THE ESTATE PLANNER

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A SPA trust can improve the flexibility of your estate plan

We live in uncertain times. There's uncertainty about the economy as well as the possibility of tax increases to address the rising federal debt. For example, there's renewed interest in proposals that would slash the historically high gift and estate tax exemption. In light of this uncertainty, it's a good idea to consider estate planning tools that offer asset protection as well as flexibility to adjust your plans to changing circumstances. One such tool is the special power of appointment (SPA) trust.

How it works

A SPA trust — sometimes referred to as a SPAT — is an irrevocable trust with a twist: as the creator or "settlor" of the trust, you grant a special power of appointment to a trusted individual, empowering this "appointer," acting in a nonfiduciary capacity, to direct the trustee to make distributions to you (or to anyone else other than the appointer or his or her creditors or estate).

> *A SPA trust is an irrevocable trust with a "twist."*

A properly designed SPA trust allows you to remove significant amounts of wealth from your estate, taking advantage of the current gift tax exemption, while retaining the ability to access the trust's assets — via the appointer — should your needs change in the future. In addition, because you aren't a beneficiary of a SPA trust, it will not be classified as a self-settled trust, making it possible to enjoy asset protection that's superior to that available through a domestic asset protection trust (DAPT).

Advantages over DAPTs

Typically, self-settled trusts aren't protected against claims by your creditors. But around one-third of the states have statutes that authorize DAPTs. These trusts shield assets against many creditors' claims, even though the settlor retains an interest in the trust assets as a beneficiary. There's some risk involved with DAPTs, however, because their effectiveness in protecting assets isn't well established, particularly for nonresident settlors who live in non-DAPT states.

With a SPA trust, you have no beneficial interest in the trust assets. So long as you don't retain any

Watch out for fraudulent transfer laws

Before you transfer assets — whether it's to a trust, another entity, or an individual — be sure to familiarize yourself with the fraudulent transfer laws in your state. If a creditor successfully challenges a transfer as fraudulent, it can defeat the purpose of a special power of appointment (SPA) trust or other asset protection strategy.

Most fraudulent transfer laws allow creditors to challenge transfers involving either actual or constructive fraud. Actual fraud, which is rare, occurs when you transfer assets with an intent to hinder, delay or defraud any creditor. Constructive fraud, which is much more common, usually means that 1) you transfer assets without receiving a reasonably equivalent value in exchange, *and* 2) you're insolvent when you make the transfer or become insolvent as a result. "Insolvent" means that your total debt exceeds the fair value of your assets. Generally, if you're not paying your debts as they become due, you're *presumed* to be insolvent.

To avoid running afoul of the fraudulent transfer laws, before you give away assets — either directly or in trust — determine whether any current or potential creditors are likely to challenge the gift as a fraudulent transfer. And analyze your financial situation to be sure that you aren't insolvent and won't render yourself insolvent by making the gift.

improper control over the trust, and distributions to you are entirely within the appointer's discretion, the assets should be protected against creditors' claims in all 50 states.

SPA trusts aren't risk-free, however. Conceivably, a creditor could argue that frequent distributions from the trust to you make you a *de facto* beneficiary. One way to avoid such a challenge may be for the appointer to direct distributions to your spouse, rather than you, making it more difficult to argue that you're a *de facto* beneficiary.

Another risk is that a creditor might challenge a gift to the trust as a fraudulent transfer. (See "Watch out for fraudulent transfer laws" above.)

SPA trust plus LLC

For certain types of assets — particularly business interests — holding these assets in a limited liability company (LLC) owned by a SPA trust can provide significant benefits. Typically, the trust would own the LLC as a nonmanaging member, while you would be appointed as the LLC's manager. The LLC provides an extra layer of protection for the underlying assets, while you retain control over the business. Because you don't own the LLC (it's owned by the trust), the assets are protected against the claims of your creditors (subject to fraudulent transfer laws). You can even receive management fees from the LLC, which, if reasonable, would be characterized as payment for services rather than distributions from the trust.

Getting the SPA treatment

In these uncertain times, transferring assets to an irrevocable trust may seem like a risky venture. At the same time, if you hold onto assets there's a risk that they'll be exposed to creditors' claims or, if Congress reduces the exemptions, to gift or estate taxes. A SPA trust allows you to transfer assets while exemption amounts are at record highs, while the special power of appointment provides a safety net in the event you need access to the funds down the road. ▮

Opportunities and challenges

Valuation in the age of COVID-19

Valuation and estate planning go hand-in-hand. After all, the tax implications of various estate planning strategies depend on the value of your assets at the time they're transferred.

The COVID-19 pandemic has had a significant impact on the value of many business interests and other assets, which creates some attractive estate planning opportunities. It also presents unique challenges for valuation professionals. As a result, it's more important than ever to involve experienced valuation experts in the estate planning process.

What are the opportunities?

With the value of many assets depressed (in many or most cases temporarily), now is an ideal time to gift them, either directly to family members or to irrevocable trusts and other estate planning vehicles. Doing so provides an opportunity to make the most of the record-high gift tax exemption (currently, $11.58 million) before it's reduced (either by operation of law at the end of 2025 or sooner by act of Congress).

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Transferring assets while values are low also allows you to use as little of your remaining exemption amount as possible, maximizing the amount available for future gifts or bequests. As the economy recovers and asset values rebound, your beneficiaries should enjoy substantial growth outside your taxable estate.

What are the challenges?

The pandemic has created a situation that's truly uncharted territory for the valuation profession. Unlike other economic crises in recent years, most of the damage to the economy has resulted from lockdowns, business closures and restrictions, and other measures designed to help contain the virus.

For business valuations, the current environment presents several challenges, including:

Known or knowable. A fair market valuation generally doesn't consider "subsequent events" — that is, events that occur after, and weren't "known or knowable" on the valuation date. Experts generally agree that the COVID-19 pandemic wasn't known or knowable as of December 31, 2019. Yet for valuation dates in the early part of 2020, determining whether the pandemic was known or knowable and should be considered in valuing a business or other asset can be a formidable task.

Note that even if an expert concludes that a subsequent event wasn't known or knowable on the valuation date, professional standards may require

the expert to disclose its potential impact on value in his or her report. In some cases, the user may be able to act based on this disclosure.

Suppose, for example, that a valuation is conducted for estate tax purposes for an individual who died in late 2019 or early 2020. In light of the pandemic's impact on asset values, the executor may elect to use the alternate valuation date, which is six months after the date of death.

Valuation approaches. Generally, valuators consider all three of the major valuation approaches: the income, market and asset approaches. The pandemic may affect the relative appropriateness of each approach and the amount of weight they should be assigned.

For example, market-based methods, which rely on data about actual transactions involving comparable businesses, may be less relevant today if the underlying transactions pre-date COVID-19 (although it may be possible to adjust to reflect the pandemic's impact).

Many valuators are emphasizing income-based methods, such as the discounted cash flow (DCF) method, which involves projecting a business's future cash flows over a defined period (such as five years) and discounting them to present value. The advantage of DCF is that it provides a great deal of flexibility to model a business's expected financial performance based on current conditions as well as assumptions about its eventual return to "normal" over the next several years.

Regardless of the method or methods used, it's important for valuators to consider a business's available cash and expected cash needs to assess its viability as a going concern. These considerations will be critical in evaluating a business's risk and impact of that risk on value.

Minimize your risk

Low values create attractive estate planning opportunities, and while the pandemic has depressed the value of many assets, some haven't been affected or have even increased in value. Obtaining a professional valuation of gifted assets — particularly closely held business interests and other difficult-to-value property — minimizes the risk that the IRS or state tax authorities will successfully challenge their reported values. ▮

Appointing a guardian for your children can be a difficult task

It's often said that a main reason people put off creating an estate plan is because of the difficulty in choosing a guardian for their children. However, that decision is one of the most important estate planning decisions you must make.

If you're hesitant to name a guardian for your children, consider the alternative: A court will name one, without any input from you. So, it's important to choose a guardian now, while you still have a say in the matter.

Choosing the right guardian

In most cases involving a parenting couple, you designate the guardian in a legally valid will. This means that the guardian will raise your children if you should die unexpectedly. A similar provision may address incapacitation issues.

Choose the best person for the job and designate an alternate if that person can't fulfill the duties. Frequently, parents will name a married couple who are relatives or close friends. If you take this approach, ensure that both spouses have legal authority to act on the children's behalf.

Also, select someone who has the necessary time and resources for this immense responsibility. Although it's usually not recommended, you can have different guardians for different children.

Consider, also, the living arrangements and the geographic area where your children would reside if the guardian assumes the legal responsibilities. Do you really want to uproot your children and send them to live somewhere far away from familiar surroundings? Don't ignore these factors, or the myriad others that impact your decision.

Justifying the decision

You don't have to justify your decision, but it can help to prepare a letter of explanation for the benefit of any judge presiding over a guardianship matter for your family. The letter can provide insights into your choice of guardian.

Notably, the judge will apply a standard based on the "best interests" of the children, so you should explain why the guardian you've named is the optimal choice. Focus on aspects such as the children's preferences, who can best meet the children's needs, the moral and ethical character of the potential guardian, and the guardian's relationship to the children.

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Turning to the courts

As previously stated, the court will use the standard of the best interests of the children. If the court agrees that the children's best interests are for you to become guardian — considering all the facts and circumstances — it will approve the arrangement. Most states require guardians to sign an oath before they can assume responsibilities. In addition, the court will generally require documentation of the guardianship. Your attorney can assist you in providing the proper documentation.

In other situations, courts will grant guardianship in cases where a child has been abandoned or the judge decides that the child should be removed from the parents' custody. Frequently, you'll have to prove in court that the parents are unfit.

Furthermore, other relatives, such as grandparents, have certain legal rights

and must be notified about guardianship hearings. Although you won't generally need formal consent from all parties, any objections they raise could adversely affect your case — not to mention the tension it will likely create. If emotions spill over, consult your attorney immediately.

Making a final decision

Your selection of a guardian can have a profound impact on your children, so it's important to choose carefully. Your estate planning advisor can provide the necessary guidance under your state's prevailing laws. ▮

ESTATE PLANNING RED FLAG

You don't have a will

The need for a will as a key component of your estate plan may seem obvious, but you'd be surprised by the number of people — even affluent individuals — who don't have one. A reason for this may be a common misconception that a revocable trust — sometimes called a "living trust" — obviates the need for a will.

True, revocable trusts are designed to avoid probate and distribute your wealth quickly and efficiently according to your wishes. But even if you have a well-crafted revocable trust, a will serves several important purposes, including:

- Appointing an executor or personal representative you trust to oversee your estate, rather than leaving the decision to a court,
- Naming a guardian of your choosing, rather than a court-appointed guardian, for your minor children, and
- Ensuring that assets not held in the trust are distributed among your heirs according to your wishes rather than a formula prescribed by state law.

The last point is important, because for a revocable trust to be effective, assets must be titled in the name of the trust. It's not unusual for people to acquire new assets and to put off transferring them to their trusts or simply forget to do so. To ensure that these assets are distributed according to your wishes rather than a formula mandated by state law, consider having a "pour-over" will that can facilitate the transfer of assets titled in your name to your revocable trust.

Although assets that pass through a pour-over will must go through probate, that result is preferable to not having a will. Without a will, the assets would be distributed according to your state's intestate succession laws rather than the provisions of your estate plan.

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.

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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.

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