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Trust UPDATE

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Values-based estate planning

As they have in so many other areas, the baby-boomers are bringing new ideas into estate planning. Where once one's primary beneficiaries were likely to be a surviving spouse and minor children, boomers are likely to have adult children, grandchildren and even great-grandchildren to consider in their wills.

Where once estate and inheritance taxes drove many planning decisions, the significant increase in tax exemptions from federal estate taxes in recent years is giving more flexibility to estate planners.

Many people would like to pass along their values to their heirs, not just their money and property. One way to fulfill this desire would be to draft a letter to be read after one's death, an approach referred to by some as an "ethical will." The letter might recount important life lessons and outline the sort of life that one expects and hopes for one's heirs.

Another approach might be to create an inheritance with strings attached.

Attached strings

Except in the state of Louisiana, children in the U.S. do not have a *right* to an inheritance. Because they can be disinherited, conditions can be imposed on the inheritances that they do receive. A trust can be used to formalize the conditions and provide the mechanism for fulfilling the legacy. Distributions may be limited to trust income only, for example, until the beneficiary reaches a specified age. Invasions of the trust may be permitted for specified purposes

Occasionally, a more, shall we say, colorful restriction might be imposed. Reportedly, Otto Flick inherited 40% of the Mercedes-Benz fortune with the condition that he never be seen driving any car other than a Mercedes.

Limits on restrictions

It's one thing to put restrictions on an inheritance, and another to get a court to enforce the restrictions. An area of potential controversy here concerns heirs keeping or marrying within a particular faith. A recent Illinois case illustrates the dilemma.

Max Feinberg's will provided an interest in a trust for each of his grandchildren. However, any grandchild who married outside the Jewish faith would be considered to have died, and the interest would be void, unless the spouse converted to Judaism within a year of the marriage. Such a provision can present many difficult questions. For example, who is Jewish? What if there is a divorce and remarriage, with the result that the satisfaction of the condition changes? Courts are not comfortable with will or trust provisions that pose restraints on marriage, but they have been enforced.

In the Feinberg case, Max's wife exercised a power of appointment over the trust that he created. Instead of an interest in a trust, the grandchildren each would get an outright distribution at her death of $250,000. However, she included a reference to Max's restriction, so that only those grandchildren who had married Jews would qualify. Only one of the five grandchildren met the condition. The disappointed grandchildren sued for their inheritance. After early victories in the lower courts, they lost in the Illinois Supreme Court. The Feinberg grandparents were within their rights to reward those grandchildren who most closely adhered to their values.

However, one wonders whether the Feinbergs would have followed this course had they known how much family strife would be created, and how much of their legacy would be eaten up by litigation expenses.

The table below, "Testamentary trusts," provides more information about how trust-based planning may be used in your will to tie together financial resources and family values.

Our invitation to you

Does your estate plan reflect the values that you wish to impart to your heirs? Would you like more information about the choices that you have when planning your will?

We specialize in estate settlement and trusteeship. We are advocates for trust-based financial planning. If you would like a "second opinion" about your estate planning, or if you have questions about how trusts work and whether a trust might be right for you, we're the ones you should turn to. We'll be happy to tell you more. ☐

Testamentary trusts in your will

A great variety of financial protection strategies may be implemented with careful trust planning. Among the choices to evaluate:

Marital trusts	Several options are available to provide lifetime asset management and financial protection for a surviving spouse.
Credit shelter trust	A married couple may expand the benefits of federal estate tax exemptions with this trust.
Support trust	For an adult child who needs a permanent source of financial support, with the trust principal protected from the claims of creditors, a support trust may provide a solution. The beneficiary's interest is limited to so much of the income as is needed for his or her support, education and maintenance.
Discretionary trust	The trustee has sole discretion over what to do with the income and principal, just as the grantor does before the trust is created. The beneficiary has no interest in the trust that can be pledged or transferred. When there are multiple beneficiaries, the trustee may weigh the needs of each in deciding how much trust income to distribute or reinvest, when to make principal distributions, and who should receive them. The trust document often will include guidelines on such matters.
Spendthrift trust	The beneficiary is forbidden to transfer any financial interest that he or she has in the trust, and may not compel distributions.
Gifts-to-minors trust	For young children. Contributions of up to $14,000 per year to this sort of trust will avoid gift taxes. A married couple together may set aside $28,000 each year for each child or grandchild, so in a few years a significant source of capital may be built up. Assets may be used for any purpose, including education funding, and will be counted as the child's assets for financial aid purposes. The assets of a gifts-to-minors trust must be made fully available to the child when he or she reaches age 21. However, the child may be given the option of leaving the assets in further trust.

Digital assets

One of the emerging areas of interest in estate planning concerns "digital assets." A variety of items will fall under this umbrella, including e-mail, electronic files, financial accounts, digital photographs and video, social media accounts, perhaps even items with substantial value such as domain names or bitcoin.

One might expect that, at one's death, the fiduciary who will be handling estate settlement would have access to all of these items. There are many reasons for such access, including:

- consoling grieving loved ones, making images and writings of the deceased available;
- identifying and marshaling the assets in the estate, especially accounts that may exist solely online; and
- heading off any post mortem attempts at identity theft.

However, the law is surprisingly unsettled in this area, and expectations may not be met.

UFADAA

A nonpartisan organization, the Uniform Law Commission, has been drafting sample legislation on a variety of subjects for the states for 124 years. In 2012 it turned its attention to the problems of digital assets in estate settlement. Last year it approved the *Uniform Fiduciary Access to Digital Assets Act (UFADAA)*. The sample legislation is now being considered for adoption in states around the country.

If the legislation is adopted, trustees and the executors of estates would be able to "step into the shoes" of a decedent with respect to digital assets, just as they already are able to do with financial assets. Deference to the wishes of the account holder is the goal, but where those wishes are unclear, the presumption will be to grant access to fiduciaries. Access is permitted only for purposes of carrying out fiduciary duties, not for "impersonating" the person for whom the fiduciary is acting.

Under the proposal, one would also be able to grant such access through a power of attorney, provided the access is specifically identified.

The drafters of the proposal identified several key benefits of their approach to bringing some clarity to this area of probate law:

- Account holders have control; their wishes will be respected.
- Digital assets will be treated as all other assets are treated.
- Protections are provided for the third parties with whom the fiduciaries interact regarding digital assets.
- Efficient uniformity will be created for all concerned.

This last aspect may be especially important as people move among states and work with digital providers who may not be located in their state of residence.

PEAC Act

Although most estate planners favor UFADAA and the simplification that it could bring to estate settlement, some of the providers of electronic communications services to the public are opposed. They favor competing legislation, the *Privacy Expectations Afterlife Choices Act (PEAC Act)*. This legislation takes a much more restrictive approach, in most cases requiring a court order before a fiduciary can gain access to digital assets.

The service providers are concerned that UFADAA is inconsistent with the provisions of the federal law related to this area, the Electronic Communications Privacy Act, which restricts access. They believe that the default assumption should be in favor of privacy, that people don't want their fiduciaries to have access to their electronic communications. Finally, they point out that UFADAA probably conflicts with millions of terms of service agreements already in effect.

What's a "terms of service agreement?" That's the fine print that almost no one reads before hitting the "I agree" button when downloading computer software or establishing a new electronic account. Most of these agreements limit access to the account holder, absent a court order to the contrary.

As a practical matter, the approach outlined in the PEAC Act would create a substantial burden on the probate court system, and it would increase the costs of estate settlement. Still, some state legislators may be sympathetic to the arguments made by service providers. Given widespread concerns over privacy, the public may feel the same. ☐

New limits on lump sums

In a move that caught some retirement planners by surprise, the IRS in July issued new rules restricting the availability of lump sum distributions from pension plans. In general, when one reaches retirement one has a choice between a stream of payments that will last for life (or for the joint lives of a married couple) or a single payment that is actuarially equivalent to that amount. The calculation of that payment is based upon life expectancy and an interest rate factor.

Beginning in 2012, some employers began offering lump sum distributions to retirees who already had begun to receive their pensions, as well as those who were not yet in pay status. The object was to remove the liability from company balance sheets. It also reduces longevity risk for the employer, the chance that the retiree will live beyond the age that the actuaries predicted when the pension was funded. Initially, the IRS approved the move.

Not anymore. From now on, subject to some narrow exceptions, once a retiree begins receiving pension payments they may not be replaced by a lump sum distribution.

The question on some people's minds is, could the IRS apply a similar rule to plan participants on the cusp of retirement? Most likely, Congressional action would be needed for so radical a change.

Estate tax filings for married couples

With the exemption from the federal estate tax now at $5.43 million, so that the vast majority of families no longer need be concerned with this levy, one might expect that estate tax filing would be down sharply. Not so. The reason is "portability."

A husband and wife together (or now a same-sex married couple also) have an exemption of $10.86 million. They are considered one economic unit for the estate tax. However, this doubling of the exemption is not automatic. When a spouse dies, an estate tax return must be filed to preserve the "deceased spouse's unused exemption amount," or it will be lost.

What are the odds that, for example, after a husband dies, his widow will come into so much money that she needs to worry about estate taxes? Very low. But estate planners generally consider the filing of an estate tax return in that situation, needed simply to preserve the portable exemption, to be "success" insurance, much cheaper than paying high estate taxes later. ☐