INSIGHT ON ESTATE PLANNING

Protect multiple generations with a dynasty trust

What's the best option for a pension plan payout?

The flexibility of stretch IRAs
Learn how your IRA can benefit your spouse and other beneficiaries

ESTATE PLANNING PITFALL
You reside in a state with high estate tax

APRIL / MAY 2017

Weinstock Manion
A Law Corporation

1875 Century Park East • Suite 2000
Los Angeles, California 90067
(310) 553-8844 • Facsimile (310) 553-5165
www.weinstocklaw.com
www.trustlaw.la

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.

Protect multiple generations with a dynasty trust

Dynasty trusts have nothing to do with the popular soap opera from the 1980s, but everything to do with leaving a lasting legacy. Although this type of trust is often created to reduce estate taxes, it can also provide other benefits and protections for affluent families. Most important: A dynasty trust may last for multiple generations.

A storied history

The roots of dynasty trusts can be traced to the common law principle known as the "rule against perpetuities." This rule prohibited trusts from lasting indefinitely and was incorporated into laws in most states. Typically, state law would require a trust to end within 21 years of the death of the last potential beneficiary at the trust's creation. Some states have adopted a simplified version limiting the trust duration to a certain number of years.

Tax benefits

In the past, dynasty trusts were used as a way to minimize transfer taxes between generations. For instance, if a family patriarch or matriarch leaves assets outright to adult children, the bequest is subject to federal estate tax in the transferor's estate, and then again in the children's estates when the assets pass from the children to the grandchildren, and so on. Although the federal estate tax exemption ($5.49 million in 2017) can shield assets from tax, the top tax rate on the excess is 40%.

What's more, the generation-skipping transfer (GST) tax applies to most transfers made to grandchildren, thereby discouraging transfers that simply skip a generation. The exemption amount and top tax rate for the GST tax are the same as they are for the gift and estate tax.

With a dynasty trust, the assets are taxed just once, when they're initially transferred to the trust. There's no estate or GST tax due on any subsequent appreciation in value. This can save families millions of tax dollars over the trust's duration. Of course, when a trustee eventually distributes the assets to beneficiaries, the beneficiaries may face

3 Q&As on dynasty trusts

Q: How do you set up a dynasty trust?

A: A dynasty trust can be established during your lifetime, as an inter vivos trust or part of your will as a testamentary trust. An inter vivos transfer to a dynasty trust may have additional benefits associated with transferring assets with greater appreciation potential out of your taxable estate.

Q: Which assets should you transfer to the trust?

A: Because the emphasis is on protecting appreciated property, consider funding the trust with securities, real estate, life insurance policies and business interests. You should retain enough assets in your personal accounts to continue to enjoy your lifestyle.

Q: Who should act as trustee?

A: Your choices may include a succession of family members or estate planning professionals. For most people, however, a safer approach is to use a reputable trust company with a proven track record, as opposed to assigning this duty to family members who aren't yet born.

income tax liability, depending on the step-up in basis rules.

The tax rules that apply to dynasty trusts could be affected by changes that are being debated in Congress this year. President Trump has advocated an outright repeal of the federal estate tax. However, the step-up in basis rules could be modified in conjunction with such a change.

A dynasty trust creates a legacy that will live on long after you're gone.

Nontax benefits

Regardless of the tax implications, there are several nontax reasons to set up a dynasty trust. First, you can designate the beneficiaries of the trust assets spanning multiple generations. Typically, you might provide for the assets to follow a line of descendants, such as children, grandchildren, great-grandchildren, etc. You can also impose certain restrictions, such as limiting access to funds until a beneficiary earns a college degree.

Second, by placing assets in a properly structured trust, those assets can be protected from the reach of a beneficiary's creditors, including claims based on divorce, a failed business or traffic accidents.

Look before you leap

Be aware that a currently effective dynasty trust is irrevocable. In other words, you may not be able to undo or even modify the arrangement if you have a sudden change of heart. Consult with your estate planning advisor to learn if a dynasty trust is right for you. •

What's the best option for a pension plan payout?

Typically, estate planning and retirement planning go hand in hand. Why? The more wealth you're able to set aside for retirement — and the better job you do of managing your retirement funds — the more you'll have left to provide for your beneficiaries after you're gone. A key decision to make is choosing the best option for receiving payouts from a pension plan.

Lump sum or annuity?

Some defined benefit pension plans give retirees a choice between receiving payouts in the form of a lump sum or an annuity. If you have other sources of retirement income, taking a lump-sum distribution allows you to spend the money as you please. Plus, if you manage and invest the funds wisely, you may be able to achieve better returns than those provided by an annuity.

On the other hand, if you're concerned about the risks associated with investing your pension benefits — or you don't want the responsibility — an annuity offers guaranteed income for life. (Bear in mind that guarantees are subject to the claims-paying ability of the issuing company.)

Single-life or joint-life annuity payout?

If you choose to receive your pension benefits in the form of an annuity — or if your plan doesn't offer a lump-sum option — most plans require you to choose between a single-life or joint-life payout. A single-life annuity provides

the plan participant with monthly benefits for life. The joint and survivor option provides a smaller monthly benefit to a married participant, but the payments continue over the joint lifetimes of both spouses.

Deciding between the two monthly options requires some educated guesswork. To determine the option that will provide the greatest overall financial benefit, you'll need to consider several factors — including your and your spouse's actuarial life expectancies as well as factors that may affect your actual life expectancies, such as current health conditions and family medical histories. One exercise that can help you make the decision is to perform some breakeven analysis. (See "Assessing the odds" on page 5.)

It's also important to consider your current financial needs — that is, your expenses and other assets and income sources. Even if you expect a joint and survivor annuity to yield the greatest total benefit over time, you may want to consider a single-life annuity if you need additional liquidity in the short term.

Choosing between the single-life and joint and survivor options can be an uncomfortable decision — essentially, you and your spouse are gambling on each other's lives. And if

you bet wrong, the losses can be significant. Suppose, for example, that you have the pension plan, you expect your spouse to outlive you by 10 years and you select the joint and survivor option. If your spouse outlives you by 20 years, he or she will receive a windfall. But if your spouse dies before you — or if you exceed your life expectancy — it may turn out that you would have been better off with the larger monthly benefit offered by the single-life option.

And, unfortunately, you can't change your decision retroactively: Once you select one or the other, you're stuck with it.

The single-life option can be a risk as well. You might choose this option, for example, if you and your spouse have comparable life expectancies or if you expect to live longer. Under those circumstances, the higher monthly payment will maximize your overall benefits. But if you die prematurely, the payments will stop.

If you choose to receive your pension benefits in the form of an annuity — or if your plan doesn't offer a lump-sum option — most plans require you to choose between a single-life or joint-life payout.

Providing your spouse a continuing income source

If it's important to provide your spouse with a continuing source of current income, consider combining a single-life pension payout with an insurance policy on your life. You select the single-life option, locking in a higher monthly payment for life. Next, you purchase a life insurance policy, using some of the higher monthly payment to finance the premiums.

If you die before your spouse, the death benefit provides your spouse with a source of income. If your spouse dies first, you can name a new beneficiary of the life insurance policy (a child, for example) or simply cancel or cash in the policy.

Keep in mind that the viability of this strategy depends on whether you qualify for affordable life insurance coverage. So it's a good idea to wait until your application is approved and the policy is issued before you elect a pension payout option.

Assess your financial situation

Before making a final decision on which pension plan payout option to select, it's worth your while to examine your family's overall financial situation. The overview should include your current and future income needs, the needs of your spouse and children, and the availability of liquid assets to meet those needs. •

Assessing the odds

Choosing a pension payout option involves a bit of risk, so it's a good idea to get a handle on the odds. Using breakeven analysis can help.

Suppose, for example, that your pension plan offers a choice between a single-life annuity that pays $3,000 per month or a joint and survivor annuity that pays $2,200 per month. Assume also that you expect to live another 20 years.

The breakeven point is the number of years your spouse would have to live for the two options to generate the same total benefit.

The flexibility of stretch IRAs

Learn how your IRA can benefit your spouse and other beneficiaries

IRAs are meant to be used for retirement saving. However, if you don't need to tap into your IRA for income during your retirement, you can preserve the assets as part of your estate, above and beyond what you've already set aside for your spouse and children. This "stretch IRA" strategy can be beneficial for both spousal and nonspousal beneficiaries.

Rules for RMDs

Tax laws encourage individuals to save for retirement in a variety of ways, but they don't allow you to keep funds in a traditional IRA indefinitely. (Note, however, that a Roth IRA doesn't have a required minimum distribution during the life of the account owner.) Under the rules for required minimum distributions (RMDs), you must begin taking traditional IRA distributions no later than April 1 of the year after the year in which you turn age 70½. You must then continue taking RMDs in each subsequent tax year.

For instance, if you turn age 70 on June 1, 2017, you must take an RMD for the 2017 tax year by April 1, 2018, and then another for the 2018 tax year by December 31, 2018. To avoid receiving two taxable RMDs in the same year — in this case, 2018 — you might arrange to take the first RMD in the year you turn age 70½.

The amount of each RMD is determined by the dollar balance in your IRA on the last day of the prior year and IRS-approved life expectancy tables based on the age of your beneficiary. For each subsequent year, the beneficiary should use the original life expectancy factor minus 1.

Rules for spousal beneficiaries

If a surviving spouse is the beneficiary of an IRA, he or she has greater flexibility than nonspousal beneficiaries. Notably, the surviving spouse can roll over the assets of the deceased spouse's IRA into an IRA in the survivor's name, continuing to benefit from tax deferral, subject to RMD rules. In this instance, the surviving spouse can postpone RMDs until he or she reaches age 70½, even if the deceased spouse was older.

Be aware that a surviving spouse under age 59½ can take money from an inherited IRA without paying the usual 10% tax penalty. However, the distributions from a traditional IRA are still subject to regular income tax.

Rules for nonspousal beneficiaries

The rules for nonspousal beneficiaries depend on whether the IRA owner dies before or after the required beginning date for RMDs. If he or she dies before the required beginning date, assets must be distributed either by the end of the fifth year following the death of the account owner or over the beneficiary's life expectancy. Choosing the life expectancy method will nearly always allow you to stretch the IRA out longer. Conversely, if the owner was already taking RMDs, a nonspousal beneficiary may receive distributions over the longer of the remaining life expectancy of the deceased IRA owner or his or her own life expectancy.

One technique that may be used to stretch IRAs even further is to name grandchildren as beneficiaries instead of children. Because they have longer life expectancies, the annual RMDs for these beneficiaries are smaller than they would be for their parents.

As with spousal beneficiaries, a nonspousal beneficiary doesn't have to pay the 10% early withdrawal penalty on pre–age 59½ distributions from an inherited IRA. Other complications may arise if there are multiple beneficiaries named or the IRA owner designates a trust or charitable organization as the beneficiary.

Uncertain future

Based on recent tax proposals by Congress, the benefits of stretch IRAs could be diminished by requiring beneficiaries to empty out accounts faster. Contact your estate planning advisor to make arrangements now to maximize the benefits under current law. He or she can also keep you updated on any tax law changes that affect estate planning. •

ESTATE PLANNING PITFALL

You reside in a state with high estate tax

Reforms being debated by Congress could repeal the federal estate tax with certain modifications. But state estate taxes might still siphon off hundreds of thousands of dollars regardless of what happens under federal law.

What are your options if you reside in a state with a high estate tax? You might shift assets out of your estate during your lifetime, possibly through direct gifts or transfers to trusts. Or you could move to a state with a lower state estate tax, or no tax at all.

Giving lifetime gifts may be the easiest move. For instance, if you transfer property to your children, the assets are removed from your estate. Of course, you also give up control of the assets.

A bypass trust is a tried-and-true method for transferring assets. Typically, you arrange for a surviving spouse to receive income from the trust, with the remainder going to your children. Thus, the assets "bypass" the estate of the surviving spouse and can benefit from the estate tax exemption. This will remain a viable strategy for state estate tax purposes if the federal estate tax is repealed. (Be aware that, unlike federal law, there's no portability of exemptions for state taxes.)

Picking up stakes and moving to another state is drastic, but might be your best bet. Currently, 14 states and the District of Columbia have a state estate tax on the books, while six states have inheritance taxes based on the relationship of beneficiaries. Maryland and New Jersey have both. But New Jersey recently approved legislation that increases its low estate tax exemption for 2017 and then repeals the estate tax completely in 2018.

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2017 IEPam17

Weinstock Manion

A Law Corporation

Comprehensive Estate Planning Services

For over 55 years, the attorneys and staff of Weinstock Manion have focused on providing personalized, high-quality counsel to moderate to high net worth individuals, real estate investors, business owners, charitable organizations, beneficiaries and fiduciaries in the following practice areas:

- Estate Planning
- Wealth Transfer Planning
- Estate and Trust Administration
- Estate and Trust Litigation
- Business Succession Planning
- Charitable Planning and Family Foundations

Working with our client's other trusted advisors, our team of specialized attorneys and paralegals create and implement comprehensive, creative and practical estate plans with the goals of maximizing wealth transfer in accordance with our clients' wishes and reducing taxation.

Estate and trust administration can have significant financial consequences for both current and future beneficiaries. In an effort to minimize income and estate taxes, while maximizing estate and trust income for beneficiaries, our process involves an extensive amount of collaboration between our estate planning, taxation and transactional attorneys.

Weinstock Manion's litigators represent both fiduciaries and beneficiaries in estate and trust disputes. Our litigators are skilled at handling claims for breach of fiduciary duty, beneficiary disputes, disputes regarding the validity of wills and trusts, undue influence and all aspects of conservatorships and guardianships.

For many clients, ensuring the future of their family business through a well-structured succession plan is an essential component of their estate plan. Our team of transactional, tax and estate planning attorneys work with our clients' other trusted advisors to develop plans for retirement, management transition and liquidity events.

Supporting charitable causes is important to many of our clients. We help our clients support the causes they are passionate about in a tax-efficient manner through thoughtful charitable planning, including the creation of family foundations.

At Weinstock Manion, we understand that significant wealth can lead to complex personal and financial issues that may result in family conflict. Our goal is to help implement wealth transfer plans that minimize potential conflicts while promoting enduring legacies for generations to come.

We invite you to explore our team and services, and to contact us to learn more about how we may collaborate to preserve your legacy.

Pursuant to applicable federal regulations we are required to inform you that any advice contained in this communication is not intended to be used nor can it be used for purposes of: (1) avoiding tax penalties or (2) promoting, marketing or recommending to another party any transaction or matter addressed herein.