ESTATE PLANNING

CHAPTER 9

Estate planning is the legal arrangement for the transfer or distribution of one's wealth in anticipation of death and the process by which that arrangement is completed. It is merely planning when one will no longer be present.

Estate planning is important to everyone. It is not a pleasant task because it addresses one's mortality – a sensitive subject. Estate planning is, nevertheless, vital to all and especially important where a developmentally disabled child is involved. With concerned, sensitive guidance, it can be a very enriching experience.

Because of the complexity of estate planning, it is recommended it be undertaken with the assistance of an attorney who specializes in that field.

DEFINITIONS

Listed below are terms that appear in this chapter but may not be commonly understood in their legal usage:

1. **Beneficiary -** a person who receives the benefits provided in a trust, will, insurance policy, bank account, deed or financial instrument (such as a certificate of deposit or stock certificate) which is issued in transfer-on-death (TOD) form;
2. **Decedent -** a person who has died;
3. **Fiduciary -** one who is bound by law to act primarily for the benefit of another; e.g., a trustee is the fiduciary for a beneficiary under a trust.
4. **Grantor –** a person who creates a trust. This person is also sometimes referred to as a "settlor" or "trustor;"
5. **Gross Estate -** the total amount of assets included for federal tax purposes in the estate of a decedent;
6. **Marital Deduction –** a deduction allowed (for federal gift and estate tax purposes) for lifetime and death transfers between spouses. With respect to transfers to spouses who are U.S. citizens, this deduction is unlimited in amount;
7. **Probate –** refers literally to a court's declaration that a written instrument is the duly executed, last will and testament of a decedent. In a broader sense, the word "probate" is often used to describe the process of administering a decedent's estate or the affairs of an incompetent person in the probate court;

8. **Property –** any form of asset which an individual owns at any given time, including real estate, automobiles, investments, bank accounts, insurance policies, IRAs and other interests in retirement plans, works of art, household furniture, etc.; and
9. **Testator –** a person who makes or has made a will. The term is also used to describe a decedent who executed a valid will before he died.

TRANSFERS OF PROPERTY

Transfers of property may occur in various ways, several of which are explained below.

Operation of Law

This form of transfer occurs automatically at the moment of death, pursuant to an applicable statute or principles of the common law. For example, property owned by two individuals as joint tenants with right of survivorship will pass immediately to the surviving owner upon the death of the first owner to die. Property titled in this fashion is not subject to probate administration at the death of the first owner (which may be desirable to avoid the delay and cost involved with probate proceedings).

Intestate Succession

If a person dies without a will or trusts in force and owned property in his sole name (with no beneficiary designation) at the date of his death, he is said to have died "intestate." The property of a person who dies intestate will be distributed to his heirs (such as his spouse, children, siblings, living ancestors, etc.), according to a pattern defined by Missouri law. In the rare instance where an individual has no blood relatives who survive him, his property can actually be distributed to the State of Missouri after his death.

A decedent has no voice in the distribution of his estate if his property passes by intestate succession. Thus, intestate succession may result in the loss of some or all state and federal benefits for a child with disabilities because the property that is distributable to an heir is distributed in an outright fashion, thus making such property an available resource to the heir. In addition, an unwieldy, probate court-supervised conservatorship may be required if property passes directly to an incapacitated heir.

Will

This classical instrument is the legal expression or declaration of a person's directions for the disposition of his property after his death. In making a will, you should consider the following:

1. The number of, and relationship to, potential heirs;
2. Assets you anticipate will be available for distribution;
3. Needs of the surviving spouse, children and other heirs;
4. The degree of handicapping condition of any potential heir and its impact upon his future planning, including such heir's ability to function independently, ability to earn a living, plans for residential or institutional placement, and needs for ongoing medical care;

5. The uncertainty of future governmental assistance programs;
6. The desirability of retaining any family business, farm operations, or other income-producing property;
7. The long-range effects on non-disabled heirs if the necessity exists to financially provide for life-long care of a child or children with disabilities. This may alter the ability to financially provide for other children, or many require the use of life insurance and life insurance trusts; and
8. The use of trusts in place of, or as an adjunct to, a will.

Trust
Depositing funds or other assets with a trustee, pursuant to a written declaration or agreement of trust, for the benefit of one or more beneficiaries, create a trust. Trusts may be either revocable (capable of being changed) or irrevocable, as determined by the grantor, typically after reviewing the tax consequences and non-tax goals to be achieved. The flexibility of trusts allows for the creation of unique terms and provisions, which can be specially tailored to meet the needs and ongoing problems of the beneficiary(ies). Trusts afford much more flexibility and greater diversity of investment, and are usually less expensive to set up and operate than a probate court-supervised conservatorship.

Selection of a Trustee
A trustee is a fiduciary whose principal functions are to: (a) manage and conserve the assets of the trust and (b) distribute the income and the principal to the beneficiaries, as provided by the terms of the trust instrument. In selecting a trustee, a grantor has several alternatives:

1. **An Individual**: An individual can provide the personalized care and responsiveness of one who knows and appreciates the needs of the beneficiary on an ongoing basis. On the other hand, such an individual may lack the investment expertise and other skills necessary to properly manage the trust funds.
2. **A Corporate Trustee:** The business of a corporate trustee is the conservation of assets and the investment of trust funds. A corporate trustee is generally a bank of a trust company, which is specifically authorized by state law to exercise the powers of a trustee. A corporate trustee can continue to function as long as it retains its corporate existence, while trust management by an individual trustee may be disrupted due to such individual's death or inability to perform his duties. Some believe that a corporate trustee may be somewhat less responsive to a beneficiary's needs than would an individual who is personally familiar with the circumstances of the beneficiary.
3. **Multiple Trustees:** An individual and a corporate trustee can be appointed to serve together as co-trustees. This arrangement can combine the expertise, skill and continuity of a corporate trustee with the input and personal attention afforded by an individual trustee who is responsive to, and familiar with, the ongoing needs of a beneficiary. Each serves as a check and a balance on the other.

Types of Trusts

There are two types of written trusts:

1. **Inter Vivos:** This is a living trust (including a life insurance trust) created by the grantor during his lifetime. It can be either revocable or irrevocable. A fully funded inter vivos trust can avoid probate proceedings and their associated expense during the life of, and after the death of, the grantor.
   A life insurance trust is a form of inter vivos trust that is usually created with the intention of providing life insurance proceeds for the trust beneficiaries after the grantor's death. While it is created during the life of the grantor, it is not funded until the death of the insured when the death benefit becomes payable to the trust. The life insurance should be placed on the life of the breadwinner, if possible, and if not, on the life of the breadwinner's spouse. It should not be placed on the child with disabilities because the need is for financial resources to provide for the care of the child when the parents are gone. The creation of a life insurance trust allows the grantor to provide for beneficiaries with disabilities in a special manner, without depriving non-disabled beneficiaries of a rightful share of the grantor's estate. In addition, provisions can be made for future transfers of assets to the trust from a will or by lifetime gift. In this manner, funds from more than one source may be combined into one trust. If there are no federal estate tax consequences, the life insurance trust should be revocable and modifiable, to allow freedom for updates and revisions.
2. **Testamentary:** This is a trust created by a will and comes into existence only after the death of the testator and the admission of the testator's will to probate.

Special Trust Provisions

Most trust instruments direct the trustee to make equal distributions to all of the current trust beneficiaries. This may work to the disadvantage of a child with disabilities, as the funds are not distributed in proportion to the needs of such child. The following are examples of special trust provisions which can address this dilemma.

1. **Sprinkling Provision:** This type of provision permits the trustee to distribute income and principal among specific beneficiaries in unequal, disproportionate amounts, in accordance with their needs. However, the trustee's exercise of a sprinkling power will usually put non-disabled children at a disadvantage, because the trustee will distribute most or all of the trust funds to those with the greatest needs, such as a beneficiary with disabilities.

   NOTE: You can combine a sprinkling power and an equal distribution directive so that the trustee has discretionary power to distribute income and/or principal until the needs of both non-disabled and children with disabilities are fulfilled, and to thereafter equalize distributions among all of the beneficiaries.
2. **Discretionary Supplemental Trusts:** A trustee may be given limited discretion to make distributions of trust income and principal when necessary to supplement the benefits to which a beneficiary with disabilities may be entitled from state, federal, local or private agency sources. This limitation is designed to protect a beneficiary with disabilities from the loss of benefits to which he would otherwise be entitled as a person with disabilities, including Social Security, SSI, HUD or other governmental

public assistance. *Tidrow v. Director, Missouri State Division of Family Services,* 688 S.W.2d 9 (Mo.App. 1985) and *Missouri Division of Family Services v. Wilson,* 849 S.W.2d 104 (Mo.App. 1993). In *Tidrow* and *Wilson* the Missouri Court of Appeals held that the assets of a discretionary supplemental trust are not considered available resources or property, for purposes of establishing a beneficiary's eligibility for public assistance, when the trustee can only use trust assets to supplement, not supplant, public or private agency support.

The advantages of limiting a beneficiary with disabilities access to the income and principal of an estate is most frequently seen when such beneficiary applies for public assistance to pay the high cost of residential care. Eligibility for public assistance in the State of Missouri is based upon financial need. In determining eligibility for public assistance, an applicant may not own or have an unrestricted beneficial interest in more than $999.99 worth of "non-exempt" resources. However, "exempt" resources will not disqualify an applicant for public assistance benefits. (Examples of "exempt" assets are (a) an irrevocable, pre-paid burial or funeral contract, (b) a life insurance policy with a death benefit of not more than $1,500, and (c) the value of the home of the applicant, if such home is providing shelter to the applicant or to his spouse or dependent child. Thus, it is essential in most cases for a child with disabilities to *not* have substantial assets or income which could be used in an unrestricted fashion for his general support.

3. **Missouri Family Trust.** As an alternative to the aforementioned private trusts, the Missouri legislature established the Missouri Family Trust ("Family Trust") in 1991 (§§402.199-402.220, RSMo). The Family Trust is authorized to accept contributions from any source, other than a beneficiary with disabilities and his spouse, to provide a pool of private financing for individuals with a handicap or is eligible for services provided by the Missouri Department of Mental Health or both. Receipt of private financing through the Family Trust does not jeopardize the eligibility of a beneficiary for government entitlement funding. Any donor may designate a specific person with a handicap as the life beneficiary of the contribution made by such donor. In addition, each donor can name a co-trustee to work with the board of trustees of the Family Trust in providing benefits to the life beneficiary. Certain powers to withdraw all or portions of the original contribution are set forth by state statute. Any principal or accumulated net income which is not subject to refund is distributed to a statutory Charitable Trust to provide benefits for eligible individuals who either have no immediate family or whose immediate family, in the opinion of the Family Trust, is financially unable to make a contribution to the Family Trust sufficient to provide benefits for such individual. Receipt of benefits from the Charitable Trust does not jeopardize an individual's eligibility for government entitlement funding.

GUARDIANSHIP

The subject of guardianships is primarily covered elsewhere in this treatise (Chapter 8), but it should be touched upon here because of its important role in estate planning for individuals with disabilities.

There are three types of guardianships:

1. **A Minor's Estate:** A minor (an individual under the age of 18) cannot inherit property directly. If funds are left to a minor, there must be a court-appointed conservator (formerly referred to as a "guardian of the estate") to take charge of the minor's property until he attains age 18. In addition, a minor will require appointment of a "guardian of the person" who will be responsible for the care, custody, education, etc., of the minor. Failure of a minor's parent(s) to designate a guardian and conservator of the minor child leaves the potential care of the child to the discretion of the probate or juvenile court.
2. **An Incompetent's Estate.** The court may, upon proper application, appoint a guardian of the person, or conservator of the estate, or both. This type of guardianship or conservatorship may only be created by the probate court after due process procedures (proper notification, right to counsel, right to a hearing, etc.) have been completed.
3. **Limited Guardianship and Conservatorship.** Missouri law permits the probate court to appoint a limited guardian and/or conservator for persons with disabilities who are not incapacitated for all purposes. A limited guardian or conservator is only empowered to make such decisions as the court specifically provides in its order and, similarly, the legal rights of the disabled person are only limited to the extent provided in the court's order.

Factors to consider in determining whether a guardianship is warranted include the:

- Need for present or future placement in a public institution or permanent residency in a community;
- Likelihood that the incapacitated person will be "duped" or taken advantage of when living or working in a less protected environment, as when placed in a community residential facility or work setting;
- Potential need for immediate medical assistance requiring "informed consent," which the incapacitated person is unable to give;
- Emotional and psychological effects of forfeiting the "civil rights" of the individual involved, including the right to vote and enter into contracts;
- Lack of flexibility with regard to financial investments and meeting personal needs, and additional and continuing costs of maintaining the guardianship or conservatorship estate.

FEDERAL ESTATE TAX CONSEQUENCES AND CONSIDERATIONS

To determine whether there are federal estate or gift tax issues to be addressed, the following factors should be considered:

1. You can make a gift of up to $11,000 in 2003 (referred to as an "annual exclusion gift") to any one person in a calendar year without any gift tax consequences. Gifts made to multiple beneficiaries qualify for separate $11,000 exclusions. For example, a donor can give $44,000 to four different persons without tax consequences, as long as each of the four donees receives $11,000 a piece. (The $11,000 annual exclusion amount is indexed for inflation, so this amount will increase in the future).
2. There is no annual or lifetime limit on the amount of non-taxable gifts which can be made to a spouse who is a U.S. citizen. However, non-taxable gifts to non-citizen spouses are limited to $100,000 each year (indexed for inflation).
3. A gift in excess of $11,000 per year to a non-spouse or $100,000 to a non-citizen spouse does not necessarily mean that the donor will have to pay federal gift tax, but it does mean that the donor will have to file a gift tax return. However, no gift tax is actually payable (for gifts in 2002 and thereafter) *until* the lifetime total of gifts exceeds $1 million (in addition to the applicable annual exclusion amount). When the total amount of lifetime gifts exceeds $1 million, the donor will have to pay gift tax on all such gifts (after taking into account, once again, the annual gift tax exclusion). The lifetime cumulative $1 million gift tax exemption does not limit the amount, which can be given tax-free to a U.S. citizen-spouse, nor does it necessarily limit the cumulative amount which can be gifted to a non-citizen spouse (as long as the gifts to a non-citizen spouse do not exceed $100,000 per year (indexed for inflation)).
4. Gifts in excess of $11,000 per person in any one year constitute "taxable gifts" under the Internal Revenue Code even though, as we have just seen, they do not trigger an actual gift tax liability until the lifetime total of such gifts exceeds $1 million. However, the total amount of lifetime "taxable gifts" is subtracted from a donor's available *estate tax* exemption at his death. For example, if an individual who previously made $300,000 of taxable gifts dies in 2004 (when the federal estate tax exemption amount will be $1.5 million, as noted below), the decedent's available estate tax exemption will actually be $1,200,000.
5. When an individual dies owning property worth more than a certain exempt amount, a federal estate tax will be imposed on the decedent's estate. The exempt amount, which can be passed tax-free to non-charitable beneficiaries, varies according to the year of the decedent's death. The exempt amounts for decedents dying in the hereafter stated years are as follows: (a) $1,000,000 in 2003; (b) $1,500,000 in 2004 and 2005; (c) $2,000,000 in 2006-2008; and (d) $3,500,000 in 2009. Under current law, the federal estate tax disappears in 2010, but due to a so-called "sunset" provision contained in the 2001 legislation, which established the just-mentioned estate tax exemption levels, the estate tax will be reinstated in 2011 with a $1,000,000 exemption. (Suffice it to say at this point that the future of the federal estate tax law and its applicable exemption amounts is subject to considerable uncertainty).

6. It is possible to pass considerably more wealth to chosen beneficiaries than the above-described amounts in an estate tax-free fashion. A married couple, for instance, with proper planning, can transfer at least double the foregoing amounts at death, with no federal estate tax liability, because they have two potential estate tax exemptions to work with. However, when married couples' property ownership is structured so that all of their collective assets pass outright to the surviving spouse (such as through joint tenancy with right of survivorship), the couple may "waste" the exemption of the first spouse to die, thereby leaving the couple with only one estate tax exemption between them.
7. In predicting the possible value of one's estate at death, the impact of life insurance is often overlooked. If you own or control an insurance contract that insures your life, the death benefit payable when you pass away will be includible in your estate, regardless of whether the death benefit is paid pursuant to a term insurance or permanent insurance contract. For example, if a decedent owned or controlled a term life insurance policy with a $1 million death benefit at the date of his death, the potentially taxable value of his estate will be increased by $1 million, even though the term insurance contract had no cash value a moment before the decedent's death. (If an insurance policy is transferred to a specially designed life insurance trust, and the insured retains no incidents or ownership over the policy, the death benefits will not be included in, or taxable to, the insured's estate (for federal estate tax purposes)).
8. There are additional tools that can eradicate estate tax liability for individuals and couples with estates larger than the then current exemption amounts, but discussion of those strategies is beyond the scope of this chapter. If federal estate tax exposure is a concern, the reader is strongly urged to consult a lawyer who specializes in estate tax planning before undertaking implementation of an estate plan when potential estate tax liability is at stake.

STATE INHERITANCE TAX

In 1985, Missouri abolished its stand-alone inheritance tax and adopted an estate tax equal to the amount of the *state* death tax credit allowed by the Internal Revenue Code (for *federal* estate tax purposes) to decedents with taxable estates, i.e., estates in excess of the applicable exemption amount previously discussed in this chapter. Before 2002, the Internal Revenue Code allowed a deceased taxpayer's estate to take a credit against its *federal* estate tax liability for a certain amount of *state* inheritance or estate tax, and many states (including Missouri) pegged their state death tax to the amount of the credit allowed against the federal estate tax by the Internal Revenue Code. (This type of state inheritance or estate tax is typically referred to as a "sponge tax" or a "pickup tax.") If a decedent's estate owes no *federal* estate tax liability, then it will have no *state* death tax liability if the decedent resided in a "pickup tax" state at the date of his death.

In 2001, Congress amended the federal estate tax law to phase out the credit for state death taxes, beginning in 2002 with a 25% phase-out (and continuing with an additional 25% phase-out each year through 2004). The credit will be replaced in 2005 with a *deduction* for state inheritance/estate tax paid by a decedent's estate. However, unless Missouri and other "pickup tax" states amend their state inheritance/estate tax laws, they will not have any effective death tax in force once the historical federal credit is phased out in 2005. (A number of states have already amended their death tax laws to reinstate a stand-alone inheritance or estate tax, but Missouri has not done so as of the date of this writing (July 2003). However, this writer expects Missouri to follow the lead of other states and to thus adopt a new inheritance tax in the relatively near future. To fail to do so will cause Missouri's future tax receipts from large estates to evaporate.)

It is also important to recognize that real estate and tangible property located in Missouri will subject the beneficiary of an estate to inheritance tax liability in Missouri, even though the decedent resided in another state. The converse is true for Missouri residents who own real estate or certain tangible property situated in other states. Therefore, one must be aware that his estate may be subject to inheritance taxation in more than one state if he resides in one state and holds substantial property in another state at the date of his death. Careful estate planning dictates (1) an examination of the revenue laws of every state where any property is held and (2) consideration of where to locate property to minimize state inheritance/estate tax liability.

CONCLUSION

All too frequently, after the parents have gone through the task of eliminating dangers and pitfalls by proper estate planning, a well meaning relative makes provisions in his will to leave outright to a child with disabilities a sum of money sufficient to undo all that the parents have attempted to do. Thus, federal and state benefits may be temporarily, if not permanently, lost. In addition, if the estate planning is not properly done, a direct distribution to the child could create a conservatorship estate. Therefore, it is essential that the entire extended family be sensitive to the needs of a beneficiary with disabilities.