Price & Farrington's Estate and Tax Planning *Fast*Facts

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Estate, Tax and Family Wealth Planning for Advisors and Clients

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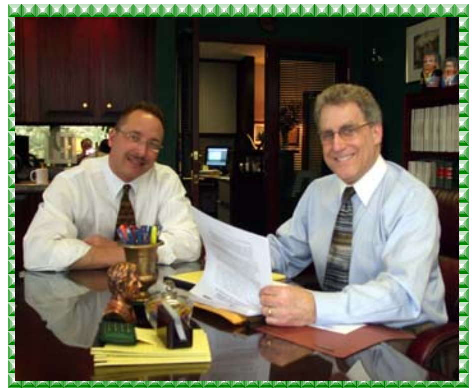
What Your Clients Want to Talk About Now: *Asset Protection*



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You'd think that with interest rates at historic lows, assets highly undervalued and the prospect of a permanent estate tax, estate planners would be deep in tax-planning sessions with clients. [*See* our February, 2009 *Fast*Facts "A Perfect Time for Some Estate Planning Techniques".] But, instead of taking advantage of this "perfect storm" for wealth transfer strategies, many clients are frozen with fear.

The wealthy and the not-as-wealthy alike have lost substantial assets. Loss is loss, and this loss goes way beyond money. Many people have lost faith in the institutions, the professionals and even in family members upon whom they used to rely as advisors and guardians for themselves and their children. Bernard Madoff, now convicted for running the largest Ponzi scheme in U.S. history, not only lost his clients' life savings but also their children's legacies held in trusts he managed.

It's not just Bernie. Clients may no longer trust investment advisors after losing half of their net worth this past year. After the convulsions in the banking industry, clients might question the trust company they appointed as trustee of their family trusts. Maybe they're wondering if a relative appointed as guardian of minor children really possesses good judgment after all. And, in good times or bad, given the divorce rate in the U.S., every future spouse is potentially a future ex-spouse.

"I've decided to step down as your C.E.O. in order to spend more time in jail…"

No wonder many clients are thinking about all of the risks to their legacies that aren't tax-related. They don't want to talk about fancy trust strategies. If they want to talk to advisors at all, they want to talk about basic ***asset protection***. It's a good discussion to have — and even for advisors to initiate. Really, **the fundamental purpose of estate planning is to protect a client's assets** — from a ***spendthrift beneficiary*** or from a ***creditor*** or from a ***predator*** (i.e., a divorcing spouse) or from an incompetent or untrustworthy ***trustee***. The plan might even provide a system of checks and balances by spreading responsibility among various institutions or individuals.

So here's what you can discuss with clients: some *non-tax risks* they face and methods to remedy those risks.

Make sure children are not stuck with a bad trustee. In choosing the critically important trustee, sometimes it's hard to foresee who'll do a good job. [*See* Jan., Feb., March, 2007 *Fast*Facts: "How To Be a Trustee" Parts 1-3.]Clients can protect against bad trustees by having their trust instrument contain a provision for the *trustee's removal*. The trustee should also be given the *power to resign* in case a beneficiary's behavior becomes too hard to handle. A list of *successor trustees* facilitates an efficient change of trustee. A provision should also be included that governs the appointment of a successor if there are no longer any named trustees. *Beware:* Giving complete *carte blanche* to remove and replace a trustee runs the risk that the beneficiary will shop around for the most compliant trustee.

Trust protectors aren't only for offshore trusts. *Trust protectors* are increasingly included in domestic trusts. They are given oversight powers over trustees. A trust protector could be given veto power over trustees' decisions, such as distributions. They also may have the power to remove and replace the trustee or to alter or update a trust provision.

Question if all trusts really have to distribute a third of the assets when a beneficiary is 25 years old, half when the beneficiary is 30 and the balance at age 35. Consider alternatives. Often, clients are told that *staggered principal distributions* offer a child the opportunity to learn financial responsibility over a period of time. But a child might never be able to manage his own financial affairs, let alone a large mandatory distribution based purely on his age. Clients can instead create a ***lifetime trust*** for a

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child with the trustee granted broad, discretionary distribution powers. At the child's death, any remaining trust assets can pass to grandhcildren–or remain in trust for their benefit if they need similar protection. To provide some additional flexibility, the child may be given a ***limited testamentary power of appointment*** (perhaps at the discretion of the trustee) to pass the estate on to the grandhcildren in the most meaningful way.

A trustee's authority to make discretionary distributions can protect against a child's *creditors* or *predators*. If the beneficiary has a limited interest in the trust property, it may not be attachable by the beneficiary's creditors. The beneficiary's interest can come into existence only when (and to the extent that) the trustee decides to make a distribution to the beneficiary.

In a discretionary trust, neither the beneficiary nor the beneficiary's creditors can force the trustee to make a distribution. A creditor, such as a divorcing spouse, acquires the same rights to the trust assets as the beneficiary. Hence, *an independent trustee with total discretionary authority to make distributions can provide substantial asset protection for the beneficiary.*

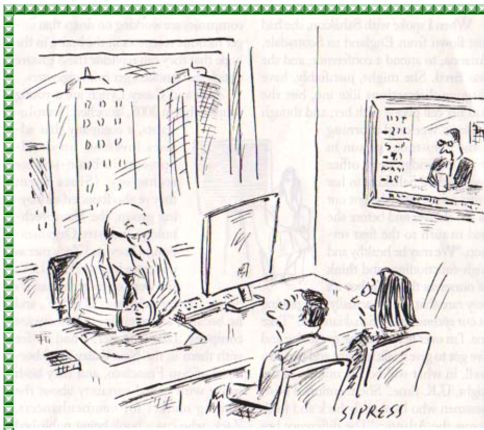
Keep in mind that if a trustee's discretion is limited by *standards*, such as health and education, the conduct of a trustee of a discretionary trust can be reviewed by a court and found to be an abuse of discretion, possibly forcing the trustee to disgorge assets to a creditor.

Protect against children's potential to be irresponsible. Even if a child is irresponsible only once, it could cost him his inheritance. If a trust doesn't contain a ***spendtrhrift provision***, the beneficiary may have control over her trust assets by selling them or giving them away. Also, the beneficiary's creditors may be able to reach the beneficiary's interest to satisfy their claims. The spendthrift provision provides significant asset protection by prohibiting the beneficary's voluntary or involuntary alienation of his/her beneficial interest.

Protect against divorce. Clients often fear that a child will make a poor marriage choice. Typically, they don't want the former daughter-in-law or son-in-law to continue as trustee or beneciary of their child's trust. And they are very concerned that this ex-spouse might receive assets from the family trust.

Estate plans should always assume that divorce is a possibility. A trust can include a provision that requires the marriage to remain in effect for a spouse to continue to serve as trustee or to receive trust distributions as a beneficiary. When clients want to name a beneficiary's spouse as a beneficiary of the trust, they should consider naming the beneficiary's spouse by reference to a defined term rather than by name (e.g., "my son's wife"). In this way the beneficiary's spouse is excluded upon a divorce, and the beneficiary's new spouse is automatically included.

Consider extending a child's interest. A trustee may be given the discretion to extend the *trust term* beyond its stated termination date. This permits the trustee to hold back an otherwise mandatory distribution of trust assets. This can be useful when a trust is terminating at a time when the beneficiary is facing a potential creditor. The provision effectively changes the trust to a discretionary



"What should you do? Invest in a time machine, go back 16 months, and convert everything to cash."

trust, thereby protecting the beneficiary's trust interest from creditor claims. The trustee may have the obligation to justify to the beneficiary (and to a court as well) its decision to withhold what would have otherwise been a mandatory distribution.

Consider discretionary trusts for multiple beneficiaries. The trustee may be given discretion to make distributions among a *group of permissible beneficiaries*, with no duty to treat them equally and with the ability to exclude a beneficiary from receiving distributions. This power helps avoid freezing the trust distributions simply because one of the beneficiaries is in trouble with a creditor.

Simple, but on target. None of these techniques are complicated. But clients will appreciate it if we sense that they are nervous and provide practical ways that they might circle the wagons around the wealth that they still have. *Meeting clients' concerns is the essence of good counseling.* Only then might they be eased into understanding that now is also an excellent time to consider all those tax-saving strategies.

10 Years of *Fast*Faxts!

This issue rounds out <u>10 full years of Price & Farrington's monthly Estate, Tax and Family Wealth Planning FastFacts</u>. We published our first issue in May, 1999. We hope these columns continue to be of value to our clients, our trusted colleagues, and to anyone interested in learning about the very best ways to protect themselves and their family with smart estate, tax, asset protection and wealth preservation strategies. All ten years of back issues are archived on our website at www.pricefarrington.com.

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