Trusts and Estates

Estate Planning From Estate and Trust Administration Perspective

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As estate planners, we carefully listen to our client's concerns and goals and prepare estate plans intended to fulfill the client's wishes regarding the disposition of his or her assets. However, sometimes even the best-laid plans are thwarted by unforeseen circumstances. To a certain extent, there are steps that can be taken during the planning process to help facilitate a smooth estate and trust administration.

Tangible Personal Property

The disposition of tangible personal property is an area fraught with the potential for disputes, as evidenced by the recent death of Robin Williams and the fight between his third wife and his children from prior marriages over items of tangible personal property. In situations where tangible personal property passes to more than one person, for example a second spouse and children from a first marriage, the will should carefully define what items of tangible personal property are included in each bequest. Phrases such as, "I give the tangible personal property located in my primary residence," or "I give my tangible personal property in substantially equal shares," create potential interpretive disputes among beneficiaries. Does "all tangible personal property located in my primary residence" include a vehicle stored in the garage, or an item of jewelry that happened to be located there at the time of death? Does a division in "substantially equal shares" mean shares of substantially equal value, or shares of substantially the same number of items? Does a disposition of photographs include digital photos as well? To avoid disputes, care should be taken in the description of items of tangible personal property. Clients may wish to take an inventory of their tangible personal property and indicate the individual who is to receive specific items from the inventory. Another option is to add a fail-safe provision that, in the event of any disagreement among beneficiaries, the ultimate determination of which items of tangible personal property are distributed to each beneficiary is made in the discretion of an independent executor.

Provisions For Minor Beneficiaries

Estate planning documents may not include provisions for the distribution of assets to minor beneficiaries, either because all named beneficiaries are adults, or the share of a minor is directed to be held in trust for him or her. However, what if the client later executes a document leaving assets to a minor, as was the case many years ago with a client whose suicide note, probated as a codicil to his will, left certain valuable items of tangible personal property to minor grandchildren, thus sparking a bitter family battle over who should serve as guardian of the minor's estate. An inadvertent disposition of assets to a minor beneficiary can be avoided, even in circumstances where the will has no minor outright beneficiaries, by adding a fail-safe provision that appoints a guardian of the estate for assets passing to minor beneficiaries, or provides that assets bequeathed to a minor be held by a custodian selected by the executor under the Pennsylvania Uniform Transfers to Minors Act until the minor turns 25.

Statutory Interest On Cash Bequests

Another area that may inadvertently create issues, particularly in today's low-interest rate environment, is the payment of statutory interest on cash bequests. Under Pennsylvania law, cash bequests are entitled to 5 percent annual interest. For cash bequests made in a decedent's will, a bequest made in trust is entitled to statutory interest from the date of the decedent's death, while an outright bequest is entitled to interest beginning one year after the decedent's date of death. For cash bequests made under a trust instrument, a bequest made in trust is entitled to statutory interest from the date it was directed to be set aside as a separate trust until it is set aside, and an outright bequest is entitled to statutory interest from three months after it becomes payable until it is paid. All of these statutory provisions are subject to any provisions of the will or the trust instrument to the contrary. Five percent statutory interest is much higher than the going interest rate, but the statute has not been adjusted to reflect the realities of today's economic environment. In situations with unanticipated circumstances, such as a will contest or beneficiary dispute, for sizeable bequests a delay can result in payments higher than originally anticipated. For example, a simple outright cash bequest of $100,000 to a favorite charity could turn into a distribution to that charity, which may be 10 percent or 20 percent higher than originally envisioned by the time the litigation is concluded several years later and the bequest actually paid. If it is the client's intention that the beneficiary of a cash bequest receive only the stated bequest amount, consider adding express language in the document that the cash bequest shall not bear any statutory income or interest. Alternatively, in situations where the client wants a cash bequest to bear statutory interest, consider adding affirmative language to that effect to avoid any ambiguity over the client's intentions. Another option is to affirmatively override the arbitrary 5 percent statutory interest scheme and replace it with interest from a specific date (e.g., date of death) that is tied to the prime rate in effect at the client's death, or some other readily identifiable indicator of market conditions. Some practitioners even advocate leveraging this statutory requirement by making a pre-residuary cash bequest to a credit shelter trust or generation-skipping trust, thereby mandating that such bequest is entitled to 5 percent annual interest from the testator's death until the trust is funded.

Withdrawal Rights For Beneficiaries

Over the past 20 years, the federal estate tax exemption amount has increased nine-fold, from $600,000 in 1995 to $5.43 million in 2015 ($10.86 million for a married couple). With the increased exemption amount, more sizeable trusts may be created for children than originally anticipated due to a significantly reduced federal estate tax burden, and, accordingly, granting a child withdrawal rights at stated ages may have unintended consequences. A child's mandatory outright distribution or withdrawal right not only diminishes federal estate tax and generation-skipping transfer tax benefits, but also risks a loss of assets if, at the time of a stated withdrawal right, the child is going through a messy divorce, has creditor problems, or has substance abuse or mental health issues. To avoid outright distributions to beneficiaries at inopportune times, often decades after the testator contemplated these provisions, consider eliminating mandatory withdrawal rights altogether and giving an independent trustee the discretion to make principal distributions for any reason throughout the beneficiary's lifetime. Alternatively, if withdrawal rights are granted to a beneficiary at stated ages, consider giving an independent trustee the ability to partially or totally suspend such withdrawal rights until the independent trustee determines it is appropriate to resume mandatory distributions, maintaining the ability in the interim to make discretionary distributions to the beneficiary.

Provisions For Special Assets

Although it typically is recommended that clients review their estate plans every three to five years, or more often as changes in circumstances warrant, sometimes clients may not revisit their estate plans for decades (if ever again). Consider incorporating provisions for special assets, such as Subchapter S corporation stock and retirement assets, into a client's estate planning documents, even if the client does not currently own Subchapter S corporation stock or designate a trust under his or her estate plan as a beneficiary of retirement assets. Lengthening a will by one or two pages may save immeasurable headaches down the road in addressing the disposition of such assets that require special consideration.

Tax Clause

In drafting wills or revocable trusts, many times practitioners will overlook the significance of the tax clause, or lack thereof. In the planning process, the tax clause should be carefully considered and possibly modified, depending on the disposition of the client's assets at death, taking into account which assets pass under the will or revocable trust and which assets pass outside of the will or revocable trust. The tax clause dictates which share or shares of the estate will pay the taxes, including whether the taxes should be apportioned among the beneficiaries of the estate or paid from the estate without apportionment. If there is no tax clause or an incomplete tax clause in the document, applicable state law would govern how the taxes are apportioned among the beneficiaries of the estate (the default statutory provisions in Pennsylvania, for example, essentially provide that the estate tax is apportioned equitably among all of the parties receiving the property, other than for pre-residuary bequests). The tax clause or the default applicable state law may substantially affect the distribution of a client's estate in ways that the client never intended. For example, many times a tax clause will state that all estate and inheritance taxes on assets includable in the decedent's gross estate shall be paid from the residuary estate, without apportionment. However, in the event that there are assets that pass to beneficiaries outside of the will or revocable trust (for example, retirement assets or life insurance proceeds that pass pursuant to beneficiary designations), that tax clause would mean that those beneficiaries would receive the assets without any reduction for the payment of taxes, but the shares passing to the beneficiaries under the will or revocable trust would be reduced by the full amount of the taxes (even with respect to the assets that they do not receive). This could be avoided by having a tax clause that limits the payment under the will or revocable trust to the taxes that are generated from the assets passing under that applicable document only.

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