

DID THE AMERICAN TAXPAYER RELIEF ACT PUT A NAIL IN THE COFFIN OF ESTATE PLANNING?

USES OF TRADITIONAL ESTATE PLANNING COMPONENTS FOR NON-TAX PURPOSES

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Most estate planners had nightmares of falling off the fiscal cliff in December 2012. Many were busy with clients, trying to take last minute advantage of the gift and estate tax laws in effect until the end of 2012, since 2013 was to bring a higher estate and gift tax rate and lower estate and gift tax exemption. Thanks to the American Taxpayer Relief Act of 2012 (the Act), which was actually passed on January 1, 2013, our country did not fall off the proverbial cliff and the estate and gift tax laws have been “permanently” adjusted to resemble the rates and exemptions available in 2012. Under the Act, the gift, estate and generation-skipping transfer tax exemptions have been increased to \$5 million (adjusted for inflation so in 2013 the amount is actually \$5.25 million) per person (\$10.5 million this year for a married couple), with a tax rate of 40 percent for transfers in excess of the exempt amount.

The end result of the Act is that significantly fewer clients are in need of estate tax planning. This article will outline why estate planning is still relevant, even if there is no estate/transfer tax.

Protecting Children/Beneficiaries from Creditors and Divorcing Spouses

An irrevocable trust established by a third party can be one of the most useful tools for asset protection. Clients who do not have any planning documents or whose documents distribute outright to their beneficiaries are foregoing the creditor and

divorce protection that could be given to their beneficiaries. If the client’s documents are drafted so that the assets are maintained in a continuing trust (rather than forcing out distributions of income or principal at staggered ages), the trust assets can be protected from the beneficiary’s creditors or divorcing spouses. This is true even if the trust is drafted as a beneficiary-controlled trust, which is designed to give the primary beneficiary as much control as possible without giving up the protection the irrevocable trust provides. With a beneficiary-controlled trust, the primary beneficiary is either the sole trustee or the investment trustee. For the optimal creditor protection, the trust will be designed as a fully discretionary trust with an investment trustee (primary beneficiary) and a distribution trustee (independent trustee). Under Nevada law, there currently are no exception creditors that may pierce a fully-discretionary, third-party-created trust.

Protecting Your Client from Creditors and Divorcing Spouses (Nevada Asset Protection Trust)

Nevada is one of several states that allow a person to establish a self-settled spendthrift trust. A self-settled spendthrift trust is an irrevocable trust that protects the trust assets from the settlor’s creditors, while still allowing the settlor to benefit from the trust assets. Each of the states that allow self-settled trusts require a statute of limitations period that must expire before transferred assets are protected from the settlor’s creditors. The Nevada statute of limitations period is two years from the date assets are transferred by the settlor to the trust (as to future creditors), or the later to occur of two years from the date assets are transferred by the settlor to the trust or six months from the date that the creditor learned of, or reasonably should have learned of, the transfer (as to current creditors). NRS Chapter 166 outlines the laws regarding the formation and maintenance of a Nevada self-settled spendthrift trust.





LAST WILL AND TESTAMENT

Last Will and Testament of _____

I, _____, of _____ (Address), do hereby publish and declare this to be my Last Will and Testament, hereby expressly revoking all wills and codicils heretofore made by me.

ARTICLE I

I direct my Executor to pay my judicially enforceable debts, funeral expenses and the administrative expenses of my estate as soon after my death as practicable. Further, I direct that all estate and inheritance taxes and taxes in the general nature thereof (together with any interest or penalty thereon), which shall become due upon or by reason of my death with respect to any property passing by or under the terms of this Will or codicil to it hereafter executed by me, or with respect to the proceeds of any life insurance policy or proceeds with respect to any other property (including property over which I have a taxable power of appointment) included in my gross estate for the purpose of such taxes, shall be paid by my Executor out of the proceeds of my estate, and I direct that no part of any such taxes be charged against or collected from the estate of any beneficiary or in possession of the property taxed, or receiving the benefit thereof, it being my intention that such taxes be paid by my legatees, devisees, surviving tenant by the entirety, appointees and beneficiaries receiving the same, without any diminution on account of such taxes.

ARTICLE II

I do give and bequeath _____ (Spouse), _____ (Name)

Protecting a Beneficiary from Himself/Herself

A trust is a useful tool for asset management. First, it can be used to provide investment management succession in the event of the incapacity of the client or other trusted individual. Second, it can be used to protect assets from a beneficiary's own misjudgment and spendthrift tendencies. Third, the trust can be used to provide supplemental benefits to a beneficiary with special needs without disqualifying the beneficiary from other government support. Very often clients with special needs children are unaware that by doing nothing, or by taking a simple approach and distributing assets outright to their children, they are placing the special needs child in a position that may disqualify them from benefits in the future.

Minimizing Income Taxes

Although a client's estate may be well within the threshold of the estate and gift tax exemption, estate planning may also be beneficial to a client interested in minimizing income taxes. With neighboring states, like California, increasing state income taxes, Nevada becomes an even more desirable "destination" in which to park trust assets for beneficiaries. A resident of a state with an income tax can establish a trust in Nevada to reduce or eliminate state income taxes as to assets contributed to the trust, if such assets produce income that is not considered source income as to the taxing state. For example, a California resident could contribute a marketable securities portfolio to a Nevada Intentionally Non-Grantor Trust (NING) to reduce or eliminate state income tax for the income of the portfolio, while still allowing the non-resident to be a beneficiary of the NING using Nevada's self-settled spendthrift trust laws.

Avoiding Probate

A revocable trust is used to avoid probate. To the extent the trust is funded during the settlor's lifetime, the assets in the trust (and any other assets that have beneficiary designations) will pass outside of probate at the settlor's death. Probate can be a costly and time consuming court proceeding and can easily be avoided by establishing and funding the revocable trust during the client's life. The revocable trust is especially important for clients who own real property in multiple states because ancillary probate proceedings are required in each state if the property is titled in the client's name. The revocable trust will outline the client's beneficiaries and provide asset management succession (in the form of a successor trustee if the client becomes incapacitated). The revocable trust can be drafted to provide the creditor and divorce protection noted above for the client's beneficiaries upon the client's death.

Adjusting Existing Documents to do "Better Planning"

If a client comes to you with a basic estate plan in place, it is always a good idea to review the existing documentation. Even irrevocable trusts can be modified through Nevada's decanting laws or the exercise of a power of appointment so that an otherwise inferior trust for creditor and divorce protection can be made superior. Attorneys and other advisors should ask to see copies of existing trusts, including irrevocable trusts of which the client is a beneficiary, to see what can be done to make use of Nevada's favorable trust laws.

Appointing Guardian for Minor Children

Clients with minor children should be encouraged to at least update or put their wills in place in order to name guardians for their children. When deciding who will be the physical custodian of the minor child, clients should also consider who will be the trustee to manage the child's inheritance.

The Act may have "cryogenically frozen" the need for estate planning for transfer tax-savings purposes for many clients, but estate planning is not dead. It is important for attorneys and other advisors to recognize the use and utility of trusts and other basic estate planning components, even if for non-transfer tax reasons. ■



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