

# Insight on **estate planning**

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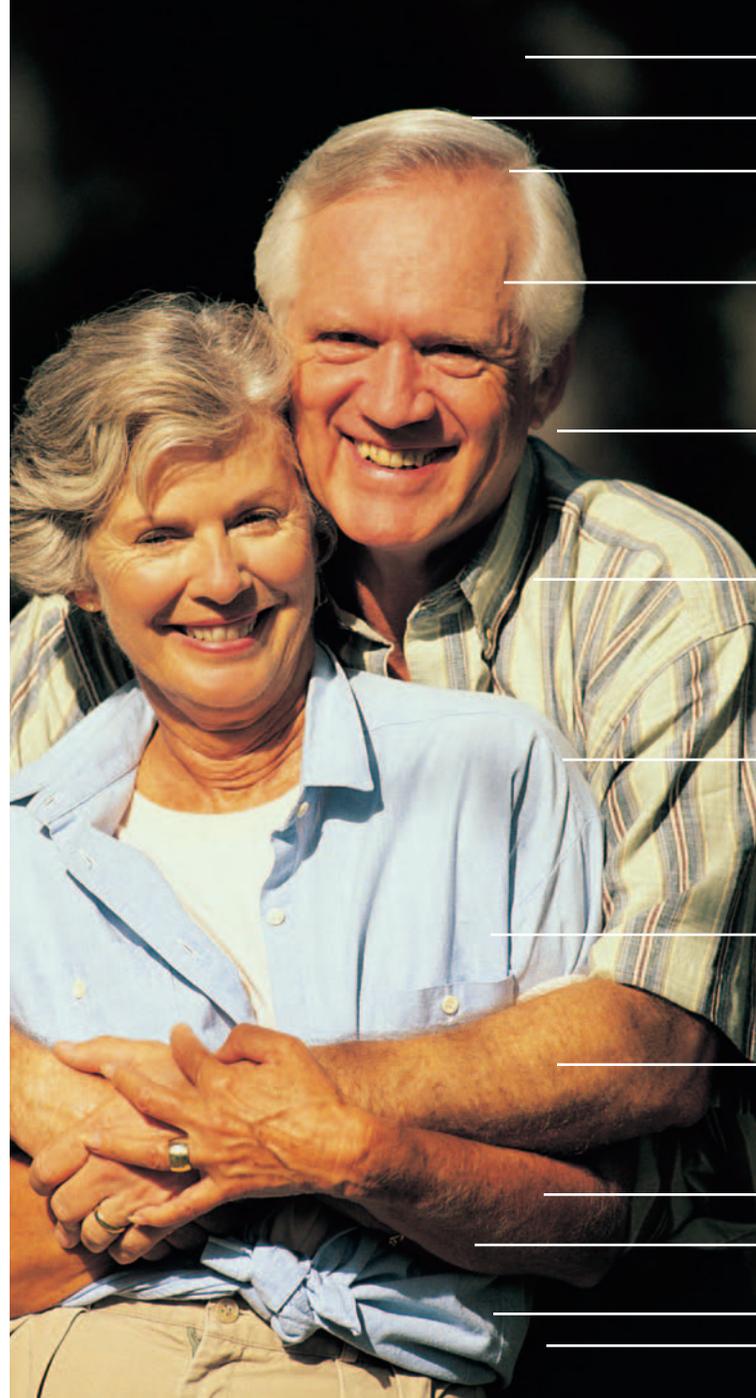
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**PLUS!**

Is a CLT too good to be true?



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# What you should know about a credit shelter trust

**C**urrently, your estate will escape federal estate tax if it doesn't exceed \$1.5 million. This estate tax exemption will increase to \$2 million in 2006 and to \$3.5 million in 2009, disappear with the estate tax repeal in 2010 and return to \$1 million in 2011 (unless further legislation is passed).

When you plan your estate, the first thing to do is to be sure you use both your — and your spouse's — exemptions. A credit shelter trust can allow you to do so.

## Funding the trust

To get started, structure your estate plan to provide that when the first spouse dies, assets equal to the then estate tax exemption will first go to fund a credit shelter trust created under that spouse's estate plan. These assets won't cause a tax on his or her estate. That is, they don't qualify for the federal estate tax marital deduction. Instead, the estate tax exemption of the first spouse to die “shelters” these assets from estate tax.



And they won't be subject to federal estate tax when the surviving spouse dies. This is because assets allocated to this trust for a surviving spouse's benefit — including appreciation — aren't part of his or her estate for federal estate tax purposes. This technique fully uses both spouses' exemptions as long as each spouse has assets at least equaling the exemption amount.

## Building a shelter

Here are some tax and nontax planning tips to creating a credit shelter trust:

**Pick the best route.** Direct the trustee to either: 1) Distribute the trust income to the surviving spouse — which may result in additional estate tax at his or her death if he or she hasn't spent the income, or 2) Accumulate the income and add it to the trust principal.

From an estate tax standpoint, the survivor should use his or her assets (or the assets in a marital trust, if the first spouse to die created one) before using credit shelter trust income. This is because his or her assets (and the marital trust) will be taxable in his or her estate for federal estate tax purposes when he or she dies — not the assets in the credit shelter trust.

**Settle the trustee question.** Decide whether the surviving spouse should act as sole trustee of the credit shelter trust or whether someone should act as co-trustee with the surviving spouse. If the surviving spouse acts as co-trustee, the trust can distribute trust funds to the surviving spouse for his or her best interests (a broad standard). If the surviving spouse acts as sole trustee, the trust can distribute funds to the surviving spouse only for ascertainable standards (that is, for support and medical care). If the surviving spouse as sole trustee could



distribute to himself or herself for his or her best interests, the tax law includes the trust in the survivor's estate for federal estate tax purposes.

What happens if a trust has co-trustees with a best-interest standard and they disagree as to discretionary situations? The trust has to provide that the nonsurviving spouse co-trustee controls — or else the credit shelter trust is included in the surviving spouse's estate for federal estate tax purposes.

## What happens if a trust has co-trustees with a best-interest standard and they disagree as to discretionary situations?

Do you want to authorize the surviving spouse to act alone with no one else involved with narrower standards or to have a co-trustee with broader standards? Other nontax factors affect this decision. If the surviving spouse has no investment experience, a co-trustee may be warranted. A co-trustee may also be appropriate if concerns exist about the

surviving spouse remarrying and using trust assets for the new spouse (which, of course, trust terms wouldn't permit).

**Ponder your investment options.** The trust will be excluded from the surviving spouse's estate for federal estate tax purposes. So consider investing these assets for growth and the surviving spouse's own assets (or the assets in a marital trust, if the first spouse to die created one) for income.

**Opt for flexibility, if advisable.** Consider authorizing the surviving spouse to "appoint" (that is, direct the distribution of) the assets remaining in the trust when he or she dies among your then-living descendants as he or she desires. The power of appointment's purpose is to permit the survivor to "reevaluate" the estate plan and modify appropriately. You may want this flexibility because, at the survivor's death, a reason may exist to treat the children unequally. That is, one child could have a child with a medical problem, one child may not be in contact with the survivor or one child could be wealthy and the other have financial needs.

### Grappling with the details

These are some of the many details you'll need to grapple with when creating a credit shelter trust. Discuss them all thoroughly with your attorney to ensure this arrangement fulfills its potential as an effective estate planning tool. ■

# 7 ways to protect your assets from creditors

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hen planning your estate, your primary objective is probably to pass on as much wealth to your heirs as possible. And if you're like most people, you want to reduce or eliminate estate taxes as well.

But litigation, divorce, malpractice and other potential claims may damage your net worth more than taxes. So protecting assets from potential claims has become an additional planning objective. Fortunately, many of the same techniques you can use to reduce estate taxes also can provide creditor protection.

You can use many techniques to reduce your estate for tax purposes while also protecting your assets from creditors. Yet these measures won't protect against existing creditors if a transfer constitutes a "fraudulent conveyance" under the Uniform Fraudulent Transfer Act. A fraudulent conveyance occurs if you had actual intent to hinder, delay or defraud a creditor when you made the transfer.

Here are seven ways to safely protect transferred assets from creditors:

**1. Outright gifts.** An outright gift protects a transferred asset from creditors. But you'll lose all economic interest in and control over the asset.

**2. Family limited partnerships (FLPs).** An FLP is an excellent asset-protection device because it limits a limited partner's creditor's ability to attach partnership assets to satisfy a debt. Creditors generally can obtain a charging order only against a limited partner's interest in a partnership. A charging order would permit a creditor to receive distributions only when they're made from the

partnership, and the general partner could choose not to make distributions. The creditor could even end up with taxable income without any cash distributions.

**3. Irrevocable life insurance trusts (ILITs).** From the standpoint of protecting your assets, an ILIT removes insurance proceeds from your estate for federal estate tax purposes. And the trust protects from creditors the cash value of the policies during your lifetime and the policy proceeds when you die.

**4. Qualified personal residence trusts (QPRTs).** A QPRT lets you transfer a primary or vacation residence to a trust while you reserve the right to live in the home for a term of years. The value of the interest you retain (that is, the right to live in the house for a term of years) is calculated using IRS tables. The value of the property transferred into trust, minus your term interest's value, is a gift known as the "remainder interest." This gift can be sheltered from gift tax by your \$1 million gift tax exemption. If you survive the term of years, the trust is not included in your estate for federal estate tax purposes.

QPRTs provide creditor protection by insulating the residence from your creditors' claims. In a creditor protection situation, the nondebtor spouse should create the QPRT and retain the term interest.

**5. Inter vivos qualified terminable interest property (QTIP) trusts.** You create this trust during your lifetime for your spouse. It qualifies for the gift tax marital deduction. The federal estate tax benefit to this technique is that when your spouse dies, the QTIP trust is included in his or her estate for federal estate tax purposes. If your spouse lacks sufficient assets in his or her own name to use his or her federal estate tax exemption, the QTIP assets will achieve this.



If you survive your spouse, an amount of assets equal to the estate tax exemption (currently \$1.5 million) will first go to fund a family trust created under the QTIP trust for your benefit. The balance of the QTIP trust assets will be allocated to the marital trust for your benefit and will qualify for the marital deduction, resulting in no federal estate tax at your spouse's death.



By structuring the QTIP trust this way, the assets allocated to the family trust when your spouse dies will escape estate tax. That is, the assets allocated to the family trust don't qualify for the estate tax marital deduction, but your spouse's estate tax exemption "shelters" them from estate tax. They also won't be subject to federal estate tax when you die, because assets allocated to a family trust — including their appreciation — for a surviving spouse's benefit aren't part of the surviving spouse's estate for federal estate tax purposes.

The inter vivos QTIP trust is extremely popular as a creditor protection device because the QTIP assets are completely insulated from claims of your creditors and your spouse's creditors during your spouse's lifetime.

**6. Charitable remainder trusts (CRTs).** A CRT usually provides for distribution of a percentage of the trust principal, at least annually, to a person, usually the grantor, for his or her lifetime. The CRT can provide that when the grantor dies, the grantor's spouse shall become the CRT annuitant for his or her lifetime. When this period ends, the charity receives the remaining CRT assets (the "remainder interest").

Creating a CRT provides several income tax benefits. For example, the grantor can deduct the remainder interest's value (the interest passing to the charity) as determined at the CRT's inception by consulting IRS tables.

An additional benefit is that the CRT is exempt from all income tax. So a grantor owning assets subject to a large capital gain can transfer these assets to the trust, and it can sell them without the grantor or the trust having to pay any tax on the gain. Or a grantor holding highly appreciated assets that aren't producing much income can contribute them to the CRT and create an income stream and owe tax only as annuity payments are received. It sells them and reinvests the proceeds to service the annuity.

A nondebtor-spouse-created CRT protects assets from a debtor spouse's creditors. A creditor can't attach the principal because of the charitable interest. And a debtor spouse's creditors can't attach the nondebtor spouse's annuity payments. If the nondebtor spouse dies first — and the CRT provides that the debtor spouse becomes the annuitant — the debtor spouse's creditors could attach the annuity when distributed to him or her.

**7. Grantor retained annuity trusts (GRATs).** A GRAT is a gift of a remainder interest in an irrevocable trust, under which the grantor has retained an annuity interest for a term of years. For example, if \$500,000 is transferred to a GRAT and the grantor has retained a 6% annuity, \$30,000 per year will be distributed to the grantor. The remainder interest in the GRAT can be a trust for the grantor's spouse, with trusts being created for children when both spouses die.

The value of the gift to a GRAT for gift tax purposes is the value of the property transferred to it, less the value of the grantor's retained annuity interest. The value of the annuity is calculated according to IRS tables.

If the grantor survives the GRAT's term, its assets will be excluded from the grantor's estate for federal estate tax purposes. If the grantor dies during the term, some of the assets will be included in the grantor's estate for federal estate-tax purposes.

If a nondebtor spouse is the grantor of a GRAT, the debtor spouse's creditors can't attach the annuity distributions to the nondebtor spouse. These creditors also can't attach the GRAT principal. If a debtor spouse becomes a GRAT beneficiary when the nondebtor spouse dies, his or her creditors could attach any distributions to the debtor spouse.

### Many options

These are just a few of the ways proper estate planning can also safeguard your assets from creditors. And in a society rife with litigation, you simply can't underestimate the importance of protecting yourself. Learn all you can about these measures and others that may benefit you. ■

# How the final HIPAA regulations affect your estate plan

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he U.S. Department of Health and Human Services' final regulations regarding the privacy provisions of the Health Insurance Portability and Accountability Act (HIPAA) now apply to all health care providers. These rules regulate how health care information is collected by doctors, hospitals and other providers and how it's shared with health care plans and third-party payors.

Health care providers now must comply with strict rules regarding the privacy of patient information. The regulations require that individually identifiable health information, called "protected health information," be safeguarded. They apply to health plans, health care providers and clearinghouses,

and extend to the patient and anyone acting on his or her behalf, such as a trustee, a health care agent or an attorney-in-fact.

Although HIPAA was intended to protect a patient's medical privacy, situations may arise in which the release of medical information can be critical to the operation of your estate plan.

### HIPAA primer

Under the new regulations, health care providers are prohibited from discussing a patient's status or releasing his or her medical records to a spouse or other family members unless they obtain written consent from the patient.

Failure to comply can result in a \$100 fine for each disclosure violation and criminal penalties. For a knowing privacy rule violation, penalties can include a \$50,000 fine and imprisonment up to one year. If the provider makes the violation with the intent to use the health information for commercial gain or malicious harm, the penalty increases to a \$250,000 fine and up to 10 years in prison.

### Effects on an estate plan

It's common practice for powers of attorney and trusts to contain a provision stating that



an agent or successor trustee can't act unless you, as the principal under the power of attorney or the trust's creator, are unable to make decisions for yourself. To avoid placing this burden on a family member, the determination of capacity often is left to a physician. He or she is required, under the document, to certify in writing that you are unable to make decisions before a successor can step in.

Under the new HIPAA rules, a physician can't provide a successor fiduciary with a written certification of your incapacity unless you've previously authorized the release of medical information to the successor. If you haven't, and no longer have the capacity to consent, the successor cannot obtain certification of your incapacity and, consequently, will be unable to assume responsibility for the management of your assets.

Without the appropriate consent under HIPAA, one option is for an attorney-in-fact

to petition the state court for the appointment of a guardian. This is both a time-consuming and expensive process.

### Revisions to your estate plan

To avoid court involvement, update your medical directive or health care power to specifically authorize your representative to obtain your medical records in accordance with HIPAA. The medical directive should clearly state the consent and authorization and should reference HIPAA.

### Emergencies happen unexpectedly

Because the federal government's final HIPAA regulations now apply to all health care providers, it's wise to review and revise your medical directive or health care power of attorney. Taking time to update your plan today can ease the burden on your successor trustee or family member in the case of an emergency. ■

## Is a CLT too good to be true?



A vehicle that allows you to regularly give money to charity and pass a substantial sum to family members free of gift or estate taxes may seem too good to be true. But it's not — it's called a charitable lead trust (CLT).

You set up this trust to pay the annuity interest to a charity for a term of years. You designate to whom the remaining trust assets (called the "remainder interest") will be paid when the term ends. The (perfectly legal) trick is to make the charity's interest large enough so the remainder interest's value (as determined by IRS tables at the trust's inception) is low. The remainder interest's value is a taxable gift but can be sheltered from gift tax by your \$1 million gift tax exemption.

For example, suppose you transferred \$500,000 to a CLT in March 2004 and provided for the charity to receive \$35,000 a year for 25 years. Assuming the trust grows at 7%, the remainder interest value and the taxable gift at the trust's inception would be \$6,713.50. In 2029, at the end of the 25th year, the balance in the CLT (\$500,000) would pass to your children tax free.

Unlike a charitable remainder trust, a CLT must pay income tax on its income and capital gains. But it can deduct the amount distributed to the charity as a charitable deduction.

A CLT is an excellent device if you are making regular charitable contributions anyway, because it lets you pass a large amount of money to family members free of gift or estate tax. And why not do everyone a little good?



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Estate Planning Services**

Founded in 1960, Weinstock, Manion, Reisman, Shore & Neumann offers estate planning, probate and trust administration, general business and corporate law, taxation, real estate and litigation services. Because 10 of our 13 attorneys are actively involved in estate planning, we specialize in helping clients meet objectives like these:

- Dispose of assets in a tax-efficient manner by using revocable living trusts.
- Minimize estate taxes by using sophisticated lifetime giving techniques, such as Grantor Retained Interest Trusts and Charitable Remainder Trusts.
- Provide liquidity and save estate taxes by using life insurance and irrevocable life insurance trusts.
- Efficiently administer probate and trust estates.
- Transfer business interests to younger family members in a tax-efficient manner.
- Minimize generation-skipping transfer tax on transfers to grandchildren and great-grandchildren.
- Implement deferred compensation and qualified retirement plans, including pension and profit sharing plans.
- Reduce income and estate taxes on the receipt of benefits from retirement plans.
- Avoid court intervention if disability strikes.
- Maximize employee productivity through the use of stock options and other incentive programs.
- Dispose of business interests among co-owners.
- Save on income taxes, both now and in the future.
- Select and form business entities, such as corporations, limited liability companies and family limited partnerships.

The professionals at Weinstock, Manion Reisman, Shore and Neumann bring over 150 years of combined experience to the services we provide. The stability of our firm enables our lawyers to work closely together with business specialists to give clients outstanding individualized attention.

Many of our lawyers are instructors at UCLA Extension and highly sought after as speakers for professional organizations in the community. Because we are at the forefront of current developments in law, we excel in designing strategies which help clients balance their business and financial interests with their personal and professional objectives in order to preserve and transfer their wealth.

**We welcome the opportunity to discuss your needs and help you meet your estate planning and wealth transfer objectives.**

**Please call us at 310-553-8844 to let us know how we can be of assistance.**