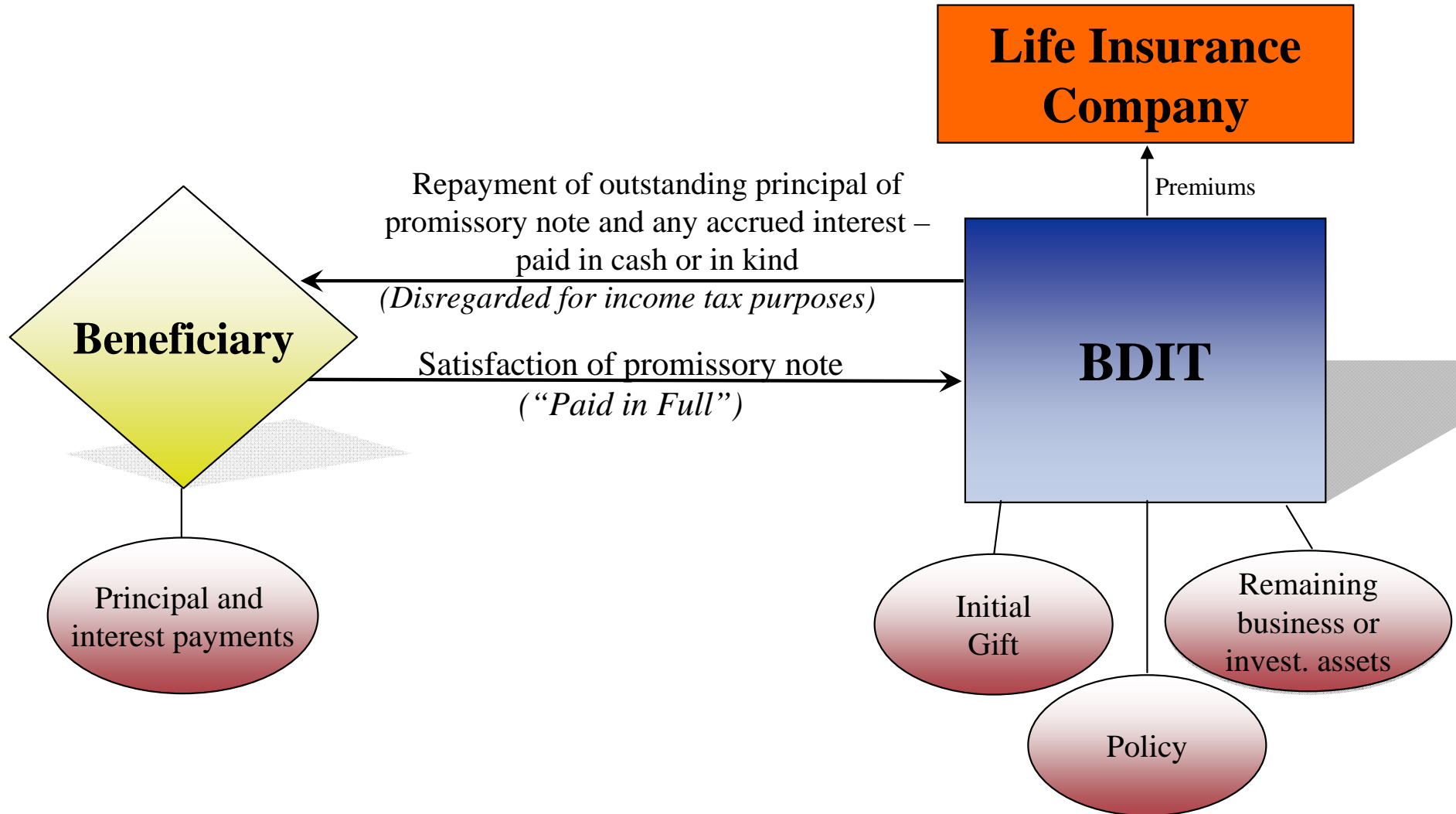
^{8/} Beneficiary cannot hold Trustee powers over the insurance on his or her life, and his or her power of appointment can't extend to that insurance

ANNUAL ADMINISTRATION OF TRUST

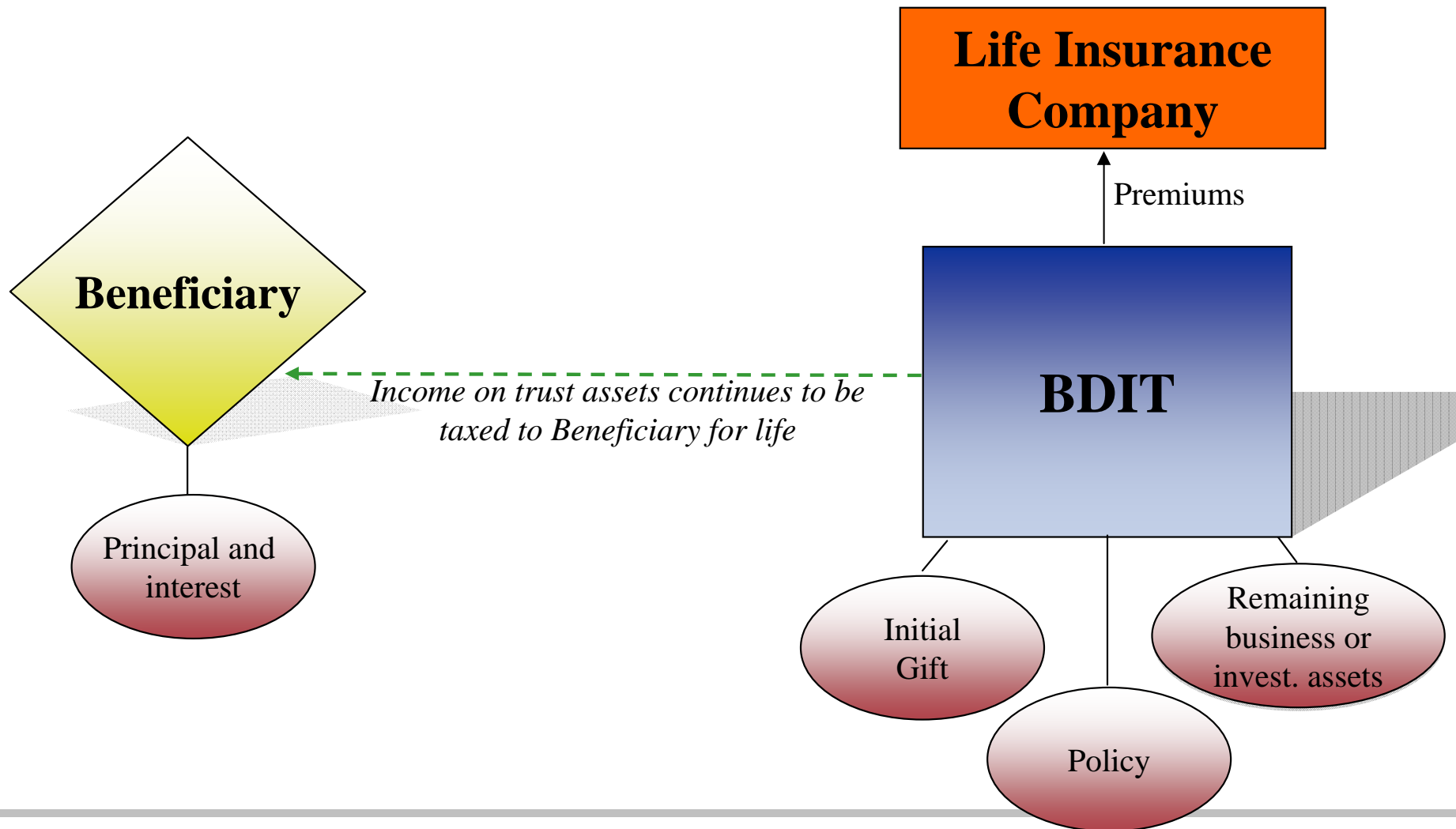


^{9/} Payment of income tax by the beneficiary on trust income is not a gift for gift tax purposes

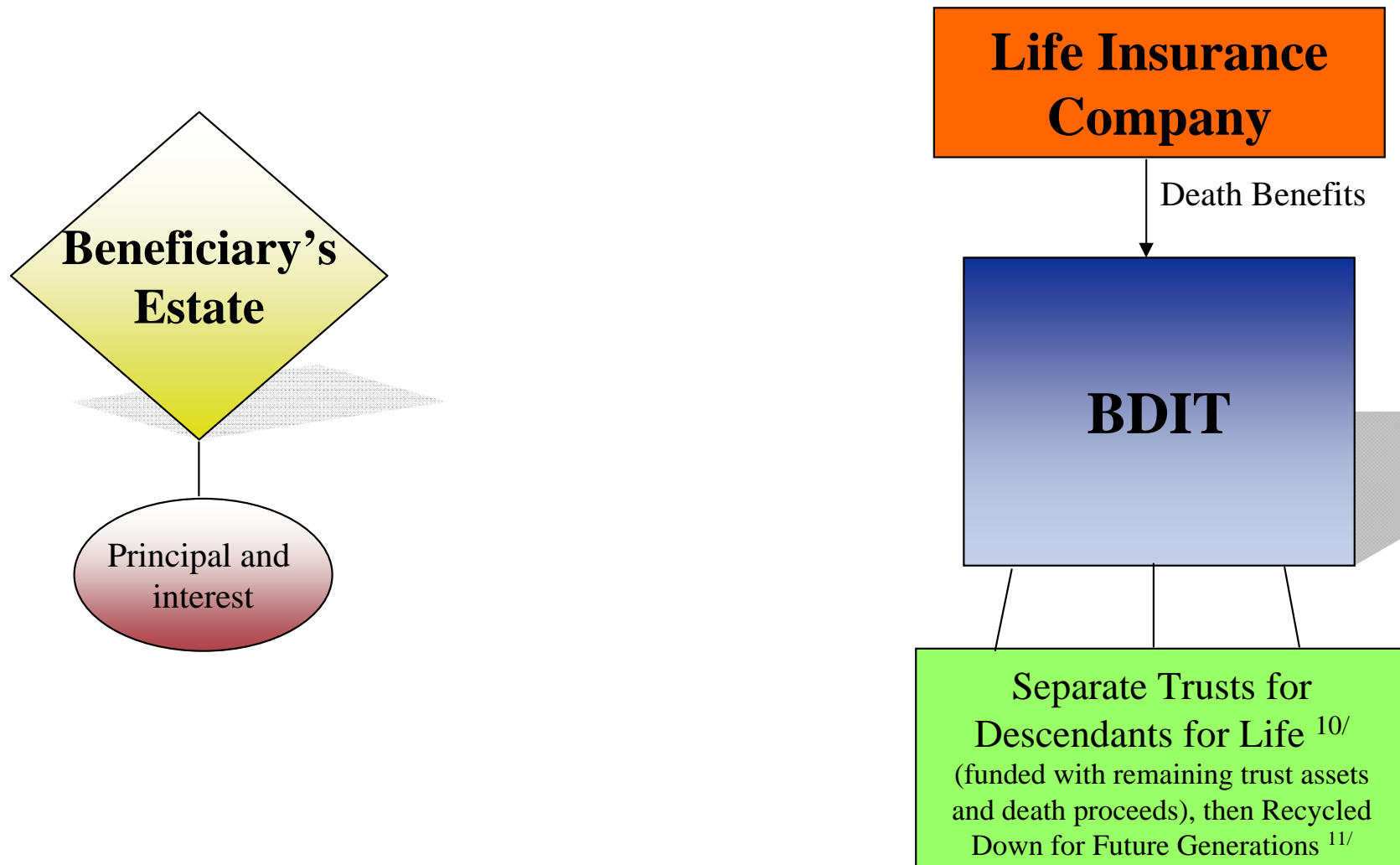
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