Legal Matters®

Estate Planning
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How to avoid common trust mistakes

Trusts can be the linchpin of a solid estate plan. But it's important to remember that you can't just set up a trust and forget about it. It's a good idea to periodically review how your trusts are working, to make sure you and your family are getting the full benefit of them. Not doing so can be costly!

Here are just a few things to consider, and some common mistakes to avoid:

▸ *Is your trustee still the best person for the job?* If your trust arrangement allows you to change the trustee, you should periodically give some thought to whether the person you've selected is still the best choice.

Picking a trustee is difficult, because trustees typically wear two hats: They must invest and manage the trust assets in order to maximize their value, and they must distribute them according to the terms of the trust and the wishes of the grantor.

The problem is that people who are good at investing and managing money are not always good at being sensitive to family needs, and vice-versa. That's why some people who create trusts name two trustees – one who is in charge of investments (perhaps even a professional or trust company), and one who is in charge of distributions (such as a family member). This can sometimes be a good solution if no one person is ideally suited to do both jobs.

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▸ *Does the trust actually own what it's supposed to?* Sometimes people create an excellent trust plan, but forget to change the title to certain assets so that the trust actually owns or controls them in the way that was anticipated.

If a trust is supposed to hold real estate, life insurance, shares of stock, retirement or bank accounts, family business units, etc., does it in fact do so? Changing the title to the assets can be complicated, but if it's not done properly, the trust won't work as intended. And if the assets have changed in any way over time, this needs to be reviewed as well.

▸ *How are the trust's bills being paid?* In most cases, the trustee's fees and other ongoing expenses should be paid out of the trust itself. But be careful – many trust companies will automatically send the bill to the person who set up the trust.

If the trust grantor pays the fees, this could cause problems. For instance, the payments might be considered a gift to the trust, which could potentially trigger the need to file a gift tax return or even pay additional taxes. Things can get even more complicated if the

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Families with disabled children get new tax-saving accounts

Congress recently approved a new kind of tax-saving account for the benefit of families with disabled children. It's called an Achieving a Better Life Experience, or ABLE, account.

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An ABLE account is a bit like a 529 college savings account. Family members and others can contribute to it on an after-tax basis, up to $14,000 per year each. The money in the account can be invested tax-free, and withdrawn tax-free for specified purposes. These purposes include a disabled beneficiary's housing, education, transportation, health, employment support, and use of assistive technology.

The beneficiary must have become disabled before age 26, and can only have one account. Total contributions to the account are subject to the same limits as 529 accounts.

ABLE account assets are not considered in determining a beneficiary's eligibility for Medicaid. Also, the first $100,000 in an account is not considered in determining eligibility for SSI benefits (except that distributions for housing will be considered income for SSI purposes).

Although ABLE accounts have been approved by Congress, all that really means is that Congress has allowed the states to set them up. It's possible that not all states will adopt them, and even states that are eager to adopt them probably won't have them up and running until sometime next year. You should also know that the rules and the exact tax benefits may end up varying from state to state, just as they do now for 529 accounts.

A big question will be whether a family with a disabled child should set up an ABLE account, a special needs trust, or both. ABLE accounts and special needs trusts have different advantages and disadvantages, and many people will find that the best plan is to have one of each.

For instance, a big advantage of the ABLE account will be that there's no tax on either its gains or its distributions. Also, an ABLE account doesn't require a trustee to manage it, and there's no need to file an annual trust tax return.

On the other hand, special needs trusts can have more than $100,000 in them (in fact, they can have an unlimited amount in them) without triggering a suspension of SSI eligibility. Further, an ABLE account can be used only for specified purposes – housing, education, transportation, health, etc. A special needs trust can be used for all sorts of supplemental expenses – everything from haircuts and grooming and a wide variety of other needs – that aren't paid for by Medicaid.

You should also note that if a beneficiary dies with assets still in an ABLE account, the assets must be used to repay the government for any Medicaid benefits that were provided after the account was set up. With a special needs trust, any remaining assets can go back to the family, and there's no requirement to reimburse Medicaid.

> ABLE accounts and special needs trusts have different advantages, and a family might benefit from using both.

In many cases, families will want to have both a special needs trust and an ABLE account. The trust can be used to hold larger, long-term investable assets and to provide for supplemental expenses, while the ABLE account can be used to save taxes while providing for nearer-term needs, and then spent down if the beneficiary has a limited life expectancy.

How to avoid common mistakes in handling trusts

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fees are paid by someone other than the grantor.

If a trust was set up in part for asset protection purposes, then paying bills from the wrong account could even undermine the purpose of the trust. As an example, suppose you've created a trust for an heir so that the assets will be protected in case the heir gets divorced. If the income tax triggered by the trust is paid out of jointly owned marital property, this could mean that the trust assets will no longer be sheltered in a divorce.

The same is true if trust assets and marital assets are combined or commingled in various ways.

► *Are you coordinating distributions to minimize taxes?* Many trusts are set up such that if they pay out income, the beneficiary pays the income tax, and if they don't, the trust pays the income tax. The problem is that, under current tax laws, the rules for trusts and individuals are very different.

For instance, in 2015, individuals pay the highest tax rate only if they have income over $413,200 for single filers, and $464,850 if they're married and filing jointly. But trusts pay the highest rate if they have income over a mere $12,300! So even if a trust doesn't earn all that much income, it can be hit with high tax rates.

Making smart distributions, especially to beneficiaries who are in a lower tax bracket, can save both federal and state taxes as well as minimize the 3.8% surtax on investment income.

Many people now have their estate planner, investment advisor and accountant work together each year on a plan to minimize both income and capital gains taxes while furthering the non-tax purposes of the trust.

► *Are you missing a chance to lock in GRAT gains?* A "grantor retained annuity trust" is a short-term trust designed to hold rapidly appreciating assets. The idea is that the trust eventually pays the grantor back the full original value of the assets plus interest (so no gift tax is owed), and any appreciation beyond that goes to the beneficiaries – tax-free.

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If you have a GRAT and the assets have indeed appreciated, you might want to buy the assets back from the trust now at their current value. This locks in the gains for the beneficiaries.

If the assets decline in value in the future, you'll have done your heirs a big favor and you'll also have reduced your taxable estate. If the assets continue to increase in value but you leave them to your heirs in your will, your heirs will still escape having to pay capital gains tax on the appreciation.

You could also buy the assets back, lock in the gains, and then put them into a new GRAT.

This is something that many people might want to consider given the stock market's gains over the past six years.

Converting to a Roth IRA can help with estate planning

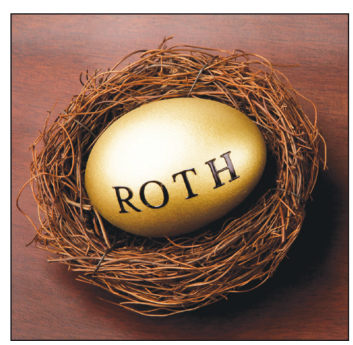
Converting a traditional IRA into a Roth IRA has many advantages and disadvantages, but what many people don't realize is that it can provide some estate planning benefits.

If you convert to a Roth, you'll have to pay income tax on the value of the IRA right away – just as if you received the entire amount as income. On the other hand, all future withdrawals will be tax-free, and there are no minimum required distributions during your lifetime.

Converting may make sense if (1) you have enough assets to pay the income tax without dipping into the IRA itself, and (2) you won't need to take distributions from the IRA during your lifetime and can leave it to your heirs.

One benefit is that your taxable estate will be reduced by the amount that you pay now in income tax, which is useful if your estate is large enough to be subject to the estate tax. While the federal estate tax now only affects estates of more than $5.43 million, many people are also subject to state estate taxes that kick in at much smaller amounts.

A second benefit is that you don't have to take minimum annual distributions. If you don't need these distributions, they will merely create unnecessary taxable income for you each year after you turn 70½, with the amount increasing each year. These distributions can push you into a higher tax bracket, reduce your itemized deductions, increase taxes on your Social Security benefits, and cause other problems. Often it's cheaper in the long run to pay the tax now all at once than to create tax headaches for yourself every single year after you turn 70½.



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New laws may clarify estate planning for online assets

Including online assets in estate planning is a new thing, and the legal rules aren't always entirely clear. But a number of states are now considering laws that will make things easier.

For instance, Delaware recently became the first state to pass a comprehensive law addressing what happens to someone's online assets when they pass away. And 13 other states are currently considering such laws, so it's likely the legal landscape will change dramatically in the next few years.

The Delaware law says that if a person dies, his or her executor can take control over the person's online assets and distribute them to heirs. The same is true for trustees and other fiduciaries. This will be allowed unless the person specifically states otherwise in his or her will.

Online assets can be very important, since they can consist of thousands of photos and e-mails, Facebook and other social media accounts, music libraries, blogs, genealogy records, and domain names, as well as PayPal and other accounts with credit balances, detailed banking and investment records, automatic bill-paying processes, and so on.

Many families have experienced grief because someone died suddenly and hadn't made provisions for access to their online assets. In some cases, online service providers have refused to give access to these assets to executors or family members – at least without a court battle.

So until the law is clarified, it could be wise to update your estate planning documents to make your wishes regarding your online assets clear.

You might also consider making your wishes clear to your online service providers. For instance, Google now lets you choose what you want to happen to your e-mail if you pass away. And Facebook recently began allowing people to name a "legacy contact" who can manage a person's page after they die.

In general, if you don't name a legacy contact on Facebook, the page will be frozen and no one will be able to update it. (You should note that even if you do name a legacy contact, that person will not be able to access your private messages.)

One thing to give careful thought to is that your e-mail accounts may contain private, personal messages from other people that you don't necessarily want to be read by family members or other heirs who might inherit an account.

In fact, a group of Internet companies strongly opposed the Delaware law in part for this reason. They made the argument that a doctor, therapist, accountant, or other professional might well have highly personal e-mail correspondence from patients or clients, and those people would likely be surprised and dismayed if the e-mails were suddenly turned over to the professional's family members without their permission.