ESTATE PLANNING

Ideas to Help You Plan for Your Future

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OH, GIVE ME A BREAK!

That is Exactly What the New IRA Distribution Rules Do

On January 11, 2001, the IRS issued revised Proposed Regulations in regard to distributions from qualified plans and IRAs. The explanation of the new IRA rules also applies to qualified plans such as 401(k) plans if the plan has adopted appropriate amendments.

In most cases the primary strategy in regard to an IRA is to leave the money in the IRA as long as possible, so that you can maximize tax-free compounding. When you reach age 70-1/2 you must begin taking distributions from your IRA. The old rules required that you had to make certain irrevocable elections. You had to take the distributions from the IRA over your life expectancy. If you designated a beneficiary, you could elect to take the distributions over the combined life expectancy of yourself and your beneficiary, with some limitations. For those who are married, you would elect to take the distributions over the combined lives of you and your spouse.

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You could also elect to recalculate your life expectancy each year. The idea of recalculation is that your IRA would never run out during your life, since each year you live your life expectancy under the mortality tables actually extends. If the beneficiary of your IRA was your spouse, you could further elect to recalculate the life expectancies of both of you and your spouse.

Unfortunately, the old rules resulted in some inequities, and in some cases a "gotcha" if you made the wrong irrevocable election or if circumstances turned out differently than you what had expected when you made the election. For instance, under the old rules if you elected to recalculate life expectancies for both you and your spouse, and then your spouse predeceased you, at your death your family would have to withdraw all of the funds in the IRA within the calendar year following your death and pay income tax on the whole thing! Whereas if your spouse had survived you, the spouse could have rolled the IRA over into a new IRA and designated your children as beneficiaries. At the spouse's death, the children could then have withdrawn the IRA out over the eldest child's life expectancy.

One strategy to defer withdrawing money from the IRA was to name a beneficiary much younger than you. That way you could use the combined life expectancies to determine minimum distributions from the IRA, and reduce the amount which had to come out of the IRA over those combined life expectancies. The rules provided that if the beneficiary was more than 10 years younger than you, you were limited to computing the withdrawals on the combined life expectancies of you and someone 10 years younger than you, but that still greatly extended the term of the withdrawals. However, at your death the IRA would go to that named younger beneficiary, who in most cases would not be your spouse. Most of us gave up that potential deferral and named our spouse as the beneficiary.

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who you name as beneficiary your required withdrawals from the IRA are based upon the combined life expectancies of you and someone 10 years younger than you. Further, the life expectancies are re-calculated each year, so that your IRA will never run out while you are alive.

The new rules apply for 2002, but may be used for Minimum Required Distributions for 2001. They may not be used if you were 70-1/2 in 2000 and you are taking your first Minimum Required Distribution by April 1 of 2001.

A more extensive discussion of the new rules can be found on the Web at www.ataxplan.com. Of course, if you have questions about your specific situation, you can always call me.

WHAT YOU SHOULD DO IF YOUR KIDS ARE NOT PERFECT ?

(This article is for 99.9% of parents.)

I recently read a national advice column in the paper. The advice columnist had suggested to the parents of a drug addicted child that they leave their entire estate to their other child, with a pledge from the non-addicted child that she would use some of the money to care for her brother. That advice brought a torrent of mail from people who disagreed, and the columnist admitted her error.

Giving the entire estate to a family member to hold in some sort of informal trust arrangement has numerous problems. If the non-addicted sibling dies, the money then goes to her spouse and children, who might have no interest in helping the addict, even if the addict recovers and leads a clean and sober life.

Many times, even though the addicted child has recovered and is leading a sober life, the hard feelings against the child are so deep-rooted that his sibling refuses to let go of the past, and denies the now-recovered child his inheritance.

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In one case of which I am aware, a father drew his Will when his younger son was in his mid-20's and drug addicted. The father died and left that son's share of the estate in a trust of which the addicted son's elder brother is the trustee and has total control over distributions of income and principal. The addicted son has now recovered and is in his mid-40s, with a family and a responsible job. The son who is the trustee of the trust refuses to exercise his discretion to make distributions to the now-recovered son. Further, the father or his lawyer apparently did not anticipate that the addicted son would recover and raise a family. So, at the death of the now-recovered son the trust assets will be distributed to the children of his siblings, and his own children will not inherit.

Similar problems arise in situations where there is a disabled child who is receiving government benefits, and the parents leave that child's share of the estate to a non-disabled child so that SSI or other government benefits would not be affected. That plan can fail if the non-disabled child dies before his disabled sibling.

The answer to these problems is a trust in the Wills of the parents. For the addicted child, the trust can provide that the trustee shall have discretion to make distributions, even to the point of paying over the entire trust to the child if he recovers. In the case of a child who has been troublesome to the family, such as a drug addict, an alcoholic, or a convicted criminal, it is probably best not to have a family member as the trustee of the trust. A non-family member such as a trusted professional or a bank can make detached decisions about whether to

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make distributions to the trust beneficiary, and will be more immune to entreaties for money from the beneficiary.

In the case of a disabled child, a Supplemental Needs Trust is a statutorily recognized vehicle for providing for the disabled child without endangering governmental benefits such as Medicaid and SSI. If properly drawn, the Supplemental Needs Trust will permit the trustee to provide the extras in life which SSI and Medicaid do not cover, but the assets in the Supplemental Needs Trust will not be considered "available assets" which would reduce or terminate governmental benefits.

Both of these situations, an addicted family member or a disabled family member, require care in the estate planning process. While the best solution in these cases is a trust for that family member, great attention must be paid to the terms of the trust and choice of trustee. These are situations where experienced professional advice is extremely important.

THE ESTATE TAX IS BAD ENOUGH, BUT IF YOU ARE NOT A U.S. CITIZEN, IT'S AWFUL!

If you are not a U.S. citizen but you live in the U.S., your estate will be subject to U.S. estate tax if you pass away while residing here. Unfortunately, your estate will **not** be permitted to use the estate tax marital deduction, if your spouse is not a U.S. citizen. Unless you have properly planned your estate, your non-citizen spouse could be facing a large estate tax bill.

The IRS is afraid that if you can leave your estate to your non-citizen spouse, he or she will take the inheritance out of this country so that the estate will not be subject to U.S. estate tax when the spouse dies. So, the Internal Revenue Code taxes gifts and bequests to non-citizen spouses.

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Let's say you have an estate of $1,350,000, and you follow the normal estate plan of leaving half ($675,000) to your spouse and putting half in a bypass trust. If your spouse is NOT a U.S. citizen, the outright gift of $675,000 to the spouse would be subject to about $270,000 in estate tax because a gift to a non-citizen spouse does not qualify for the estate tax marital deduction. If your spouse were a U.S. citizen, there would be no tax on the gift.

You could defer that estate tax until the death of the surviving spouse if the gift to the spouse is put into what is called a Qualified Domestic Trust (QDT). However, the spouse will only receive the income from the QDT. While the principal of the QDT could be invaded for the spouse, any invasions of principal will require the trust to pay estate tax on the amount of the invasions. At the death of the spouse, the assets remaining in the trust are subject to U.S. estate tax at the then current rates. Obviously, if the assets have appreciated, there will be more estate tax than if those assets had been taxed when the first spouse died. That is the price of tax deferral.

Worse yet, you cannot give unlimited amounts away to your non-citizen spouse during your lifetime to attempt to avoid this estate tax problem. Gifts to non-citizen spouses are limited to $100,000 per year. If you give more than that, you could have to pay U.S. gift tax.

For U.S. citizens, property which is jointly owned by spouses is considered owned half by each

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spouse for gift and estate tax purposes. For non-citizens, property which is jointly held will be fully included in the taxable estate of the first spouse to pass away, unless the estate can prove that the surviving spouse provided the funds for the joint property.

I recently did planning for a Canadian couple living in the U.S. I calculated that their jointly held property and the husband's IRA, which was payable to the wife at the husband's death, would have imposed a very large estate tax on the wife because the husband had earned all of the family wealth. Further, this estate tax problem was not something which could have been cured after the husband's death, since if the wife disclaimed the joint property or the IRA, the disclaimed property would have passed to their children and would still have generated the large estate tax.

We solved the problem by having the jointly held property put into the husband's name, and I then prepared Wills for the couple incorporating a by-pass trust and a QDT. That plan will at least defer the estate taxes until the second spouse has passed away. Meanwhile, the husband is giving the wife $100,000 per year, in order to put assets in the wife's hands tax-free. Those assets in the wife's estate will fund the by-pass trust under her Will in case she passes away first.

Bequests at death to a non-citizen spouse may qualify for the marital deduction if the spouse becomes a U.S. citizen before the estate tax return is filed; the filing of the estate tax may be deferred up to 15 months after death. But I am told that by immigration lawyers that it is very difficult to make someone a citizen in less than two years.

Non-citizens who reside in the U.S. have very special estate planning needs which require a very sophisticated estate plan. Non-citizen spouses who leave everything to each other could be giving the survivor a very unpleasant estate tax surprise.

The information contained in this newsletter is for general information only. It is not intended as legal advice, nor should it be considered to provide specific advice or recommendation. You should obtain the advice of legal counsel.