



 Shenkman

# PRACTICAL PLANNER<sup>®</sup>

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## OLD IRREVOCABLE TRUST MAKEOVER

**Summary:** Do you have an old irrevocable trust? When's the last time you've dusted it off and really looked at it? While trusts should be reviewed with your planning team annually (it is not that painful or costly) the reality is few folks do. In many cases, a trust that was set up long ago (remember when you had hair and could see your feet?) has been on autopilot since inception with nary a thought given to why it continues to exist. The same CPA files a similar tax return yearly (in too many cases incorrectly). The same gift is made each year to the trust. Why? The requirement to issue Crummey withdrawal notices is consistently ignored (shhhh, we won't tell). The key is that if those involved with old irrevocable trusts would review them, better results might be achieved.

■ **Trust's Purpose:** Why was the trust created? Understanding the initial purpose will often provide a framework to evaluate what can be done to improve the trust or whether it should be terminated. If it was to save for your daughter's college and she's now a physician paying for her son's college education, does the old trust make any sense? Does the old trust still serve that purpose? Is there another use to which the trust might be directed?

■ **Inventory:** Gather all relevant data pertaining to the trust. It is rare that anyone (trustee or adviser) seems to have all key documents readily accessible. This is necessary to evaluate the current status of the trust, and how to improve it if necessary. The inventory might include: ■ Fully signed trust. ■ Documentation for any legal action taken with respect to the trust since it was signed, e.g. a resignation of an initial trustee. ■ Balance sheet of all trust assets. ■ Recent bank and brokerage statements. ■ Form SS-4 or other documentation of the tax identification number assigned to the trust. ■ Details of other trust assets, e.g. if the trust owns real estate, a copy of the deed. If the trust owns life insurance, a copy of the full policy. ■ Annual demand/Crummey notices. ■ Correspondence or memos regarding the organization or operation of the trust. ■ Recent income tax return. ■ Gift tax returns reporting any gifts to the trust.

■ **Compilation:** Once the expense and hassle has been incurred on the above archaeological dig for trust documents create a compilation of all key documents so that a working document is readily available should issues arise in the future. Organize all key permanent trust documents, perhaps chronologically, and scan them. Be sure the trustee, protector and all key advisers have a copy.

■ **Tax Scan:** Determine the tax status for the trust. Not always an easy feat. Is the trust exempt from the generation skipping transfer tax? Were transfers to the trust completed gifts for gift tax purposes? Were gift tax returns filed properly confirming GST and gift tax treat-

ment? Is the trust simple, complex or grantor for income tax purposes? If the trust holds stock in an S corporation does it meet the requirements to do so? Which state or states does the trust pay income taxes to? Can the state income tax status be improved? **Example:** A trust for children was established in your home state with gifts of marketable securities and Uncle Joe as the trustee decades ago. The kids all live in different states and Joe is on in years. Depending on state law, changing the trustee to one in a state with no income tax might avoid the home state income tax. **Example:** An insurance trust was set up a doz-

en years ago. It was not made GST exempt. Now that the GST exemption is \$5,490,000 it might be worthwhile to make a late allocation of GST exemption to the trust changing its tax status.

■ **Updated Plan:** What are the current estate, financial, asset protection and other planning goals of the grantor and beneficiaries of the trust? Since the initial goals of the trust were determined above, those can now be compared to the current planning goals to see where there are differences. The differences identified will provide guideposts for evaluating how the old trust might

*(Continued on page 2)*

## CHECKLIST: ANNUAL REVIEW

**Summary:** Annual checkups are vital to all plans. You cannot keep your ship on course if you don't regularly check its location, direction and final destination. Too often this doesn't happen. Folks uniformly say "nothing has changed." Those meeting regularly with their wealth managers often feel that the wealth manager knows all. They don't. There is no substitute for getting all your advisers involved in planning on a regular basis. While what should be looked at each review will vary by person and by meeting, here are a few suggestions:

✓ **Budget:** When was the last time you realistically looked at your budget? Most wealthy people seem to think that

wealth means you are beyond budgeting. Nope. Even wealthy people can overspend but their budget is more. It may demonstrate you can give more to children now, more to charity. Like exercise, everyone needs a budget. ✓ **Financial Plan:** What you do with that budget is key. Have your wealth adviser forecast out to some reasonable age (think 95+) and see what your finances look like. If your forecasts were limited to age 80 or 85, unless you have a known health issue, that's pretty risky given longevity increases. Stress test the results (more health care costs, etc.) to find what seems to be a realistic balance. While

*(Continued on page 3)*

## ...OLD IRREVOCABLE TRUST MAKEOVER

(Continued from page 1)

be modified to improve results. **Example:** A decade ago when a will and various irrevocable trusts were created it was believed appropriate only to hold trust assets until each beneficiary was 35 at which time they should be mature enough to handle the wealth. Now it is realized that beneficiary maturity is not the only issue, rather protecting wealth from lawsuits and divorce. All current planning therefore relies on long term or perpetual trusts. The old planning is simply not adequate. **Example:** Just a few years ago an irrevocable trust was created to hold insurance or gifts of business interests. Trusts today might be much more flexible and robust than even those created in the past. Freeze the value in the old trust by having it sell assets for a note to a new more flexible trust before values increase.

■ **Change Trustees:** You named one of your frat bros trustee. Since he still revels in playing beer pong, you are wondering if he is still the right choice to manage the trust. Merely changing

the trustees might trigger significant change in the trust. For example, replacing a now elderly ineffectual family trustee with a professional institutional trustee might take the trust in an improved direction, provide better management, and more. Too often whoever was named ages earlier as trustee continues to plod along, not evaluating whether it still makes sense for them to serve.

■ **Change State Law:** State laws have evolved in recent years such that if a trust could be moved to a state with more advantageous laws, that alone might significantly improve the trust. Changing trustees to a financial institution in a state with advantageous laws may be the initial step in the process. The trust instrument may permit a change in governing law.

■ **Trust Protection Action:** Today trusts more commonly include a position called “trust protector” and empower the person so serving to change a number of characteristics of the trust, or to exert a variety of powers over the trust. These might include the right to terminate and replace the trustee and change governing law and situs. **Example:** Old trust terminates when the beneficiaries reach age 35 providing very limited divorce or asset protection. The trusts are subject to income taxation in the settlor’s home state. The Trust Protector terminates the home state trustee, names an institutional trustee in a state that won’t subject the trust to income tax and which has laws that are more protective, including a liberal statute permitting decanting (see below) to modify the trust terms to continue the trust perpetually.

■ **Decant:** An existing trust can be merged or poured into a new trust thereby changing many of the administrative aspects of the trust. In a recent case the trustees of an irrevocable trust were permitted to merge an existing trust into a new trust. At the time the old trust was decanted the beneficiary had the current right to withdraw 75% of the trust principal and was in the midst of a divorce. These actions by the trustee might have facilitated the protection of those trust assets. *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017). New

York courts have also given a rather expansive view of a trustee’s right to decant. Where the trustee had broad discretionary principal distribution authority the trustee was permitted to eliminate a beneficiary. *Matter of Hoppenstein*, NYLJ 1202783016744, Sur Ct, NY County 2017.

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■ **Non-Judicial Modification:** A Delaware law enacted in 2016 permits seemingly unlimited modification to an irrevocable trust if the administration of the trust is governed by Delaware law. So for a trust administered elsewhere the trust protector may be able to move the trust to Delaware and have Delaware law govern the administration of the trust to take advantage of this power: “Notwithstanding any provision of law or a trust’s governing instrument limiting or prohibiting amendment of the trust, an irrevocable trust may be modified to include any provision that could have been included in the governing instrument of a trust created upon the date of the modification upon written consent or written nonobjection of the trustor, all then serving fiduciaries and all beneficiaries even if the modification violates a material purpose of the trust.” Del. C. Sec. 3342(a). If the grantor is alive and competent there is almost no limit to how an “irrevocable” trust can be changed. However, because the beneficiary must consent or nonobject, the favorable result that appears to have been achieved in the Massachusetts divorce case above might not be possible if the courts might view a non-judicial modification as an action by the divorcing spouse whereas a decanting is an action taken by the trustees. Also, watch out for tax traps. **PP**

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**Publisher Information:** Practical Planner (Reg. U.S. Pat. & Tm. Off) is published quarterly by Law Made Easy Press, LLC, P.O. Box 1130, Fort Lee, New Jersey 07024. For Information or subscriptions: email [news.letter@shenkmanlaw.com](mailto:news.letter@shenkmanlaw.com), or call 888-LAW-EASY.

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## ...CHECKLIST: ANNUAL REVIEW

(Continued from page 1)

many wealth managers think this exercise is solely within their purview, that's a dangerous mistake (note the collaboration theme song). If the wealth manager uses very conservative assumptions she could be hurting the client. Example: Dr. Jain is worried about malpractice liability, and she and her husband are evaluating funding non-reciprocal spousal lifetime access trusts ("SLATs") for asset protection purposes. If the wealth manager completes conservative forecasts, that might suggest lower funding of the SLATs then what is actually done for asset protection. Those forecasts around might prove damaging to Dr. Jain if a future malpractice claimant argues that the funding of the SLATs was excessive and a fraudulent conveyance. Teamwork folks.

✓**Asset Allocation and Location:** Asset allocation is what portion of your investments are held in a particular asset class, e.g., small cap equities. Asset location is which "buckets" specific assets are held, e.g., bonds in your IRA and family business interests in a dynasty trust. Be sure asset location decisions are reviewed with input from your entire team. Also, buckets can be changed. An irrevocable grantor trust (trust income taxed to you) might be changed to a non-grantor trust (income taxed to the trust), part of your regular IRA might be converted to a Roth. The "which bucket" decision can be made in a broader context with adviser input and perhaps net you better income tax or asset protection results.

✓**Life Insurance:** Coverage should be reviewed periodically. Who owns the policy? Are there options in the policy to evaluate (e.g., convert a term to permanent policy because of a negative health diagnosis), should more be paid in to the policy to assure appropriate funding? Are there new insurance needs, fewer needs, or just different needs?

✓**Property, Casualty and Liability Insurance:** This coverage is vital to everyone's financial security but is too often treated casually if at all. Periodically identify risks that may exist and then determine if the cover-

age meets those risks. Risks change over time. The wealth being protected changes. Too often policies bought under different circumstances are just continued without thought. Example: Mom has home health care workers. Was appropriate workers compensation purchased? Employment practices? Have the number or role of those workers changed?

✓**Estate Planning Scan:** Step back and take a big picture look at the plan and whether it makes sense. Overviews of each document and component of the plan are often worthwhile to get everyone on the planning team, especially the folks whose plan it is, up to speed. But avoid complacency.

✓**Communication with Fiduciaries:** When is the last time the trustee and trust protector of each trust have been at an annual review meeting?

Don't answer the question. You get the point. Without periodically having all key players involved in an update discussion they won't be prepared when a problem arises. Formalities can't be adhered to if the fiduciaries charged with carrying out trust duties have no active role.

✓**Communications with Advisers:** Are all the advisers in the loop? Not every adviser has to be at every meeting, but every adviser should be kept up to date with the plan and general overview. If you've met with a wealth manager quarterly for years but don't remember your attorney's name that's a problem!

✓**Communication with Heirs:** Have the heirs ever been spoken to about the planning? Age and position appropriate discussions are important to have. Acclimating heirs slowly over time is best. **PP**

## RECENT DEVELOPMENTS

- A Nevada domestic asset protection trust ("DAPT") was upheld as protecting assets from spousal support and child support claims. *Klabacka v. Nelson*, 133 Nev. Advance Opinion 24 (5/25/2017). In another case a court recently held that a taxpayer fraudulently transferred assets to a trust to avoid tax debt. *M.R. Leathers*, CA-10, 2017-1 USTC ¶50,212, May 4, 2017. In contrast to the *Klabacka* holding the Uniform Voidable Transactions Act ("UVTA") advocates in Comment 8 to Section 4 that any transfer to a DAPT is voidable if the transferor's home jurisdiction hasn't enacted DAPT legislation. The following states have enacted the UVTA: California, Georgia, Idaho, Iowa, Kentucky, Michigan, Minnesota, New Mexico, North Carolina, North Dakota and Utah. What about residents of other states that have not enacted the UVTA but have DAPTs created in states permitting them? Perhaps this uncertainty suggests using multiple trusts, LLCs and FLPs owned in part by trusts (belt and suspenders), and other steps to bolster their DAPTs. Perhaps if the grantor's financial situation has improved sufficiently he or she might even renounce any rights as a beneficiary of that trust. **Example:** Jane created a DAPT in 2012 as she was worried that the exemption would be reduced from \$5M to \$1M. Her investment portfolio outside the DAPT has grown so substantially in the years since the DAPT was funded she is no longer worried about having access to it. Since her status as a beneficiary is a purely discretionary on the part of an independent institutional trustee her advisers do not believe that a taxable gift could result from her renouncing that beneficiary status. They might report the renunciation as a non-gift transaction on a gift tax return for Jane.
- Portability is the right to have the surviving spouse use the first to die spouse's exemption. But complexity of the law has result in many missing this valuable opportunity. The IRS recently issued a procedure for relief. The executor must file a complete and properly prepared Form 706 on or before the later of January 2, 2018, or the second annual anniversary of the decedent's date of death. State at the top of the Form "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)." If an estate you know may have missed filing for portability contact your tax adviser immediately. **PP**

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**Seminars:** “Estate and Financial Planning Nuggets” will be given at noon in August: ■8th Wash DC; ■10th Raleigh NC; ■17th Palm Beach FL. A webinar with Steve Leimberg will be hosted on ■14th @ 1pm by Leimberg Information Services, Inc. (LISI).

“Asset Protection Continuum” with Alan Gassman and “Financial & Estate Planning for Chronic Illness” will be presented in St. Petersburg FL on August ■21st at 3pm.

For more information call Tara Lembright of the American Cancer Society at 888-227-6446 x 4550 or email tara.lembright@cancer.org.

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## PLANNING POTPOURRI

■ **Definition of Estate Planning:** On a recent committee call from the National Association of Estate Planners and Councils (“NAEPC”) the discussion turned to defining “estate planning.” Seems so obvious and simple but it is not. The fact that most people improperly define “estate planning” is why their plans don’t work well (or not at all). Few people return to their estate planning attorney for a yearly review because they view an estate plan as a will or trust and “I have that.” Most people don’t involve their CPA in their estate plan because “They do my tax return.” Care managers are just starting to be included on the estate and financial planning team. So what is estate planning? Here’s a terrible definition that came up near the top of a Google search: “The act of preparing for the transfer of a person’s wealth and assets after his or her death.” This is so bad as to be dangerous. Investment planning, retirement planning, asset protection planning and the range of other

things we all need to do to make sure our lives are full, safe and financially secure are all excluded. What about religious concerns, health challenges and so much more? Estate planning should be more about planning for life than death. It should encompass the transmission of values not just money. It should provide peace of mind from a myriad of tax, legal, financial, insurance and other risks. It is tough to come up with a universal definition, but what is assured is that if your definition is too narrow, you and your loved ones won’t be protected (or if you’re a professional adviser, you won’t be helping your clients sufficiently).

■ **Cloud Vaults:** Have you stored all of your key legal and estate planning documents in a password protected cloud vault your family, fiduciaries and others can access? If not, you should.

■ **Schematics:** If your estate plan includes more than one or two building blocks (and for almost every one of

any financial means it should) do you have a schematic illustrating the plan? You should. Remember the old adage a picture is worth a thousand words? For example, if you have non-reciprocal SLATs and an insurance trust that might be merged, reflecting the transactions in a graphical format can make it easier for bankers and insurance consultants to know which assets go where. If you have a family business, slices of which are owned by an array of trusts, a schematic of the ownership structure, can be helpful to all. A schematic (and for many a series of schematics) can help family, fiduciaries and advisers all get a quick overview of the components of a plan. PP



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