

How Anticipating Future Problems With Powerful Estate Planning Documents Can Save You Time and Money

In the world of estate planning, the best defense to changes in the law and life circumstances is usually a good offence. Rather than running to court or the drafting attorney each time a crisis occurs, estate plans can be drafted “defensively,” such that several escape hatches or other planning options spring into existence whenever necessary. This article discusses several areas where such offensive strategies can be effectively integrated into the estate plan.

Unanticipated Special Needs

One unanticipated life event might be the development of special needs by a beneficiary. If a child suffers a debilitating injury, or develops a mental disability, a large inheritance could disqualify such a child from needs-based governmental assistance. To prepare for this scenario, a trust could be drafted with provisions for a “springing” special needs trust, which only comes into existence if a beneficiary receives needs-based government assistance. A special needs trust preserves the inheritance without disqualifying a child from government assistance. Such a trust can also be switched “off” if the child later overcomes the disability.

Changing Marital Status after Death of One Spouse

What happens when a trust is set up during the lifetime of a surviving spouse, and that spouse later remarries? [Spousal trusts](#) are often established in order to minimize estate tax or to provide a stream of income to the spouse during lifetime. Upon death of the spouse, the principal in these trusts usually transfers to the children of the first marriage. In the event of remarriage, what happens to the distributions from these trusts? Continuing the usual distributions might result in unanticipated consequences, such as unintentionally disinheriting the children of the first marriage, or leaving the surviving spouse vulnerable in the event of remarriage. To prepare for this scenario, a trust for the benefit of a spouse can be drafted such that, in the event of remarriage, a pre-marital agreement must be executed which requires distributions from the trust to remain separate property. Or, distributions could be tweaked upwards or downwards based upon the marital status of the surviving spouse.

Unanticipated Debts or Creditor Issues

Many individuals leave a portion of their estate in [beneficiary-controlled trusts](#). These trusts combine the benefits of control over one’s inheritance with protection from ex spouses or other creditors. They also may have tax benefits when the trust excludes property from the beneficiary’s estate. But what happens when a creditor sues a beneficiary-trustee, and requests that the trustee exercise their power over distributions in favor of the creditor? As beneficiary

control over a trust increases, so also does the potential ability for a creditor or ex-spouse to reach the assets of the trust. In California, this may be unavoidable. In this scenario, a “distribution trustee” can be named in the beneficiary controlled trust, who swings into action only when the creditor problem arises. Such trusts can provide beneficiaries with either freedom or third-party control as required in the circumstances.

Changes in the Estate Tax Law

Estate tax laws will change significantly over the next few years. As of this writing, the estate tax exemption amount (the amount that can be transferred at death without tax) will be \$1 Million in 2013 and later years. At any time, Congress could change this exemption amount. Most practitioners appear to believe that the exemption amount will settle somewhere between \$3.5 Million and \$5 Million in 2013. This is because President Obama advocated a \$3.5 Million exemption amount while running for President, and Republicans favor a higher exemption amount or an outright repeal of the tax. For the rest of 2012, the exemption amount is \$5 Million.

An exemption amount that is either too low or too high, or an outright repeal of the estate tax, could have significant consequences for families with estate plans in place or for those with no planning at all. For instance, couples with A-B trust may not require the “B” or Bypass trust if the exemption amount remains high. In such a case, if the surviving spouse follows the directions in the trust and funds the Bypass trust, capital gains tax might result which exceeds the amount of any estate tax, as there would be no step up in the basis of property held in the bypass trust at the death of the surviving spouse.

A similar problem results if “portability” applies, or if Congress repeals the estate tax. In the event that “portability” applies (not certain for 2013) or future years, a funded bypass trust may not be necessary. In the event of an outright repeal, Congress would likely replace the estate tax with carry over basis. Carry over basis means that the basis of property at the death of an individual “carries over” to the beneficiary rather than “stepping up” to the value at the date of death. Whether “portability” or an outright repeal applies, carry over basis could result in potentially higher capital gains tax. Moreover, it also results in uncertainty when determining the basis of property: Many individuals are not aware of the purchase price of stocks, automobiles, and even real property that was acquired before the widespread use of digital records.

Another example of how the changing exemption amounts cannot be easily planned for is the case of a spouse with a joint estate under \$5 Million who dies in 2012, leaving a spouse who survives into 2013. In this case, if the exemption amount is ultimately increased to \$5 Million, it wouldn’t make sense to fund a bypass trust. However, if the exemption amount stays at \$1 Million, the bypass trust should be funded in order to avoid potential tax at the death of the surviving spouse.

In order to prepare for increases in the exemption amount, portability, or an elimination of the estate tax, a third party can be designated in the trust who can toggle “on” and “off” the provisions in a bypass trust which exclude the property therein from the surviving spouse’s estate. This strategy would avoid the loss of basis step up and result in additional benefits: the asset protection or family inheritance protection aspects of the bypass trust could be preserved.

Other Areas to Consider

There are many other changing circumstances that should be anticipated with flexible estate plan design. These include qualifying for California Medi-Cal benefits through authorizing the [gifting down of incapacitated individual’s estate](#); minimizing income tax from distributions from an [IRA account made payable to a living trust](#); minimizing generation skipping transfer tax for [trusts that become multi-generational](#); preventing contests by disgruntled beneficiaries through properly drafted no-contest clauses; and [minimizing property taxes](#) in scenarios where children receive an interest in real property. In each of these cases, provisions can be put in place which allow “escape hatches” or trusts to “spring” into place to account for the change in circumstances.

No Substitute for Good Planning

Remember, most trusts—whether written by a lawyer or through an internet program—are not written with the escape hatches and springing trusts described above. Because of this failure of trusts, attorneys are often required to go to court to sort out the problems which arise. Going to court usually increases the overall fees and costs associated with [estate administration](#). This author recommends that individuals seek out an [estate planning attorney](#) who is knowledgeable about the above strategies in order to effectively anticipate future problems.

NOTICE: While we would love your business, we cannot represent you as an attorney until we are able to determine that there are no conflicts of interest between yourself and any of our existing clients. We ask you not to send us any information, (other than as requested on the "Contact Us" page,) about any matter that may involve you until you receive a written statement from us that we will represent you.

DISCLOSURE UNDER TREASURY CIRCULAR 230: The United States federal tax advice, if any, contained in this website and associated websites may not be used or referred to in the promoting, marketing, or recommending of any entity, investment plan, or arrangement, nor is such advice intended or written to be used, and may not be used, by a taxpayer for the purpose of avoiding federal tax penalties.