The Wealth Counselor

A monthly newsletter for wealth planning professionals

Free Your Clients From Old, Obsolete Trusts

The Perils of Outdated Plans and How to Overcome Them

From

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Condie & Adams, PLLC is a values-driven law firm committed to providing individuals, families and small businesses with personalized, client-centered legal services in estate planning, probate and trust administration, tax planning, and related legal matters.

Estate planning needs evolve. An old, obsolete estate plan often fails to achieve client goals, resulting in dissatisfaction, unnecessary taxes or probate costs, and a greater likelihood of lost assets under management. Fortunately, we can help your clients revitalize the obsolete aspects of their plans and get them back on track for the future, making you the hero and enhancing your relationship as a trusted advisor.

How to spot an outdated trust or will

There are two types of outdated trusts and wills: (1) documents your clients have created and (2) documents created by deceased loved ones of your clients where your clients are beneficiaries.

The fastest way to determine whether documents your clients have created are outdated is to look at the signature pages. If the documents were signed during or before 2012, your clients need an immediate estate plan review. Of course, if there are no signatures (a not unheard of situation), then we absolutely need to speak with your clients since their wishes are likely not legally valid.

For trusts and wills signed in 2013 and afterward, it’s a good idea for us to sit down with your clients to make sure the plan still meets all of their needs and avoids confusion, complexity, and needless cost due to obsolete tax planning.

As mentioned earlier, clients may be the beneficiary of a deceased loved one’s trust or estate.

You can usually spot this when a trust or account bears someone else's name with language like "FBO" or "for the benefit of" at the end. For example, the Susie Smith Article 6 Trust FBO Adam Smith. These trusts can sometimes be decades old and almost certainly have obsolete language. It is almost always worth examining these documents to ascertain opportunities for tax and administrative improvement.

Many individuals take a set-it-and-forget-it approach to their estate plans or feel like they cannot modernize an old trust they've inherited. Like investment or financial planning, tax planning, health and fitness, and so many other aspects of life, proper estate planning is an ongoing process that clients must revisit regularly.

We routinely monitor the latest developments in legislation and know how to modernize clients' plans. If outdated plans go unchecked, negative consequences can occur. Let's look at some potentially obsolete estate planning techniques that are worth a second look.

Be wary of the alphabet soup from yesteryear

FLPs, ILITs, AB trusts, and other convoluted acronyms can be indicative of trusts or planning strategies that have outlived their usefulness to your clients. Admittedly, these strategies can still be a great fit for the right client, but Family Limited Partnerships and other discounting-driven planning tools may produce a worse result now for some clients, as they can increase capital gains taxes. These discounting-driven plans were originally designed to reduce estate and gift taxes, which were a substantial issue at the time that these plans became popular. At the time, these were good strategies to implement, but changes in tax laws make them contraindicated (or even downright harmful) for many clients now.

The current $5.49 million exemption for the estate tax ($10.98 million for married couples) means that the overwhelming majority of clients do not have to worry about paying estate tax and can still take advantage of an income-tax-saving basis step-up on all of their assets.

While estate taxes have become less of an issue, federal capital gains tax rates have been rising and are now up to essentially a 20 percent base rate. For some clients, the net investment income tax (often referred to as the NIIT) tacks on 3.8 percent more. Add on state income taxes (ranging from 5-13.3%), and an obsolete discounting-driven plan could "save" a client on a non-existent estate tax bill while creating a built-in capital gain that could be taxed as high as 37.1 percent. This happens because discounting-driven planning strategies, such as FLPs, do not obtain a full basis step-up at the death of a client, which can create unnecessary capital gains taxes. Any plan that saves non-existent estate tax while creating a capital gains tax bill should be reviewed and likely reworked. Any clients with estates less than the exemption of $5.49 million ($10.98 for married couples) that have used these strategies in the past should take a second look.

Clients are not trapped with old plans (even if those plans are "irrevocable")
Old, obsolete plans can be updated. Just as there are many ways to remodel a home, there are many strategies and legal tools that can be used to modernize obsolete estate plans.

- **Updating an old trust**

Once you are aware of an outdated trust posing a potential risk to a client, advise the client to see us so we can help them craft a restatement or amendment. This is a straightforward solution that can update and modernize revocable trusts created by your clients. This makes their plan ready for the realities of the legal and financial landscape we live in today.

A client may have an irrevocable trust, perhaps an inheritance from a parent or grandparent or a trust created by the client for tax reasons that no longer make sense. There are several options to modernize these trusts, including decanting, trust protector restatement, judicial modification, and non-judicial settlement, depending on the circumstances, the clients' needs, and the laws of the state. There are no one-size-fits-all solutions, but the best place to start is with a discussion about your clients' circumstances, needs, and goals.

- **Untangling an obsolete plan**

Tax-driven planning often utilizes more than a single document. For example, a discounting-driven plan often involves a family partnership or family LLC agreement, one or more trusts, promissory notes, appraisals, and a gifting strategy. Similar to the solutions to old trusts described above, there are many tools and strategies available to unwind these plans when they have outlived their usefulness. Since each client and plan is unique, the way to unwind it will be as well. Coming up with the most effective strategy requires delicate consideration of the client's current goals and needs, as well as tolerance for risk.

Even though there is no way to know for sure what to do until some analysis is complete, it's better to have an informed choice rather than acting upon the assumption that the plan is going to work for the best interests of the client or that the plan cannot be changed. These are complex legal processes, and there is no one-size-fits-all answer. But no matter how tangled the threads of your clients' old trusts or plan seem to be, we can ascertain the right way to smooth things out.

Consult with us and let's see how we can achieve your clients' goals. Get in touch today for a fast-track solution to your clients' outdated trusts and obsolete plans.

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