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Values-based estate planning

The phrase "estate planning" typically conjures up an image of a family gathered in a lawyer's office for the reading of a will. The protection and distribution of property is, of course, the main aim of every estate plan. However, in recent years there have been some moves to augment the financial side of estate planning with a spiritual, or values-based, element.

For example, some estate planners are now talking about the creation of an "ethical will," an idea said to date back to the Old Testament. An ethical will is simply a letter that attempts to put one's values in writing. It may be prepared at leisure or written during a crisis or turning point in one's life. Not a deathbed communication, an ethical will is instead a sober reflection on one's life and hopes for one's heirs. In our fast-paced, materialistic age, these are subjects that many families broach too rarely.

Sample questions to ponder

Unlike a normal will, an ethical will has no requirements, and it needs no special formats. The ethical will is literally a blank page, and may be as unique as a person's fingerprints. The point is to communicate a sense of the values that shaped one's life. Among the questions that various authorities have suggested to start the ruminative process:

- What were the most important things that you learned from your parents? Your grandparents? Your children?
- What religious ceremonies or holidays meant the most to you?
- How did your ethnic heritage influence your life?
- Did you have any life-changing experiences? Why were they so significant?
- Looking ahead, is there something that you hope to accomplish with the rest of your life?
- What do you believe are the best measures of success in life?

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- What was your proudest moment?
- What were the best decisions that you ever made?
- What three things do you hope that people remember about you? Why?
- What feelings have you left unexpressed in your life?
- What are your hopes for the material possessions that you leave to your heirs? Do you have concerns about the inheritance?

The gift that lasts longest

The ethical will is intended for reading after the author's death. However, the time to transmit values comes long before then, so the ethical will itself can be at best an expression of hope that the endeavor was successful.

But there is a larger point here. When one drafts a normal will, one is required to inventory one's property and complete an honest assessment of how best to put that property to use after one's death. If something has come up short (for example, not enough liquidity to cover taxes), the execution of an estate plan may become an occasion for corrective action. Similarly, by going through the process of drafting an ethical will, an individual may become aware of shortcomings in his or her relationships, or in the quality of the transmission of ideas and values to the next generation. Best to consider such matters while there is still time to do something about them!

Fragment of an ethical will

This beginning of an ethical will illustrates the flavor and spirit that are common in these documents.

"My name is Beatrice Taishoff and, as I approach my 100th year, I am, to the best of my knowledge, the only living member of my generation. I would like to be remembered long after I am gone from this world for how I was able to cope with circumstances of life, which made me a stronger person. I do not believe it could have been possible in any other country than the United States of America.

"As I write this I have been residing for three months in The Jewish Home and Hospital in the Bronx section of New York. I was born on September 22, 1902 in a section of New York City called the lower east side which was predominately inhabited by Jewish people. My parents were Lewis and Esther Levine and I was the second child of three. My father named me "Bracha", the feminine form of "Baruch", which was his grandfather's Hebrew name and the person whom he worshipped. Baruch amazingly acquired an education in Russia, which was unheard of at that time. His fame was so widespread that the Czar employed him. My father told me he named me after him because he felt I, too, would be able to attain any goal I wished. . . ."

Beatrice was 100 years old when she drafted her ethical will, which went on to mention highlights of her life, the importance of religion to her, and her wishes for her family.

The trust angle

A variety of trust approaches may be employed with family values in mind.

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.

Spendthrift trust. The beneficiary is forbidden to transfer any financial interest that he or she has in the trust, and may not compel distributions.

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.

Incentive trust. Similar to a discretionary trust, with specific goals identified for triggering distributions, such as completion of education, or starting a family.

Gifts-to-minors trust. For young children, contributions of up to $15,000 per year to this sort of trust will avoid gift taxes. A married couple together may set aside $30,000 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.

Our invitation to you

Does your estate plan reflect the values you wish to impart to your heirs? Would you like more information about the choices 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, 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. ☐

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Home rentals

The new tax law is expected to lower personal income taxes for a majority of taxpayers. However, one group that won't be seeing a reduction could be some homeowners in highly taxed states. The one-two punch that they will be hit with is the $10,000 cap on the deduction for state and local taxes (SALT), coupled with potential reduction in deductible mortgage interest. Only the interest on the first $750,000 of mortgage principal for the purchase of a first or second home during 2018 through 2025 will be deductible.

Here is one way around these limits. Rent the home for more than 15 days per year. In that situation, a portion of the property tax and mortgage interest become deductible on Schedule E.

Property taxes

Assume your property tax bill comes to $12,000, or $1,000 per month. What happens if you rent the home for four months? You will be able to deduct four months' worth of taxes, $4,000, on Schedule E for rental income, and the remaining $8,000 may be deducted on Schedule A. The $8,000 is less than the cap on the SALT deduction, although many taxpayers also will have a state income tax to pay, which may lift them over the cap.

If you were in the 37% tax bracket, you would save $740 in federal income taxes, plus you have gained the rental income.

Mortgage interest

Assume that you have a $1 million mortgage on a home purchased in 2018. Only the interest on the first $750,000 of debt is deductible. If the total annual interest payment came to $60,000, only $45,000 would be deductible on Schedule A.

Now let's say that you rent the home for three months. In that case, one-quarter of the mortgage interest ($15,000) would be deductible on Schedule E. In the 37% tax bracket, that would create a tax savings of $5,500.

Some experts believe that these tax incentives may lead to an increase in short-term home rentals. In the era of Airbnb, perhaps so? ☐

NOTED

Once a CEO hungers for a deal, he or she will never lack for forecasts that justify the purchase. Subordinates will be cheering, envisioning enlarged domains and the compensation levels that typically increase with corporate size. Investment bankers, smelling huge fees, will be applauding as well. (Don't ask the barber whether you need a haircut.) If the historical performance of the target falls short of validating its acquisition, large "synergies" will be forecast. Spreadsheets never disappoint.

—Warren Buffett's 2017 Letter to Berkshire Hathaway shareholders

We don't do PowerPoint (or any other slide-oriented) presentations at Amazon. Instead, we write narratively structured six-page memos. We silently read one at the beginning of each meeting in a kind of "study hall." Not surprisingly, the quality of these memos varies widely. Some have the clarity of angels singing. They are brilliant and thoughtful and set up the meeting for high-quality discussion. Sometimes they come in at the other end of the spectrum.

—Jeff Bezo's 2017 Letter to Amazon shareholders

"Upstream" estate planning

The doubling of the amount exempt from the federal estate tax has shifted the focus of tax planners from death taxes to the basis step-up at death. Some estate planners are using creative ways to capture an additional basis boost. Several strategies were reviewed recently in *Tax Notes* by Jonathan Curry ["TCJA Supercharges 'Upstream' Estate Tax Planning Techniques," April 2, 2018].

Run the money through an elderly parent's estate

One approach is to involve an elderly relative who has little wealth. In one scenario, a wealthy individual has $10 million worth of highly appreciated securities to be transferred to children. An irrevocable trust would be created, funded with the securities. An elderly parent would be given a general power of appointment over the trust, which is the power to direct the distribution of the assets. At the parent's death, the ownership of that power causes inclusion of the trust in the parent's estate for federal estate tax purposes, triggering the basis step-up. Assuming that the current estate tax exemption levels are still in place at the parent's death, there is no transfer tax cost for the basis step-up.

Of course, there is the danger that someone who has a power of appointment over a trust may choose to exercise it, diverting the trust assets away from the intended beneficiaries. The simplest solution to that potential problem is to not inform the power holder of the existence of the power, according to estate planning expert Jonathan Blattmachr. "The cases are legion that the assets are included in your estate under section 2041 even if you didn't know about the general power," he said.

A less devious alternative would be to provide that the power only can be exercised with the consent of an adverse party.

GRATs

A grantor retained annuity trust (GRAT) also may be employed to capture added basis step-up. In the usual GRAT, a trust is established for a term of years, with the grantor retaining annuity payments sufficient to bring the gift taxes on the funding of the trust down to zero. When the trust terminates, the remaining trust assets (if any) pass to children or other beneficiaries at no additional gift tax cost. The strategy works best if the assets appreciate significantly during the trust term.

The new approach is to make a parent the remainder beneficiary, so as to obtain a basis step-up for the assets before they pass to the children. This also transfers future growth in the trust assets tax free. What's more, the parent may use his or her generation-skipping transfer tax exemption to apply to the trust. The donor will have used up only his or her own lifetime gift tax exemption.

These sophisticated strategies require the supervision of an experienced attorney. ☐

Speak to our trust and investment advisors to learn how a trust can enhance your family's financial security.

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