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# THE PLANNER

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A monthly newsletter for Accounting, and Financial Professionals with a focusing on Estate Planning, Elder Law, and Special Needs Persons.

The Planner is a newsletter to inform and educate Accounting and Financial Professionals of the ever changing areas of estate taxes, and elder law to better service their clients.



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## Niche Trusts

Revocable Living, Irrevocable Life Insurance, Charitable Lead, and Grantor Retained Annuity - these are trust descriptors that are familiar to estate planning professionals. However, there are many less well-known types of trusts that clients may ask about or benefit from having. Some of those other types of trusts will fill an estate planning need like no other arrangement can. Some arrangements called “trusts” do not fit the traditional trust definition. Still other things called “trusts” are outright shams.

As professionals, we need to know about the lesser-known trusts, when to use them, when to avoid them, and when to warn our clients to get out of them.

In this issue of The Planner, we review some trust basics and then provide an introduction to a number of these lesser-known trusts and things called “trusts.”

### What Is a Trust?

Almost always, when someone says “trust,” they mean

what is called an “express trust” - a tri-party relationship intentionally established by a grantor (who is the owner of property), a trustee (who receives and agrees to hold and manage the property), and a beneficiary or beneficiaries (for whose benefit and enjoyment the property is to be held). In this discussion, “trust” means “express trust” unless the contrary is stated.

**Planning Tip:** An entity that is not classified as a trust under Treas. Reg. 301.7701-4 is a business entity.

### Private Trusts

Most trusts are private trusts. In addition to those commonly encountered, there are many that have very special purposes. Some of them are:

**Health and Education Exclusions Trust (HEET):** The HEET is a multi-generational or “dynasty” trust. Through a HEET, a wealthy grantor can confer even

more benefit on grandchildren and generations beyond than the amount that is exempt from the Generation Skipping Transfer (GST) Tax. The HEET does this by limiting distributions for the benefit of “skip persons” to direct payments of their medical and higher education tuition expenses. A skip person is someone two or more generations younger than the grantor. A HEET also prohibits direct payments to skip persons or for purposes that are not exempted from gift, estate, and GST tax. The HEET must have a least one beneficiary with a substantial present economic interest who is a non-skip-person. Typically, the non-skip beneficiary chosen is a charity so that the HEET can continue in existence for as long as the charity exists.

**Planning Tip:** A HEET is frequently created by a taxpayer who has already used their GST exemption, has charitable goals and wishes to create an education and health care safety net for future generations.

#### **Delaware Incomplete-gift Non-Grantor (DING) Trust:**

A DING is a non-grantor self-settled irrevocable trust that gives the grantor creditor protection and avoids state income tax on undistributed ordinary income and capital gains. Delaware was the first state to allow self-settled asset protection trusts. Now, however, DINGs are not limited to Delaware. States where domestic asset protection trusts can be established now include Alaska, Nevada, New Hampshire, Rhode Island, South Dakota, Tennessee, Utah and Wyoming.

Assets placed in a DING get a step up in basis on the grantor’s death and are included in the grantor’s estate for estate tax purposes. A DING must require the consent of an adverse party for any trust distribution (typically a committee composed of two beneficiaries of the trust other than the grantor).

#### **Rabbi Trust:**

The first Rabbi Trust was set up for a rabbi; hence, the name. They are used with various nonqualified deferred compensation arrangements for highly compensated executives who wish to defer the receipt of some of their compensation in order to minimize current income taxes. The Rabbi Trust can be revocable or irrevocable and funded or unfunded. A funded Rabbi Trust provides

the executive more security; however it must be carefully structured to prevent the employee from being taxed now. The trustee must be an independent third party and the assets must be held separate from the employer’s other funds.

**Planning Tip:** Assets held in a Rabbi Trust are subject to the claims of the employer’s general creditors, so it is important to use this technique only with a financially solid company. The fact that the executive will be an unsecured creditor of the company should the company become insolvent is not especially reassuring, but is necessary in order to prevent the executive from being taxed currently on the deferred compensation.

#### **Oral Trust:**

Although trusts are usually written documents, that is not always required. The Uniform Trust Code (UTC) does acknowledge that under certain circumstances a trust may be created orally. However, oral trusts of real property are not permitted in some states. The biggest problems with an oral trust, of course, are interpretation and enforcement. Disputes about the terms or even the very existence of an oral trust are common.

#### **Alimony and Maintenance Trust:**

These are also called “Section 682” trusts. They are an exception to the general grantor trust rules in that the income paid from these trusts to an ex-spouse under a dissolution or separation decree/agreement will be taxed to the payee (the ex-spouse) and not to the grantor. Typically the trust’s income is paid to the former spouse for a specified term or amount or until the spouse dies. After the former spouse’s interest has ended, the trust can continue for the benefit of the grantor’s designated successor beneficiaries, typically the children.

**Planning Tip:** An alimony trust may be useful if a business owner cannot or does not want to sell an interest in the family business to make payments to his former spouse or if the business lacks the liquidity to redeem the stock of the former spouse. It can protect the payee in the event the payor should die or become financially insolvent before all payments have been made. Also, the trustee can be a neutral third-party who can act as an intermediary between the former spouses. One downside is that the trust can become under- or over-funded, so

care should be taken when drafting the document and funding the trust.

### **Commercial Trusts**

Also known as a business trust, the commercial trust is an unincorporated business organization. It is created by a written agreement under which assets are managed by a trustee for the benefit and profit of its beneficial owners. It is typically funded in a bargained-for exchange and shares of beneficial ownership are issued to the participants. The trustee can make risky investments for entrepreneurial gain and share that risk of loss with the beneficial owners. This arrangement is different from the traditional grantor/trustee/beneficiary relationship and the trustee does not have the same kinds of fiduciary duties and protections as in a conventional trust arrangement. It is not clear that these trusts would have as much asset protection as a conventional corporation or an LLC, or how they would be recognized in bankruptcy. Specific commercial/business trusts include:

#### **Investment Trust:**

This trust is used by multiple individuals to pool funds for common investments. One common type of Investment Trust is the Real Estate Investment Trust (REIT). The trust may provide that beneficial interests in the trust may be bought and sold.

#### **Environmental Remediation Trust:**

These are established to collect and disburse funds for environmental remediation of an existing waste site when the ultimate cost of remediation is uncertain. They are used in sales of contaminated real property.

#### **Statutory Land Trust:**

These private non-charitable trusts are used to hold title to real property while keeping the identity of the beneficiary confidential, and are used to maintain privacy in the transfer of real estate (acquisition or sale). They can avoid probate, but do not provide asset protection.

#### **Liquidating Trust:**

These relate primarily to income tax and bankruptcy. In bankruptcy, they are used to liquidate assets under Chapter 11. Outside bankruptcy, they are used to facilitate a sale.

#### **Voting Trust:**

These allow voting rights in a business entity to be

transferred to a trustee, usually for a specified period of time or for a specific event. They are useful in resolving conflicts of interest, in securing continuity, for corporate reorganization, and in divorce when it is necessary to divide an LLC or corporation owned by a divorcing couple.

### **Specific Purpose Trusts**

There are some trusts created for specific purposes rather than for the benefit of individual beneficiaries. Non-charitable purposes include pets, artwork, aircraft; charitable purposes include private foundations organized as trusts and charitable land banks. Specific examples include:

#### **Funeral and Cemetery Trust:**

A funeral trust is an arrangement between the grantor and funeral home or cemetery involving prepayment of funeral expenses. An endowment cemetery trust is a pooled income fund held in the name of the cemetery for ongoing maintenance of cemetery grounds. A service and merchandise cemetery trust, similar to a funeral trust, is for merchandise like a gravesite marker or mausoleum and for burial service.

#### **Pet Trust:**

Many pet owners want to provide for the continuing care of their pets after their own deaths. As a result, many states have adopted some form of pet trust legislation. It is important to specifically identify the animal the trust is to benefit, especially if the pet is valuable or a large sum of money is involved. Special considerations include: how long the trust will need to last, what kind of care is needed and who will provide it, whether to name a separate trustee to manage funds in addition to a caretaker, successor fiduciaries and caretakers, a sanctuary or shelter of last resort if the pet outlives the caretakers or those named cannot serve, liability insurance for potential damage caused by the pet, a trust protector, and reimbursement of taxes if the payee is subject to additional income taxes. Also consider how much money will be required to fund the trust and what will happen to any funds that remain after the pet has died.

#### **Gun Trust:**

Federal, state and local firearms laws strictly regulate

possession and transfer of certain weapons and bar certain persons from owning or having access to firearms. When an estate has firearms, the executor must be careful to avoid violating these laws. Transferring a weapon to an heir to fulfill a bequest could subject the executor and/or the heir to criminal penalties. Just having a weapon appraised could result in its seizure.

A trust designed specifically for the ownership, transfer and possession of a firearm (known as a gun trust or firearm trust) can avoid some of the rules that regulate such transfers. The trust, which must be carefully drafted to account for the different types of firearms held and comply with firearms laws, establishes a trustee as the owner of the firearms. The trust can name several trustees, each of whom may lawfully possess the weapon without triggering transfer requirements. Once a weapon becomes a trust asset, any beneficiary (including a minor child) may use it.

**Marketing Tip:** There are four million members of the National Rifle Association (NRA) and an estimated 240 million firearms in this country. That means millions of American own guns. Many families also have guns as heirlooms. Providing guns trusts (and pet trusts, for that matter) is an excellent way to reach out to potential clients for estate planning.

### **Other Trusts**

**Blind Trust:** These are used by higher net worth clients who are involved in public companies or politics and who need to strictly limit their knowledge of how their assets are being managed in order to avoid any conflict of interest or even the appearance of one. Investments are transferred to an independent trustee who is permitted to sell or dispose of any assets transferred to the trust, and then reinvest in assets that are unknown to the grantor.

### **Coogan Trust:**

This is a statutory trust account required in some states to protect a part of the earnings of child actors. It is named after the child actor, Jackie Coogan, who learned on becoming an adult that his parents had saved very little of his earnings.

### **Totten Trust:**

This is a pay-on-death account that, until the death of the depositor, is treated as an informal revocable living trust. While living, the depositor may be the grantor, trustee and beneficiary. Upon the depositor's death, the proceeds in the account will be paid to the beneficiary previously designated on a signature card by the depositor (who can change the designation any time before his/her death).

### **Sham Trusts:**

These are so-called trusts marketed by hucksters that violate public policy and are not recognized by state or federal income tax authorities or the courts. The document may claim to create a trust and promise tax benefits, but makes no actual change in ownership or control of the grantor's property or beneficial interests. They may be complex, involving multiple foreign and domestic trusts, and entities holding interests in other trusts. Funds may flow from one trust to another by various agreements, fees and distributions; often there are no named beneficiaries. They may claim that paying taxes is entirely voluntary. Names include Constitutional Trusts, Pure Trusts, Pure Equity Trusts, Contract Trusts, and Freedom Trusts.

**Planning Tip:** If your client has one of these sham trusts, the risk of an IRS audit with accompanying penalties - civil and criminal - is high. They thus provide the advisor an opportunity to un-do a great harm, providing the client is willing.

### **Constructive Trusts**

A constructive trust is not a trust, but it resembles one. It is an equitable remedy imposed by a court to transfer the benefit of property to the rightful party when someone else has unjustly received it. A court may impose a constructive trust to remedy fraud, misrepresentation, bad faith, overreaching, undue influence, duress and mistake. Courts may also use the constructive trust doctrine creatively when a wrong has been committed but no legal remedy is available.

### **Conclusion**

There are many kinds of trusts and trust-like arrangements that estate planners may not routinely use in their practices. It's good to be aware of them, and to understand when one might be useful for a client and when one might

be dangerous, or possibly even criminal. Each represents an opportunity for the professional to enhance their role as trusted advisor.

## 7 Tips for Helping Families with Special Needs

There are numerous misconceptions in this area that can result in costly mistakes when planning for special needs beneficiaries. Understanding the pitfalls associated with special needs planning is a must for all of us who assist families who have loved ones with special needs.

### **Tip #1: Avoid disinheriting the special needs beneficiary.**

Many disabled persons receive Supplemental Security Income (“SSI”), Medicaid or other government benefits to provide food, shelter and/or medical care. The loved ones of the special needs beneficiaries may have been advised to disinherit them - beneficiaries who need their help most - to protect those beneficiaries’ public benefits. But these benefits rarely provide more than basic needs. And this solution (which normally involves leaving the inheritance to another sibling) does not allow loved ones to help their special needs beneficiaries after they themselves become incapacitated or die. The best solution is for loved ones to create a special needs trust to hold the inheritance of a special needs beneficiary.

**Planning Note:** It is unnecessary and in fact poor planning to disinherit special needs beneficiaries. Loved ones with special needs beneficiaries should consider a special needs trust to protect public benefits and care for those beneficiaries during their own incapacity or after their death.

### **Tip #2: Procrastinating can be costly for a special needs beneficiary.**

None of us know when we may die or become incapacitated. It is important for loved ones with a special needs beneficiary to plan early, just as they should for other dependents such as minor children. However, unlike most other beneficiaries, special needs beneficiaries may never be able to compensate for a failure to plan. Minor beneficiaries without special needs can obtain more resources as they reach adulthood and can work to meet essential needs, but special needs beneficiaries may never have that ability.

**Planning Note:** Parents, grandparents, or any other loved ones of a special needs beneficiary face unique planning challenges when it comes to that child. This is one area where families simply cannot afford to wait to plan.

### **Tip #3: Don’t ignore the special needs of the beneficiary when planning.**

Planning that is not designed with the beneficiary’s special needs in mind will probably render the beneficiary ineligible for essential government benefits. A properly designed special needs trust promotes the comfort and happiness of the special needs beneficiary without sacrificing eligibility.

Special needs can include medical and dental expenses, annual independent check-ups, necessary or desirable equipment (for example, a specially equipped van), training and education, insurance, transportation and essential dietary needs. If the trust is sufficiently funded, the disabled person can also receive spending money, electronic equipment & appliances, computers, vacations, movies, payments for a companion, and other self-esteem and quality-of-life enhancing expenses: the sorts of things families now provide to their child or other special needs beneficiary.

**Planning Note:** When planning for a beneficiary with special needs, it is critical that families utilize a properly drafted special needs trust as the vehicle to pass assets to that beneficiary. Otherwise, those assets may disqualify the beneficiary from public benefits and may be available to repay the state for the assistance provided.

### **Tip #4: A special needs trust does not have to be inflexible.**

Some special needs trusts are unnecessarily inflexible and generic. Although an attorney with some knowledge of the area can protect almost any trust from invalidating the beneficiary’s public benefits, many trusts are not customized to the particular beneficiary’s needs. Thus the beneficiary fails to receive the benefits that the parents or others provided when they were alive.

Another frequent mistake occurs when the special needs trust includes a pay-back provision rather than allowing the remainder of the trust to go to others upon the death of the special needs beneficiary. While these pay-back provisions are necessary in certain types of special needs trusts, an attorney who knows the difference can save family members and loved ones hundreds of thousands of dollars, or more.

**Planning Note:** A special needs trust should be customized to meet the unique circumstances of the special needs beneficiary and should be drafted by a lawyer familiar with this area of the law.

**Tip #5:** Use great caution in choosing a trustee.

Loved ones or family members can manage the special needs trust while alive and well if they are willing to serve and have proper training and guidance. Once the family member or loved one is no longer able to serve as trustee, they can choose who will serve according to the instructions provided in the trust. Families or loved ones who create a special needs trust may choose a team of advisors and/or a professional trustee to serve. Whomever they choose, it is crucial that the trustee is financially savvy, well-organized and of course, ethical.

**Tip #6:** Invite others to contribute to the special needs trust.

A key benefit of creating a special needs trust now is that the beneficiary's extended family and friends can make gifts to the trust or remember the trust as they plan their own estates. For example, these family members and friends can name the special needs trust as the beneficiary of their own assets in their revocable trust or will, and they can also name the special needs trust as a beneficiary of life insurance or retirement benefits. Unfortunately, many extended family members may not be aware that a trust exists, or that they could contribute money to the special needs trust now or as an inheritance later.

**Planning Note:** Creating a special needs trust now allows others, such as grandparents and other family members, to name the trust as the beneficiary of their own estate planning.

**Tip #7:** Relying on siblings to use their money for the benefit of a special needs child can have serious adverse effects.

Many family members rely on their other children to provide, from their own inheritances, for a child with special needs. This can be a temporary solution for a brief time, such as during a brief incapacity if their other children are financially secure and have money to spare. However, it is not a solution that will protect a child with special needs after the death of the parents or when siblings have their own expenses and financial priorities.

What if an inheriting sibling divorces or loses a lawsuit? His or her spouse (or a judgment creditor) may be entitled to half of it and will likely not care for the child with special needs. What if the sibling dies or becomes incapacitated while the child with special needs is still living? Will his or her heirs care for the child with special needs as thoughtfully and completely as the sibling did?

Siblings of a child with special needs often feel a great responsibility for that child and have felt so all of their lives. When parents provide clear instructions and a helpful structure, they lessen the burden on all their children and support a loving and involved relationship among them.

**Planning Note:** Relying on siblings to care for a special needs beneficiary is a short-term solution at best. A special needs trust ensures that the assets are available for the special needs beneficiary (and not the former spouse or judgment creditor of a sibling) in a manner intended by the parents.

**Bonus Tip:** Stay up to date on changes in the law. The rules applicable to special needs trusts are constantly changing. Most recently, the Social Security Administration changed the rules on special needs trusts that are created using assets of the special needs beneficiary (called a "self-settled special needs trust"). The new Social Security regulations require certain provisions to be present in any self-settled trust drafted after January 1, 2000 that allows for early termination of the trust (termination prior to the death of the special needs beneficiary).

If these required provisions are not in the trust, the special

needs beneficiary could lose SSI or Medicaid eligibility. The new regulations go into effect October 1, 2010. Please contact us if you have questions about the new regulations or if you would like more information on the changes.

**Planning Note:** A recent change in the Social Security Administration regulations governing self-settled special needs trusts could render some existing trusts invalid for SSI or Medicaid purposes. It is imperative to stay up to date on changes in the rules that apply to special needs trusts to ensure the benefits received by a special needs beneficiary are not jeopardized as a result of changes in the law.

**Conclusion.** Planning for a special needs beneficiary requires particular care and knowledge on the part of the planning team. A properly drafted and funded special needs trust can ensure that special needs beneficiary has sufficient assets to care for him or her, in a manner intended by loved ones, throughout the beneficiary's lifetime. Please contact us if you have any questions or would like to discuss any information in this newsletter further.

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