Stepping Stones

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In this Issue:

Save the Date

Stepping Stones Conversations:

How to Talk to Your Children About Financial & Estate Planning

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9:00 a.m. - 11:00 a.m.
Partridge Snow & Hahn LLP
180 South Main Street
Providence, Rhode Island 02903

Asset Protection for the Generations

Lawrence D. Hunt

Unknown or unforeseen circumstances such as divorce, indebtedness, illness, substance abuse, or a child's or grandchild's own spending and investment choices can threaten the preservation of a family legacy. Your good example and sound investment and spending habits may provide a degree of protection but further protective enhancements may be desirable. A carefully drafted Dynasty Trust in an estate plan may provide additional protection of wealth for the benefit and enjoyment of future generations.

A Dynasty Trust, which is sometimes also referred to as a Generation-Skipping Trust, directs a trustee to hold property over several generations. During the term of the trust, the trustee may make distributions to or for the benefit of a class (or classes) of beneficiaries – typically descendants. The trust may direct the trustee to follow a standard which limits distributions for certain purposes, such as the beneficiaries' health, support, and education, or a combination of purposes.

While your property is held in trust, several factors work to protect it from unintended depletion. Although the beneficiary is entitled to enforce the standard of distribution, the beneficiary does not have unfettered access to the trust property. This limitation protects the beneficiary from his or her own spending choices. It also lends an element of creditor protection because a creditor can generally only access what the beneficiary has the right to receive. Since the beneficiary's right to trust property is subject to the discretion of the trustee, the creditor cannot compel a distribution to satisfy a judgment. This mechanism also protects the trust property from the beneficiary in the event of a subsequent divorce.

A Dynasty Trust also provides a framework for preservation of trust property through ensuring appropriate investments. A trustee is held to a high fiduciary standard, which

requires prudent investment according to an investment plan with a sound strategy where as assets distributed outright to a child or grandchild are subject to the beneficiary's investment choices.

Your selection of a trustee is critical to the success of a Dynasty Trust. While it is sometimes appropriate to name a family member as trustee, an independent professional trustee might be a better choice. Considerations in naming a trustee include whether the trustee is capable of handling aspects of trust administration including distribution decisions and investment expertise. Another consideration is the succession of trustee as the trust carries through the generations.

The law of the state where your Dynasty Trust is created will impact the length of time that the trust can preserve assets. Massachusetts law places a limit on the length of time which property can remain in trust for your descendants. This limit is generally computed as 21 years after the death of the last remaining beneficiary who is alive when the property is placed into the trust. Rhode Island does not have such a limit, allowing a trust to continue in perpetuity.

Like all estate planning, your personal situation should be analyzed in determining whether a Dynasty Trust helps you to meet your goals.

Planning to Preserve a Child's Inheritance in the Event of a Divorce

Deborah DiNardo

The Forest Institute of Professional Psychology in Springfield, Missouri reports that approximately 50% of first marriages end in divorce, as do 67% of second marriages and 74% of third marriages. More frequently than we might like, our clients are faced with the need to address the impact of a child's (or grandchild's) divorce on the clients' estate plans. Faced with such a circumstance, we might recommend an amendment to your revocable

trust to retain the share which your son or daughter would inherit outright so that the share may be protected from division in the divorce proceeding.

Various forms of irrevocable trusts and wealth transfer strategies, such as family limited partnerships, grantor retained annuity trusts, irrevocable life insurance trusts and qualified personal residence trusts, offer excellent tax planning and asset preservation – when the family is harmonious. However, when divorce looms, it may be necessary to unwind these strategies. This process often requires special tax planning and careful coordination between estate planning and divorce counsel to address beneficial interests in these entities. There are numerous tax as well as trust and corporate law considerations to address to achieve optimum results.

Divorce often necessitates a change in ownership or beneficiary designation of life insurance. The Internal Revenue Service's "transfer for value" rules must be carefully reviewed whenever a change in ownership - perhaps from one person to another, or from one trust to another - is required in a divorce. Fortunately, the tax laws include specific provisions which provide some relief from taxation. These include the non-recognition of gain or loss on the transfer of property, required because of divorce, from a person to a present or former spouse. Additionally, there are special rules which provide favorable tax treatment of trust income received under a divorce decree or separate maintenance agreement.

When family members can work harmoniously through a divorce, wealth transfer strategies may still be successfully employed. For example, perhaps you engaged in gift planning over the years, in order to transfer significant assets to your child free of gift or estate taxes, and now your child is divorcing. Should the court order your child to provide financial support to his or her spouse, assets that you transferred to your child may be exposed. One way to address this is the creation of a trust by your child for the benefit of the former spouse and their children to limit the former spouse's interest. That interest could take the form of a sum certain or an annuity payment each year, for example. The key is that the former spouse is provided for, but in a limited fashion, and without an opportunity to argue or litigate in the future. If the trustee has no discretion and no ability to alter the amount to which your child's former spouse is entitled from the trust, future litigation and legal expenses should be avoided while the child's spouse receives the cash flow which he or she is required to receive pursuant to the divorce decree.

While the emotional and personal impact of divorce on a family cannot be understated, failure to focus on the tax and practical implications of asset transfers, unwinding and restructuring of wealth transfer vehicles should not be overlooked.

Wishing You and Your Family a Very Happy Holiday Season

Probate, Trust & Personal Planning Team

Front L to R: Melissa Camille, Bernice A. Sousa, Barbara Bancroft, Elizabeth A. Pierce, Karen G. Bouchard, Christina P. Kennedy, Deborah DiNardo, Kristin N. Matsko, Jennifer S. Medeiros. *Back L to R*: Steven E. Snow, Michael A. Kehoe, Kathleen A. Ryan, Lawrence D. Hunt, Donna D. Beals, David C. Morganelli, Melissa E. Darigan, Marvin S. Silver, John J. Partridge. *Unavailable for photo:* Elizabeth A. Baglini, Linda G. Sears.

Photo by Melissa Bravo, Sky Studio

Trust Solutions for Developmentally Challenged Beneficiaries

Michael A. Kehoe

Families with developmentally challenged members are faced with a cruel dilemma. Do they include the individual with special needs in their gift and estate planning? If they include that family member as a beneficiary, will the family member become ineligible for governmental assistance and benefits?

To the "rescue" is the Supplemental Needs Trust (commonly known as a Special Needs Trust). The purpose of a Supplemental Needs Trust (SNT) is to allow a developmentally challenged individual to enjoy the benefits of his or her family's property while still accessing essential governmental benefits and services. Benefits may include supplemental security income (SSI), Medicaid, vocational rehabilitation, subsidized housing and adult day health programming. Usually, these benefits are based upon financial need and programmatic qualification.

Congress, in passing the Omnibus Reconciliation Act of 1993, authorized the use of two types of SNTs, one to hold assets of a third party ("Third Party SNT") and a second to hold assets of an individual who is under the age of 65 years and "disabled" according to Social Security standards ("Self-Settled SNT"). The law and regulations promulgated thereafter give us guidance regarding the specifics of a well-drafted SNT.

Every SNT must be irrevocable and have its own employer identification number. The SNT cannot allow the beneficiary to "demand and receive" funds from the trust. The trustee must have discretion to expend funds, with the clear intent that such expenditure only be made as a supplement to the benefits otherwise available.

With a properly drawn SNT, families no longer need to disinherit the challenged individual with special needs and rely upon the good will of siblings and other family members. Additionally, monies placed in the trust are not subject to liens of, seizure by, or forfeiture to the beneficiary's creditors.

When should families consider establishing an SNT? A parent or grandparent may establish an *inter vivos* irrevocable SNT or an SNT may be created at death under a will or revocable trust. The government allows a self-settled SNT to be established anytime before the beneficiary's 65th birthday. Gifts may be made to the trust (especially from non-parent sources) and insurance policies may have the SNT as a beneficiary of death benefits. Over the long term, the assets may grow and thus provide a larger pool of money with which to maintain the quality of life for the beneficiary.

Many clients have heard that there is an obligation to repay the state for amounts paid by Medicaid or other governmental programs once the supplemental trust beneficiary dies. Usually, an SNT funded by parents or other third-party sources will not be required to pay back such amounts. However, in a third-party SNT, such as a trust to hold proceeds or a tort settlement, the trust must make provision for the repayment of governmental assistance.

Working knowledge of the language required for the trust to be non-countable in determining the beneficiary's eligibility for governmental programs is a must. The practitioner drafting an SNT must have a thorough knowledge of the various laws and regulations involved in the governmental programs and benefits available.

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The Probate, Trust & Personal Planning Group is available to assist you with these and other issues. Contact your attorney for a consultation on how these issues impact your situation. For general comments or questions regarding this publication, you may contact Kathleen A. Ryan, kar@psh.com | 401-861-8200.

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