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

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Estate, Tax and Wealth Planning for Advisors and Clients

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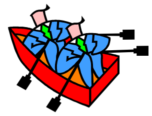
Children in a Rowboat and Other Potential Estate Planning Mistakes



As estate planning attorneys, we like to remember those plans that made our clients and their families happier, more secure or both. Sometimes, though, it's more instructive to analyze why things go wrong; why a client's plan has ended up not so much with technical flaws as with "design" or "people" mistakes.

A major task for the estate planning professional is to find the best way – within the client's time and attention tolerance levels– to educate him or her about the pros and cons of different choices so that the client makes decisions that are thoughtful and informed. The quality of the estate plan will be directly related to the quality of the planning conferences with the client.

Here is a brief review of some points in the planning process where planners want to be sure not to make big picture mistakes.

Children in a Rowboat. The number one opportunity for an estate plan to go wrong occurs when parents tie the children to the same asset or require the children to do a job together as a group. This can happen when a parent names several children to serve as executors of a complicated estate, to run the family business, to share an expensive house or even to distribute assets of the family foundation. I refer to this as "putting children in a rowboat" because it is a metaphor clients easily grasp.

Danger. Imagine loading the children into a rowboat on a big lake and requiring them to agree on one destination when their rowboat can only go in one direction, no matter how many passengers it holds. A client might desire the children's common ownership of the beach house. Is that idea likely to succeed? Will the joint ownership become divisive when one child thinks the group should pay for a new kitchen or wants to sell and move elsewhere? It's very difficult for children with different financial profiles, different values or different residential states to be on the same track at all times with each other, not to mention with their respective spouses. Plans that require children to agree among themselves when their parents are gone are filled with danger. Requiring a majority vote in order to supersede the normal legal requirement of unanimous decision-making for fiduciaries (trustees or executors) will often not solve the real problem. An outvoted child will dislike the others for "just looking out for themselves".

Battle of Wills: Planning to Avoid the Family Fight

Many boomers who expect to inherit money from their parents could be disappointed: family assets have dwindled or their parents haven't given them any information about their finances or estate plans. Problems have increased because of changes in family structure: increase in divorce and remarriage and confusion about rights of stepchildren and second spouses. Boomers find they're fighting with family members over who gets how much. Lawyers and planners need to spend more time helping their clients plan to avoid family disputes after death, even if the method of distributing assets results in higher tax costs. Saving the family trumps saving taxes every time. ■

"Someday, Son, this will all be yours— assuming I can get my father to give it to me.!"

Yellow flag. A critically important goal for most clients is that they don't want a legacy to result in their children avoiding (or worse, suing) one another. Don't we owe the client at least a yellow flag –or sometimes a red one– when a suggestion is made to put the children in the same rowboat as executors, trustees or beneficiaries?

If, after the yellow flag has been waved, the client still wants to name the children as co-fiduciaries or joint owners, the thoughtful planner should suggest ideas that will help the children work things out if getting along becomes difficult. A mandatory buyout or sale provision might help. Parents can plan to allow a division of assets instead of having those assets become a divisive factor in the family.

Sink or swim together. Sometimes it's not only desirable but necessary to put the children in the same rowboat. How about where one child runs the family business (typically as a salaried executive while the parents own all of the stock) and another child has nothing to do with the business, which represents most of the family wealth. If a majority of the stock is left to the child involved in the business, the other child who is given a minority interest might end up with a piece of paper that provides little current value. Forcing the children to "work things out" by giving them equal amounts of stock and putting them into a deadlock might be the only practical alternative in some cases. This plan will work much better, though, if it also includes a mandatory or suggested method that allows one child to buy the other child's interest if the two cannot work things out. The threat of that possibility might lead the children to treat each other well enough so that the family business can be preserved under terms that benefit both children, or its value can be maximized for a sale.

Pot trusts. A pot trust holds assets for multiple beneficiaries. This can cause significant problems for families. When the beneficiaries have very different needs, values and expectations, it can be difficult for a trustee to determine what's fair and appropriate in making investment and distribution decisions. If done properly, the law now allows a way to put some children out of the pot trust and into separate rowboats, a happy development for many families.

Three related points. (1) There is no rowboat problem when a client names two children as executors of an estate than consists of assets that are not likely to create problems. (2) It is important to deal expressly with the right of those named as trustees to be compensated fairly for their services. The parents need to set the rules so that no child can fairly complain about the fee taken by a sibling. (3) The rowboat metaphor doesn't cover another high risk situation involving children: naming one child trustee of *another* child's inheritance. That decision will likely guarantee that they end up disliking or even hating each other. Naming one child as trustee for another child is acceptable only if there is no other realistic alternative, and that's almost never the case. Bottom line: when a client suggests putting the children in the same rowboat, we ask whether the plan will work well and whether the client should build in features that will reduce the pain if it doesn't.

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

The overstuffed QTIP and related issues. In many cases, the wealthier spouse opts to put everything except the house in a QTIP trust to assist the surviving spouse during the rest of his/her life and then pass the assets on to the children. The estate planning attorney should raise three key questions to make sure this plan works. Does the client realize that: (1) the QTIP trust makes it much more difficult to implement strategies to reduce estate taxes when the surviving spouse dies; (2) the children cannot receive principal from the QTIP while the surviving spouse is alive and might be 65 years old before the trust assets benefit them; and (3) unless the surviving spouse is the sole trustee, the spouse will have to ask the trustee or co-trustee for money whenever the spouse needs or wants more than the net income. Invasion of principal can create tensions between the spouse and the remainder beneficiaries (e.g., children or stepchildren). Properly drafted "unitrust" provisions can avoid this problem.

Bottom line? The planning attorney's job is to explain the pros and cons of seemingly conventional transfer strategies so the client has enough information to make a thoughtful choice.

The clueless fiduciary. When estate or trust administration becomes really messy, the "clueless fiduciary" is often to blame. The inadequate executor or hopeless trustee comes in many forms, including: (1) the penurious surviving spouse torn by indecision and inexperience who is unwilling to pay the accountant or lawyer's hourly fee to get the job done right; (2) the trustee-child with no fiduciary experience who fancies himself an investment genius and won't seek professional guidance, and; (3) the trust "specialist" in a startup bank who's had a short cram course on estates and trusts since moving from the lending department.

A client is done a disservice when the attorney blithely accepts their suggested line-up of fiduciaries without some interrogation. Clients tend to focus on naming relatives and friends because they resist naming a professional fiduciary. Depending upon the circumstances, though, the corporate fiduciary can be not only a good idea, but the best choice. In addition to banks, skilled individuals (often former trust officers or lawyers) may be hired to act as fiduciaries. For every bad bank experience we've heard about, there are ten other situations where individuals messed up even more. Naming an individual as *co-fiduciary* with the power to change banks might be the most effective compromise. Bottom line? The choice of trustee, agent or executor is one of the critical issues in good planning. We encourage candid and thoughtful discussions with our clients on this subject in an effort to reduce the chances of an excellent plan turning disastrous in the hands of the clueless fiduciary. There are too many of them lurking in plans already in place out there. As well as too many ill-advised instances of children in the same rowboat...

Glen D. Price