

# FAMILY-FOCUSED ESTATE PLANNING



What goals and objectives would you like your estate plan to accomplish? Most people, upon reflection, might respond something like this:

- First of all, I want to provide fully for the economic security of my surviving spouse (assuming a spouse is in the picture).
- Next, I want to ensure that family members or others who depend on me financially are properly supported and cared for – especially those who are disabled or have special needs;
- I want to minimize any disappointment, family conflict or hurt feelings that might arise from the distribution of my estate;

- I would like to keep “death taxes” and probate costs to an absolute minimum, with more of my assets going to family and charities and less to the tax collector;

- I would like to leave the world a better place, and pass on what I’ve learned in life to the next generation.

Some people also have special situations that need to be addressed, such as the transition of a family business, or arranging for the care of beloved pets. And many would be pleased if the foregoing goals and objectives could be accomplished in the context of a plan that culminates in significant support for worthwhile causes and organizations.

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### SECURITY FOR A SURVIVING SPOUSE

It's common that one spouse will leave his or her entire estate to the surviving spouse, either by will, joint ownership, trusts or other beneficiary designations. The expectation is that the survivor's estate plan will provide for children and others. Through 2012, a surviving spouse can elect to retain the unused portion of the estate tax not used at the first spouse's death. This allows married couples to shelter up to \$10 million from estate tax. What will happen if either or both spouses have children from a prior marriage? Or if the surviving spouse should remarry? It's wise to consult an estate planning attorney who can anticipate all the contingencies that married people should consider and suggest estate planning tools that will accomplish a couple's goals and minimize taxes.

Many married couples know their estates can be tax exempt if they leave everything to each other – but sometimes that can create problems. Take the case of Richard. Richard was a widower for many years but eventually remarried and now is living in contented retirement with his new wife, Charlotte. He has eight grown children from his first marriage, all of them “on their own.” Richard has three major estate planning objectives: (1) that Charlotte be financially secure after he dies; (2) that most of



his estate pass to his eight children after Charlotte dies and (3) avoidance of all federal estate taxes at his death.

As much as Richard might trust Charlotte to leave his assets to his children in her will, he worries that she may remarry and leave everything to her new husband. Instead, Richard could direct that most or all of his estate go into a QTIP (qualified terminable interest property) trust from which the trustee would pay Charlotte only the trust income for life, then distribute everything to the children.<sup>1</sup> The legal effect is that he can “lock in” his children as trust beneficiaries when Charlotte dies, and everything in the trust will qualify for the 100% estate tax marital deduction at his death.

The QTIP arrangement helps in one's personal planning and saves taxes at the death of the first spouse. But note that there still may be a very large tax when the surviving spouse dies. So it may not

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be wise to leave everything to your spouse from a tax standpoint, or from a personal standpoint, for that matter. Many married people conclude, upon reflection, that there are others they should benefit – including worthwhile organizations – and that doing so will not jeopardize their spouse’s security.

### **BENEFIT FOR SPOUSE, CHILDREN AND OUR FUTURE**

You can plan your estate so that your husband or wife will receive a large part of your estate through a QTIP trust, with some or all of the trust property coming to us at your spouse’s death. The QTIP trust must pay all trust income to your spouse for life. Everything placed in the trust will qualify for the 100% estate tax marital deduction at your death, and anything passing for our benefit will qualify for the 100% estate tax charitable deduction at your spouse’s death.<sup>2</sup>

A spouse also can bequeath property to a QTIP trust that pays the surviving spouse income for life, then transfers into a charitable remainder trust for children. The charitable trust furnishes the surviving spouse’s estate with estate tax relief and gives the children income for life or a fixed term of years. Everyone benefits from such an arrangement.<sup>3</sup>

There are many ways for people to share



their estates among family members and worthwhile causes, often with excellent tax results. If you would like to learn more about the satisfaction of “charitable estate planning,” please write or call our office.

### **DESIGNING AN “HEIR-FAIR” ESTATE PLAN**

Few events cause sibling rivalry to rear its ugly head more than the death of a parent. As much as parents try, it’s usually impossible to divide an estate into precisely equal shares – and sometimes that’s not a parent’s goal. There are ways for parents to minimize friction, however:

- Talk with your children about your intentions, particularly if you are leaving more to one child than the others. This “favoritism” may be due to health problems, financial setbacks or to “even out” assistance given to others during your lifetime. Whatever the reasons, discuss the plans with your children. Don’t surprise them when the will is probated and leave them with the nagging question: “Why?”<sup>4</sup>

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■ A letter of instruction may prevent disputes over who should receive certain assets of sentimental value. Unlike a will or living trust, a letter of instruction is not a legal document, but it will express your wishes regarding items of personal property and can be updated without the formal requirements of a will. If it's important for one child to have a particular item, consider giving it to him or her now. A gift also removes the value of the asset from your gross estate.

■ If one child wishes to buy the family home, consider leaving it to him or her in your estate plan and dividing the rest of the estate among the other children. If the home represents a major portion of the estate, allow the child to purchase the other siblings' shares or place the home in a trust for the benefit of all the children. The child living in the home will pay rent that is then distributed to the others; he or she can also buy the home from the trust.

■ When designating assets for the children, consider valuation issues. Leaving the silver to one and an antique vase to another may seem "fair" today, but the assets may not appreciate at the same rate over the years. Having periodic appraisals will help determine if one child is reaping a windfall and will also assist the executor in appraising the assets for estate tax purposes.

### DON'T LET WALL STREET CREATE A BAD "HEIR" DAY

The ups and downs in the stock market make it important to review plans for how your estate will be distributed. Take a look at your will or revocable living trust to see if changes in stock values could result in some of your beneficiaries being squeezed out of their appropriate share. Take the case of Maureen, a widow who plans to divide her estate between her two children. Her will leaves her house and certificates of deposit, representing about one-half of her net worth, to her son Charles and the rest (her stock portfolio) to her daughter Sandra as a residuary bequest. The risk to Sandra is that her bequest will be devalued if the stocks have taken a downturn at Maureen's death. One way to avoid this possibility is to bequeath percentage shares of the estate, so that declines in the value of securities or other estate assets are shared proportionately by all beneficiaries. Another possibility is to anticipate potential reductions in value and provide for smaller specific bequests in the event one's total estate falls below a certain value.

Parents who wish to provide equally for their children should also consider the tax consequences of certain assets at death. How does one child benefit at the expense of others? In the previous example, suppose



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Maureen had left a retirement account, valued at \$500,000, to her son and her stock portfolio (also valued at \$500,000) to her daughter. It seems like a fair distribution, but the tax collector might cause a different result. If Maureen's estate is not liable for estate tax, both heirs benefit fully. But the child receiving the retirement plan benefits will owe income tax on the value of his inheritance. Maureen's daughter loses nothing to income tax because the stocks receive a step-up in basis.

State laws can affect what beneficiaries receive. For example, life insurance and retirement plan benefits generally pass outside probate. If the will directs that estate administration expenses and taxes are to be paid by the estate, the child receiving probate assets may pay tax on assets passing to siblings outside probate. A better option may be to name all children to receive assets jointly.

These situations may seem like technicalities, but they can spoil your planning. Check with your advisers to determine if

your estate plan takes taxes and other state and federal laws into account.

### FAMILY TRUSTS IN ESTATE PLANNING

In your will you can – and possibly should – create a family trust for your beneficiaries. Many of our friends have found that a well-planned trust will not “tie up” their property, will not be interpreted as a lack of confidence in their beneficiaries and will not be a burdensome expense. Indeed, you may find that a trust in your will is the best method of providing financial security for your family and other beneficiaries. The trust you create need not be complex. You simply direct, as part of your will, that certain property be transferred to a trustee, to be held and managed by the trustee for the benefit of the persons or institutions you name.

A husband, for example, may name a trustee of his own choosing to invest the trust property and to handle all the other burdens of property ownership. He will also make specific provisions for the future enjoyment of the property. “Pay all the income to my wife for her life” may be one direction given to the trustee. “Pay my wife as much principal as she needs for her customary support” may be an additional direction. The trustee may also be directed to divide whatever property remains at the wife's death equally among his children, or the husband may direct that the final distribution be made to the children as his wife may direct in her will.<sup>5</sup>

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The practical advantages of a trust are obvious. The trustee will take care of all investments and management, give the beneficiaries periodic reports, and even attend to the personal finances of the beneficiaries in times of illness or disability. The beneficiaries can have all the advantages and rewards of property ownership without its burdens and frustrations.

### OPTIONS IN TRUST PLANNING

In deciding whether a trust makes sense in your estate planning, consider these additional points:

- Trusts are highly flexible. You can tailor your trust to meet your own goals and the specific needs of your beneficiaries.
- You name a trustee of your own choosing and you define the powers and duties of the trustee.
- You direct exactly how the income will be distributed, when it is to be paid, to whom it is to be paid and under what circumstances changes can be made.
- You define the circumstances under which all or part of the principal can be paid out to a beneficiary.
- You direct how long the trust will last – for the life of one beneficiary or the lives of several beneficiaries, or until your children reach a certain age.

- You direct how the trust property is to be eventually distributed or you can permit someone else to determine the ultimate beneficiaries.

Other advantages? A trust created by your will may result in meaningful estate and income tax savings. Equally important, a skilled trustee may be the most able to conserve your estate and provide investment growth.

The flexibility of a family trust also permits our friends to split the enjoyment and the benefits of a single piece of property or a single fund of money between their families and our organization. This concept of providing dual benefits from a single property can also produce meaningful tax and financial rewards. Such a trust can split the benefits from a single property in either of two basic patterns:

- Give all the immediate benefits to your family for a period of time – with the property ultimately benefiting our programs.<sup>6</sup>

- Give all or part of the immediate benefits to us for a period of years – with the property eventually going to your family.<sup>7</sup> Both trust arrangements will help ensure our future. They will not impair the security of your family and can result in major estate tax and income tax savings for your family.



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### SPECIAL NEEDS TRUSTS OFFER SOLUTIONS

Parents who have a son or daughter with disabilities may find it inadvisable to leave that child a large inheritance. Adverse consequences might include:

- Disqualification from eligibility for various types of government assistance;
- Inability of the child to manage the inherited assets properly.

Government programs are needed for many disabled people, but government funding typically is not available for such items as over-the-counter medications, transportation costs to visit family members, reading material and even toiletries. Parents take care of these items during life, but worry about what will happen after they are gone.

Professional advisers often suggest such parents establish a “special needs” trust that will benefit the child but safeguard qualification for government assistance. The trust typically would allow the trustee discretion to provide nonessential services and items to the child, such as piano lessons or recreational equipment. These trusts must be carefully drafted to comply with state law.

- The trust must be specifically drafted to be supplemental, providing only “extras” for the son or daughter. Inclusion of words such as “health, education and

support” will cause the Social Security Administration to view the trust as “primary” – and eliminate or postpone government benefits.<sup>8</sup>

- Family members can serve as trustee, but parents often turn to commercial trustees – some of which have social workers and private care managers on staff.

- Some organizations operate master trusts or pooled funds to provide management services for funds from a group of individuals.

- Funding for a special needs trust can be accomplished through investments or, commonly, life insurance – especially a cost-effective second-to-die policy that pays out at the death of the last parent to die. If estate taxes are a concern, the trust can be established during life as an irrevocable life insurance trust that is structured to avoid gift and estate taxes.

- Parents should write a “letter of intent” to the trustee explaining the child’s history, setting priorities for care and services and stating their own hopes and expectations for the child.

### CHARITABLE REMAINDER TRUSTS CAN HELP

The IRS has approved charitable remainder trusts that pay income to a legally incompetent child for life, but with



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payments going to a special needs trust established for the child.<sup>9</sup> The IRS also has approved a plan where the charitable remainder trust was payable to a trust for the lifetime of a child for life who was merely “financially disabled.”<sup>10</sup>

The IRS said “financially disabled” trust plans are appropriate where the income beneficiary, by reason of a medically determinable physical or mental impairment, is unable to manage his or her own financial affairs. The trustee of the child’s trust could have broad discretion as to how much income or principal would be paid to the beneficiary, and could take into account government benefits to which the beneficiary may be entitled.

Assets in the trust for a child could pass at the beneficiary’s death either to charitable or family beneficiaries. Proceeds from the charitable remainder trust would be paid, of course, for our benefit or to any qualified organization.

### TIME-RELEASE BEQUESTS TO YOUNGER HEIRS

Harold, a 70-year-old widower, is a wealthy retiree and one of our strongest supporters. Harold is worried about federal estate taxes – and he’s also concerned whether his son Rob and daughter Rachel, still in their early 30s, will be able to handle their future inheritances wisely.



Harold wants to do something truly significant for our programs through his estate plan, but also wants to do the best thing for his children. What kind of arrangement might save estate taxes and provide generously for our future, keeping in mind the nature of his assets and his family situation?

A charitable lead trust, established by will, can pay income to an organization temporarily (for example, a term of five or ten years) and ultimately pass all trust principal to family beneficiaries, with significant estate tax savings. Lead trusts are sometimes called “wait a while” trusts. Harold’s message is: “Kids, you’re going to get everything from my estate, but as to part of it, you will merely have to wait a while.” It’s a form of charitable giving that may be more attractive to surviving family members than outright bequests to charity. And, as in the case of Rob and Rachel, a 10- or 15-year wait might not be a bad idea – that is, they may be more



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mature and better able to handle large sums of money at an older age.

The children will not have access to the trust income or principal for several years. However, if they are in a high tax bracket during the trust term, the financial loss may not be significant. What is gained is a substantial benefit for our programs and an estate tax deduction that helps importantly to minimize “shrinkage” in Harold’s estate. Note: Charitable lead trusts can be set up even where estate taxes are not a concern, if the goal is simply to stagger the distribution of one’s estate over several years and help a worthwhile cause in the interim.

### HELP FOR FAMILY MEMBERS WITH FINANCIAL NEEDS

Joan Smith, age 66, is a widow. Her two children, Greg and Jessica, are professionals earning good incomes. They and their children were well provided for through a trust set up under the will of Joan’s husband, John. Joan’s sister, Amy, age 70, is not so well off. Amy’s husband has suffered a series of financial setbacks, and Amy has little income of her own. Joan sends Amy checks from time to time, but she would like to do something more for Amy – and to support our programs. Joan owns various properties, including some highly appreciated, low-yield stock worth about \$200,000 and some highly appreciated, undeveloped real estate worth about \$120,000. She has contemplated leaving these assets to us at her death.

A charitable remainder trust can go a long way to achieving Joan’s personal and financial goals. Charitable remainder trusts can provide a variety of tax and financial advantages to donors, in addition to facilitating gifts to charity. These trusts have the ability to:

- Increase a donor’s income (or that of a family member) by reinvesting low-yield or no-yield properties in high-income investments. By putting the stocks and real estate into a charitable remainder trust, Joan can provide Amy with a 6% annual income from \$320,000 for the rest of her life, with the income then coming back to Joan for her life. The trustee provides professional investment and management services that will ensure a steady income for the rest of Amy’s life.
- Avoid capital gains taxes when property is sold and reinvested by the trustee. Ordinarily, Joan would lose 15% of any profits to tax if she sold the stock and real estate.
- Provide substantial income tax and estate tax charitable deductions that greatly reduce the cost of benefiting our future. Joan will receive a charitable deduction of more than \$100,000.<sup>11</sup>
- Memorialize the life of someone close to the donor. Joan will designate the trust as the John and Joan Smith Memorial Trust.



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Note that life income gift arrangements can be set up in an estate plan, as well as during life. Do you have a family situation that might benefit from a trust arrangement? We'd be pleased to discuss all the possibilities.

### PROVIDING FOR THE CARE OF PETS

One hears stories from time to time about people who attempted to leave large sums of money to a dog or cat in their wills. What will actually happen to a pet when the owner passes away? Is there any way to ensure the continued care of a beloved animal? One possibility is simply to leave the pet through your will or living trust to a faithful friend or family member, along with sufficient funds to provide for food and medical treatment during the animal's life expectancy. But what if the caretaker becomes incapable, through death or illness, of attending to the pet's needs? Some states in recent years have passed laws permitting "statutory pet trusts" that address some of these challenges.<sup>12</sup> A traditional trust may or may not be helpful, depending on the laws of your state or the state where the caretaker and trustee reside. You may be able to find animal shelters or similar organizations that will sign a contract for the future care of your pets. It's wise to check with legal counsel as to the correct legal form of such arrangements in your area and whether

they can be enforced. The Estate Planning for Pets Foundation provides information for pet owners and advisers at <http://estateplanningforpets.org>.

### "ETHICAL WILLS" CAN PASS ON VALUES

Everyone needs a will, and everyone should have a "living will" (or other health care directives), as well. In recent years, many people also have begun creating "ethical wills" – statements of their beliefs, values and ideals that they plan to leave behind for friends and family. These aren't legal documents, and they are not made for the purpose of distributing valuables – although one could argue that ethical wills leave behind the most valuable of all assets: a person's wisdom and knowledge drawn from a lifetime of experience. That's important to people who would like to see their values live on.

Ethical wills tend to be written statements, but video or audio recordings of one's thoughts and experiences serve as well. The content, not the form, is what's important. What do people put into ethical wills?

- Expressions of faith and beliefs and the role such convictions have played in their lives;
- Lessons learned during life, including the impact of specific events and experiences;

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- Personal messages of forgiveness, apology and reconciliation that were left unsaid during life;

- Words of hope and inspiration for those who carry on.

One advantage of an ethical will is the ability to reflect on one's thoughts over a long period of time – and polish the words to convey just the right meaning. Face-to-face conversations on these topics may not be as effective, or comfortable. People who have made ethical wills often comment that they wish their parents or grandparents had left behind similar statements. Ethical wills are sometimes shared during life with family and friends, who commonly remark that they were touched by the words and were seeing their parent or friend in a new light. You can find more information on ethical wills at [www.ethicalwill.com](http://www.ethicalwill.com); [www.personalhistorians.org](http://www.personalhistorians.org); [www.lifehistoryservices.com](http://www.lifehistoryservices.com) and [www.lifebio.com](http://www.lifebio.com).

### COMPLETE YOUR ESTATE PLANNING

We hope you will consider making an “ethical will,” but urge that you not neglect traditional estate planning. Everyone should have an up-to-date plan that provides for:

- *Thoughtful distribution of your estate.* With a will or living trust you can direct who will receive your property

when you die. Otherwise, the state will distribute some of your property for you – according to its own inflexible laws.

- *Naming executors and guardians.* Your will enables you to nominate the person you want to administer your estate or be responsible for minors or disabled persons under your care.

- *Health care directives.* You should make your wishes known on the question of health care treatment you would want maintained or withheld if you were seriously ill or injured with no chance of recovery. You can do so through a power of attorney, or “proxy,” for health care and a living will. Ask your advisers which form is appropriate in your area, or any states where you live part of the year.

- *Financial management for your family.* With a trust, or carefully prepared will, you can provide practical security for beneficiaries who are not really qualified to manage and budget their inheritance. A trust in your will can guarantee your beneficiaries all the rewards and advantages of property ownership – but with none of its burdens and frustrations.

### PERPETUATING SOMETHING MEANINGFUL

Making an ethical will can be a satisfying complement to your other estate planning.



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As you make or revise your will or living trust, your thoughts about personal values and experiences may lead you to contemplate the people and organizations that have been important in your life.

A charitable bequest may be the most logical idea in the world for someone who reflects for a moment on the importance of our mission. Including an estate gift for our benefit is easily accomplished through a codicil to your will or amendment to your living trust. Simpler yet is to make us a partial beneficiary of life insurance, financial or retirement accounts.

### ASSETS BEST LEFT TO CHARITY, NOT FAMILY

We mentioned earlier that some of your assets may be heavily taxed if you leave them to family members. These items will produce so-called income in respect of a decedent (IRD) and may cost your heirs both income taxes and “death taxes.”<sup>13</sup> We are a tax-exempt organization, of course, and would keep 100% of the proceeds from these items, while another beneficiary might end up with only 30% or 40% after taxes. Here are some examples:

Individual retirement accounts (IRAs) and other retirement plan assets, U.S. savings bonds, accounts receivable of a professional or business owner, renewal commissions of insurance agents, deferred compensation, last salary check, bonuses and distributions from employee benefit plans, accrued royalties under a patent license, a deceased partner’s distributive share of partnership income up to date of death, payments on installment notes such as land sale contracts, commercial annuities and employee stock options.

It’s important, from a tax standpoint, for a donor’s will to specify that these items are to pass to a qualified organization. With retirement accounts, a donor can change the death beneficiary to a qualified charity; beneficiary designations also are possible with revocable living trusts that contain IRD. One attorney suggests the following all-purpose provision: “I instruct that all charitable gifts, bequests and devises should be made, to the extent possible, from assets that constitute income in respect of a decedent, as that term is defined in the Internal Revenue Code.” Please call our office if you would like more information.



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### NOTES FOR TAX ADVISERS

1. IRC §§2044, 2056(b)(7). QTIP treatment generally must be elected by the executor.
2. A husband or wife also can establish a testamentary charitable remainder trust for the survivor that will receive qualified terminable interest property treatment under IRC §§2056(b)(8).
3. It may be costly to make the children survivor beneficiaries of a qualified charitable remainder trust for the spouse. Under IRC §2056(b)(8), the interest of the surviving spouse will not qualify for the estate tax marital deduction at the first spouse's death if the survivor is not the sole non-charitable beneficiary.
4. Care must be exercised where a parent, for whatever reason, wishes to leave nothing to a particular child. For example, a parent might be advised to make a nominal bequest to a child whose inheritance was accelerated into a lifetime gift to avoid any contention that the parent, due to mental impairment, simply forgot about the child.
5. This is the classic form of the "bypass" or "B" trust, which provides significant benefits to a surviving spouse or other beneficiary but does not provide so much control to the beneficiary that the trust assets will be included in the beneficiary's estate. Generally, trust property is taxed in an estate only if the beneficiary had a "general power of appointment" (see IRC §2041).
6. IRC §664. A charitable remainder trust can be arranged to make fixed or variable payments to one or more individuals for life or a fixed term of years (maximum of 20 years).
7. IRC §§1.170A-6(c)(2), 20.2055-2(e)(2), 25.2533(c)-3(c)(2). This is the basic description of a charitable lead trust, which pays an annuity or unitrust to charitable organizations, either for a term of years or for the lifetimes of one or more individuals. Charitable lead trusts are so called because the charitable interest "leads" (comes first), in contrast to charitable remainder trusts, where charity's benefit follows a private income interest.
8. Federal "Supplemental Security Income" (SSI) is governed by Title XVI of the Social Security Act, 42 U.S.C. §1381 et seq; 20 C.F.R. Part 416.
9. A charitable remainder trust may pay income to another trust for the life of an individual where the measuring life is an incompetent [Rev. Rul. 76-270, 1976-2 C.B. 194].
10. Rev. Rul. 2002-20, 2002-17.
11. Charitable deductions represent the present value of charity's remainder interest, which is based upon the ages of the income beneficiaries, the amount of the annual trust payout and the "applicable federal rate" (§7520 rate), which is assumed to be 3.0% in this example. See generally, IRC §664 and associated regulations. Note that the donor in this example has made a private gift of an income interest to her sister, which may be subject to federal gift tax. Gift taxes may be minimized where the grantor reserves the right, exercisable only by will, to revoke the income interest of the beneficiary.
12. See Section 2-907 of the Uniform Probate Code. For further legal analysis, including a compendium

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of state laws and regulations on the subject, see <http://estateplanningforpets.org/legalprimer.htm>.

13. The full, date-of-death value of such items as retirement savings is subject to federal estate tax (IRC §§ 2001, 2031). Both federal income tax and state income tax (depending on the place of residence of the decedent's heirs) will

be due on death benefits from an IRA or other IRD – costing up to 40% or more [Code §691(a)(1)]. Federal estate taxes (but not state death taxes) are a deduction against income tax paid by an heir. Note that items of IRD can be left to a primary beneficiary under terms that allow the beneficiary to disclaim the bequest in

*The materials contained in this booklet are intended to show only some of the ways you can benefit our future and minimize your federal tax liability – with examples of anticipated federal tax liability. Thus, you should not take any action without first consulting your attorney.*



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