THE ESTATE PLANNER

March/April
2020

CREATING AN EDUCATION LEGACY

E-wills: Are they ready for prime time?

Wealth preservation and estate planning go hand-in-hand

Estate Planning Red Flag

Your spouse failed to designate you as beneficiary of his or her IRA

SHUMAKER
Shumaker, Loop & Kendrick, LLP

Creating an education legacy

For many people, an important goal of estate planning is to leave a legacy for their children, grandchildren and future generations. And what better way to do that than to help provide for their educational needs? A 529 plan can be a highly effective tool for funding tuition and other educational expenses on a tax-advantaged basis. But when the plan's owner (typically a parent or grandparent) dies, there's no guarantee that subsequent owners will continue to use it to fulfill the original owner's vision.

To create a family education fund that lives on for generations, a carefully designed trust may be the best solution. But trusts have a significant drawback: Unlike 529 plans, the earnings of which are tax-exempt if used for qualified education expenses, trusts are subject to some of the highest federal income tax rates in the tax code. In 2020, for example, trust income is generally taxed at the highest individual rate — 37% for ordinary income and 23.8% (including the 3.8% Net Investment Income Tax) for capital gains and qualified dividends — after the amount exceeds $12,950.

One strategy for gaining the best of both worlds is to establish a family education trust that invests in one or more 529 plans.

529 plan basics

529 plans are state-sponsored investment accounts that permit parents, grandparents or other family members to make substantial cash contributions (up to $400,000 or more, depending on the plan). Contributions are nondeductible, but the funds grow tax-free and earnings may be withdrawn tax-free for federal income tax purposes (plus state tax breaks in some cases) provided they're used for qualified education expenses.

Qualified expenses include tuition, fees, books, supplies, equipment, and some room and board at most accredited colleges and universities and certain vocational schools. In addition, under the Tax Cuts and Jobs Act, 529 plans can be used to pay up to $10,000 per year per student for elementary and secondary school tuition.

Establishing a trust to hold one or more 529 plans provides several significant benefits.

Contributions to 529 plans are removed from your taxable estate and shielded from gift taxes by your lifetime gift and estate tax exemption (currently, $11.58 million) or annual exclusions (currently, $15,000 per recipient). If gift taxes are a concern, you can even accelerate up to five years' worth of annual exclusions into a single year, allowing you to make nontaxable contributions up to $75,000 per beneficiary in year 1 rather spreading them over five years.

529 plans offer the owner a great deal of flexibility. For example, depending on a plan's terms, owners have control over the timing of distributions, can change beneficiaries from one family member to another and can roll the funds over into another state's plan tax-free (up to once a year). It's even possible to recover funds that won't be used for education expenses (subject to taxes and, in most cases, a 10% penalty). (See "What happens to unused 529 plan funds?" on page 3.)

In addition to the risk that a subsequent owner will use the funds for noneducational purposes, disadvantages of 529 plans include relatively limited

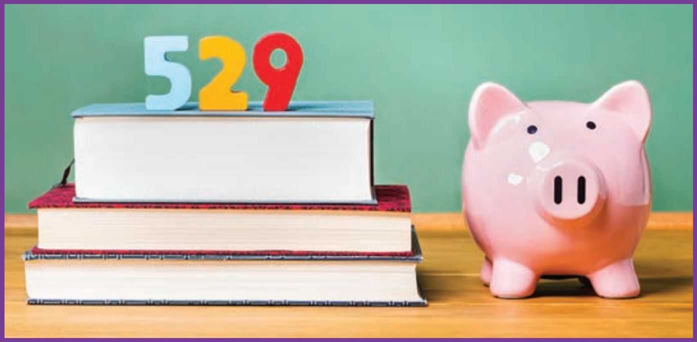
What happens to unused 529 plan funds?

There comes a time when funds held in a 529 plan are no longer needed for qualified education expenses. Perhaps your youngest grandchild has finished college and you're left with a sizable balance in your account. If that happens, you have a few options:

Withdraw it. As the account owner, you're free to withdraw the funds at any time for any purpose. Because 529 contributions are nondeductible, they're considered after-tax dollars, so you can withdraw them tax-free. Withdrawn earnings, however, will be taxable and, in most cases, subject to a 10% penalty. There's no penalty, however, to the extent that your beneficiary doesn't need the assistance because he or she received a tax-free scholarship or grant or certain other assistance.

Use it. Change the beneficiary to another family member or even to yourself and use it to pay for vocational school, continuing education or other qualified expenses.

Leave it in the plan. Let the funds continue growing tax-free and save them for future generations' educational needs.



investment choices and an inability to invest assets other than cash.

Holding a 529 plan in a trust

Establishing a trust to hold one or more 529 plans provides several significant benefits:

- It allows you to maintain tax-advantaged education funds indefinitely (depending on applicable state law) to benefit future generations and keeps the funds out of the hands of those who would use them for other purposes.
- It allows you to establish guidelines on which family members are eligible for educational assistance, direct how the funds will be used or distributed in the event they're no longer needed for educational purposes, and appoint trustees and successor trustees to oversee the trust.
- It can accept noncash contributions and hold a variety of investments and assets outside 529 plans. For example, the trustees might invest in hedge funds, private equity funds, life insurance or other alternative investments if they conclude that the increased returns would outweigh the tax cost.

A trust can also use funds held outside of 529 plans for purposes other than education, such as paying medical expenses or nonqualified living expenses.

Plan carefully

If you're interested in setting up a family education trust to hold 529 plans and other investments, be sure to plan carefully. Your estate planning advisor can help you design a trust that maximizes educational benefits, minimizes taxes and offers the flexibility you need to shape your educational legacy.

E-wills: Are they ready for prime time?

Today, most people communicate, shop, bank and even sign documents online. But one area that hasn't yet embraced the digital revolution is estate planning. Most people continue to execute wills and related documents with paper and ink at a lawyer's office in the presence of witnesses and a notary public.

This is beginning to change, though. As of this writing, there are two states that permit electronic wills (e-wills) by statute, and another two that are considering doing so. The Uniform Law Commission (ULC) recently issued the Uniform Electronic Wills Act (E-Wills Act).

What's a uniform law?

The ULC isn't a legislative body. It's a nonprofit organization that "provides states with nonpartisan, well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law." A uniform law doesn't apply in a given state unless the state adopts it, and lawmakers are free to modify the law's language as they see fit.

E-Wills Act in a nutshell

The E-Wills Act is designed to allow participants in the estate planning process (lawyers, clients, witnesses, notaries) to create, transfer, sign, and record wills and other documents in electronic form, while preserving traditional protections against undue influence and fraud.

Although the rules will likely vary from state to state, the E-Wills Act contemplates that any requirement that witnesses be in the physical presence of the client will be supplemented by an "electronic presence" option. The act defines electronic presence as "the relationship of two or more individuals in different locations communicating in real time to the same extent as if the individuals were physically present in the same location."

So, for example, an attorney might prepare an e-will, send it to the client and notary, and conduct a video chat with all of the parties during which the client signs the e-will, the witnesses sign the e-will and any necessary affidavits and the notary notarizes the documents and sends them back to the attorney.

Pros and cons

E-wills offer several significant advantages, including:

Convenience. People who are elderly or disabled or have health problems that make it difficult to travel can review and execute wills and other estate planning documents from the comfort of their homes, without the need to send paper back and forth. Similarly, people who live in rural areas, or otherwise lack easy physical access to lawyers, notaries and witnesses, can execute these documents in a matter of minutes rather than hours or days.

> *The E-Wills Act is designed to allow participants in the estate planning process to create, transfer, sign, and record wills in electronic form.*

Encouragement of estate planning. Millennials and other young people are accustomed to the speed and convenience of online transactions, so the availability of e-wills may encourage them to plan their estates earlier than they would otherwise.

Security. E-will laws that incorporate fingerprint scanning (or other identity verification procedures),

archived video recordings and other security features provide some protection against fraud and abuse.

Potential disadvantages include:

Uncertainty. Will states without e-will laws recognize e-wills executed in other states?

Cybersecurity issues. As with any type of online transactions, hacking and identity theft is a concern, so it'll be critical for vendors that provide e-will services to incorporate robust security features into their offerings.

Susceptibility to fraud and undue influence. Some have expressed concern that e-wills will be more susceptible to challenges based on fraud or undue influence. But it appears that these concerns generally revolve around the possibility that people will execute e-wills without involving an attorney.

The first disadvantage — uncertainty over whether e-wills will be recognized by other states — is particularly relevant if you execute an e-will in a state that allows it, but later move to another state that does not. Although the E-Wills Act contemplates that the second state would give effect to the e-will under the laws of the first state, some states may not be so inclined.

Handle with care

If you're considering an e-will, be sure to discuss it first with your attorney. E-wills offer convenience, but it's still necessary to follow certain procedures and protocols. And if you may eventually relocate, it's critical to ensure that the new state will honor your wishes.

Wealth preservation and estate planning go hand-in-hand

A central tenet of any estate plan is the protection of your assets. You've worked a lifetime to build your wealth, and you undoubtedly want to pass as much of it to your loved ones as possible.

Asset protection strategies can range from simple to quite sophisticated. We'll review some of the more popular strategies, but the main takeaway to keep in mind is that it's best to begin planning earlier rather than later.

Asset protection made simple

Traditionally, asset protection strategies have focused on avoiding or minimizing federal estate tax liability. Although estate taxes remain a concern for some families, most should find sufficient tax shelter under current estate tax law. However, be aware that estate taxes may still apply at the state level.

For instance, the Tax Cuts and Jobs Act (TCJA) hiked the unified gift and estate tax exemption to

$10 million (subject to inflation indexing) for transfers to nonspousal beneficiaries and for assets passing tax-free to a spouse under the unlimited marital deduction. The indexed exemption amount for 2020 is $11.58 million. Also, portability effectively allows couples to double this tax shelter to $23.16 million. (Bear in mind, however, that the exemption amount is scheduled to drop significantly in 2026.) Finally, you can still use the annual gift tax exclusion of $15,000 per recipient in 2020.

Thus, you can simply "gift" assets to your loved ones, realizing the estate tax benefits of the exemption and gift tax exclusion amounts.

For some, asset protection is as easy as that — case closed. But this simplified approach requires you to give up control of those assets during your lifetime, which might not be desirable or feasible. As a result, more complex techniques may be preferred.

There's a trust for that

Frequently, trusts are featured in an asset protection plan. The traditional bypass trust (or A-B trust), which was created mainly to avoid federal estate tax, is still a viable option. Such trusts offer protection from creditors, while continuing to provide tax shelter.

A similar variation, often called a spendthrift trust, can be established for a beneficiary who isn't qualified to manage investments or might indulge in spending sprees. An independent trustee assumes the financial management responsibilities.

With a qualified terminable interest property (QTIP) trust, a grantor can provide an income stream for a surviving spouse while still determining the disposition of the trust assets when the spouse dies. This enables a surviving spouse to maintain a comparable lifestyle. A QTIP trust is often used by someone who has remarried and has children from a prior marriage. The children typically receive the assets when the trust terminates.

> *Although estate taxes remain a concern for some families, most should find sufficient tax shelter under current estate tax law.*

Another type of trust, the domestic asset protection trust (DAPT), has been growing in popularity. This is a "self-settled" trust, where the grantor personally benefits from the income. The main objectives are to provide protection from creditors and retain control over the assets. Accordingly, DAPTs may be used when there's a divorce or spendthrift concerns.

Currently, 19 states have enacted legislation authorizing DAPTs. They are Alaska, Connecticut, Delaware, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming.

Business considerations

Asset protection is also vital to business owners. Depending on your situation, you might form a company as a C corporation to protect your business assets or as an S corporation providing partnership-type taxation. There are additional factors at work, so choose the business form carefully.

Choosing the right asset-saving strategy

If you're concerned about wealth preservation, contact your estate planning advisor. He or she can analyze your set of circumstances and devise an ideal asset-protection plan.

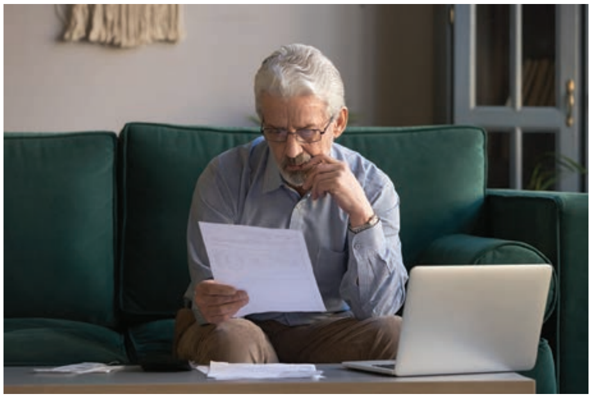
ESTATE PLANNING RED FLAG

Your spouse failed to designate you as beneficiary of his or her IRA

One advantage of inheriting an IRA from your spouse is that you're entitled to transfer the funds to a "spousal rollover IRA." The rollover IRA is treated as your own IRA for tax purposes, which means you need not begin taking required minimum distributions (RMDs) until you reach age 70½. (Note: When you inherit an IRA from someone other than your spouse, you generally must begin taking RMDs immediately.)

But what happens if your spouse mistakenly named a trust as beneficiary of his or her IRA, or failed to name a beneficiary at all? According to IRS guidance, there may be strategies you can use to ensure that you receive the benefits of a spousal rollover. Typically, this guidance comes in the form of private letter rulings (PLRs), which cannot be cited as precedent but indicate how the IRS is likely to rule in similar cases.

In one example, as described in a 2019 PLR, a deceased person named a trust as beneficiary of his IRA and failed to name a contingent beneficiary. The trustee executed a qualified disclaimer of the trust's interest in the IRA, as did the deceased's son and two grandchildren. The IRS ruled that the deceased's wife was entitled to complete a spousal rollover. Other rulings have permitted similar strategies when deceased individuals have failed to designate a beneficiary, causing an IRA or qualified retirement plan account to be included in their estates.



PLRs depend on the specific facts presented in each case, so it's important to consult your estate planning advisor before following them. But these rulings indicate that, when loved ones make beneficiary designation mistakes, there may be strategies you can use to correct them.

Experience. Responsiveness. Value.

At Shumaker, we understand that when selecting a law firm for estate planning and related services, most clients are looking for:

- A high level of quality, sophistication, and experience.
- A creative and imaginative approach that focuses on finding solutions, not problems.
- Accessible attorneys who give clients priority treatment and extraordinary service.
- Effectiveness at a fair price.

Since 1925, Shumaker has met the expectations of clients that require this level of service. Our firm offers a comprehensive package of quality, experience, value and responsiveness with an uncompromising commitment to servicing the legal needs of every client. That's been our tradition and remains our constant goal. This is what sets us apart.

Estate planning is a complex task that often involves related areas of law, as well as various types of financial services. Our clients frequently face complicated real estate, tax, corporate and pension planning issues that significantly impact their estate plans. So our attorneys work with accountants, financial planners and other advisors to develop and implement strategies that help achieve our clients' diverse goals.

Shumaker has extensive experience in estate planning and related areas, such as business succession, insurance, asset protection and charitable giving planning. The skills of our estate planners and their ability to draw upon the expertise of specialists in other departments — as well as other professionals — ensure that each of our clients has a comprehensive, effective estate plan tailored to his or her particular needs and wishes.

SHUMAKER®

Shumaker, Loop & Kendrick, LLP

We welcome the opportunity to discuss your situation and provide the services required to help you achieve your estate planning goals. Please call us today and let us know how we can be of assistance.

www.shumaker.com