THE WALSHLAW REPORT

Advisors in Estate Planning, Elder Law, Taxation, Business Law **Winter 2009**

CREATING YOUR OWN DYNASTY -

YOUR CHILDREN AND GRANDCHILDREN WILL THANK YOU

Most clients, when asked how they would like to have their estates distributed if there were no such thing as taxes to be considered, tell us they want most everything to go to their spouse, or to be divided among their kids if their spouse is not living. After calculating the potential estate or inheritance taxes, most clients want to create a structure that comes as close as possible to giving their spouse outright ownership of property, yet keeps that property from being part of the spouse's estate for tax purposes, ultimately minimizing, if not eliminating, estate taxes for their children and grandchildren.

Most of our clients know this involves leaving property in a trust for the benefit of your surviving spouse upon your death. In many estate plans, (1) the surviving spouse is designated as the trustee, (2) the trustee (surviving spouse) can use the assets in the deceased spouse's trust for health, support, maintenance or education (magic language from the estate tax regulations in order to exclude the first spouse's trust assets from the calculation of the second spouse's estate tax), and (3) the surviving spouse has the power (whether narrowly focused or practically unlimited) to alter how the first spouse's trust is distributed upon the second spouse's death.

With this approach, the surviving spouse has practically complete control over the first spouse's trust assets during the balance of his or her lifetime. Yet the first spouse's trust assets (including any appreciation in value) are not subject to estate tax when the second spouse dies. Furthermore, if the surviving spouse later got into financial trouble, such as a huge judgment from a horrific motor vehicle accident that exceeded the surviving spouse's insurance coverage, the assets in the deceased spouse's trust *should* be exempt from the claims of the surviving spouse's creditors. The surviving spouse's other assets might be fair game for the judgment creditor and his attorneys, but at least the deceased spouse's assets *should* be protected.[1]

With these benefits of control yet protection from estate taxes and potential creditors, does it make sense to terminate the trust and just distribute assets outright to children when the second spouse dies? In an increasing number of cases, we think not.

Instead, let's keep those benefits for the children and future generations. We'll still divide up the estate between or among the children, but we'll maintain each child's share in a trust. Assuming each child is old enough and able to do so, we name each child as the sole trustee of his

[1] Although we believe this analysis to be correct under current law, we cannot guarantee results. At the very least, the surviving spouse should resign as trustee if any event occurs that might create a large potential liability.

or her share. As trustee, each child can use the trust funds as needed for health, support, maintenance or education. The child can have the power to direct how the trust fund is distributed upon his or her death, but if they don't exercise that power, their share of the trust will be divided among their children, and the pattern will repeat itself generation after generation until someone down the line changes it. The child excludes the trust assets from their own estate tax, and can protect the trust assets from the claims of their own creditors[2], including a future ex-spouse. Over the past ten years or so, a combination of law changes and cases have occurred to make this pattern feasible.

First, the generation-skipping transfer ("GST") tax exemption has increased from $1 million in 2003 to $3.5 million today. The GST tax is a separate and additional estate tax that applies when a lot of property goes down two or more generation levels below the transferor. But, the GST tax exemption is measured by the value of what initially went into the trust, not by what eventually is distributed from it. So if $3.5 million is placed in such a trust today, and $70 million is distributed from the trust to great-grandchildren 60 years from now, the whole amount still escapes any additional estate tax or GST tax.

Second, Maryland has joined a number of other states in repealing or limiting the "Rule Against Perpetuities," a hold over from English common law that said, in effect, that a trust could only last for the lifetime of the current generation plus 21 years.[3] Maryland law has allowed trusts created after September 30, 1998 to opt out from the Rule Against Perpetuities.

Third, many states have expanded and strengthened the rules regarding the exemption of trust assets from execution for the liabilities of trust beneficiaries. In Maryland, this principle was upheld in the court case of *Duvall v. McGee*[4], where Maryland's highest court clarified and reiterated the principle that assets of a trust (not created by the beneficiary himself) could not be attached by a beneficiary's judgment creditors.

We realize that this approach is counter-intuitive, but most of our clients who have heard this recommendation adopt it. Let's consider some other factors.

Isn't there a lot to do in maintaining the trust? The trustee needs to keep the trust assets in one or more separate accounts, and file a separate income tax return (federal form 1041 and Maryland form 504) for the trust each year. In general, to the extent that the trust distributes income to a beneficiary in any year, the beneficiary pays the tax on that income. If the trust retains income, it pays the tax on that income itself.

What if my son or daughter needs the money? They can use it, as long as they use it for "health, support, maintenance or education". If they can't justify a distribution on one of those four standards, it's probably not a distribution worth making.

Won't setting up their inheritance in trust show that I don't trust my child? No, or we wouldn't be naming them as their own trustee. They are still in control of their inheritance; you are just affording them the opportunity to protect that inheritance from an ex-spouse, other creditors and additional estate tax.

[2] The same caveats as noted at footnote 1 apply.

[3] This is a very shorthand description of the Rule.

[4] "Bad Facts Make for Good Law", *Walshlaw Report*, Spring-Summer 2003.

Are there other advantages to creating such a trust? Although we don't know of any studies yet showing this to be the case, we believe that putting the inheritance in a segregated trust fund, even one controlled by the beneficiary, will earmark those funds in the beneficiary's mind and encourage the beneficiary to preserve those funds to be used only when truly needed.

I have a modest estate, isn't this overkill for me? Albert Einstein once remarked that the most powerful force in the universe was compounding interest. Call us skeptical, but we believe that the long-term trend for taxes is up, both in the form of tax rates and lower exemptions. Even if you don't have an estate tax problem today, your children or grandchildren may well have significant estate tax problems down the road. Just like you should do what you can to take advantage of the current economic environment[5], you should do what you can to take advantage of the current legal and tax environment. Assume that you have an estate of $500,000 now that is not subject to estate tax, but will be subject to federal and state estate taxes of 50% for your children and grandchildren. Let's also assume that the trust grows at the rate of 8% per year, and that each generation is an additional 30 years. Here's a summary calculation of the difference to your children's and grandchildren's estates:

	Subject to Estate Tax	Estate Tax Exempt
First Generation (Children)		
Gross Value	$ 5,031,328	$ 5,031,328
Less Estate Taxes	- 2,515,664	- 0
Net: Next Gen.	$ 2,515,664	$ 5,031,328
Second Generation (Grandchildren)		
Gross Value	$25,314,264	$50,628,527
Less Estate Taxes	-12,667,132	- 0
Net: Next Gen.	$12,667,132	$50,628,527

By avoiding a 50% tax every generation, in two generations your family will have four times as much wealth.

If this is such a great tax saving idea, why does the IRS allow it to stay on the books? As a matter of fact, this issue has now attracted the attention of Congress. However, historically Congress has always grandfathered existing irrevocable trusts from later changes in estate tax laws; and any new law would likely limit, but not completely repeal, the benefits of this approach. This is not yet a major issue for Congress, just a blip, and the most likely legislative remedy would be to enact a sort of Rule Against Perpetuities for estate tax purposes. Even so, as the example above shows, keeping your estate free from estate taxes for only two generations can provide significant benefits to your family.

If you are interested in providing "dynasty trust" provisions in your estate plan, please contact our office.

Walsh & Company, P.A.
Suiting Your Needs In The Following Areas:

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5 See "Planning in a Down Economy" also in this issue.

Elder Law Corner

Don't Be A Victim of Boilerplate Word Processing

A principle of good estate planning is that there is no "one size fits all" estate plan. Every estate plan should be customized for the particular needs and desires of a family or individual, whether or not the estate is "taxable" (in 2009, over one [1] million dollars for state estate tax purposes, or over three and one-half [3.5] million dollars for federal estate tax purposes). This is especially true concerning estate planning for seniors.

Nonetheless, many estate planners take a robotic approach to estate planning for seniors with non-taxable estates. As a result, often times templated documents are used and the client becomes little more than a victim of word processing. To prove this, allow me to become a psychic for a few moments. Take a look at your will. It probably says something like the following: "I leave everything to my spouse, if he or she survives me, or if not, I leave everything to my children in equal shares, per stirpes. I appoint my spouse as my personal representative, or if not, I appoint my children as my personal representatives. I excuse my representative from posting bond", and so forth. Am I correct? If so, you are possibly a victim of word processing and not a beneficiary of good estate planning.

Beyond mere customization of documents, because seniors with non-taxable estates currently do not have tax problems as much as they have long-term care and asset protection problems (this may change in the future depending upon the status of estate tax applicable exclusion amounts), estate planning for seniors with non-taxable estates should involve a philosophical analysis of the client's particular goals and desires, to include the following considerations: (1) the state of the client's health and/or the health of their spouse, (2) the client's desire to protect their assets, (3) the desire for asset protection relative to the desire to maintain current lifestyle and total control of assets for as long as possible, (4) the client's feelings about the probate process, (5) the client's desire to protect the shares of their children (or other beneficiaries) from creditors, predators, and the ramifications of divorce, and (6) specific instructions about the client's personal care and lifestyle choices that the client would like to make known in the event of incapacity.

These few questions illustrate the kind of thinking that should go into the initial phases of estate planning and the considerations that ultimately dictate what type of planning is most appropriate. For example, where a client wishes to maintain complete control over their assets and has no desire to engage in a strategy to protect their assets from long-term care draw down, what I call "regular" estate planning (either simple or complex) would be appropriate. In those cases where a healthy spouse wants to maintain complete lifetime control of his or her assets but wants to protect the interests of their ill spouse in the event that they (the healthy spouse) were to die first, we would engage in some type of "intermediate" asset protection plan. And finally, where full asset protection planning is desired and appropriate, that type of estate planning should be implemented.

In summary, estate planning for seniors with non-taxable estates is not a simple proposition. On the contrary, such planning should involve complex considerations based upon all available facts and best assumptions to achieve the client's goals. If you have been a victim of word processing, consider having your estate plan reviewed so that you afford yourself the opportunity to thoughtfully consider all of the details that should go into your best estate planning.

PLANNING IN A DOWN ECONOMY-
Does Your Estate Plan Still Make Sense?

Most, if not all of us, are feeling the need to tighten our belts in the current economic climate. If we have recently bought a home or borrowed against our existing one, we may be "upside down" on our loan. Perhaps you simply are less wealthy as you see equity in your home or the value of your 401(k) and IRA dwindle. Despite the feeling that our belts are getting tighter, the new economic climate is the appropriate time to review and be sure your estate plan still makes sense. Just because the economy has taken a nosedive does not mean you get away with putting your long-term estate planning on the shelf.

Just as you see yourself cutting costs in your day-to-day lifestyle (shortening or canceling vacations, clipping coupons, eating out less, driving at the speed limit to save gas), you can take steps to cut costs that your estate might face if you neglect to plan properly. Most of these tips apply in economic boom times just as equally as they do in economic gloom times.

Though you might be gone when the time comes to administer your estate, your loved ones will still be here to clean up the mess. If you take the right approach while you still can, you can tidy up that mess and prevent most of your assets from the probate process which can tie up your money and property for an extended period of time, causing headache on top of heartache for your surviving heirs. To make matters worse, if you are the primary source of income for your family, your accounts might be frozen after your death, making it very difficult for your loved ones to handle their own affairs.

One way to eliminate the concern over how your surviving spouse, partner, or children will pay the bills (or how they will survive at all, given the massive decline in many of our retirement accounts) is through a life insurance policy. If you're in a marriage or long-term relationship, chances are you own your home jointly. However, if the house is mortgaged, your survivor will still be on the hook to make the payments. Purchase enough life insurance to cover the balance of the mortgage, and what is most likely your largest purchase (and therefore your largest expense) can be paid off as soon as the insurance pays out.

If you have a revocable trust, are all of your assets included in it? If you purchased a new home or vacation property after forming your trust, be sure the deed shows the trust as the owner. Keep in mind that a trust can help you avoid probate for most of your assets, but it is difficult to avoid it entirely. And avoiding probate does not mean avoiding taxes, necessarily. Your goal in avoiding probate should be to avoid headache, not your legal duty to pay taxes.

To that end, check the beneficiary designations on your retirement plans and brokerage accounts. If you were recently married, divorced, or had a child, this is very important. It is most likely that you do not want to see your nest egg go to your remarried ex-spouse or partner, nor do you want to neglect one or more of your children.

Review your will, as well. Are there any specific gifts that you have made to a loved one that no longer exist or that have severely depreciated? If to produce extra cash in this economy, you sold that 1963 Corvette that you left to your oldest son in your will, he will not receive any other gift in its place unless you make a revision to your will.

Do your current assets still suit your plans for distributing your estate? If you thought your husband would have enough money of his own to live on after you were gone and decided to leave your kids all your brokerage holdings, does that plan still hold water? Or is it time to reconsider?

Now what about those stocks that you have owned for more than a year that have actually *made* you money despite the doom and gloom on Wall Street? Many investment analysts and economists believe that the capital gains rate on investments will go up in the near future. If you sell off those stocks now and pay the current 15% capital gains rate, you will avoid paying an increased rate in the future. Sell now and take full advantage of the opportunity to offset capital gains with other deductions that are still at your disposal.

If, on the other hand, you have stocks that have lost you money, consider gifting those to loved ones. You can gift up to $12,000 ($24,000 if you are married) to a loved one without paying gift taxes. If you do this with a stock worth $6.00 per share today, and the stock goes up to $12.00 in April, you have effectively made a gift worth twice as much without owing any tax.

Whether you already have an estate plan or have been putting it off, there is no time like the present to evaluate what you have and how you want it to be distributed after you are no longer here. If history is any indicator (and it is), the market will be back and you will be glad to have put the matter of planning your estate behind you.

MINIMUM REQUIRED DISTRIBUTIONS SUSPENDED IN 2009

For those who are over 70½ and are, by law, required to take minimum distributions from their traditional IRAs or other Qualified Plans, the year 2009 has become an exception to the rule.

Just before skipping out of Washington for the holidays, Congress suspended the rule tacking on a 50% excise tax for those who fail to take minimum required distributions.

For example, Tom is 73 years old, and is required to withdraw $10,000 from his traditional IRA in 2008. If he does not, he would pay a $5,000 penalty in addition to the normal tax he would owe on the $10,000.

In 2009, however, that is not the case. With IRA balances down 30% or more from their 2007 levels, some relief has come in the form of this Congressional act. If you have the means to get by on funds outside of your tax-deferred accounts, you can pass on withdrawing any funds from those accounts in the hopes that, by the time required distributions recommence, the value of the securities in those accounts has rebounded.

The distributions won't stop without some action on your part, however. If you expect to receive a distribution that you would like to suspend, contact your IRA custodian or plan administrator to request a voluntary suspension. If you have already received a distribution for 2009, you have 60 days to return it and take advantage of the relief offered by Congress.

You are also free to take a partial distribution by receiving your 2009 minimum distribution and returning the portion you want to keep in your account. Another alternative, if you depend on the money, is to do nothing and take the distribution as usual. The choice is yours, as the relief is an "opt-in" program requiring you to affirmatively take advantage of the option for 2009.

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