

Insight on **estate planning**

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What's the purpose of a purpose trust?

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ave you ever wondered if it's possible to leave money in your will or living trust for the care of your pet or your prized antique automobile? Through the use of a purpose trust, you may be able to achieve your objectives. One caveat, though, is to be sure that your state permits such trusts. While many do, purpose trusts aren't currently allowed in all states. But in such a situation you may be able to set up an offshore trust.

In essence, a purpose trust is a way for you to provide for the care of *something* rather than *someone*. This concept flies in the face of conventional trust wisdom, which says a trust must have a beneficiary to be legitimate.

Purpose trust history

Thanks to a groundswell of desire to have a mechanism for caring for a pet or other nonperson, the ability to create such a trust was initially offered by the Uniform Probate Code (UPC) in 1990 and then expanded in 1993. An optional code section — that is, states can choose to include it in their UPC, but aren't required to do so — permits trusts for the care of pets and trusts for honorary purposes. An honorary trust would be one that “is for a specific lawful noncharitable purpose.”

Many foreign jurisdictions that allow noncharitable purposes for trusts do so in a manner that is fairly consistent across the board.



Although a “noncharitable purpose” isn't specifically defined, the broad language suggests there is wide application of its use. In fact, the major limiting factor is that the UPC suggests restricting the duration of these trusts to 21 years.

But the newly created Uniform Trust Code (UTC) similarly permits trusts for the care of animals and for other lawful noncharitable purposes. The UTC gives, as an example of a noncharitable purpose, the care of a cemetery plot. And, like the UPC provisions, the code suggests limiting the trust's duration to 21 years.

Applicability is limited

Even though a growing number of states have adopted either UPC or UTC provisions, the acceptance isn't universal. Nor, for that matter, is the acceptance of UPC and UTC in general. And despite the provisions of both UPC and UTC that allow for the more generic noncharitable purpose trust, they, too, aren't widely accepted by the states.

Thus, it's wise to consult with an estate planning professional before creating a purpose trust. He or she will be able to tell you whether your state has already adopted either UPC or UTC, or both. If your state has yet to adopt the relevant section of either uniform code, or if it has adopted a more restricted version of the code, you still may be able to create a trust that can accomplish your goals.

Borrow law to achieve your purposes

To reach your objectives, you may need to “borrow” a law that is more suited to your purpose. As you might use an offshore trust for asset protection, you could use the law of a foreign jurisdiction to create a trust for the benefit of your pet or for another non-charitable purpose.

This can be easily accomplished, as trust law is clear that the settlor has the right to decide which jurisdiction's law will govern the trust. But deciding where to create the trust is a more fundamental issue, and will be determined largely by the preferences of the trust's settlor.

Moreover, many foreign jurisdictions that allow noncharitable purposes for trusts do so in a manner that is fairly consistent across the board. In fact, the largest potential impediment — that there must be a legal connection between the



Take the simple route

If you like the concept of the purpose trust but prefer to keep things simple, consider alternative means of accomplishing virtually identical results. Depending on your estate situation, for instance, you might be able to reach your objectives with no tax consequences whatsoever.

Suppose, for example, that a friend has agreed to care for your pet. You could provide something for him or her in your estate plan. That is, suppose you'd like to leave \$5,000 for the future care of your pet.

Rather than bear the cost of creating and administering a purpose trust, you could designate that your friend is to receive a \$5,000 bequest. Just be sure to select someone you trust, because there's no way to legally ensure the friend uses the money to care for your pet.

jurisdiction and the settlor — can, in most cases, easily be overcome.

For instance, having a foreign trustee would likely be sufficient to create the connection. And most foreign jurisdictions would mandate that the trustee, or at least one trustee, be located in that jurisdiction. Thus, your most difficult decision might be deciding which jurisdiction you'd like to use for the trust, as you can learn the laws of your desired location.

In fact, your decision of which offshore jurisdiction to use often becomes a driving force. For example, if you like the Cayman Islands, and anticipate being there frequently for other reasons, that would be the logical choice for your trust.

Powerful, yet complex

The purpose trust can be a powerful estate planning option, but it also can be difficult to set up. And, whether you create the trust domestically or offshore, there might be income and estate tax issues to address. Be sure to consider whether your trust is going to create unwanted tax consequences, such as gift and income tax concerns. ■

Grant the powers

Powers of attorney for health care and property are a critical part of any estate plan

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ost estate planning documents address what happens to your estate after your death. But there are important documents that are more concerned with what happens *before* you die — specifically, with what happens in the event you become incapacitated. A power of attorney for health care and a power of attorney for property are key pieces of a sound estate plan.

Health care

When creating a power of attorney for health care, you designate an agent who will have authority to make health care decisions on your behalf if you become legally incapacitated. The form requirements are unique from state to state. Wherever you live, though, it should be designed to specifically allow your agent access to your medical records in accordance with the federal Health Insurance Portability and Accountability Act of 1996 (HIPAA).

Further, make your power of attorney for health care as detailed as possible. After all, in addition to making decisions on health care issues, you could empower your agent to make organ donation choices on your behalf as well. To the extent you've made your choices clear, your agent will have an easier time determining the decisions that are most in line with your expectations.

And, depending on the rules specific to your state, your agent may be given certain powers simply by virtue of being your agent. That is, you might not specifically have to authorize

organ donation; your agent may be deemed to have authority to make such decisions on your behalf unless you specifically *restrict* such ability. So, be mindful of your state's rules, and make your choices accordingly.

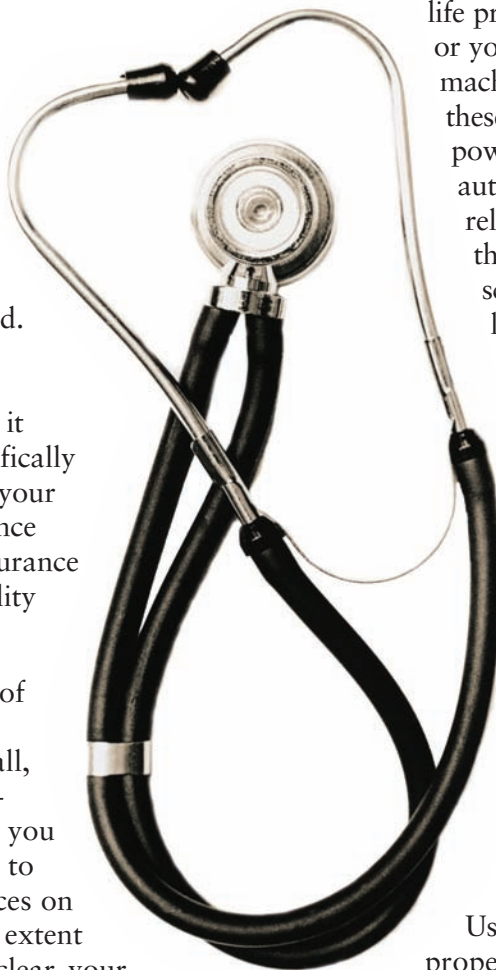
A health care power of attorney also generally allows you to express your wishes with respect to end-of-life decisions. You can indicate, for example, whether you want dramatic life preservation methods employed or you prefer not to be kept alive by machines. In many jurisdictions, these provisions would allow your power of attorney to usurp the authority that previously had been relegated to your will. Generally, though, a will is too limited in scope to solely address end-of-life issues.

And, perhaps more important, ensure that your agent either has a copy of your power of attorney or knows where one is located. Also, give your primary physician a copy. That way, in the unfortunate event of your becoming incapacitated, there can be a smooth transition to your agent with respect to decision-making power.

Property

Use a power of attorney for property to give decision-making authority on your behalf with regard to property considerations. Your agent doesn't take possession of your assets, but has full authority to take action on those assets.

As with a power of attorney for health care, be as specific as possible with respect to your wishes. If you want to authorize



your agent to make gifts on your behalf, for instance, include such a provision in your document. The more information, the better, especially when it comes to helping your agent make the decisions that you would make if you were able to do so.

Much of the role of a power of attorney for property also can be provided by your living trust. The important distinction is that the terms of the living trust will govern only those assets that have been titled in the name of the trust. The ability to make decisions with respect to any assets not titled in the name of the living trust, though, would come from your power of attorney for property.

If you have a living trust, it may be smart planning to have its trustee serve as the agent for your power of attorney for property, as the roles that the trustee and agent play are similar.

Peace of mind for all concerned

Your powers of attorney for health care and property are powerful documents that can help you achieve many of your planning objectives in the event you become incapacitated. Because requirements for these documents vary from state to state, be sure that yours are properly drafted so they can be as useful as possible. ■

Planning for the increased lifetime estate tax exemption

As of Jan. 1, 2006, the lifetime estate tax exemption amount increased from \$1.5 million to \$2 million, giving you a tremendous opportunity to review your estate plan and make any necessary revisions.

To maximize your available lifetime exemption, your will or living trust should automatically allocate assets between taxable and nontaxable in the most efficient manner. Thus, if your estate plan directs \$1.5 million to a family trust — of which your spouse is the primary beneficiary but which will not be included in his or her estate — and the balance to a trust for your spouse, you may want to change the language to a formula instead of a specific number: for example, “... the largest amount that can be transferred by me to persons other than my spouse”

By handling your will or living trust in this manner, you won't have to change it again when the exemption increases to \$3.5 million in 2009. Plus, specifying a certain amount could cause problems when the exemption drops back to \$1 million, as it's currently scheduled to do in 2011.

However, there are two sides to this issue: A formula can give you comfort that, regardless of how the exemption amount changes, you'll be assured of maximizing the amount sheltered from estate tax.

If you're married, ensure that you split assets between your spouse and yourself so that, if the combined estate exceeds \$4 million, both of you will have at least \$2 million included in your estate. If you don't, you could be creating a situation where the estate of the survivor faces a larger estate tax than necessary.

If your assets are split evenly, a total of \$4 million is sheltered from estate tax and only \$1 million will be subject to tax. Suppose, for instance, you and your spouse have assets totaling \$5 million, but all of it is titled in your name. If your spouse dies first, none of the assets are sheltered from estate tax. At your subsequent death, only \$2 million is sheltered and \$3 million is subject to tax.

The odd couple

Bankruptcy law changes and your estate plan

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ate last year, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) became law. It dramatically overhauled the rules surrounding bankruptcy filings. And, as a bonus, it included provisions that expanded the protection afforded to IRAs and other retirement plans. Thus, regardless of whether bankruptcy is a concern for you, BAPCPA may affect your estate plan.

Impact on retirement plans

Perhaps the area BAPCPA most significantly affected is retirement plans. The act clarifies that retirement plan accounts treated under the Internal Revenue Code as tax-exempt also are exempt from the bankruptcy estate.

This, in practical terms, means that 401(k), 403(b) and 457 plans and related plan money enjoy full protection under bankruptcy laws. Further, any amounts rolled over from these retirement plans into IRAs will enjoy the same protection. Thus, all retirement funds that started out as 401(k) or related money are treated as exempt from the bankruptcy estate.

The law goes a step further by allowing an additional \$1 million exemption (with inflation-adjusted increases) of traditional or Roth IRA money as well. In fact, the \$1 million figure can be increased at the discretion of the bankruptcy judge.

Interestingly, though perhaps not coincidentally, the law was passed while the ink was still drying on the Supreme Court decision of *Rousey v. Jacoway*, in which the Court ruled that IRAs would be afforded the same bankruptcy protection as other retirement accounts in certain circumstances.

In light of that decision and BAPCPA, there are two important items to note with respect to your retirement plans, including IRAs:



1. The bankruptcy rules may offer more protection of such plans, but bear in mind that, for you to be afforded this protection, you must be in bankruptcy — other credit protection laws aren't as liberal and won't apply to you. Plus, in divorce proceedings, filing for bankruptcy won't keep your spouse from being able to seek — and being entitled to — a portion of your retirement plan.
2. Distributions from retirement plans aren't protected in bankruptcy proceedings and are subject to creditor claims.

Estate planning in conjunction with BAPCPA

How do the provisions of BAPCPA apply with respect to your estate plan? For many, retirement plan assets make up a large portion of their estate, so BAPCPA could have a significant impact. Although each situation is different, let's look at a few possibilities.

First, suppose Joe, a commodities trader, wants to hedge against certain risks inherent in his business. He realizes that circumstances can quickly change, so he and his wife decide to increase contributions to their retirement plans. Besides, he reasons, it makes sense today because of the income tax benefits.

Should Joe ever need to file for bankruptcy, the unlimited exemption for his 401(k) and the \$1 million exemption for his traditional IRA should serve him well. Thus, he'd be able to shelter a significant amount and build a significant bankruptcy-protected estate.

Second, consider Michelle, a widow with enough assets for her to live comfortably. Her assets include an IRA rolled over from her 457 plan and a traditional IRA. Michelle's son, Robert, is her only heir and has financial problems.

She has generously helped him in the past, but worries that he might have to declare bankruptcy. Further, she's concerned he might not be able to protect the assets he inherits, regardless of what everyone tells her about how to accomplish those goals.

Michelle determines that the best way to help Robert is to boost her retirement funds as much as possible. Although tax laws prevent her from contributing any additional funds, she is careful not to pull out any more than her required minimum distribution.

BAPCPA clarifies that retirement plan accounts treated under the Internal Revenue Code as tax-exempt also are exempt from the bankruptcy estate.

She recognizes that this would be a good idea for income tax purposes anyway, but feels even better knowing that she might be able to help her son keep more assets in the event he files for bankruptcy after her passing. In addition, Michelle understands that there is ambiguity as to whether inherited IRAs will enjoy full — or any — protection under BAPCPA.

Shining a light on BAPCPA

No, bankruptcy is never a pleasant thought to contemplate, but there may be unforeseen circumstances in your future that will force you to consider that option. BAPCPA might, on its face, not seem terribly relevant in an estate planning context. But, seen in the proper light, it may help you to ensure your loved ones are provided for after you're gone. ■

