Legal Matters®

Estate Planning
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Should you tell your children about your estate planning?

Often, one of the hardest decisions people make in the estate planning process is how much (and when) to tell their children or other heirs about their plans.

There's no single right answer for everybody; what to do depends on the nature of your planning and your family circumstances. But it's worth giving the issue some consideration.

Many people are very hesitant to reveal the details of their family's expected inheritances. A recent survey by UBS of almost 3,000 investors showed that only 54% had discussed their estate plans with their heirs, and only 34% had mentioned specific dollar figures.

Many parents say they fear that if their children find out they can expect a substantial legacy in the future, they'll be less likely to work hard and save in the present.

Another worry is that revealing an estate plan could lead to family squabbling and resentment. This is especially true if you plan to leave unequal inheritances to family members.

Imagine a family where one child is a successful banker while the other earns little money but does socially valuable work for a non-profit. If the parents leave more money to the poorer child, the banker might feel resentful and unloved. But if they leave everything in equal shares, the poorer child might feel slighted and misunderstood. Many families will simply avoid talking about the subject in order to keep peace.

If there's a blended family with children from a prior marriage, things can get even more complicated.

But while it can be difficult, there are also some very good reasons for having a detailed talk with your family about your estate plan.

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For one thing, if there's a chance of family squabbling and bitterness, it can be better to tell everyone what to expect now, while you're still alive and have a chance to explain your motives and smooth things over. You could explain, for instance, why you're leaving more assets to a child with a large family than to a

continued on page 3

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Some older wills can cause unnecessary capital gains tax

As a result of changes in the law, a lot of wills that were drafted even relatively recently may now result in a capital gains tax issue, and if you have such a will, you might want to consider revising it to save taxes.

Here's the background: When a person dies, he or she can leave an unlimited amount of assets to a spouse without incurring the federal estate tax. If assets are left to anyone else, including children, then everything above the "exemption amount" is subject to a very significant tax.

In the past, the exemption amount was not very large. As recently as 2001, it was only $675,000. Back in 2008, it was $2 million.

So let's suppose a couple is worth $4 million. If the husband died first and left everything to the wife, then the wife died and left everything to the children, the entire $4 million would be subject to the estate tax when the wife died, and anything over the exemption amount would be taxable.

To minimize this problem, a lot of older wills say that when the first spouse dies, some amount of assets (up to the exemption amount) will go into a trust, typically for the primary benefit of the surviving spouse. As a result, the assets that go into the trust aren't taxable at either the husband's death or the wife's death.

That's great … but in 2015, the exemption amount is now $5.43 million, so for the vast majority of people the federal estate tax is no longer an issue.

That means the trust arrangement in those older wills might no longer be necessary. In fact, in some cases it might be a tax problem.

The reason: When a person dies, any assets left to someone in their will get a "step-up" in their capital gains tax basis. So if you bought stock years ago for $20,000, and it's worth $100,000 when you die, your heirs will inherit the stock with a capital gains basis of $100,000.

But if the first spouse to die put the stock into a trust when it was worth only $20,000, it *won't* get a step-up in basis at the second spouse's death. That means that if the stock is sold, there will be a capital gains tax on $80,000 in appreciation.

So if you have a will that was written some years ago and includes this kind of trust, it's a good idea to have it reviewed now.

Caution: There might be many other reasons why a trust is still appropriate, including asset protection planning, providing for children of a previous marriage, and optimizing the generation-skipping transfer tax exemption. Still, now that the law has changed, it would be wise to reconsider whether your current plan achieves your goals in the best possible way.

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Using '529' plans for grandchildren's college can backfire

Grandparents often want to help with their grandchildren's college tuition bills. But you should be very careful about using a 529 plan for these expenses.

The reason? College financial aid programs generally don't consider parents' contributions from a 529 plan as student income, but they typically *do* consider *grandparent* 529 contributions as income. As a result, these contributions could reduce a student's eligibility for grants, subsidized loans, and work-study programs.

Only 11% of grandparents are aware of this problem, according to a recent study by Fidelity.

If a student expects to be eligible for financial aid, in many cases it might be preferable for grandparents simply to give money directly to the parents in order to help out – even though this means forfeiting the tax-sheltered advantages of a 529 plan. Grandparents can also contribute to the parents' own 529 plan, although not all states allow a tax benefit for doing so.

If you're a grandparent and you already have a 529 plan, you can try to transfer ownership of it to the parents. However, some plans don't allow such transfers, and some treat them as a distribution, which means incurring taxes and penalties.

You can also wait and make one large contribution in the student's senior year, since the student will no longer have to fill out financial aid forms in the future. However, some schools consider grandparent 529 plans when calculating financial aid packages even if no contributions are made from them, so this strategy won't work if the student goes to such a school.

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continued from page 1

child who is single, or why you're leaving money to a charity that has always been important to you.

In fact, the UBS survey showed that heirs who weren't told in advance about inheritance arrangements were more than twice as likely to be unhappy about them afterward.

Another thing to consider is that, if someone dies suddenly, the family is often left very confused about finances. They don't know what assets there are or where they're located, and searching for them can be extra stressful when the family is already suffering the grief of losing a loved one. If you discuss your assets and your plan now, so that everyone knows what to expect, it can make things much easier after you pass away.

In addition, many parents who talk about their plan with their children are surprised to discover that their children sometimes have good ideas. If a family owns a vacation home, for instance, the parents might have one thought about what to do with it, but the children might come up with a plan that better protects the home and better suits their future needs.

Talking with your children also allows you to coordinate your estate plan with your children's own estate plans. You might discover, for instance, that the whole family can save taxes if you give more assets directly to your grandchildren, or create trusts for your children instead of leaving assets to them outright.

Speaking of trusts, the issue of whether to talk with your heirs gets more complicated if you put substantial assets into a lifetime irrevocable trust. That's because the beneficiaries of the trust might be legally entitled to see the trust statements.

Different states have different laws about how "quiet" or "secret" a trust can be, and some require full disclosure once a beneficiary reaches a certain age. Also, some institutional trustees make it a practice to send statements to *anyone* named in a trust, unless told otherwise – so if you have a trust for a child but a grandchild is named as a future or contingent beneficiary, the trustee might send statements to the grandchild as well.

If you're concerned about these issues, it's a good idea to discuss them with your attorney.

How to 'fix' a trust that isn't working as intended

Sometimes, despite everyone's best efforts, things change and the terms of an older, irrevocable trust just don't work as well as they could in the present circumstances.

But there's a movement afoot to allow people in such a situation to solve the problem by moving the assets from an older trust into a newer one with more appropriate rules.

This is sometimes called "decanting" a trust, because you're basically pouring the assets from an older container into a newer one.

Today, some 22 states allow decanting of irrevocable trusts in some circumstances. That's up from 11 states just three years ago, so there's a lot of momentum behind the change.

Of course, even in states that allow decanting, not all trusts are eligible. For one thing, decanting generally works only if the trust agreement gives the trustee discretion over the principal, not just over income distributions.

Here are some examples of ways that decanting a trust could be beneficial to everyone concerned:

- A trust designed to terminate at a certain point and distribute assets to a beneficiary could be recast to keep assets in trust for the beneficiary and future generations, which could save taxes.
- A trust could be redone to provide stronger protection against creditors and divorcing spouses.
- A trust could be moved to another state that has more favorable laws, or that allows you to avoid state income taxes.
- A trust could be changed to include a power of appointment, which can reduce your capital gains tax.
- Decanting can be used to combine a number of small trusts into one, or to divide a larger trust into separate trusts for each beneficiary.
- If a trustee dies or is unable to serve, a new trust can solve this problem.
- If a beneficiary becomes disabled or has special needs, a revised trust could continue to provide help while also allowing the person to qualify for Medicaid and Social Security benefits.

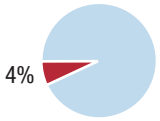
Parents disagree as to when children can handle an inheritance

If you're wondering at what age your children or grandchildren will be old enough to handle an inheritance, well, you're not alone.

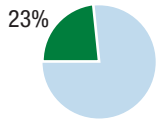
U.S. Trust recently conducted a survey of wealthy Americans (with assets of $3 million or more) and asked them that precise question. The issue is important because many parents leave assets in a trust for children or grandchildren until they reach a certain age, so the parents have to choose an age at which to release the funds.

The survey answers varied widely. Here's a closer look at the results:

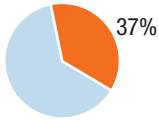
Age 18-24



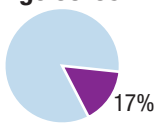
Age 25-29



Age 30-34



Age 35-39



Age 40 or older

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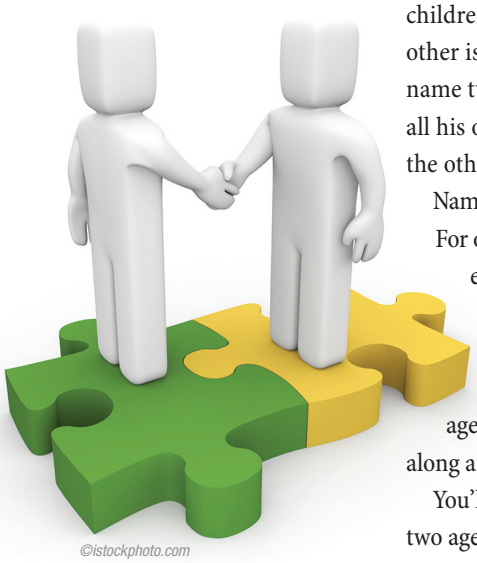
Your 'power of attorney' can name more than one agent

A power of attorney document allows someone else to act as your agent and handle your legal and financial affairs. It's critical to have such a document in case you become incapacitated.

Sometimes, people want to name more than one agent. For instance, a person may have two children, and not want one child to feel that the other is being favored. Sometimes a parent will name two children and give them both access to all his or her affairs, so one child won't suspect that the other is abusing the power.



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Naming more than one agent has some advantages. For one thing, if one agent is hard to reach in an emergency, the other may be able to step in.

On the other hand, naming two agents can be a disaster if they can't agree on how to handle matters. You should name two agents only if you feel confident that they can get along and agree on a course of action.

You'll also want to make very clear whether the two agents can act independently or whether they both have to sign off on everything.

If they both have to sign off, this will eliminate any suspicion that one is abusing the power. But it's much more cumbersome, and makes it hard to act in an emergency.

Allowing the agents to act independently is more efficient, but it also means that the agents might act in contradictory ways. And some financial institutions are reluctant to let one agent make unilateral decisions, for fear that the other agent will say something different and leave the institution stuck in the middle.

It's also possible to name one person as an agent and another as a successor or "backup" agent, who will take over if the primary agent resigns or becomes incapacitated. This can be a good solution – but you'll want to be very specific about when the successor agent can take over. Some financial institutions are very reluctant to follow a successor agent's orders unless they have clear proof that the first agent is no longer able to make decisions.