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Estate planning for corporate executives

Once upon a time, the primary concern of estate planning was preparing for—and minimizing when possible—estate and/or inheritance taxes (the "death taxes"). That concern has receded now that the federal exemption from estate taxes is set permanently at $5 million (plus inflation adjustments; it's $5.34 million in 2014).

For the corporate executive, the more important estate planning concerns are likely to be liquidity, concentrated holdings of employer stock, deferred compensation and stock options. When the company is closely held, the issues can become quite thorny. Typically, a buy-sell agreement will be employed to provide a ready market for the executive's shares upon his or her death. Such an agreement can provide a methodology for valuing shares. At the same time, it provides for continuity of ownership for the surviving shareholders.

As the executive transitions into retirement, additional concerns may come into play. For the philanthropically minded, a charitable remainder trust offers the opportunity for tax-free diversification of a concentrated holding and/or stock options, converting those assets into a reliable stream of lifetime retirement income. When the trust terminates at the death of the owner and other named private beneficiaries, the remaining assets pass to a designated charity. A charitable remainder trust may pay an annuity, expressed as a percentage of the initial value of the trust, or the income may be determined each year as a percentage of the value of the trust in that year (a "unitrust" interest). This choice, coupled with the number and ages of the named beneficiaries and market interest rates at the time of the funding of the trust, will determine the level of tax benefits associated with the arrangement.

Other issues that may come up in planning for an executive's estate include interests in qualified retirement plans, life insurance, and split-dollar insurance arrangements. The counsel of an experienced fiduciary will be important.

Planning in action:
The tax magic of GRATs

Here's an example of an estate planning strategy that has been used by many top executives, including Facebook's Mark Zuckerberg, casino magnate Sheldon Adelson, and Lloyd Blankfein, the CEO of Goldman Sachs. They, along with hundreds of other highly compensated executives, have employed a Grantor Retained Annuity Trust (or GRAT to estate planners) to move wealth within the family at little or no gift tax cost. According to a report from Bloomberg, Adelson may have passed some $7.9 billion through 30 different trusts to his heirs, saving about $2.8 billion in gift taxes. An estimated $100 billion in gift taxes has been avoided legally since 2000.

How can the reporters possibly know all this? Aren't IRS filings and trust documents private? Yes, they are, but the SEC requires many disclosures from the major owners of publicly traded companies. It is from SEC filings that the reporters gleaned this information.

How does it work? The idea is that the grantor places an asset in a trust for a term of years, receiving income from the trust during its existence. At the end of the term, the trust terminates, and the remaining assets pass to the heirs. When the trust is created, there is a gift tax due on what the heirs will receive, discounted to reflect the value that the grantor retained for himself or herself.

One of the Walton heirs pushed this strategy farther. A GRAT was set up to last for just two years, funded with Walmart stock. The annuity was set so high that essentially the entire value of the transfer had to be returned to the donor, so the value of the gift was "zeroed out," and no gift tax would be due. What's the point? If the stock transferred to such a trust zooms in value during the two years, the excess appreciation passes to the heirs entirely free of gift taxes, and has been removed from the estate of the donor.

Bloomberg reported that in 2009 Adelson placed about $30.9 million worth of his Las Vegas Sands stock in a GRAT for two years. In 2011 the trust terminated and distributed $31.1 million to him—the initial contribution plus interest. During those two years, the price of the stock soared from $2.58 per share to $46.87. The final result was that $518.8 million passed to Adelson's heirs with no gift tax. That same amount has been removed from his estate, and it will be free of estate taxes as well.

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