PRIVATE ASSET MANAGEMENT

Estate planning: postponement is not an option

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Much has recently been written about the uncertainties surrounding the Federal Estate Tax. Will the tax be repealed and, if so, will the repeal be spread out over time or will it happen overnight? Will the Estate Tax be replaced by a capital gain tax at death? Should we wait and see what happens before reviewing or updating our estate plans?

Of these questions, only one has an absolute answer, at least for most of us; waiting to see what happens is not an option. For almost all of us, what Congress does in the next few months should have no impact. The Internal Revenue Service just announced that the exemption from the Federal Gift and Estate Tax will increase on January 1, 2018 to $5,600,000 per person such that a married couple, with proper planning, can shelter $11.2 million from the tax.

To give you an idea of the extent of the impact of the Federal Estate Tax on most Americans, in tax year 2015, just 4,918 estates, nationally, paid any Federal Estate Tax. What remains relevant, however, for everyone, and what should not be deferred, is making sure that your estate plan accurately reflects your intentions for the disposition of your assets and, as part of that assessment, to ensure that your current documents contain protections for your beneficiaries from creditors, predators and the potential of the diversion of assets from your family.

Even for those who are still likely to be impacted by the Federal Estate Tax, delaying planning is not an alternative. Although one may decide to wait to see what will happen before making irrevocable transfers, there is still the need to assure that your estate plan matches your overall goals with respect to family issues. As the tax picture becomes clearer changes can be made to take advantage of tax savings opportunities.

Although simplicity of planning is often a goal, making an estate plan too simple has its downsides. For example, outright transfers, whether to a surviving spouse or to children, while simple, carry risks. Without the added protections of a trust or similar structure, the transferred assets may be claimed by the beneficiary's creditors; the beneficiary could fall prey to predators, including an unscrupulous "second" life partner who is intent on diverting the inherited assets to him/herself; the beneficiary could lose the inheritance by one foolish investment; and, perhaps worst of all, the very access to a substantial amount of money could do actual harm to the beneficiary.

Under the laws of many states, creditors may attach assets as to which a beneficiary has an unrestricted right, i.e., an absolute right to withdraw monies within the consent or approval of anyone. This is so even where a dispositive document contains what is referred to as a "spendthrift clause." Further, without some additional protections, even where a spendthrift clause is effective to protect assets while still in the hands of the executor, upon a required distribution of the assets to the beneficiary they become subject to attachment by the beneficiary's creditors.

Even in the case of a happily married couple, a simple Will, i.e., a Will that simply provides for the assets of the first spouse to pass to the survivor with the expectation that on the death of the surviving spouse the assets will pass to children, often leaves open the possibility of asset diversion from intended beneficiaries. For example, upon the death of a wife, there is the possibility, even probability, that her surviving husband will remarry and at least a possibility that he will name his second wife as the beneficiary of all or part of his estate. Even if the surviving husband does not make his second spouse a beneficiary, without an appropriately drafted and executed prenuptial agreement, the second wife may make an "election against the Will" of the husband which, in Pennsylvania, would entitle her to approximately one-third of the husband's estate. While it was likely the intention of the deceased wife to allow her husband the benefit of her assets, almost without exception, there was never the intention that the second wife be able to divert those assets, in whole or in part, from her children.

Similar situations, i.e., the unintended diversion of assets, can arise in the case of outright transfers to children. For example, a daughter, the beneficiary of a family gift or a parent's Will, has a simple Will leaving her entire estate to her husband. Particularly if there are no children of that marriage, on the death of the daughter, her estate, including any assets received from her parents, will likely pass to her husband and it would not be uncommon for his estate, which would then include any inherited assets inherited from his wife, to pass to <u>his</u> family under the terms of his Will. Even if there are children but the son-in-law remarries, not only can he divert the assets voluntarily to his second wife, but, as described above, if he designates his children (or specifically the children from his first marriage) as the beneficiaries of his estate, in the absence of a prenuptial agreement, the son-on-law's second wife can elect against his Will allowing her to claim against the son-in-law's estate, including the assets inherited from the daughter's parents.

Outright bequests also expose the inherited assets to loss at the hands of the beneficiary. This can occur through ill-advised investments by naïve beneficiaries (or poorly chosen advisors) or from risky business adventures funded by new-found wealth. It is often alarming how gullible otherwise sophisticated persons can be in investing with friends in "can't miss ventures."

Finally, and perhaps most troubling, sudden access to any substantial amount can sometimes result in repressed personality issues becoming self-destructive opportunities. Beneficiaries with addictive personalities, if given unfettered access to any significant amount of money, can easily fall prey to their own demons. It could be a chemical, alcohol, opioid or other dependency, a gambling addiction or other compulsive behavior that might be fueled by a sudden influx of an inheritance.

These unwanted situations need to be considered and can often be addressed through the use of trusts. While trusts have often been used to reduce or defer the Estate Tax, historically, the purpose of trusts has been to preserve and protect assets for the benefit of the beneficiary, keeping those assets safe from loss, dissipation, creditors and predators.

A trust is an arrangement whereby one person, the grantor or settlor, places assets in the hands of a trusted advisor, the trustee, for the benefit of a beneficiary. In the case of trusts created during the grantor's lifetime, the trust may remain subject to amendment (or even revocation) by the grantor or may be irrevocable. A testamentary trust, funded only upon the death of the grantor, is by definition irrevocable.

Once funded, the rules for the administration and distribution of trust income and principal are as set forth in the trust instrument. Although there is great flexibility in establishing such rules, there are some basic guidelines that are generally followed.

Where a spouse is the beneficiary, the trust typically provides for the spouse to receive all of the trust income in annual or more frequent installments. Principal distributions to the spouse may be on request or at the discretion of the trustee. (Where the trust intends to take advantage of the marital deduction as part of estate tax planning, annual distributions of income to the spouse is mandatory and during the life of the surviving spouse no one, other than the surviving spouse, may be a beneficiary of the principal.) On the death of the surviving spouse, any remaining principal often passes to the benefit of the next set of beneficiaries in line, typically children, to be held, administered and distributed as provided in the trust instrument.

Where minors are the beneficiaries, and for so long as the beneficiaries remain minors, the trust typically authorizes the trustees to expend income and principal as advisable for the health, support, maintenance and education of the beneficiary. Once a child reaches a designated age, typically 21 or 23 (the age by which the beneficiary's baccalaureate education is completed), the trustees are directed to distribute income leaving distributions of principal to the discretion of the trustees. The beneficiaries may also be given rights of withdrawal in lump sum or in installments, either at designated ages or over designated periods of time. However, because many states allow creditors to attach trust assets to the extent of a beneficiary's unrestricted right of withdrawal, these rights of withdrawal are often made subject to the trustees' approval, which approval is to be withheld if, in the judgment of the trustees, such a withdrawal would not be in the best interests of the beneficiary.

These are merely some typical provisions of trusts. The actual provisions to be included in any person's documents will be as specified by the grantor in consultation with his or her attorney.

The "bottom line" is that only you can protect your heirs and your assets from creditors, predators, folly and diversion. Postponing placing these protections in place can be fatal to your estate planning goals.
