

FACTORS TO CONSIDER WHEN CREATING AN ESTATE PLAN

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When individuals contemplate the transfer of their accumulated wealth, during both their lifetime and upon death, there are many factors that need to be considered to insure that their ultimate beneficiary(s) receive the maximum benefit of the bounty. Most individuals, when preparing an estate plan, fail to consider and plan for each and every possibility and their goals and objectives may never be accomplished. The following is a brief analysis of factors that should be considered when beginning the planning process.

Having a Will or a Trust:

The most commonly asked question, during the planning process, is should I/we have a Will or a Trust. The simple and short answer is based upon what type of planning is appropriate for his/her specific needs and objectives. Deciding factors should include, but are not be limited to, the following: (i) desire to avoid the probate process; (ii) ease in administration of assets upon death or disability; and (iii) the ownership of real property in multiple states.

Terms and Structure of Distributions and Ramifications:

The terms contained in your document(s) will determine, upon your death, the amount, manner and which of your assets will be distributed to the ultimate beneficiary(s). The assets may be distributed outright or subject to restrictions (long or short term). The restrictions may consist of the following: (i) the timetable and terms for distributions of assets (age restrictions, length of time the assets are to be held in trust and amounts of income and/or principal) to a beneficiary; (ii) mandatory or discretionary distributions of income and/or principal for the health, support and maintenance of a beneficiary; (iii) protection of assets from a beneficiaries' creditors or in divorce proceedings; (iv) prevent assets, such as stock in a closely held corporation, from being encumbered or sold; (v) encourage the beneficiary to act in desired ways (by providing funds only if the beneficiary earns a certain amount of income or achieves certain accomplishments); (vi) discourage a beneficiary from acting in undesirable ways (not providing funds to them if they are addicted to drugs or alcohol or are a spendthrift); (vii) protect the beneficiary from improvidence or himself/herself; (viii) manage assets for someone disabled (due to illness or incapacity); or (ix) language to assist in the saving of federal transfer taxes (estate and generation skipping taxes).

The distributive terms may also provide for discretionary distributions of principal or income, either directly to the beneficiary or on their behalf, for any of the following purposes: (i) education (undergraduate and/or graduate school or training); (ii) starting a business; (iii) marriage; (iv) supporting a child; and (v) purchase of a residence. In addition, the distributive terms may require a beneficiary(s) inheritance to be held perpetually for their lifetime and successive generations. When planning there are almost no limitations that can be placed upon the ultimate plan of distribution to a beneficiary.

Situs of Your Estate:

The selection of the situs for your estate will have significant income and estate tax consequences. Several states have no income tax (as of 2004 they include Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming) and the establishment of your residency under their laws may allow for the avoidance of additional estate taxes on amounts later distributed to a beneficiary and future generations. Some states do not impose a tax on income retained in a Trust located within their state lines, unless the beneficiary is a resident, while other states impose an income tax on amounts retained in a Trust only if the grantor was domiciled in the state at the time the Trust became irrevocable.

Trusts for Minors:

Most states require that a beneficiary reach the age of majority (18 to 21 years) prior to being able to receive an inheritance outright. When a beneficiary is under the minimum age their inheritance must be placed into an account (custodial or trust) for their benefit. The creation of an account or trust for this type of scenario, during the planning process, allows you to determine who will manage the beneficiary account and avoid a court or third party (ex-spouse or family member) from making the decision on your behalf. In most scenarios, it may be beneficial to appoint a specific family member or professional trustee to control the account investments. The custodian or trustee may also have joint investment authority with the beneficiary to insure they will receive professional guidance for the time when control and responsibility over the account becomes theirs alone.

Disability (Child or Adult):

The disability of a beneficiary (child or adult) is never an easy issue to contemplate. However, the failure to plan for this possibility could result in the beneficiary losing their eligibility for government (Supplemental Security Income (SSI) and Medicaid) and other benefits. An outright receipt of an inheritance may result in the loss of eligibility for benefits by a beneficiary and require them to spend down the inheritance in order to re-qualify to receive them.

This result can be avoided by having an inheritance pass directly into a "Special Needs Trust." The Trust assets will be in the name of the trustee, not the disabled individual, who will have absolute discretion over the use and expenditure of the funds. The trustee may then, without any obligation for the care or needs of the beneficiary, make expenditures for the beneficiary's medical and dental expenses, clothing and equipment, programs of training, education and treatment, transportation and essential dietary care, housing or residential accommodations, expenditure of funds, visual and/or audio equipment for entertainment purposes (radio, television set, etc.), vacations, movies and trips. When planning to establish a trust of this nature it is important to notify friends and relatives about the plan and advise them of the specific manner to leave a bequest to the disabled individual.

Drug Testing:

A plan may require, prior to any or all distributions to a beneficiary, that they pass a mandatory drug test. The test may be predicated upon a suspicion or knowledge that the beneficiary is involved with illegal drugs. The testing may be conducted annually or randomly and required

prior to any beneficiary distribution. If a drug test is failed, the account custodian or trustee may require the beneficiary to complete a rehabilitation program in order to receive their inheritance.

Creditor Protection and Spend Thrift Provisions:

A provision of this nature may be used to protect the beneficiary from creditors and/or himself/herself. The objective may be accomplished by maintaining the beneficiary's inheritance in a long-term trust, rather than an outright distribution, with income and principal distributions made solely in a trustee's discretion. A spendthrift clause will protect assets by providing that a beneficiary cannot voluntarily or involuntarily (in bankruptcy) assign his or her interest in the asset. This will protect the inherited assets from any creditor until a distribution is made to the beneficiary. The spendthrift provision may also protect the beneficiary's interest from claims of a spouse, in a divorce proceeding, but not a claim for child support.

Second Marriage (QTIP Trust):

A “qualified terminal interest property” (QTIP) Trust provision may be used when: (i) one or both of the spouses have children from a prior marriage or relationship; (ii) provide management and control of assets by a deceased spouse for the benefit of a surviving spouse; or (iii) insure that assets left for a surviving spouse pass, upon the death of the surviving spouse, to the beneficiaries selected by the first deceased spouse. When properly implemented the trust assets will qualify for the unlimited marital deduction, insure that an independent trustee controls and manages the assets for the surviving spouse, and determine the ultimate beneficiary(s), usually the children of the deceased first spouse.

Citizenship of Spouse:

Most U.S. citizen spouses are aware that they may leave an unlimited amount of money (the “Unlimited Marital Deduction”), without gift or estate tax consequences, to a surviving U.S. citizen spouse. However, when there is a marriage of a U.S. citizen and a non-U.S. citizen, there are specific estate and gift tax matters that must be addressed in the planning process. When one spouse is not an U.S. citizen, the Unlimited Marital Deduction will not apply and the nontaxable inheritance and gifting amount will be capped. If the surviving spouse is a non-U.S. citizen they may become a U.S. citizen, before the decedent’s Federal Estate tax return is due, in order to take advantage of the unlimited marital deduction. Alternatively, the funds may be inherited by the non-citizen spouse under a “Qualified Domestic Trust” (QDOT) to receive the unlimited marital estate tax exemption.

Charitable Giving:

When leaving a portion of your estate to charity or a not-for profit organization it is important to consider all of your available options. Charitable giving may be completed through several options: (i) outright gift (donor retains no interest in the donated asset); (ii) testamentary bequest (made upon death of donor under the terms of a Will or Trust instrument); (iii) charitable split-interest trust (one party benefits from the trust's initial interest, and another benefits from the remainder interest); or (iv) private foundation.

An outright gift, during your lifetime or upon death, can provide a one time direct benefit to a charitable organization. Alternatively, a charitable trust (lead or remainder interest) or foundation can provide years of benefit to one or more charitable organizations. With a charitable remainder trust, an individual beneficiary receives income either for life or a designated period of years after which the assets are distributed to a charitable organization. With a charitable lead trust, a charity receives income for a designated period of years after which the remaining assets go to a beneficiary. Charitable giving can also provide income and estate tax benefits through an income tax deduction, use of appreciated assets to fund the gift (avoidance of capital gains taxes) and by decreasing the size of a future taxable estate and the amount remaining for your beneficiaries.

Estate & Gift Taxes:

The impact of estate and/or gift taxes is an important consideration to the ultimate beneficiary(s) of your estate, unless it is a charitable or non-profit organization. The use, either maximum or partial, of an individual's "Unified Credit" and "Unlimited Marital Deduction" are two methods to pass wealth without any federal estate tax implications (it is important to recognize that some states do not recognize the federal Unified Credit amount and a state estate tax may apply).

A US citizen spouse may pass (by gift or upon death) an unlimited amount of assets to their surviving spouse. However, a US citizen may only gift one million dollars (adjusted for inflation beginning in 2004) during their lifetime and pass the Unified Credit amount (maximum or partial amount) upon their death to a non-spouse. With proper planning at least three million dollars may be passed today (applicable for 2004 and 2005 and scheduled to increase in the future) to future generations without any federal estate tax consequences.

Titling of Accounts.

Assets that are not titled in the name of a Trust (individual name, joint ownership, "Pay on Death" (POD) or "In Trust For" (ITF) accounts) or with a designated beneficiary ("Individual Retirement Account" (IRA) or life insurance) may not be subject to the terms of your planning instrument. This may result in the asset being immediately transferred to the named beneficiary without any restrictions on the funds and defeat the purpose of an estate plan. Alternatively, the proper titling of the account beneficiary can insure that the intent of the estate plan are implemented and the beneficiaries are classified as designated beneficiaries for purposes of computing minimum required distributions from any retirement account.

Guardianship:

Most individuals are unaware that the commencement of guardianship proceedings terminates the ability of an attorney-in-fact (power of attorney holder) from handling financial matters on your behalf. This may result in a court appointed guardian (family or non-family member) controlling the disposition of your assets. Ownership of your financial assets in a Trust may avoid this result. With a Trust, should you become incapable of handling your own affairs, your selected successor can step in and act for you.