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Superior Estate Planning Documents:
GOING THE EXTRA MILE

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I. INTRODUCTION

One of the estate planner's most important jobs is to provide as much flexibility as possible to anticipate the client's personal, economic and tax changes, and to reflect the client's desires when the client can no longer express them. The estate planner must write today to anticipate future circumstances and enable another's present wishes to be fulfilled. Such unforeseeable changes include changes in marital status, parental issues, financial success or failure and accompanying pressure from creditors, health-related problems, including alcoholism and drug addiction, social and political changes. Also unforeseen are revisions of existing, and enactment of new, tax measures. Since it is impossible to predict many changes and their consequences, the conscientious lawyer will build in as many capabilities to react as is reasonable. This outline discusses areas where flexibility may be desirable.

This issue is even more apparent when estate plans include irrevocable inter vivos trusts. The irrevocable nature of many trusts places a tremendous burden on the estate planner to build into the trust flexibility and to address issues which transcend the basic objectives of the trust. Since irrevocable trusts cannot be changed by the grantor in future years, the cost of not including flexibility in such documents becomes very apparent.

II. WHO IS THE TRUSTEE?

A. The Grantor

The client should never be the trustee of an irrevocable trust which is the recipient of gifts from the client, since the property transferred to the trust would be included in his estate for federal estate tax purposes.

The Grantor would have retained overly-broad powers under Internal Revenue Code Sections 2036 and 2038.

B. A Corporate Trustee

If life insurance is the primary corpus of a trust and the client's objective is that a corporate trustee manage the trust assets only after the insurance matures into cash at the client's death, the client may consider refraining from appointing the corporate trustee until his death. Corporate trustees commonly charge minimum fees for serving as trustee, and its primary responsibilities prior to the death of the client/insured may be the tasks of safeguarding the insurance policy, paying premiums and monitoring the status and creditworthiness of the insurance company. The minimum fee could be avoided by designating a family member as initial trustee, with the corporate trustee becoming trustee upon the event of the death of the client/insured.

However, in today’s difficult financial environment, the client should appreciate the importance of monitoring the status of the policy and the insurance company. This task is much more difficult today than it was in the past. Perhaps the fees charged by the corporate trustee are justifiable.

C. Trustee Appoints Own Successor

In addition to providing for the appointment of successor trustees in the event the primary trustee cannot serve for any reason, under appropriate circumstances the trust instrument could give the trustee then serving the power to override the appointment contained in the instrument and appoint his own successor. Consider the situation where the children are minors when the trust instrument is signed and cannot be named as trustees. Perhaps the client's spouse, and then his siblings are appointed. If the spouse in later years, once the children have become adults and matured, determines that the children should serve as successors, the spouse, as acting trustee, could have the power to redesignate successors, eliminate the siblings (who may have died or become incapacitated), and designate one or more of the children as successor trustees.

D. Power to Remove Trustee

For a variety of reasons, the trustee appointed by the client may not be an appropriate trustee in future years. The trustee or beneficiaries may have moved to another state. The relationship of the trustee to the beneficiaries may have changed because of divorce, marriage or other personal circumstances. The beneficiaries may simply prefer to deal with a successor trustee or, within parameters set forth in the power of removal provision, to appoint another trustee. As a common example. a spouse of a descendant may have been appointed trustee but may become divorced from the descendant. Flexibility frequently prescribes giving the beneficiaries the ability to react to this type of situation.

E. Delegation Among Co-Trustees

When co-trustees are serving, each may have its own talents and expertise. Perhaps the corporate trustee should handle investments. Perhaps the corporate trustee should be absolved from responsibility for managing the family business. If three children are jointly serving as trustees, perhaps two of the children should delegate to the third full authority to sign checks and perform certain ministerial duties. Estate planning documents can contain directives addressing this type of issue.

F. Delegation to Corporate Agent or Custodian

Frequently a spouse or other individual is designated as trustee. This individual may lack the sophistication or inclination to maintain accurate records, make investment decisions, collect and deposit income, prepare estate and income tax returns, or perform many of the responsibilities of a trustee. Although in practice individuals frequently appoint corporate fiduciaries to serve as agent or custodian, general principals of trust law contain a prohibition against trustees delegating their powers and responsibilities. A trust provision specifically authorizing such delegation would encourage an individual trustee to avail himself or herself of available professional services.

G. Conflicts of Interest

Sensitivity to situations in which a family member serving as executor or trustee may have a conflict of interest can be critical to the implementation of the client's estate plan. Consider the estate of a person who owns a closely-held business. The executor or trustee will be a family member who may already be involved in the business and/or who may receive a controlling interest in the business under the client's estate plan. Many conflicts can arise with other beneficiaries, possibly other children who are not involved in the business. The executor and trustee will control the board of directors, so he can elect himself as president, and can establish his own salary and fringe benefits. He can control decisions regarding the declaration of dividends, which may be the only available vehicle to provide income to other family members who own minority interests in the business. In conjunction with effectuating a testamentary clause equalizing distributions among all family members, the executor can select a friendly appraiser who will value the business conservatively.

To avoid the conflicts of interest which are inherent in vesting control of the estate plan in the family member inheriting the business, the client may consider the following alternatives:

1. Using one or more disinterested fiduciaries.

2. Appointing a special trustee to participate in decisions involving potential conflict.

3. Choosing a committee of trusted persons who must consent before certain actions maybe taken by the actual fiduciary.

4. Include a will provision requiring the fiduciary to notify all beneficiaries in advance of any conflicts of interest and perhaps requiring the consent of all other beneficiaries before action can be taken.

III. Who are the Beneficiaries?

A. Power of Appointment to Include Spouse as Beneficiary

Frequently trusts for lineal descendants do not grant beneficial interests to spouses of lineal descendants. In some situations it may be appropriate to grant to a descendant the power to decide whether a spouse can receive any beneficial interests upon the death of the descendant. The descendant may have recognized the fact that the spouse would depend upon income from the trust for support and may want to direct that the spouse receive all income for the balance of the spouse's life, or perhaps until the spouse's remarriage. The descendant may also be granted the power to direct that principal be distributed to the spouse. Because the surviving spouse did not create the trust and is not the "transferor" for estate tax purposes, this power would not result in inclusion of the trust assets in the surviving spouse's estate under Internal Revenue Code Sections 2036 and 2038.

B. Power to Change Distribution to Descendants

If one spouse dies and leaves a trust which provides that the remainder be divided among descendants after the death of the surviving spouse and paid out at certain specified ages, the descendants may not receive any distributions from the trust for many years. What happens if the family circumstances change? What happens if the surviving spouse concludes that one child cannot prudently manage money and needs an independent trustee for life? What if one child develops a serious illness and needs more than a pro rata share of the trust for future support? What if one child becomes disabled and would qualify for governmental aid in the absence of receiving a portion of the trust? The surviving spouse can be granted a limited power to rearrange the manner in which the trust assets pass to descendants, varying the ages of distribution and perhaps the percentages to be distributed to each child. Because the surviving spouse did not create the trust and is not the "transferor" for estate tax purposes, this power does not result in inclusion of the trust assets in the surviving spouse's estate under Internal Revenue Code Sections 2036 and 2038.

C. Mandatory or Discretionary Distribution Ages

Most estate plans under which descendants are the primary object of a client's bounty provide for mandatory distribution to children or other descendants as they reach certain ages. For example, a trust may be created which requires the trustee to make distributions in equal thirds at ages 25, 30 and 35. What happens if a child or descendant becomes mentally incompetent prior to reaching the designated distribution ages? To whom does the Trustee make distribution? What happens if the child or descendant is satisfied with the administration of the trust for his or her benefit and does not want to terminate it? Instead of requiring mandatory distributions at certain ages, a trust instrument can provide that the trust remain in existence for the life of the beneficiary, subject to the power of the beneficiary to terminate the trust in stages as he or she attains certain ages. If the beneficiary is not mentally competent at the designated ages or thereafter, he or she is incapable of exercising the power, and the trust will continue. If the beneficiary is competent and wishes to continue the trust, he or she can simply refrain from exercising the power and terminating the trust.

D. Large Age Differences Among Children

How fair is an equal division of trust assets among children if the eldest child is 28 years old and the youngest is 14 years old? The youngest child will spend part of his or her inheritance to provide upkeep and maintenance during minority and to pay for his or her own college education. The parents had already paid these expenses for the eldest child. One solution to this problem is to increase the share of the youngest child by a formula amount intended to provide true equalization. Another solution is the creation of a "pot" trust containing the following terms:

> Spray income and principal among descendants for health, education, support and maintenance until the youngest child attains age 25 (the age at which higher education should be completed).

> Any principal paid to a child, or that child's descendants, after that child attains age 25 is charged to that child's share upon ultimate distribution of the trust assets.

E. Expenses of Guardian

In selecting a guardian for minor children, a testator should be sensitive to the additional financial burden the guardian frequently assumes by undertaking the responsibility of raising the testator's children. The guardian may need to make an addition to his or her current home or move to a new home. There may be additional housekeeping expenses. The cost of including the testator's children in family vacations could be substantial. There maybe additional costs incurred in the children's visits with grandparents. Is it appropriate, for example, for the trustee to pay the cost of improving or adding a room to the guardian's home? Such cost would inure to the benefit of the guardian as well as the children. Although an appropriate subject for discussion between the guardian and the trustee, specific directions in a testamentary document expressing a sensitivity to the financial burden and directing the trustee to pay certain expenses eliminates any question about the propriety of the expenses.

F. Contingent Marital Deduction

If a husband prepares a trust for the benefit of his wife and funds the trust with an existing policy of insurance on his life, the face amount of the life insurance will be included in his estate under Internal Revenue Code Section 2035 if the husband dies within three years of the date of the insurance transfer. The trust should contain a contingent marital deduction provision, which would create a transfer to or for the benefit of the wife which qualifies for the marital deduction, eliminating estate taxes, in the event any of the trust assets are included in the grantor's estate because of an untimely death.

G. Divorce

Under Alabama law, a person who is divorced from a decedent or whose marriage to the decedent has been annulled is not a surviving spouse of the decedent for probate purposes. Code of Alabama (1975) § 43-8-252. If, after executing a will, the testator is divorced or his marriage is annulled, the divorce or annulment revokes any disposition or appointment of property made by the will to the former spouse, and revokes any nomination of the former spouse's executor, trustee, or guardian, unless the will expressly provides otherwise. Code of Alabama (1975) § 43-8-137.

The above Alabama statutes do not apply to non-testamentary disposition, such as dispositions under the terms of inter vivos trusts. It is therefore important to include in any inter vivos trust agreement a provision accomplishing this same objective.

IV. Miscellaneous

A. Authorization to Make Gifts

Although a revocable management trust may appear not to require the same sensitivity to flexibility as an irrevocable insurance trust, this trust becomes irrevocable upon the death or permanent disability of the grantor. One issue which should be addressed in preparing a revocable management trust is the continuing authority of a trustee to make gifts for the grantor. Only with an appropriate authorization can a trustee continue a preexisting gift-giving program or otherwise make gifts to save estate taxes.

B. Reciprocal Trust Doctrine

If reciprocal trusts are created whereby two settlors, such as spouses or siblings, create trusts, each of which names the other settlor as a beneficiary and is identical in its terms, each settlor may be constructively treated as the settlor of the trust of which he is a beneficiary. The result of such a construction would be that I.R.C. Sections 2036 and 2038 would include in the beneficiary's estate the entire corpus of a trust which would not otherwise be includible.

Application of the rule does not require that the trusts are created in consideration of each other with tax avoidance motives. Estate of Moreno v. Commissioner, 260 F.2d 389 (8th Cir. 1958); U.S. v. Estate of Joseph P. Grace, 395 U.S. 316, 69-1 USTC 12,609 (1969); Rev. Rul. 85-24, 1985-1 C.B. 329; and PLR 8717003. When drafting trusts in this situation, the drafter should be senstive to this rule and vary the terms of the two trusts to the extent necessary to avoid an argument by the Internal Revenue Service that the trusts are reciprocal.

C. Uniform Transfers to Minors Act

When making lifetime gifts to minors, draftspersons should consider incorporating the trust provisions contained in the Alabama Uniform Transfers to Minors Act ("AUTMA"), Code of Alabama (1975), Section 35-5A-1 et. seq., rather than drafting trust agreements. The provisions of AUTMA essentially create a trust which terminates in favor of the child at age 21 and allows the trustee (referred to in AUTMA as "custodian") to pay or accumulate income or principal for the support and education of the child. This informal trust is frequently appropriate for the client's circumstances and is more economical than the preparation of trust documents.

D. Monetary Devises

Rather than leaving specific dollar amounts to specified beneficiaries, an estate plan will have more flexibility if the monetary devises are expressed in terms of a percentage of the testator's estate. If the size of the estate increases or decreases in value, the amount of the devise will be adjusted as well. The potential inequities caused by monetary devises which constitute a disproportionately large or small portion of an estate can be eliminated.

E. Beneficiary's Withdrawal Rights

Many clients prefer to stagger mandatory corpus distributions to their children on the theory that it is wiser to let the child make an early mistake with less than all of the property. Many of these clients are receptive to a suggestion that distribution at specified ages not be mandatory. Instead, the child is given withdrawal rights to increasing portions of the trust as he or she grows older and, presumably, better able to care for his or her money If the beneficiary is satisfied with the trust's administration, if he or she is ill, disabled, unavailable because of travel or other commitments, or just not comfortable undertaking

large financial responsibilities, he or she may prefer to forego withdrawal rights, at least for a time.

F. Incentive Planning

Estate planners are increasingly being asked to draft plans that include incentives for productive behavior on the part of minors or young adult beneficiaries. Incentive plans typically reward productive behavior and penalize non-productive behavior. For example, a trustee may be authorized to distribute to the grantor's children such part or all of the net income or principal of their respective trusts as the trustee shall determine in its discretion, provided that the child falls within one of the following descriptions:

1. The child is a full time student at an accredited college, university, vocational school or similar institution and maintains the equivalent of a grade point average of 2.5 or better on a scale in which 4.0 is an "A" grade, and the child's course of study is progressing towards the completion of an undergraduate or other degree at the rate of a full time student;

2. The child is employed full time in an occupation to which the child devotes at least 35-40 hours of work per week or the child is pursuing a career which is socially productive on a full time basis, such as a career as an artist or a musician, to be determined solely by the trustee in the trustee's discretion;

3. The child is disabled and such disability prevents him or her from being a productive and self-supporting member of society as determined by the trustee in the trustee's sole discretion;

4. The child is pursuing an educational, scientific or charitable goal which the trustee has determined, in its sole discretion, is in the best interest of the child and the general public and which makes the child a productive member of society as determined by the trustee in the trustee's sole discretion; or

5. The child is occupied full-time caring for other family members, and the trustee determines in its sole discretion that such obligation reasonably precludes the child from

earning a living (an example of such occupation would be motherhood).

G. Conclusion

Contrary to the preconception of many clients and more than a few attorneys, the preparation of estate planning documents is not simply a matter of pushing a few buttons on a computer to invoke one of several standardized documents. The preparation of superior estate planning documents requires a sensitivity to the current needs of the client and a projection of the needs which may arise as circumstances change in the future. Only by being sensitive to these issues and skillfully creating or adapting forms to meet current and anticipated needs can the attorney fully address the needs of his clients.

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The information contained herein should not be construed as legal advice or a legal opinion with respect to any specific facts or circumstances, and is not to be used as a substitute for the advice of counsel.

Changes in tax laws have occurred since the preparation of this article. Seek legal counsel for updates.