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

April, 2003

Estate, Tax and Wealth Planning for Advisors and Clients

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Children in a Rowboat and Other Potential Estate Planning Mistakes – Part 2

This month's FastFaxts concludes a two part article. Part I, which appeared in our January '03 issue (available on request), made the following points:

Although some estate plans fail because of tax errors and poor drafting, others miss the mark because of design errors or people mistakes. Drafting legal documents correctly is important, but so is avoiding "big picture" mistakes. For example, a QTIP trust might be drafted correctly from a technical standpoint for the surviving spouse to maximize tax savings. But it's a disaster if it promotes major family discord.

A potential danger exists when parents leave a complicated asset (e.g. a beach house or family business) jointly to the children or require their offspring to do a challenging job together – such as serving as trustees. When parents want to put "Children in a Rowboat" together, it's important for the advisor to help the client evaluate whether the plan is likely to become divisive and, if so, to help the kids deal with a problem if one develops. Even the best-designed estate plan can become a disaster if the wrong executor or trustee is left in charge. Some additional issues:

The Client Without a Philosophy. We have a role to play with clients that goes far beyond well-drawn wills and clever tax strategies. Advisors can help make good things happen for clients with discretionary wealth (i.e., money to take care of the basics comfortably along with assets to direct to other good causes) by helping them think about their "wealth philosophy", which will inform the choices they make in designing their estate plans. For example, many clients don't realize that their plan (if they have one) for their children leaves too much or too little, in the wrong way, too soon or too late, with too many or too few conditions attached.

Clients need our help devising a plan that reflects what they want to achieve from their financial success. A tax-saving plan that fails to look at bigger issues is like constructing an elevator that never gets to the top floors of the building. Helping a client use their wealth in creative and thoughtful ways is a valuable service that goes beyond the basics.

The "Off-the-Rack" Planner. Estate planning attorneys with a blind spot use a standard form to fit all sizes, as though a size 38-regular or 42-short fits every individual regardless of size. But the need for tailor-made treatment is not uncommon. Sometimes slight modifications of standard forms will do the trick—shortening the sleeves here or letting the waist out there. In other cases, specific family circumstances and goals might call for custom tailoring. Even if there is a bit of extra cost involved, the planner should offer this kind of service to the client, and the client's family will reap huge dividends.

"I take it, then, that opinion is divided along family lines?"

The Powerless Trust. I'm surprised at the number of trusts we see that fail to include effective "powers of appointment" (the right given to a person to select -within limits- who should receive an interest in property and how and when) to be exercised during life or at death. The "rigid" trust often won't work over a long period. Things don't stay the same: laws; investment results; family needs; social norms – they all change. The power to accommodate change can be given to the trustee, a beneficiary, or a third party; but it needs to be given to someone. Well-drafted powers of appointment not only permit flexibility in responding to circumstances; they often allow technical or tax problems that arise in the future to be addressed easily and inexpensively. Moral of the story: beware of powerless trusts unless you think that things will never change.

The Unintended Taxpayer. Here's a

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"He that won't be counselled, can't be helped."
-Benjamin Franklin

problem that often causes family members to want to shoot someone: one beneficiary gets certain property but somebody else has to pay the estate taxes on the transfer. Example: Mom leaves a $500,000 beach house to her daughter and leaves the $1 million residuary estate (the balance) to her two sons. Does that provide the same amount of inheritance to the three children? Nope. If the will doesn't address the payment of estate taxes, state law may provide that the daughter takes the beach house free of liability for the estate taxes (including those attributable to the beach house!), which will be paid out of the residue. The sons get substantially less, even though that wasn't Mom's intent. These types of issues need to be addressed squarely in order to avoid family turmoil.

The advisor has got to be on high alert to make sure that the tax liability lands in the right place whenever the recipients of assets are not the same as the residuary beneficiaries. This problem can arise with specific bequests under a will as well as with life insurance, property subject to a general power of appointment, QTIP trusts, joint tenancy assets, distributions from IRAs and qualified plan accounts, and other non-probate assets. Clients won't think about this without the estate planning attorney's help. And failure to deal with this issue could subject the members of the estate planning team to the wrath of beneficiaries who feel sure that they have become "unintended taxpayers".

The Client Who Mistook a Will for an Estate Plan. Clients can be shocked when they're told that their will looks fine but that it controls little or nothing of their estate. Non-probate assets such as real estate titled in joint tenancy with right of survivorship can pass outright, doing an end-run around the will. A good advisor can help avoid a deadly disconnect between a client's will and a client's assets. How assets are titled and how beneficiary forms are completed is extremely important and can subvert the plan, resulting in the "Client Who Mistook a Will for an Estate Plan".

The Unnecessary Trustee. Planners should help clients achieve the goals of simplicity, privacy and keeping their affairs within the family. Sometimes, though, it's necessary to have a trustee who is not a beneficiary or an immediate family member. Example: A beneficiary who is the sole trustee of a trust that permits discretionary distributions will have the trust assets included in his taxable estate. Not a good result. But if the trustee's powers to make distributions to himself are limited by "ascertainable standards", as defined in IRC §2041, there is no tax reason that the beneficiary cannot be the sole trustee of that trust (assuming technical provisions are properly drafted). The client might not want the beneficiary to be sole trustee for other reasons, but that's a different issue.

There is a lot of confusion about this basic tax point because so many trusts are drafted to include an unnecessary trustee on a client's mistaken assumption that it was necessary to name a trustee who is not a beneficiary.

What's the moral here? Planners shouldn't add to the hassles of trust administration for clients by naming a trustee outside the immediate family unless there is a good tax or non-tax reason for doing so.

This two part article (including our January, 2003 *Fast*Faxts) doesn't exhaust the list of design or non-technical problems that frequently occur in estate planning. The full list is much longer. Our goal has been simply to spotlight some of the more important problems that can come about even with a will or trust that is technically perfect on the surface. You can provide better results for your clients by reviewing their estate plans and directing them to a competent estate planning attorney who is mindful of the Children in a Rowboat, the Overstuffed QTIP, the Clueless Fiduciary, the Off-the-Rack Planner, the Powerless Trust, the Unintended Taxpayer, the Client Who Mistook a Will for an Estate Plan, and the Unnecessary Trustee.

As always, please let us know how we can best help you and your clients accomplish important goals through proper planning.

Glen D. Price

FYI

An IRC §412(i) defined benefit pension plan is a legal way to obtain large, annual income tax deductions, full-creditor protection for the plan assets and a fully guaranteed retirement income.

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Call us if you would like more information.