Estate Planning Studies®

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Hecklering Notes

The 53rd Annual Heckerling Institute on Estate Planning was held in January in Orlando. There were some 3,400 attendees, a record, including 700 first-timers. Evidently, estate planning remains vital, even in the absence of the federal estate tax spur for most affluent families. The complete proceed-ings will be published by LexisNexis later this year. Here are notes on a few of the presentations, including:

- changes in family demographics
- including minors in the estate plan
- choice of fiduciary
- incapacity planning
- charitable IRA rollovers

Modern Families

Family structures are in a period of transformation, which has important implications for estate planners. That subject was explored by R. Hugh Magill, Executive Vice President and Chief Fiduciary Officer at Northern Trust. Among the demographic changes:

• Married couples, which were 80% of households in the 1950s, now represent fewer than 50%.

• Only 18% of adults age 18 to 29 are married, compared to 59% for this age group in 1960.

• The most common family in the 1950s was a married couple with three children. That ranks seventh today, as the most common household now is a single person. Married and childless is second, married with one child third, and married with two children fourth.

• As divorce has increased, one-sixth of American children are growing up in blended families, and 40% of Americans have at least one step-relative.

Magill offered an example from his own experience of the issues that these shifts may raise. An individual in a second marriage had children from each of the two marriages. He was roughly 15 years older than his wife, who was roughly 15 years older than the children from the first marriage. They were roughly 15 years older than the children from the second marriage. An estate plan for this family will need to take four distinct generations into account.

The stepmother in that situation was unhappy with the traditional approach, that the children from the first marriage would have to wait for her death to receive their inheritance. The solution in this particular

case involved a family conference and a plan to advance the inheritance to those children during life, with the clear understanding that there would be nothing further in the future.

Magill observed: "In an era of dramatically increased transfer tax exemptions, our focus may be less centered on transfer taxes and more oriented to family goals (accomplished in a tax-efficient manner). The planning process is becoming less paternalistic and colloquial, and evolving into one that is more engaging and adaptable to family composition, one that is less narrow culturally to one that is more cognizant of cultural perspectives; and finally one that adds to its perspective on the balance sheet, an enlarged understanding of each family's total wealth." Family wealth means values, as well as assets.

Trusts for today's families

Trusts will continue to play a vitally important role in family wealth management. The happy news is that in many cases they will no longer be constrained by tax considerations.

Magill suggested that trusts should include an explicit statement of intent, to bridge the divide between the grantor's hopes for the trust and the beneficiaries' expectations. A statement of intent tells the trustee what the purpose of the trust is, and it will provide guidance in the exercise of discretionary powers. This may prove especially valuable in situations where there is more than one fiduciary responsible for trust management.

The more important audience for a statement of intent is the trust beneficiaries. Why is a trust being used for family wealth management? Why is the trust superior to other alternatives for wealth management? What goals will be pursued by the trust?

With the advent of nearly perpetual private trusts, following the modification of the rules against perpetuities in many states, a statement of intent could become essential in a generation or so. Magill noted that "Perpetual trusts will 'speak' to multiple generations of beneficiaries, many of whom will never have met the grantor." Guidance for the trustee of a long-lived trust will need to be carefully drawn, especially regarding discretionary distributions.

Will the Kids be Alright?

Reportedly only one-third of parents with a minor child have a will in place. One obstacle seems to be the naming of a guardian for the child in the event that a parent dies while the child is a minor. Attorney Sarah Moore Johnson of Birchstone Moore, LLC, tackled the issues that concern parents.

Guardianship roles

Natural guardian. The mother and father are the natural guardians of the child, with rights to custody and control of the child.

Guardian of the person. A non-parent who has legal custody of a minor is responsible for the child's education, social activities, and medical care. The guardian of the person does not have personal financial responsibility for the support of the child.

Guardian of the estate or property. Some states have bifurcated the role of the guardian, giving a separate person responsibility for property management.

Standby guardian. A legal guardian whose service begins when the parent is living but no longer able to take care of the child due to physical or mental incapacity.

Agent. A parent may delegate some caregiving duties via a power of attorney.

Considerations

One should start with the largest possible list of potential guardians, according to Johnson. Relatives, friends, business partners, parents of the friends of the children, all are worthy of consideration. Then the list can be narrowed down by considering:

• *Age of the child or children*. Infants and toddlers require substantial time and attention, and many people would find it difficult to accept such responsibility. Older children present a different set of issues, and they also may have established friendships and school identities.

• *Geography*. If a child is well established in the community, with friends and successes in school, it would be best to avoid disrupting that following the trauma of losing a parent. On the other hand, a child who is not happy, perhaps because of bullying or other issues, might welcome a clean slate.

• *Religion*. Children need spiritual guidance, so finding a guardian of the same beliefs as the parents is often an important consideration. In the absence of that, a "spiritual guardian" might be appointed to supervise church attendance and religious instruction.

• *Grandparents*. Age and health permitting, grandparents may be a very good choice as guardians. Grandparents may be retired, and so have plenty of time to dedicate to the job. They may already be familiar enough to be a ready source of emotional support for the child. Grandparents may be able to relocate if they are not bound by employment requirements. On the other hand, courts may raise questions if the grandparent is very old, even if one is presently in good health.

• *Adult children*. A child who has reached adulthood may be a reasonable choice for guardianship over younger siblings, provided he or she is mature enough and able to command the respect of the young ones. Family members are often favored by the courts for this role. On the other hand, there are opportunity costs imposed on the guardian being thrust into a position of such responsibility, which may interfere with getting established in a career or completing one's education.

• *Married couples as co-guardians*. Co-guardianships are expressly anticipated in some state statutes, but Johnson raised important concerns about this approach. There is the chance that the couple will be divorced when the time comes to name a guardian, so which one will it be? There is the chance that the couple will divorce after becoming guardians, creating additional custody issues. Still, if the couple being considered for guardianship have children of their own, it is reasonable to name both as guardians so that the wards have the same status as the natural children.

• *Splitting up the children*. If there are several minor children to provide for, there may be practical problems in finding a single guardian for all of them. If there are large age gaps, that may suggest a path to a solution. Johnson cites the case of a family with two teenage daughters and twin sons, age 5. The parent of each daughter's best friend was named guardian for her, and a close neighborhood friend was named guardian for the boys. A moral obligation was included that all four children would meet together every Sunday for a family dinner.

• *Willingness to serve*. The prospective guardian should be asked about willingness and ability to serve in that role. The nominee should be given time to consult with his or her family before making a decision to accept the responsibility. Clients should be encouraged to keep the nominee active in the child's life, through visits, phone calls, and the like.

Divorced parents

After a divorce, the custodial parent may be concerned that naming a guardian may prove ineffective. The concern is valid, because the noncustodial parent will have the first right to take custody of the children at the death of the custodial parent. There are two ways to resolve this dilemma.

First, the noncustodial parent may consent to appointment of a guardian, abandoning parental claims. Alternatively, one may try to prove that the surviving parent is unfit. This may be achieved with a sworn affidavit reciting the reasons for the unfitness.

Using a trust

After the guardianship issue has been settled, a plan is needed to manage the inheritance for the child or children. Johnson recommended a "sprinkling trust" (sometimes called a "minor's trust," a "children's trust," or a "pot trust") rather than individual trusts for each child. A sprinkling trust replicates the manner in which family finances are managed, providing for each child according to his or her needs. When all the children have reached adulthood, the trust may divide into separate share for each child.

In addition to providing distributions for the children's health, education, and support, Johnson recommended having an explicit directive that the trustee is to provide funds to allow the children to visit relatives on a regular basis. Also, the trust may allow for compensation for the guardian, so that the guardian is no worse off for having accepted the role. However, Johnson cautions that additional safeguards may be needed to be certain that the guardian is not considered a beneficiary of the trust for transfer tax purposes.

Who Do You Trust?

Attorney Stuart Bear gave a presentation titled "Why Can't My Brother-in-law Bob be the Executor of My Estate?" He reviewed some of the important, practical considerations for choosing the best fiduciary to supervise the implementation of an estate plan, beginning with this job description:

1. Correspond with disgruntled beneficiaries
2. Manage family drama
3. Provide accounting to disgruntled beneficiaries
4. Invest assets (don't lose money or you will hear from disgruntled beneficiaries); and
5. Receive phone calls from disgruntled beneficiaries inquiring when they will receive their inheritance (but remember it's not about the money).

Some highlights from his talk are below.

Resist the first impulse

Very often a client's first thought in selecting an executor or trustee is that either a spouse or adult child can handle the job. Bear recommended probing the family dynamics before greenlighting such a decision. Sample questions might include:

- Do your children communicate regularly?
- How would one child react to his or her sibling receiving compensation for managing and distributing assets?
- Is any child likely to demand an inheritance immediately?

Clients often need to be brought up to speed on what fiduciary duties are, how much time and expertise they may require, and the value of having an impartial third party involved in decisions that may not always be popular.

Individual fiduciaries

The benefit of naming an individual to serve as fiduciary chiefly is familiarity with the client's values, family members, and family dynamics. There is a perception that an individual will be less costly, or may even waive fees for serving as fiduciary. Bear warned that most individuals will need to hire experienced professionals to help in the discharge of fiduciary duties, so the total cost of administration may actually be higher with an individual in charge.

Corporate fiduciaries

Corporate fiduciaries bring experience, expertise, professionalism, and objectivity to the jobs of trusteeship and estate settlement, noted Bear. Continuity of service is another advantage. Although there may be employee turnover, and the banking industry has experienced a series of acquisitions and mergers, a trust division doesn't take vacations, get sick, or move out of state. Corporate fiduciaries are regulated and bonded.

Bear recommended interviewing a handful of candidates before deciding upon a corporate fiduciary. Sample questions include:

- What services will be performed?
- What services will not be performed?
- Are distribution requests handled by an individual or by a committee?
- How long does it usually take to decide on a request for a discretionary distribution?
- At what asset level would the trustee terminate the trust and distribute the assets outright?
- Will specific language need to be included in the trust document?

If the client is having trouble deciding between an individual or a corporate trustee, it may be possible to have multiple fiduciaries, a sort of "best of both worlds." However, someone needs to be in charge, and that should be made plain in the estate plan. Don't overlook the importance of planning for the selection of a successor trustee, perhaps through the appointment of a trust protector.

Family meeting

Attorney Bear offers to facilitate a family meeting for his estate planning clients, to be held in his office. To get everyone on the same page, he said, everyone needs to be in the same room. The meeting should include the nominated fiduciaries and the client's children. There is sometimes a question about including the spouses of the children, but Bear prefers to have them attend as well. It provides for better control of the message, and it is likely to reduce future conflicts.

A family meeting will be especially important for a second marriage or blended family situation, if specific property will go to specific beneficiaries, if assets will be distributed unequally, and if there will be a hierarchy in the nomination of fiduciaries.

The goal is to avoid surprises and reduce future conflict after the death of the client.

When the client is quite certain of the plan for disposition of the assets, the family meeting should be scheduled after the documents have been signed. However, if the client is uncertain about the plan or the choice of fiduciaries, it may be better to have the meeting earlier.

Bear opens the family meeting with a discussion of wills, trusts, and the respective roles and responsibilities of personal representative, trustee, attorney-in-fact, and health care agent. He summarizes the planned distribution of assets, and then turns the meeting over to the client. The client then may explain the thinking behind the distribution plan and the choice of fiduciary or fiduciaries.

Bear concluded his presentation by saying: "Educating clients on fiduciary selection and fiduciaries on their duties can go a long way to ensure the success of any given estate plan."

Incapacity Planning

What should an estate planner do when a client reveals an unfortunate medical diagnosis that suggests he or she will lose mental and physical abilities in the near term? That was the question addressed by Attorney Bernard Krooks of Littman Krooks LLP. Areas that need addressing are testamentary dispositions, health care preferences, long-term care preferences, and substituted decision making.

Estate planning

Usually estate planning involves a substantial amount of guesswork and ambiguity. How far into the future will it be before the plan is needed? What family circumstances might change in the interim? What will the assets be? What will the tax laws be like?

Many of these uncertainties may be swept away when the client is on the verge of incapacity, because this could be the final review of testamentary documents, the last chance to amend them to implement the client's intent. Beneficiaries need to be reviewed. Krooks advised incorporating a statement of intent in the will or trust, to aid in the understanding of that intent. He also suggests discussing in some detail with the client some of the "boilerplate" that may appear in the documents.

For example, "health, education, maintenance, and support" is a routine standard for distributions to beneficiaries. What does the client expect that phrase to mean? Does it take into account other assets that the beneficiary may have?

This is also a good time to determine if any of the probable beneficiaries has a disability. If so, care needs to be taken so that their inheritance does not compromise their access to government benefits.

Revocable living trusts

A revocable living trust is a superior tool for asset management in case of incapacity, according to Krooks, because a trustee typically will have an easier time dealing with brokers and banks than would an attorney-in-fact. The trust document also needs to be reviewed carefully if an onset of incapacity is expected.

For example, does the client want to empower the trustee to make distributions to heirs before the client's death? Or is the trust to be for the sole benefit of the client and perhaps spouse? The trust needs to be crystal clear on this point.

If individuals will serve as trustee instead of a corporate trustee, when should they be removed for incapacity? What standard should be used? Should the opinion of a physician be required?

Krooks recommended consideration of giving someone other than the settlor the power to amend the trust after incapacity sets in. This might be the trustee, a trust protector, or the attorney-in-fact. If more than one person is granted the power, there should be a hierarchy of priority and a process for resolving conflicts.

If a charity is named as a trust beneficiary, a provision may be needed in case the charity no longer exists at the client's death.

Health care at the end of life

Typically, we expect heroic medical procedures for those who have a long and productive life ahead of them. The specter of incapacity may change this calculus for the client. How aggressive does the client want treatments to be? Are there treatments that should be avoided? Does the client hope to donate organs?

Does the client want a durable power of attorney

for health care decisions? Who should be the power holder? The power will need to comply with the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

An advance medical directive is also advisable for setting out the client's expectations for medical treatment. What artificial means of extending life should be used? What should be avoided? These issues need to be discussed with family members to minimize future misunderstandings and conflicts.

To help clients and their families work through these issues, Krooks recommended the Caring Conversations toolkit from the Center for Practical Bioethics, the American Bar Association Commission on Law and Aging Toolkit for Health Care Advance Planning, and similar materials produced by the U. S. Department of Health & Human Services, National Institute on Aging.

Long-term care

A diagnosis of impending incapacity makes the need for planning for long-term care urgent. Step one is to determine how long that the client may be able to stay in the home. Does the design of the house present obstacles to remaining there? Can they be fixed?

Who will provide the long-term care? Most such care is provided without charge by family members, such as a spouse or adult children. However, as dementia sets in, professional help may be required.

Will the client's income be sufficient to cover the costs of a nursing home? Does the client have long-term care insurance as part of this picture? The analysis can be daunting. If the income will not be sufficient, a plan may be needed for the orderly liquidation of assets to cover those costs.

Substituted decision making

Who will make decisions when the client loses the capacity to do so? For asset management, the trustee of a living trust may handle those duties. For legal, medical, and personal issues, the durable power of attorney will be used. In general, a family member will be given this responsibility.

Krooks recommended that the durable power of attorney be made effective immediately, rather than springing into action upon the client's future incapacity. This eliminates the need for a physician's consultation to decide upon incapacity. Next, Krooks suggested that the client and the attorney-in-fact visit financial institutions and financial advisors together, to alert them to the change in status.

Should the power of attorney include the power to make gifts? If so, how broad should the power to make gifts be? Should the class of recipients be limited or unlimited? Should the amounts of the gifts be limited to the annual federal gift tax exclusion ($15,000 this year).

If the client has a revocable living trust, the durable power of attorney should include the power to add assets to the trust. The power to establish trusts may be included in appropriate circumstances.

One reason for having a living trust and/or a durable power of attorney is to avoid the need to have a guardian or conservator appointed for the client. However, it sometimes develops that as capacity declines, the client makes harmful decisions, placing himself or herself in danger, and may need to have the ability to make such decisions legally removed. Krooks suggests including language in the durable power of attorney nominating the attorney-in-fact to be named as guardian, simplifying the process.

The attorney-in-fact will not automatically be able to handle tax matters. The IRS requires the filing of Form 2848 for this purpose. Similarly, the Social Security Administration requires a person to be appointed Representative Payee to be able to affect a third party's benefits. The law recently has been changed in this area. The Strengthening Protections for Social Security Beneficiaries Act of 2018 included a provision for designating representative payees, and the Commissioner of Social Security was direct to come up with a procedure for implementation. The change in law becomes effective April 13, 2020, and the procedure is due six months before that date.

Charitable IRA Rollovers

Law Professor Christopher Hoyt reviewed two facets of planned giving, the Charitable IRA Rollover and income tax deductions for charitable bequests of income in respect of a decedent. Here we summarize only the first topic.

Making a direct transfer from an IRA to a char-

ity, long a valuable planning strategy, has become even more valuable following the enactment of 2017's *Tax Cuts and Jobs Act*. That's because the higher standard deduction coupled with the $10,000 cap on the deduction for state and local taxes effectively means that for many taxpayers there will no longer be a tax benefit for charitable giving. They won't have enough itemized deductions to get over the standard deduction threshold. A direct transfer from an IRA to a charity provides a tax benefit *in addition to* the standard deduction. What's more, the transfer satisfies the required minimum distribution (RMD) rules that apply to those who are over age 70½.

Seven requirements

1. Only those over age 70½ are permitted to use this strategy. Watch for this tax trap in the year that a donor reaches the magic age. All IRA distributions made during the year one turns 70½ count toward the RMD, but only those made after the half birthday may be rolled tax free to a charity. Professor Hoyt said that a technical correction should be made to remove this anomaly.

2. IRAs only. Distributions from 401(k) plans, 403(b) plans, pension plans, or profit sharing plans are not eligible for charitable IRA rollover treatment. For those plans, the donor must first roll the assets into a new IRA.

3. Direct transfers only. The check from the IRA must be made out to the charity. A check made out to the IRA owner that is endorsed over to the charity will not work.

4. Public charities and private operating foundations must be the recipient. Ineligible recipients include private grant-making foundations (non-operating foundations), donor-advised funds, and supporting organizations.

5. The payment would have qualified for a full charitable deduction. In other words, no *quid pro quo*; the donor must receive nothing in return. The qualified charitable distribution cannot be used to purchase a charitable gift annuity, for example, or even to pay for tickets to a fundraising dinner.

6. Distributions are limited to $100,000 per year and must be otherwise fully taxable. Nondeductible IRA contributions are not taxable when distributed, and thus they are not eligible for treatment as qualified charitable distributions.

7. Documentation required. The charity must supply a contemporaneous written acknowledgement of the gift and certify that the donor did not receive any financial benefit from making the gift.

Failure to meet any requirement results in the entire distribution being taxable to the donor.

Benefits

The biggest winners in using the charitable IRA rollover are those seniors who are using the standard deduction. They would otherwise get no tax benefit from their charitable gifts.

Those who pay more tax as their adjusted gross income rises also are better off with this strategy. This includes people subject to the 3.8% tax on net investment income, those whose income is high enough to cause their Social Security benefits to be taxed, and those who are paying higher Medicare Part B premiums because of their high income. Donors who live in states that do not allow a charitable income tax deduction generally will achieve a tax benefit from the direct transfer to charity, as their adjusted gross income for state tax purposes won't be increased. The 60% of AGI limit on the charitable deduction does not apply to the charitable IRA rollover.

Finally, the heirs will be winners as well. They will prefer to receive assets that receive a basis step-up to getting income in respect of a decedent, which will be fully taxable as ordinary income.

Other issues

Professor Hoyt highlighted several additional considerations that may come into play for retirees considering this strategy.

Spouses. Each spouse may roll up to $100,000 to charity if each meets the age requirement and if each has an IRA. Rolling $160,000 from one spouse and $40,000 from the other would not work to secure the full $200,000 tax-free transfer.

Inherited IRAs. Qualified charitable distributions may be made from inherited IRAs if the beneficiary meets the age requirement.

Pledges. A qualified charitable distribution may be used to satisfy a pledge to a charity without triggering income to the donor, and without being a prohibited transaction that would otherwise cost the

IRA its tax deferred status.

Professor Hoyt noted that although we've had qualified charitable distributions since 2006, the IRS never has updated Form 1099-R to allow them to be identified. Because IRA administrators only report gross distributions to the IRS, it is up to the taxpayer to report qualified charitable distributions. The taxpayer reports all of the IRA distributions on line 15A of Form 1040, and reports only the taxable portion on Line 15B.