December 30, 2014

Estate Planning Update - December 2014

FINANCIAL LITERACY FOR TEENS AND YOUNG ADULTS

Teaching your children financial literacy may help lead them down a path of fiscal responsibility, but each child is different and what works for one may not work for all. If you are thinking about educating your children about finances, here are some ideas you can try:

OPEN A UNIFORM TRANSFERS TO MINORS ACT OR A UNIFORM GIFTS TO MINORS ACT ACCOUNT

- Although in most states minors cannot open accounts or hold assets in their own name, you can set up custodial accounts for children under the Uniform Gifts to Minors Act or the Uniform Transfers to Minors Act (depending on the state). The assets in these accounts are held in the name of a custodian, typically a parent, who controls and manages the assets on behalf of the minor until the child reaches age 18 or 21 (again, depending on the state). Custodians can engage the children by encouraging them to assist with active management of the account, and with online access, children can easily monitor the account balance.

TALK TO YOUR CHILDREN ABOUT CREDIT SCORES

- We suggest you explain to your adult children (over 18) what credit scores are and the importance of maintaining good credit. Depending on whether your child has used any credit (e.g., a credit card), you may want to help him check his credit score. The Fair Credit Reporting Act requires each of the nationwide credit reporting companies to provide a free credit report every 12 months. To request a free annual credit report, visit www.annualcreditreport.com or call 877-FACTACT.

SET UP A ROTH IRA

- Many children have part-time or summer jobs from which they earn income. Consider helping your child start saving for retirement by opening a Roth IRA account funded with his earned income for the year. For each of the years 2014 and 2015, total contributions to a Roth IRA cannot exceed $5,500. Of course, it is likely your child will want to keep his take-home pay so it is available for spending. Accordingly, we suggest a form of "matching" his earnings; you may make a gift to him equal to his earned income and he can use that gift as the amount he contributes to his Roth IRA for the year.

THINK ABOUT INTRODUCING YOUR CHILDREN TO YOUR ADVISORS

- Investment. Your financial advisor may help your children understand the goals of investing, the different investment vehicles available and the risks associated with different types of investments.
- Tax. Your tax professional may educate your children about reporting taxable income and tracking deductions to which they are entitled. For individuals with income below $60,000, the IRS offers free brand-name software and free e-filing. Visit www.irs.gov/uac/Free-File:-Do-Your-Federal-Taxes-for-Free for more information. Regardless of who prepares the return, your adult child should review his income tax return before signing it.
- Legal. Your own estate planning lawyer is available to help your adult children prepare certain documents to manage their affairs if they are unavailable (for example, studying abroad in a remote area) or incapacitated with a health issue.

    - A Power of Attorney allows your child to appoint someone (typically a parent) to have authority to manage the child's financial assets, such as bank accounts, while your child is unavailable or unable to do so himself. Often, your child will not need to retain a lawyer to prepare a Power of Attorney, as most banking institutions have separate forms your child can complete.
    - An Advance Health Care Directive designates someone (again, typically a parent) to make healthcare decisions on behalf of your child if he is unable to communicate his wishes. Without this document, a medical professional may not be willing to speak with you about your adult child's health.

INFLATION ADJUSTMENTS

Each year, certain estate, gift and generation-skipping transfer (GST) tax figures are subject to inflation adjustments. For 2015, the annual exclusion amount for gifts remains at $14,000. The estate, gift and GST tax exemption amounts for estates of decedents dying in 2015 and gifts made in 2015 are increased to $5,430,000. The annual exclusion amount for gifts made to a noncitizen spouse in 2015 is increased to $147,000.

NEW YORK ESTATE TAX

The New York estate tax exemption, which applies to New York residents and those who own real property located in New York, is subject to annual adjustment for the next several years. The New York estate tax exemption is $2,062,500 and will increase to $3,125,000 effective for decedents dying on or after April 1, 2015, through March 31, 2016.

New York residents should also be aware of an unusual aspect of the New York estate tax that can cause estates that are slightly larger than the applicable New York estate tax exemption to incur a disproportionate amount of New York estate tax. For example, the estate of a single person dying in June 2015 with a taxable estate of $3,250,000 would owe $183,650 in New York estate tax, meaning the "cost" of exceeding the New York exemption amount by $125,000 is an effective marginal tax rate of 147 percent!

To address this, we recommend including a provision in the estate plans of New York residents at or near the anticipated exemption thresholds that authorizes a charitable gift if that gift will reduce the amount of estate tax due by an amount

greater than the gift itself. With such a provision, the estate in the previous example would make a $125,000 gift to charity, which reduces the estate tax to zero and thereby increases the amount available to beneficiaries by $58,650.

The effect of this provision is even more dramatic as the New York exemption increases, as it is scheduled to do. For example, for a person dying in 2018, when the exemption will be $5,250,000, with a $5,500,000 estate, the New York estate tax would be $443,150. However, making a charitable gift of $250,000 reduces the estate tax to zero and results in $193,150 more to beneficiaries.

If you may be subject to New York estate tax, please contact us to see if a change to your estate plan to include this additional charitable gift makes sense for you.

MAY A TRUSTEE KEEP QUIET?

By definition, in setting up a trust, a settlor transfers legal title of property to a trustee but gives the beneficial interests in that property to others. The relationship created imposes fiduciary duties on the trustee, including, generally, a duty to keep beneficiaries informed of the trust's terms and its administration. Through that awareness, beneficiaries are positioned to watch over the trustee's actions and protect their beneficial interests.

Despite the benefits of transparency and shared information, some settlors prefer that details about a trust or even the trust's existence be withheld from beneficiaries for a period of time. Members of a family's senior generations may be concerned that knowledge of a large trust will negatively impact a young heir's behavior. They may wish to delay when children or grandchildren learn about the family's wealth. Although rare, trust agreements occasionally instruct a trustee to keep quiet. The "quiet trust," for which certain terms, aspects of its administration or value, or even its existence are withheld from one or more beneficiaries, is gaining attention in the trusts and estates field. Although its structure may appeal to some, in many jurisdictions the question whether quiet trusts are permissible is unsettled.

In some instances when a settlor has tried to keep beneficiaries unaware of a trust, courts have ruled that regardless of the trust's terms, the trustee's fiduciary duties to inform and account cannot be overridden. Furthermore, some in the legal community are asking: If no one is accountable to the beneficiary for the management of the trust property, does a trust, in fact, exist?

The Uniform Trust Code (or UTC, a nationwide effort to establish uniform state laws regarding trusts) respects the principle that a trustee owes a duty to beneficiaries to keep them informed of a trust's material facts. The UTC's substantial disclosure requirements for trusts are, nevertheless, among its most controversial provisions.

Certain states that have enacted the UTC, such as Massachusetts, have modified the disclosure provisions so they are default rules and, thus, can be overridden by the terms of the trust agreement. Some practitioners in Massachusetts argue this permits a settlor to negate all disclosure requirements, thus paving the way for quiet trusts in the Commonwealth. Others argue, in contrast, that Massachusetts has a long history of mandating that a trustee provide some level of information to a beneficiary, which the UTC did not supplant. It is currently unclear whether the Massachusetts UTC, which was intended to supplement existing trust law, allows settlors to eliminate the duty to inform entirely. The issue will likely be litigated and

ultimately decided by the courts.

The analysis is more concrete in certain other jurisdictions, such as Delaware and New Hampshire. In Delaware, for example, there has been a movement to permit the creation of quiet trusts in deference to "the principle of freedom of disposition and to the enforceability of governing instruments." With that in mind, the Delaware legislature authorized the creation of trusts that are not disclosed to their beneficiaries "for a period of time." What constitutes a permissible "quiet period" remains an open question. Under the New Hampshire UTC, a trust can remain "quiet" for generations.

Although limiting access to information may be of interest, the disadvantages of quiet trusts are significant. For one, quiet trusts preclude the benefits of dialogue between the trustee and beneficiaries regarding investments and fiscal responsibility.

The secrecy surrounding a quiet trust conflicts with the general duty of a trustee to keep beneficiaries informed. The core of a quiet trust?-- an uninformed beneficiary?-- means there may be no one with an interest in the trust property to enforce the trust's terms. Even in jurisdictions that authorize quiet trusts, their creation and administration are not without complication.