

The ESTATE PLANNER

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COLLEGE FINANCING: AN INTEGRAL PART OF YOUR ESTATE PLAN

PROTECT YOUR PEACE OF MIND
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ARE YOUR RETIREMENT SAVINGS
SECURE FROM CREDITORS?

ESTATE PLANNING RED FLAG
You don't have a will

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COLLEGE FINANCING: AN INTEGRAL PART OF YOUR ESTATE PLAN

The staggering cost of college makes it critical for families to plan carefully for this major expense, and in many cases grandparents want to play a role. As you examine the many financing options for your grandchildren, be sure to consider their impact on your estate plan.

DIRECT PAYMENTS

A simple but effective technique is to make tuition payments on behalf of your grandchild. So long as you make the payments *directly* to the college, they avoid gift and generation-skipping transfer (GST) tax without using up any of your gift or GST tax exclusions or exemptions.

But this technique is available only for tuition, not for other expenses, such as room and board, fees, books, and equipment. So it may be desirable to combine it with other techniques.

A disadvantage of direct payments is that, if you wait until the student has tuition bills to pay, there's a risk that you'll die before the funds are removed from your estate. Other techniques allow you to set aside funds for future college expenses,



shielding those funds from estate taxes. A tool that's particularly attractive for grandparents is the health and education exclusion trust. (See "To reduce pain of college tuition, apply HEET" on page 3.)

A disadvantage of direct payments is that, if you wait until the student has tuition bills to pay, there's a risk that you'll die before the funds are removed from your estate.

If your grandchild is planning to apply for financial aid, also be aware that most schools treat direct tuition payments as a "resource" that reduces financial aid awards on a dollar-for-dollar basis.

GRANTOR AND CRUMMEY TRUSTS

Trusts offer several important benefits. For example, they can be established for one grandchild or for multiple beneficiaries, and assets contributed to the trust, together with future appreciation, are removed from your taxable estate. In addition, the funds can be used for college expenses or for other purposes. Also, if the trust is structured as a "grantor trust" for income tax purposes, its income will be taxable to you, allowing the assets to grow tax-free for the benefit of the beneficiaries.

On the downside, for financial aid purposes a trust is considered the child's asset, potentially reducing or eliminating the amount of aid available to him or her. So keep this in mind if your grandchild is hoping to qualify for financial aid.

Another potential downside is that trust contributions are considered taxable gifts. But you can reduce or eliminate gift taxes by using your annual exclusion

(for 2013, \$14,000 per recipient; \$28,000 per recipient for gifts by married couples) or your lifetime exemption (\$5.25 million in 2013) to fund the trust. To qualify for the annual exclusion, the beneficiary must receive a *present* interest. Gifts in trust are generally considered *future* interests, but you can convert these gifts to present interests by structuring the trust as a Crummey trust.

With a Crummey trust, each time you contribute assets, you must give the beneficiaries a brief window (typically 30 to 60 days) during which they may withdraw the contribution. You also must notify beneficiaries of their withdrawal rights.

If a Crummey trust is established for a single beneficiary, annual exclusion gifts to the trust are also GST-tax-free. If there are multiple beneficiaries, however, contributions may be subject to GST. The impact of the GST tax can be mitigated, or even eliminated, if you allocate some of your GST exemption to the trust.

SEC. 2503(C) MINOR'S TRUST

One alternative to a Crummey trust is a Section 2503(c) minor's trust. Contributions qualify as annual exclusion gifts, even though they're gifts of future interests, provided the trust meets these requirements:

- ◆ Assets and income may be paid to or on behalf of the minor before age 21,
- ◆ Undistributed assets and income will be paid to the minor at age 21, and
- ◆ If the minor dies before reaching age 21, the trust assets will be included in his or her estate.

A Sec. 2503(c) trust qualifies for the annual exclusion without the need to offer Crummey withdrawal rights. Once the beneficiary turns 21, however, it's possible to extend the trust by giving the minor the opportunity to withdraw the funds for a limited

To reduce pain of college tuition, apply HEET

If you want to finance college expenses for your grandchildren and other future generations at a minimal tax cost, while also giving to a charity, consider a health and education exclusion trust (HEET). A HEET is a "dynasty" trust designed to make direct payments of tuition (and, if you desire, medical expenses) on behalf of its beneficiaries.

You can use your annual exclusions and lifetime exemption to make gift-tax-free contributions. Contributed assets are removed from your estate.

Most significant, a properly designed HEET allows you to avoid generation-skipping transfer (GST) tax without using up any of your GST tax exemption. A trust can trigger GST taxes in two ways: 1) a taxable distribution to your grandchild or another "skip person" (that is, a person more than one generation below you), or 2) a taxable termination, in which all nonskip trust interests terminate and only skip interests remain.

A HEET avoids taxable distributions by making direct payments to educational or health care organizations. And it avoids taxable terminations by granting a significant interest (usually 10% or more) to a charity, which ensures that there's always at least one nonskip interest.

time (30 days, for example). After that, contributions to the trust no longer qualify for the annual exclusion, unless you've designed it to convert to a Crummey trust. Then, so long as you comply with the applicable rules, gifts to the trust will qualify for the annual exclusion.

AN INTEGRATED APPROACH

Other college financing options include Sec. 529 college savings and prepaid tuition plans, savings bonds, retirement plan loans, Coverdell Education Savings Accounts, and various other tax-advantaged accounts. The best approach is to integrate college financing into your estate planning efforts and to select options that help you optimize your family's overall financial situation. ❖

PROTECT YOUR PEACE OF MIND WITH A TRUST PROTECTOR

When Will created an irrevocable trust, he understood that he was relinquishing control of the assets he placed in the trust. He appointed a family member as trustee to oversee the distribution of assets after his death, but he wasn't 100% comfortable that this person could effectively handle all of a trustee's responsibilities. Will's estate planning advisor suggested he appoint a trust protector.

WHAT ARE THE RESPONSIBILITIES?

A trust protector is to a trustee what a corporate board of directors is to a CEO. A trustee manages the trust on a day-to-day basis. The protector oversees the trustee and weighs in on critical decisions, such as the sale of closely held business interests or investment transactions involving large dollar amounts.

There's virtually no limit to the powers you can confer on a trust protector. For example, a trust protector can be given the powers to replace a trustee, appoint a successor trustee or successor trust protector, approve or veto investment decisions, and resolve disputes between trustees and beneficiaries.

It may be tempting to provide a protector with a broad range of powers, but this can hamper the trustee's ability to manage the trust efficiently. The idea is to protect the integrity of the trust, not to appoint a co-trustee.

WHAT ARE THE UPSIDES?

Trust protectors offer many benefits. For example, a protector with the power to remove and replace the trustee can do so if the trustee develops a conflict of interest or fails to manage the trust assets in the beneficiaries' best interests.



A protector with the power to modify the trust's terms can correct mistakes in the trust document or clarify ambiguous language. Or, a protector with the power to change the way trust assets are distributed if necessary to achieve your original objectives can help ensure your loved ones are provided for in the way you would have desired.

Suppose, for example, that your trust provides that assets will be distributed to your son after he graduates from college and is gainfully employed. After college, however, your son decides to spend two years in the Peace Corps. If that doesn't meet the trust's strict definition of "gainfully employed,"

yet your son did well academically and has demonstrated an ability to manage money responsibly, the trust could authorize the protector to modify the trust to allow for early distributions.

It may be tempting to provide a protector with a broad range of powers, but this can hamper the trustee's ability to manage the trust efficiently.

WHOM SHOULD YOU APPOINT?

Choosing the right trust protector is critical. Given the power he or she has over your family's wealth, you'll want to choose someone whom you trust and who's qualified to make investment and other financial decisions. Many people appoint a trusted advisor — such as an accountant, attorney or investment advisor — who may not be able or

willing to serve as trustee but who can provide an extra layer of protection by monitoring the trustee's performance.

Appointing a family member as protector is possible, but it can be risky. If the protector is a beneficiary or has the power to direct the trust assets to him- or herself (or for his or her benefit), this power could be treated as a general power of appointment, exposing the protector to gift and estate tax liability and potentially triggering other negative tax consequences.

IS A TRUST PROTECTOR RIGHT FOR YOU?

After Will decided to appoint a trust protector for his irrevocable trust, his estate planning advisor ensured that the trust documents clearly defined the protector's role and authority. Without such clarity, misunderstandings between the trustee and trust protector may result. If you're considering appointing a protector, your estate planning advisor can help you determine what powers and duties will best complement your estate planning objectives. ❀

ARE YOUR RETIREMENT SAVINGS SECURE FROM CREDITORS?

Estate planning and asset protection go hand-in-hand. After all, no matter how well your estate plan is designed, it won't do much good if you have no wealth to share with your family.

If you have significant assets in employer-sponsored retirement plans or IRAs, it's important to understand the extent to which those assets are protected against creditors' claims and, if possible, to take steps to strengthen that protection.

EMPLOYER PLANS

Most qualified plans — such as pension, profit-sharing and 401(k) plans — are protected against creditors' claims, both in and out of bankruptcy, by the Employee Retirement Income Security Act (ERISA). This protection also extends to 403(b) and 457 plans.

IRA-based employer plans — such as Simplified Employee Pension (SEP) plans and Savings

Incentive Match Plans for Employees (SIMPLE) IRAs — are protected in bankruptcy. But there's some uncertainty over whether they're protected outside of bankruptcy.

IRAS

The level of asset protection available for IRAs depends in part on whether the owner is involved in bankruptcy proceedings.

In a bankruptcy context, creditor protection is governed by federal law. Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), both traditional and Roth IRAs are exempt from creditors' claims up to an inflation-adjusted \$1 million. The exemption through the first quarter of 2012 is \$1,171,650; it's scheduled to be adjusted on April 1, 2013.

The IRA limit doesn't, however, apply to amounts rolled over from a qualified plan or a 403(b) or 457 plan — or to any earnings on those amounts. Suppose, for example, that you have \$4 million invested in a 401(k) plan. If you roll it over into an IRA, the entire \$4 million, plus all future earnings, will generally continue to be exempt from creditors' claims in bankruptcy.

IRA-based employer plans are protected in bankruptcy, but there's some uncertainty over whether they're protected outside of bankruptcy.

To ensure that rollover amounts are fully protected, it's a good idea to keep those funds in separate IRAs rather than commingling them



with any contributory IRAs you might own. Also, make sure the rollover is fully documented and the word “rollover” is part of its name. Bear in mind, too, that once a distribution is made from the IRA, it's no longer protected.

Outside bankruptcy, the protection afforded an IRA depends on state law. Most states provide traditional and Roth IRAs with some protection against creditors' claims, ranging from the amount needed for the owner's support to a full exemption. It's uncertain whether SEP plans or SIMPLE IRAs are protected outside of bankruptcy; there's some precedent for the argument that state-law exemptions don't apply to these IRAs.

WHAT ABOUT INHERITED IRAS?

Federal courts are divided on whether bankruptcy protection extends to inherited IRAs. In a non-bankruptcy context, some states expressly exempt

inherited IRAs, while courts in other states are divided on the issue.

To provide additional asset protection to your heirs, consider naming an IRA trust as beneficiary of your IRA. If the trust is designed properly, it will preserve the tax-deferral and other benefits of the IRA while offering greater asset protection to your beneficiaries than an inherited IRA.

PROTECT YOURSELF

If you're concerned that your retirement savings are vulnerable to creditors' claims, consult your estate planning advisor about asset protection strategies. The effectiveness of these strategies depends on factors such as whether future creditor claims arise in bankruptcy and what state law applies. ❁

ESTATE PLANNING RED FLAG

You don't have a will

Regardless of your age, health and net worth, if you want to have a say in what happens to your children and your wealth after you're gone, you need a will.

If you have minor children, a will is the primary way to name a guardian. If you don't choose a guardian, a court will choose one for you. Typically, courts appoint a family member, such as a grandparent, aunt or uncle, or older sibling. But if your relatives disagree with the court's decision, a costly (and potentially traumatic) custody battle may follow.

A will also ensures that your assets will be distributed among your heirs according to your wishes rather than to a formula prescribed by state law (known as "intestate succession").

There's a common misconception that you don't need a will if you have a living trust (also referred to as a "revocable trust," "declaration of trust" or "inter vivos trust"). Assets transferred to a living trust during your lifetime will be distributed after your death to the beneficiaries you name, in the manner you specify, without going through probate.

But a living trust is effective only for assets titled in the trust's name. After your estate plan is in place, it's easy to acquire new assets and neglect to transfer them to your trust.

So you need a "pour-over will" to allow assets titled in your name to be transferred to your living trust at your death. Although these assets must go through probate, a pour-over will ensures that they'll be distributed according to the trust's terms. Absent a pour-over will, assets held outside your trust that aren't otherwise transferred by, for instance, a beneficiary designation, will be distributed according to your state's intestate succession laws.



EXPERIENCE. RESPONSIVENESS. VALUE.

At Shumaker, we understand that when selecting a law firm for estate planning and related services, most clients are looking for:

- A high level of quality, sophistication, and experience.
- A creative and imaginative approach that focuses on finding solutions, not problems.
- Accessible attorneys who give clients priority treatment and extraordinary service.
- Effectiveness at a fair price.

Since 1925, Shumaker has met the expectations of clients that require this level of service. Our firm offers a comprehensive package of quality, experience, value and responsiveness with an uncompromising commitment to servicing the legal needs of every client. That's been our tradition and remains our constant goal. This is what sets us apart.

Estate planning is a complex task that often involves related areas of law, as well as various types of financial services. Our clients frequently face complicated real estate, tax, corporate and pension planning issues that significantly impact their estate plans. So our attorneys work with accountants, financial planners and other advisors to develop and implement strategies that help achieve our clients' diverse goals.

Shumaker has extensive experience in estate planning and related areas, such as business succession, insurance, asset protection and charitable giving planning. The skills of our estate planners and their ability to draw upon the expertise of specialists in other departments — as well as other professionals — ensure that each of our clients has a comprehensive, effective estate plan tailored to his or her particular needs and wishes.

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We welcome the opportunity to discuss your situation and provide the services required to help you achieve your estate planning goals. Please call us today and let us know how we can be of assistance.

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