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Snippets

An Estate Planning and Financial Planning Newsletter
Summer 2014

In this Issue:

Establishing a Legacy for Your Special Needs Child or Grandchild

If you are a parent, grandparent, or care giver to a special needs individual, you have likely given some consideration to the potential uncertainty of that individual's financial future when the day comes that you are no longer there to provide him or her with the support he or she needs. A comprehensive understanding of the individual's future needs and eligibility for outside resources is necessary in order to craft a plan that will protect that person's financial security. A "supplemental needs trust" or "special needs trust" has become a necessary and central component of estate plans for families' with disabled individuals. Such trusts ensure that a special needs individual will have access to the private resources provided by family members and such resources will be properly managed by a Trustee. These trusts also enable the disabled child to benefit or continue to benefit from government and other public assistance opportunities.

Eligibility for Government Benefits: Many people with disabilities (children and adults) rely on Supplemental Security Income ("SSI") and Medicaid for support (among other, typically lesser, potential sources of assistance) to provide them items like cash, food, housing, staff supervision, day programs, employment support, transportation and medical care. These financial and social programs provide so-called 'needs based' assistance, meaning that a disabled person's eligibility for support is based on their financial circumstances (i.e. that they have limited resources). For many families, once a child with special needs turns 18 years of age, they may qualify for SSI and/or Medicaid as long as they have no more than $2,000 in assets to their name (children under 18 can also qualify, but typically their parents finances will be considered, which, in many cases, can disqualify a child as a result). The limitations are very strict.

While the parents of a disabled child over 18 are alive and well, the arrangement may work relatively seamlessly. The parents can make purchases for the child, take them on vacations, and do other things for the disabled child to enrich their life– as long as the disabled child does not actually own assets. But what happens in the event of the death of the parents? If the parents provide in their Will an inheritance for their disabled child that goes directly to them, the child will lose their government benefits. However, if, in the alternative, the parent provides for that child's inheritance in a supplemental needs trust, then that inheritance will be available for the use of that child, but it will not be a countable asset for purposes of SSI and Medicaid. So the disabled child will continue to receive their government benefits, and the inheritance or assets in trust will be available to supplement the government benefits which can be used to enrich the child's life.

The Supplemental Needs Trust: A supplemental needs trust is a vehicle that preserves a disabled individual's eligibility for SSI and Medicaid by keeping the assets out of the individual's name. The trust can provide that the trust assets may be used for expenses other than the individual's basic support (i.e. food and shelter). The assets in the trust may not be used for room and board, but can be used to enhance a child's living situation or be used for such things as medical and dental expenses, annual checkups, eyeglasses, transportation and vehicle purchases, education, insurance, rehabilitation, home health aides, entertainment (e.g. vacations, movies, concerts, sporting events, etc.) and other goods and services that add pleasure and quality of life.

Self-Settled vs. Third Party Supplemental Needs Trusts: There are basically two ways in which assets can be contributed to a special needs trust for a disabled individual. Either the assets are contributed to the trust by the disabled child (typically funds are obtained by the disabled child via an inheritance or lawsuit), or by someone other than the disabled child (i.e. parent or grandparent). When the assets contributed to the trust originally belong to the disabled individual, or his or her spouse, then the supplemental needs trust must be drafted as a self-settled trust. A self-settled supplemental needs trust also comes in two types (the difference between which are beyond the scope of this article), but in both cases, the major limitation to this kind of trust is that upon the death of the disabled individual, the assets of the trust must be used to reimburse Medicaid for any health care costs paid on the disabled individual's behalf. Any remaining assets can then go to other family members or friends.

A third-party supplemental needs trust is created with assets of someone other than the disabled individual. In this circumstance, because the assets never belonged to the disabled individual, the law allows the assets to be used for the benefit of the disabled individual during that person's lifetime, and upon the disabled person's death, all of the remaining assets then remaining can be distributed to another individual. The advantage to this kind of trust is that Medicaid will not be entitled to any form of reimbursement upon the death of the disabled individual. For clients who either want to give assets currently to a disabled person, or want to provide in their estate plan that upon their death, a certain portion of their assets are used for the benefit of a disabled person, the third-party supplemental needs trust is a valuable tool for making sure that the disabled individual is well taken care of when the client is no longer there, and further ensures that the assets in trust are not wasted on expenses that can be provided for through government benefits.

If there is a disabled individual in your family, a special needs trust should be considered in order to ensure that the disabled family member's financial future is protected.

Intra-Family Loans: An Overlooked, But Effective Estate Planning Tool

The Internal Revenue Code allows for loans to family members at lower rates than those charged by commercial lenders without it being deemed a gift. The lender, typically a parent or grandparent, must charge minimal interest in order to avoid making the gift. The IRS publishes these minimum rates, called the Applicable Federal Rates (AFR), each month. For a three to nine year loan made in June 2014, the interest rate may be as low as 1.91%. If viewed as a loan, it will not have gift tax implications and go against the unified credit.

Intra-family loans create an opportunity to shift wealth from one family member to another, usually a child or grandchild, if that child or grandchild can earn a greater return on the amount borrowed than the AFR. To the extent the borrower is able to earn a higher rate of return on the borrowed funds than the interest being paid, he or she can keep the excess without incurring any gift tax liability. To provide the borrower with the maximum opportunity for principal growth, these loans are often structured with a "balloon payment" which allows the borrower to pay interest only during the term and repayment of the principal only at the end of the term. Additionally, any repayment of interest remains "in the family" and may return to the borrower via a later gift or inheritance. There are income tax consequences of the interest paid and interest received.

For example, if a parent makes a 9 year loan to a child of $1 million in June 2014, the loan will be a successful estate planning tool if the child can earn more than 1.91% with the borrowed money. If the child invests the $1 million at a 5% annual rate of return, he or she will have about $1,551,328 at the end of the loan, and will only have to repay his or her parents $1,185,635 throughout the course of the loan. Therefore, the child is entitled to keep the difference of about $365,692 without any gift tax consequences. If the parents were going to make the same investment that the child made anyway, the risk to the family as a whole has not changed and the loan was a successful way to transfer wealth to the next generation. Since properly documented intra-family loans are not treated as gifts, use of an intra-family loan in this manner may be particularly beneficial to parents who have already exhausted their lifetime gift exemption.

Distinct from being a wealth transfer tool, intra-family loans can be more beneficial to the borrower than a commercial loan. An inter-family loan comes with no limitations on how the borrower uses the proceeds. Therefore, in addition to funding an investment for wealth transfer purposes, they are a great way to help a child start a business, pay down a higher interest rate debt, or even finance a home particularly in situations where a child has limited access to commercial loans due to little or poor credit history. If the loan is used to acquire a home, the interest paid may be tax-deductible to the borrower just like a traditional mortgage. Additionally, intra-family loans also save on the fees typically associated with commercial loans including administrative costs, closing costs and appraisal fees.

In order to take advantage of intra-family loans it is critical that they be properly documented. Failure to document the specifics of the loan, including interest, repayment terms, security, etc., could result in the IRS reclassifying it as a gift and taxing it accordingly. Please contact our office if you would like more information on intra-family loans.

More of the Same: 2015 Budget Proposals For Estate & Gift Tax

Obama's 2015 budget proposal restates the same proposals with respect to sophisticated estate planning techniques as in the 2014 budget proposal, and targets one additional estate planning tool, the Crummey Power. While we believe the 2015 budget proposal has very little chance of being enacted, here is a summary of the provisions of President Obama's 2015 budget that could impact your estate plan.

First, the restated proposals from the 2014 budget-

- Beginning January 1, 2018, increase the federal estate tax rate from 40% to 45% and lowering the individual exclusion amount to $3.5 million for estate and GST taxes, and $1 million for gift taxes (currently the lifetime exclusion for estate, gift, and GST Tax is $5.34 million).
- Requiring GRATs to have a minimum term of 10 years and not permitting "zeroed out" GRATs.
- Eliminating the estate tax benefits to Intentionally Defective Grantor Trusts (IDGT).
- Requiring that non-spouse beneficiaries of IRAs take inherited distributions over no more than 5 years from the deceased owner's date of death.

We have discussed estate planning techniques such as GRATs and IDGTs in prior Snippets but are happy to provide information to those who would like to know more.

And now, the new proposal-

Currently a donor can give $14,000, or $28,000 if acting with their spouse, in cash or other assets each year to as many individuals as they want. This is known as the "annual exclusion." One condition for the annual exclusion is that the gift must be a present interest, meaning something the recipient has the right to use right away. This gift tax exclusion doesn't apply to gifts to a trust unless the donor gives the beneficiaries Crummey powers, which allows the beneficiaries the right to withdraw the gift for a limited time. Crummey powers have been used to create trusts for multiple beneficiaries and gift large amounts of money to the trust tax free.

The new proposal suggests a new category of transfers that qualify for the annual exclusion, without regard to Crummey rights, which takes away the present interest requirement. The caveat is that each donor would be limited to $50,000 worth of transfers per year in this category that would qualify for the gift tax annual exclusion. The new category would include transfers in trusts (other than trusts that are solely for a single beneficiary and includible in the beneficiary's estate at death), transfers of interest in pass-through entities, transfers of interest subject to a prohibition on sale, and other transfers that, without regard to withdrawal, put, or other such rights in the donee, cannot immediately be liquidated by the donee. This means that if the donor gave more than $50,000 via trust, the gift would be taxable, even if the total gifts to individuals did not exceed $14,000 per donee. It also means that existing wealth transfer trusts, such as irrevocable life insurance trusts, that require a total annual contribution or gift in excess of $50,000, would begin to eat into the current lifetime exclusion.

While these proposals remain just proposals, they once again indicate that the $5 million exemption is not as "permanent" as Congress suggested in 2012 when The American Taxpayer Relief Act (ATRA) was signed into law and that the time left to utilize some of the most effective estate planning tools may be short. Given Obama's track record, if these proposals are not enacted for 2015, they will undoubtedly rear their heads once again on his 2016 budget proposals.

SCHLOSSBERG, LLC – ESTATE AND TRUST TEAM

For further information on any of these topics or to review your estate plan, please contact an Estate and Trust Team Member

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