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**Possibly the Best Way to Pass Assets to Your Children or Other Loved Ones:
GST Planning - Part Two**

By Richard M. Morgan & Loraine M. DiSalvo

In last month's newsletter, we set out to explain the many potential benefits which GST planning can provide for both a client and the client's loved ones. GST planning uses long-term trusts to provide most of its benefits. Long-term trusts present many issues which should be carefully considered and addressed while the plan is being designed, when the legal documents are being drafted, and when the plan is being implemented. The issues presented involve taxes, family dynamics, beneficiary personalities, and other factors. It is critical to use an attorney who is familiar with and aware of all these issues, and has experience in addressing them. If you are considering using GST planning in your own estate plan, you should also be prepared to spend time and effort to consider these issues and work with your attorney to ensure that your plan addresses them. This article is intended to help you start considering the issues raised by GST planning and give you guidance about how to select an attorney to help you design and implement your GST planning. Like last month's newsletter, this month's newsletter is structured in an informal, question and answer format.

I like the concept of GST planning. What is the first issue I should start thinking about in trying to design a plan? The first thing you should do if you are interested in using GST planning is to choose a competent estate planning attorney who is well-versed in the issues GST planning can involve. One big issue in GST planning is the need to deal with the possible application of the generation-skipping transfer ("GST") tax. As discussed in the last newsletter, GST planning uses trusts which are designed to last throughout the lifetime of at least one generation of beneficiaries (for example, a trust created for the benefit of a child will typically remain in existence throughout that child's lifetime, with the remaining assets passing to the child's children at the child's death). Any time a trust is designed to outlive an initial beneficiary and pass to other beneficiaries at the initial beneficiary's death, there may be a GST tax. In addition, if a trust is created for the benefit of a beneficiary at one generational level, such as a child, and the trust permits distributions to be made to or for the benefit of the beneficiary's children, a GST tax may apply to any distribution to or for the younger generation of beneficiaries. An attorney who is helping a client with GST planning needs to know how to maximize the use of the client's GST exemption, to protect the long-term trusts and reduce the GST tax exposure. In addition, since there may be more assets than can be made fully GST tax exempt using a client's exemption, the attorney also needs to be able to find ways to reduce the potential impact of GST tax on any non-exempt assets. Unfortunately, the GST tax rules are wildly complicated, even compared to many other federal tax rules. In addition, the other potentially applicable federal estate, gift, and income taxes (as well as potentially applicable state taxes of various types) need to be addressed as well as the GST tax, making things even more complex. Many attorneys who do estate planning do not have the level of tax law knowledge necessary to deal with GST planning. Ideally, you should choose an estate planning attorney who is completely comfortable with all of the potentially applicable taxes; this generally means a tax attorney who specializes in

estate planning.

Another big issue you should consider when selecting an attorney is the attorney's willingness to help you look far into the future when discussing the way your estate plan will operate. GST planning is intended to create trusts which last throughout the lifetime of at least one generation of beneficiaries, and usually far into the lives of at least a second generation of beneficiaries. A lot can happen in the many decades these trusts will exist, and your documents should try to self-adjust for as many reasonably forseeable possible situations as they can. Your attorney should ask you questions you may not even have considered, such as:

- If one of your primary intended beneficiaries is not living at the time you want your assets divided up, what do you want to have happen to the share that primary beneficiary would have received (does the share just not get created, does it go to the beneficiary's children, if any, does it go to another alternate beneficiary, etc...)

- Should a beneficiary's spouse be allowed to benefit from the beneficiary's trust while the beneficiary and the spouse are married? How should such benefits be limited in the event of a divorce?

- Should a beneficiary's committed, but unmarried partner (such as in a same-sex couple situation) be allowed to benefit from the beneficiary's trust, and how should such benefits be restricted if the beneficiary and the partner dissolve their relationship?

- Should a beneficiary's surviving spouse or unmarried, committed partner be a beneficiary of the trust after the beneficiary's death, and, if yes, should the spouse or partner's interest end if he or she remarries or enters another romantic relationship?

- Should a beneficiary have the power to change the way assets in his or her trust are distributed at his or her death? If yes, do you want to limit the possible beneficiaries of the trust to only certain categories of people, or would you prefer to allow the beneficiary a wide range of options, possibly including people who are not family members and charitable organizations as possible recipients?

- If a beneficiary receives a share and the share is being held in trust, and the beneficiary dies, what happens to that beneficiary's share? What happens to the share if your first choice alternate beneficiary is not living?

- What happens if, at any time after your death and prior to the termination of any trusts created by your plan, none of your intended beneficiaries is still living? Do you

want the remaining property to pass to your heirs, to other individuals, or to one or more charities? If you want other individuals, please remember: you still need to plan for the possibility that those individuals won't be alive at that time either.

If your attorney is not asking you these kinds of questions, you should consider finding one who does. Attorneys who know to ask these kinds of questions are more likely to be able to draft a plan which adequately provides for multiple possible outcomes, and you are more likely to receive a plan which will operate as intended no matter what happens. Ask a prospective attorney about his or her familiarity with long-term trusts, and about the GST tax. Watch as the attorney begins walking you through the details of a plan, and note whether they are stopping too soon on different issues. If the attorney seems unclear about the issues raised by the GST tax and unfamiliar with planning for long-term trusts, you may want to find a new attorney.

Okay, I feel like I have some idea of how to select the attorney. What else do I need to think about? One of the benefits of GST planning, from the perspective of the person whose estate plan uses it, is that the trusts created for the intended beneficiaries can be made very flexible or very restrictive. In a very flexible trust, the primary intended beneficiary will generally be allowed quite a lot of control over and access to the trust, at least once he or she reaches a certain minimum age. In a very restrictive trust, the primary intended beneficiary could be given no right to control or access the trust at all, and all of the power to decide how the trust assets are managed and used can be given to one or more third party Trustees. Of course, there is a wide spectrum in between these two extremes, and a trust can pretty much be drafted to be as flexible and open or as restricted as the person whose plan will create the trust prefers. GST planning requires that the person doing the estate planning decide how much flexibility or restrictiveness they want to allow their intended beneficiaries.

For example, say you have children who you want to benefit under your estate plan. Your children are all responsible, stable, mature adults and you would feel comfortable allowing them to have immediate, outright, distributions of their inheritances at your death. You decide that you like the various protective benefits which GST planning can provide your children, but you would still prefer that they receive as much control over their own inheritances as possible after your death. In this case, you will likely opt to give your children trust shares with maximum flexibility, by allowing each child to become his or her own Trustee, allowing the child to appoint his or her own successor Trustees or Co-Trustees, and giving the child a broad power to have the remaining trust assets distributed to the child's desired beneficiaries at the child's death. Allowing your beneficiary to enjoy maximum control over and access to his or her trust can make the trust feel almost invisible from the beneficiary's perspective, while still allowing the trust to provide a kind of protective cocoon around the trust assets, to help protect them from the beneficiary's own potential creditor, divorce, estate tax, or predator problems.

As another example, say you have three children, of whom two are responsible, stable, and mature, and one seems to be unable to make consistently good financial choices, tends to surround himself with unsavory friends, and has a substance abuse problem. You don't want to disinherit your less-than-perfect child, but you don't want him to squander the assets you leave him, have them effectively stolen from him, or use them in self-destructive ways. In this case, you can give the two responsible, stable children trust shares with maximum flexibility, and you can place fairly tight restrictions on the trust share created for your other child. You will likely want to use a third party Trustee to manage the restricted trust share and decide how the funds get used. You can simply give the third party Trustee broad discretion to use the assets for your child's benefit, while at the same time limiting the child's ability to make demands. You may also wish to consider more detailed restrictions, such as stating that the trust assets should be used primarily for either "safety net" expenses such as medical care, adequate but not luxurious housing, and moderate transportation costs, or for educational purposes. You could even try to provide your child with incentives to engage in constructive activities and refrain from negative activities. Some examples of incentives for constructive behavior would be providing for an outright distribution of a certain amount to the child upon the child's graduating from college with a bachelor's degree or matching income the child earns from holding a steady job. An example of an incentive to refrain from negative behavior could be tighter limits on the child's benefits from the trust property if the child tests positive for illegal drug use or is determined by the Trustee to be abusing alcohol or prescription drugs.

The starting point for considering how much or how little flexibility to build into your GST planning is your own gut instincts, and your knowledge of your intended beneficiaries, their families, their friends, and their past behaviors. Your attorney should ask you questions and guide you in considering these issues. The attorney should not tell you what trust provisions to use, but should be the person who gives you suggestions about how to handle various concerns and points out potential concerns or pitfalls with a proposed structure. When you are done designing your plan, you should feel comfortable with your choices and the impact your planning choices may have on your intended beneficiaries. Your life does not come out of a box, neither should your estate plan.

It sounds like choosing a Trustee is pretty important in GST planning. How do I go about choosing a Trustee? Yes, the choice of a Trustee for the trusts created in GST planning is very important. There are several potential situations for which you may be choosing a Trustee, and each situation has its own issues which can influence your choice. Some of those situations may apply even in non-GST planning estate plans, such as the choice of a Trustee for your own revocable trust, who may serve during your lifetime, for a trust to be held for the benefit of a surviving member of a couple during the surviving member's lifetime, or for a young beneficiary during that beneficiary's youth. In GST planning, however, since trusts for beneficiaries are intended to last for many decades and the lifetime of at least one generation of beneficiaries, the question of selecting initial and successor Trustees can become more difficult.

To a great extent, the choice of a Trustee for GST planning trusts is driven by the degree of flexibility the trust's creator wants to give to the beneficiary. If the intent is for the beneficiary to eventually have maximum control over the trust, then the beneficiary can be allowed to serve as his or her own Trustee once he or she reaches a certain age. As the trust creator, you can provide a transition period during which a beneficiary serves as Co-Trustee along with the Trustee you select, to help ensure that the beneficiary learns how to manage the trust before taking full control over it. The beneficiary can also be allowed to select his or her own successor Trustees. This level of flexibility makes the trust creator's Trustee selections somewhat less important over time, since the creator's selected Trustee may only need to serve until the beneficiary is able to take over. However, even in this situation, the beneficiary may not ever actually be able to take over (due to death, illness, or injury, for example). So it is wise, at a minimum, to provide an avenue through which a successor Trustee can be appointed without court involvement.

Where a beneficiary is never intended to have full control, the choice of a Trustee becomes even more important, since the Trustee(s) selected by the creator may need to serve for many decades. Your attorney should help you consider the options for selecting a Trustee. In many cases, a corporate Trustee may be the best choice, in place of or in addition to one or more individuals. If you would like more information about Trustee choice, please ask us for a copy of our April 2010 newsletter, which discussed issues relating to the choice of a fiduciary.

How much is this GST planning going to end up costing me and my beneficiaries? It sounds like it could be expensive, what with all these trusts. Many of our clients ask this question. They say that the added protection the GST planning offers for their intended beneficiaries sounds great, but they worry that the costs and hassles of administering the plan will be significant and end up burdening the beneficiaries. However, the added costs of using GST planning are not significant when compared to the benefits it can provide. We often tell our clients that, if you have enough assets to make using a trust worthwhile, it's often worth using GST planning.

Any time assets are transferred as part of a gift or an inheritance, there will be some costs associated with the need to transfer title to those assets. These costs are generally the same whether the assets are being distributed to a beneficiary outright or whether they are being distributed to a trust. The costs associated with managing the assets and making appropriate investments should also be very similar without regard to whether a trust or the beneficiary owns the assets. The primary differences from an administrative cost standpoint would be (1) the potential need to pay Trustee fees in addition to any investment advisory fees; (2) the costs to keep the trust's books and records, in addition to the beneficiary's personal books and records; and (3) the costs to prepare and file the trust's state and federal income tax returns and any accountings which must be provided to the beneficiaries. These fees can be managed and held to quite reasonable levels even if the beneficiary is not serving as his or her own Trustee, and if the beneficiary is also the Trustee, these costs can be extremely low.

To the extent that income earned in a given year is retained by a trust rather than distributed in the same year, the income tax rate paid by the trust may be higher than the individual beneficiary would have paid on the same income. However, distributions made during a calendar year generally "carry out" portions of trust income earned in the same year, with the effect that the income carried out is taxed at the beneficiary's rate, rather than the trust's rate. In many cases, the Trustee may be able to use this income tax treatment to minimize the overall difference between trust income tax rates and individual income tax rates.

Of course, from the standpoint of the person doing the GST planning as part of his or her estate plan, there are also some additional, up-front costs associated with preparing and implementing the plan. In our practice, a client who wishes to use GST planning in his or her estate plan does pay somewhat higher legal fees, in general, for the document preparation work than does a client who does not use GST planning. The legal fee difference is due to the additional complexity of the planning and drafting phases of the GST planning based estate plan versus an estate plan which does not use GST planning. However, keep in mind that an individual beneficiary who wants to protect assets he or she inherits outright would have to spend a lot of money in order to obtain creditor, predator, and estate tax protection benefits which are even close to what you could have provided the beneficiary if you had used GST planning. In fact, even after spending a lot of money and undertaking transactions which are usually much more restrictive than any of the GST planning trusts we create for our clients, the beneficiary would still not be able to get the same level of protection for the beneficiary's own assets which you could have provided by simply using GST planning in your own estate plan for the beneficiary. So, on the whole, the additional costs associated with using GST planning should be seen as insignificant, while the benefits can be great.

Won't the beneficiary just end up depleting the trust over time anyhow? If you use careful planning when you and your attorney are preparing your estate plan, and if your Trustee uses careful investment and management techniques, a GST planning trust can actually end up growing over time, rather than being depleted. A GST planning trust can give the Trustee the power to have the trust purchase personal use assets on behalf of the trust's beneficiary, and then allow the beneficiary to use those assets. This technique allows the trust assets to be invested in assets which may not be traditional investment assets, but which may still appreciate inside the trust, rather than forcing the Trustee to make a distribution to allow the beneficiary to buy the asset himself or herself. "Personal use assets" can include a vacation home, artwork, jewelry, collectibles, antiques, and other assets which may appreciate over time. In addition, with proper drafting, the trust can invest in a business to be run by a beneficiary, which can end up with much of any appreciation in the business accumulating inside the trust, rather than in the beneficiary's name. Since the trust assets can be used by the beneficiary, there is no good reason in many cases for income or other distributions to be forced out of the trust. This means that, to the extent possible, investments can be made inside the trust and accumulated there. In other words, depending on the amount of assets in the trust and how the trust assets are invested and used, it is entirely possible that the beneficiary's needs will not

deplete the trust's assets.

What happens if at some point the beneficiary does deplete the assets, or if things change and it is no longer a good idea to have the trust for some reason? We generally recommend using "safety valves" designed to allow a trust to be terminated if the trust's assets drop to a level at which continuing to operate the trust is no longer economically effective. We also generally recommend having provisions under which a Trustee who is not a beneficiary of the trust can make distributions to or for the benefit of the beneficiary in an essentially unlimited fashion. These provisions help avoid the possibility that a trust which is no longer desirable for some reason can be terminated. If a beneficiary is serving as his or her own Trustee, provisions which allow appointment of successor Trustees or Co-Trustees can be used to trigger these safety valve provisions.

Okay; it all sounds good. How do I get started? Contact us at (678) 720-0750 or sollila@morgandisalvo.com to set up an estate planning consultation with either Richard Morgan or Loraine DiSalvo. You can discuss GST planning and find out what benefits it can offer you and your loved ones. You can also start the process of incorporating GST planning into your own estate plan, if you haven't already. We look forward to meeting with you.