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# Strategies for Trusts and Estates in New York

*Leading Lawyers on Protecting Clients' Assets,  
Determining the Best Estate Planning Strategy, and  
Adapting to New Laws and Trends*



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# The Importance of Fully Understanding the Goals of an Estate Planning Client

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## **Initial Steps When Taking on a New Trust and Estate Client**

The first step in the estate planning process is to define the client's goals. Only after the client's goals are firmly established do we attempt to structure an estate plan, since those goals should be the foundation of the plan. While we will attempt to implement an estate plan in a tax-efficient manner, the tax benefits are secondary to the client's goals.

For example, there may be tax advantages to making gifts during a lifetime, and some of these advantages are discussed below. However, if the client's primary goal is to preserve assets to produce an income stream, then gifting assets may prevent the client from achieving his or her desired level of income. In such a case, the client should not be encouraged to take advantage of tax savings opportunities if, by doing so, his or her primary goal will be jeopardized.

Similarly, it may be advantageous for the client to create an irrevocable trust to own and hold life insurance policies on the client's life so the policies will not be subject to estate tax upon the client's death. Generally, if life insurance is transferred to an irrevocable trust by an insured, the policy proceeds will not be subject to estate tax in the insured's estate, provided that more than three years has elapsed since the date of transfer. See I.R.C. § 2035(a) (2000); I.R.C. § 2042 (West 2009). However, to achieve this tax benefit, the client must relinquish control over the policies and the trust terms may not be amended. The client may prefer to forego this tax planning opportunity rather than give up that control, either over the policies or over the terms of the trust.

The above examples highlight the importance of taking the time to understand the client's ultimate desires, and any proposed course of action must be consistent with those desires. The client should not be advised to implement any course of action solely to achieve tax benefits.

At the initial meeting with a new trust and estate client, we seek to determine the nature and extent of the client's assets, including estimated current values, and the nature and extent of his or her liabilities. We also discuss the client's family situation to gain an understanding of the

dynamics of his or her family. A threshold issue is whether the people who will be named as beneficiaries under the client's estate planning documents are the same individuals who are the client's heirs-at-law, or the so-called natural objects of his or her bounty. If not, we must be mindful of a potential will contest, and, to the extent possible, try to safeguard and protect the client's assets from such a challenge.

An estate planning questionnaire is often used to gather basic client information. It is helpful to have a completed questionnaire, and thus basic knowledge about the client, in hand before the initial meeting. However, for a variety of reasons, when it comes to addressing their estate plan, many clients tend to procrastinate. As a result, it is generally more efficient for the initial meeting to be the first step in the estate planning process.

Whether or not a questionnaire is utilized to gather information, we ultimately will request from the client certain documentation to confirm some of the facts the client verbally conveys to us. This documentation may include, but is not necessarily limited to, copies of deeds to confirm title to real property, stock certificates to confirm ownership of any privately held companies, and beneficiary designations for life insurance policies and retirement accounts. We also ask to review any contracts and agreements to which the client is a party, especially buy-sell agreements for any business in which the client has an ownership interest.

### **The Process of Creating the Estate Plan**

Once we have gathered the basic information about a client's assets, liabilities, intended beneficiaries, and family dynamics, we utilize that information to discuss with the client a potential structure for his or her estate plan and determine the types of documents we believe should be prepared. Generally, we would prepare a will and, most likely, a power of attorney, living will, and health care proxy. Depending on the situation, we also might recommend that the client create one or more trusts. The trusts may be incorporated into the will, in which case they will take effect after the client's death, or they may be created in one or more separate documents if they are intended to take effect during the client's lifetime.

## **Questions to Ask Clients Establishing a Trust in New York**

The initial line of questioning in the estate planning process is designed to define the client's goals. Thereafter, an analysis is made to determine the propriety of establishing one or more trusts in furtherance of those goals. For example, a variety of trust vehicles may be used to achieve certain tax benefits. Thus, we would inquire about the client's assets to determine what type of tax planning is appropriate. We would seek to determine if, because of the client's business activities, he or she is at risk of having substantial liabilities in the future, to determine if trusts may be appropriate to protect assets. We also ask if the client owns real estate in multiple jurisdictions. If so, we generally would recommend transferring all properties located outside the client's domiciliary state to one or more trusts in order to avoid having to probate the client's will in more than one state.

We ask questions to determine if it is appropriate for a client to create a revocable trust and transfer some or all of his or her assets to that trust. Generally, an agreement for a revocable trust is structured so the client is the beneficiary of the trust during his or her lifetime. The agreement also provides for the disposition of the trust assets after the client's death and, thus at the client's death, becomes a substitute for a will.

The revocable trust would be advantageous, for example, if the client wishes to provide for an orderly transition of asset management in the event of disability, or if the client wishes to avoid probate for any reason. To completely avoid probate, which means eliminating any necessity to file the client's will with the court upon his or her death, the client must transfer all of his or her assets to the revocable trust during his or her lifetime. By doing so, upon the client's death, there would be no need to probate his or her will. As indicated above, in such a case, the revocable trust becomes a substitute for the client's will.

As an illustration, avoiding probate may appeal to a client who is a public figure or otherwise concerned about privacy since, without probate, the client's estate planning documents are kept out of the public eye. Avoiding probate also may be important to a client who is concerned about a potential will contest. When a will is filed for probate, all of the client's heirs-at-law (i.e., the people who would be entitled to inherit the client's

estate under state law if the client died intestate or without a will) must be notified and given the opportunity to object to the will. See N.Y. SURR. CT. PROC. ACT § 1403 (West 2009). Thus, if the will does not provide for the heir to receive at least their “intestate” share of the client’s estate, that heir has an incentive to challenge the will. Even if the heir ultimately does not succeed, the challenge itself may cause unnecessary delays in settling the client’s estate.

The disadvantage of using a revocable trust as a will substitute is the need for the client to transfer all of his or her assets to the trust during his or her lifetime. As indicated above, unless every asset is transferred, the client’s will must be probated, even if the will provides for any assets remaining in his or her name to be added to the trust. In some situations, it may be difficult or impracticable to transfer every asset to the trust and, in those cases, the use of a revocable trust solely to avoid probate is not a viable option. We therefore do not assume that the revocable trust is appropriate in all cases, or recommend a revocable trust as a default option.

Despite some misconceptions, there are no tax advantages to creating a revocable trust. The income earned by the trust will be taxable to the creator (often referred to as the grantor or settlor), and the assets of the trust will be included in the grantor’s estate for estate tax purposes upon his or her death. See I.R.C. § 676(a) (West 2009); I.R.C. § 2038(a) (West 2009). Thus, the benefit of creating such a trust for a client is solely dependent upon satisfying that client’s specific non-tax goals. It is important that we understand those goals before we recommend establishing such a trust.

At the interview stage, we also seek to ascertain the client’s concerns about his or her beneficiaries, such as their ages, health needs, ability to manage money (including any spendthrift tendencies), and marital stability. This is done to determine if one or more trusts may be needed to have a third party manage the trust assets and/or to protect the beneficiaries from liabilities or other financial pressures.

The variations that exist for different clients in different situations may dictate the type of trust that might be established. For example, the client may create one or more trusts to achieve tax benefits, protect a surviving spouse who is elderly or who may potentially remarry, protect assets from

creditors, provide for minor children, avoid probate, or protect an adult beneficiary in a variety of situations. To illustrate some potential instances of this, an adult beneficiary may be disabled, have substantial health care expenses, be unable to manage investments, be a profligate spender, or may be in a bad marriage.

Again, the structure of an estate plan and the types of trusts that may be recommended should be largely dependent upon the client's goals. Thus, the interview process is primarily intended to help determine and define those goals.

### **Titling of Assets and Use of Estate Tax Exemptions**

Aside from analyzing the basic information to discuss and craft the terms of the needed documents, we evaluate the manner in which the client's assets are owned and whether his or her assets are sufficient to consider implementing a lifetime gift-giving program.

In the case of a married couple, the titling of assets is crucial to assure that they avail themselves of all applicable estate, gift, and, where appropriate, generation-skipping transfer tax exemptions. For example, if all of a couple's assets are held in joint names with rights of survivorship, upon the death of the first spouse, the ownership of all of those assets will vest in the surviving spouse by operation of law. While such a scenario might obviate the need to probate the will of the deceased spouse, it also fails to take advantage of the estate tax exemptions that are available to the deceased spouse's estate. Under current law, the federal estate tax exemption is \$3.5 million and the New York State estate tax exemption is \$1 million. See I.R.C. § 2010(c) (2002); N.Y. TAX LAW § 951(a) (2000).

To highlight the point, assume that the clients are domiciled in New York State and have \$10 million in jointly held assets. Upon the death of the first spouse, those assets automatically will pass to the surviving spouse, without the need to probate the deceased spouse's will. In addition, there will be no estate tax liability, since all assets passing to a surviving spouse are exempt from estate tax by reason of the marital deduction allowed under the Internal Revenue Code and the New York State Tax Law. See I.R.C. § 2056 (1997); N.Y. TAX LAW § 955 (2000). Upon the surviving spouse's

subsequent death, he or she will have an estate of \$10 million, and will be subject to combined federal and New York State estate taxes of \$3,512,180 (i.e., \$2,444,580 in federal estate taxes and \$1,067,600 in New York State estate taxes). See I.R.C. § 2001(c) (2003); N.Y. TAX LAW § 952(c) (2004).

Alternatively, we would recommend that the jointly owned assets be divided so that each spouse has at least \$3.5 million in his or her own name. By doing so, the clients would be able to utilize the estate tax exemptions that are available to both of them, and not waste the exemption available to the estate of the first deceased spouse.

Let us change the facts so that the clients' \$10 million estate is divided as follows: \$3.5 million in assets in the husband's name, \$3.5 million in assets in the wife's name, and \$3 million in assets in joint names. Upon the death of the first spouse, the \$3.5 million in assets held in his or her individual name, instead of passing to the surviving spouse by operation of law, would be disposed of in accordance with the terms of the deceased spouse's will. Often, these terms provide for the exemption amount to be held in a trust for the benefit of the surviving spouse (the so-called bypass trust or credit shelter trust). Under current law, these assets will not be subject to any federal estate tax in the deceased spouse's estate by reason of the \$3.5 million federal estate tax exemption. In addition, the trust assets will not be subject to estate tax in the surviving spouse's estate upon his or her subsequent death.

However, in designing the clients' estate plan, we also must take into account state estate taxes. As indicated above, the New York State estate tax exemption is only \$1 million. Thus, upon the death of the first spouse, if his or her estate fully utilizes its \$3.5 million federal estate tax exemption, the estate would be liable for a New York State estate tax of \$229,200. See N.Y. TAX LAW § 952(c). In some cases, we might recommend that the first deceased spouse only utilize \$1 million of his or her federal exemption in order to avoid paying a New York State estate tax upon the first death. This, of course, increases the surviving spouse's estate, and would result in more federal estate taxes being paid upon his or her subsequent death. We often structure wills so that the surviving spouse has the option to determine, after the death of the first deceased spouse, whether it is

advantageous to have the deceased spouse's estate pay the New York State estate tax.

Under the revised facts, upon the surviving spouse's death, he or she will have an estate of \$6.5 million (i.e., \$10 million total assets, reduced by \$3.5 million, which was set aside in the credit shelter trust created under the first deceased spouse's will). The combined federal and New York State estate taxes imposed upon the survivor's estate will be \$1,665,700 (i.e., \$1,091,700 in federal estate taxes and \$574,000 in New York State estate taxes). See I.R.C. § 2001(c); N.Y. TAX LAW § 952(c). The total taxes paid by both estates will be \$1,894,900 (i.e., \$229,200 upon the death of the first spouse, and \$1,665,700 upon the survivor's death). Accordingly, by properly structuring the clients' wills and re-titling their assets so they fully utilize their respective estate tax exemptions, their overall estate tax liability has been reduced by 46 percent from \$3,512,180 to \$1,894,900, for a savings of \$1,617,280.

### **Implementation of Lifetime Gift-Giving Program**

As noted above, we evaluate whether the client's assets are sufficient to consider implementing a lifetime gift-giving program. For clients with substantial wealth, a lifetime gift-giving program will enable the clients to take advantage of various estate planning techniques that will reduce their estates. Some of these techniques include utilizing the annual gift tax exclusion allowed under I.R.C. § 2503(b) (1998), directly paying educational expenses and/or medical expenses for their family members allowed under I.R.C. § 2503(e), and removing assets from their estates that have a substantial potential to appreciate in value.

While the current federal estate tax exemption is \$3.5 million, the federal lifetime gift tax exemption is only \$1 million. See I.R.C. § 2505 (2002). If the client utilizes any portion (or all) of the \$1 million federal lifetime gift tax exemption, his or her federal estate tax exemption will be reduced by the amount so utilized. See I.R.C. § 2001(b). If the client makes lifetime gifts in excess of the \$1 million exemption, the excess amount is subject to a 45 percent tax. See I.R.C. §§ 2001(c), 2502.

However, certain transfers may be made without gift tax consequence. That is, the transfer will not reduce the \$1 million lifetime gift tax exemption and will not be subject to gift tax. These transfers include the so-called annual exclusion and the direct payments of tuition or medical expense allowed under I.R.C. §§ 2503(b), (e), respectively.

For gift tax purposes, under current law, each individual may transfer up to \$13,000 to any person on an annual basis without incurring any gift tax or using up any part of his or her \$1 million lifetime exemption. See I.R.C. § 2503(b); Rev. Proc. 2008-66, 2008-45 I.R.B. 1107 (2008). There is no limit on the number of donees for whom the donor may claim this \$13,000 annual exclusion. Further, the annual exclusion may be utilized by making gifts of cash or gifts of property in kind, including corporate stock, partnership interests, and/or undivided interests in real property. The \$13,000 limit on the annual exclusion is determined by aggregating the amount of cash and the net fair market value of all property transferred to each donee. Thus, for clients who have sufficient assets to meet their personal financial needs, the use of the annual exclusion is a powerful method by which a client may reduce his or her estate. By way of example, if a client has three children and eight grandchildren, they may make gifts of \$143,000 per year to his or her heirs (i.e., \$13,000 to each of the eleven beneficiaries) without using any portion of his or her \$1 million lifetime exemption or incurring any gift tax liability.

In addition to the annual gift tax exclusion, amounts paid on behalf of an individual for education, training, or medical care are not subject to gift tax. To qualify for these exclusions, the payments should be made directly to the qualifying medical or educational provider. The tuition exception does not apply to amounts paid for room, board, books, or supplies. The medical expense exclusion does not apply to amounts reimbursed by insurance. See I.R.C. § 2503(e); Treas. Reg. §§ 25.2503-6(b)(2), (3) (West 2009).

Another valuable method of reducing future estate tax costs is to make gifts of assets that are likely to substantially appreciate in value. By gifting these assets, all future appreciation will inure to the benefit of the client's estate beneficiaries without any estate or gift tax consequence. However, the client may not be willing to give up the income generated from the assets or give

up control over its management, especially where the assets consist of business interests. Again, the client's desires should be paramount to any tax considerations.

Clients domiciled in New York State should consider utilizing his or her \$1 million lifetime federal gift tax exemption even if the gift is made with property that may not appreciate in value. Since there is no New York State gift tax, this technique will reduce the New York State estate taxes payable upon the client's death by approximately \$90,000.

Gifts also may be made in a tax-advantaged manner through various trusts, such as life insurance trusts, qualified personal residence trusts, grantor-retained income trusts, charitable lead trusts, and charitable remainder trusts, or through "discounted value" gifts of minority interests in partnerships, corporations, or limited liability companies. A discussion of the intricacies of these gifting techniques is beyond the scope of this chapter.

### **Client Motivations for Establishing Trusts**

The client's motivation affects the strategy, because the structure of an estate plan is driven by the client's goals. As a general rule, a client will be motivated to establish a trust if, by doing so, one or more of his or her goals are accomplished.

The client may wish to maximize tax benefits, in which case the client's will should be structured accordingly, and serious consideration should be given to implementing a lifetime gift-giving program.

The client may be married to someone who is not the parent of his or her children. In these second marriage situations, the client may wish to provide for his or her spouse but also preserve assets for ultimate distribution to his or her children. In such a case, the client's will should include a trust that accomplishes both of those wishes.

The client's beneficiaries may include an adult child who is a profligate spender or in a bad marriage, and thus the client's goal may be to assure

that the child's inheritance is protected from the child's spendthrift tendencies, beyond the reach of the child's creditors, or preserved as "separate property" in a future divorce proceeding. Any or all of these goals may be accomplished with a properly structured trust.

Clients with philanthropic tendencies may wish to encourage their children and grandchildren to become charitable. This goal may be accomplished with one or more charitable trusts or a family foundation.

It should be obvious that a proper estate plan may not be developed without a clear understanding of what the client wishes to accomplish.

### **The Timeline for Most New Trusts**

The timeline for a trust will depend on the type of trust that is being created. For example, the typical bypass or credit shelter trust is designed to provide for a surviving spouse during his or her lifetime, and is structured to assure that the assets of the trust will not be subject to estate tax upon the surviving spouse's death. Thus, the timeline for this type of trust will be for the remaining lifetime of the surviving spouse.

In contrast, the client may create a trust in which they retain an interest, such as a grantor-retained annuity trust, a charitable remainder trust, or a qualified personal residence trust. To achieve the tax benefits these trusts may provide, the client's interest in any such trust must terminate prior to his or her death. Thus, in creating such a trust, current interest rates, as well as the client's age, health, and life expectancy, must be considered to determine the appropriate duration of the trust.

The timeline for a trust created for the benefit of a child will depend upon the circumstances. Generally, trusts created for the benefit of a minor child would terminate when the child attains a designated age. However, in cases where the child is unable to manage investments, is disabled, has substantial health care expenses, is a profligate spender, or is in a bad marriage, the client may wish to create the trust for the child's lifetime, and leave it up to the trustee to determine when it is appropriate for trust assets to be distributed to the child.

A client with a large estate may be motivated to create a “dynasty trust” to utilize his or her available generation-skipping transfer tax exemption. This exemption is currently \$3.5 million. See I.R.C. § 2631(c) (2001). The timeline for such a trust is usually governed by the rule against perpetuities under applicable state law. For example, the duration of a dynasty trust created under a will subject to New York State law would continue for the lifetimes of all of the trust beneficiaries who survive the client plus twenty-one years. See N.Y. EST. POWERS & TRUSTS LAW § 9-1.1 (West 2009). Any trust that is established should take into account the client’s goals and applicable tax law.

### **Other Services Trust and Estate Lawyers Can Offer**

The trust and estate lawyer should not only have in-depth knowledge of applicable state law and tax laws, but he or she should have a basic understanding of, and be sympathetic to, family relationships and their often-unique dynamics.

The estate planner will develop the skill to understand these relationships not by studying law, but by listening to what the client has to convey and by experience. However, some circumstances may require the assistance of a professional psychologist. For example, the understanding of family dynamics is particularly important in situations where the client owns a business, has more than one child working in the business, and wishes to develop a succession plan to preserve the business for future generations. If more than one child is working in the business, which one should be selected as the next chief executive officer to replace the client when he or she steps down? How does the client objectively evaluate the skills of his or her own children? In these situations, it may be advisable to suggest that the client retain a professional psychologist who specializes in this area, to assist in developing an appropriate succession plan.

The estate plan should not only be designed to transfer wealth from one generation to another in the most tax-efficient manner, but it also should factor in its impact on the family and on each member’s relationship with other family members, all within the framework of the client’s wishes.

## The Frequency with which Estate Plans Need to Be Updated

Some clients review and revise their wills once a year. As a general proposition, however, an estate plan should be reviewed every three to five years, absent any unusual circumstances. An estate plan may need to be changed, or at least should be reviewed, whenever there is a major change in applicable law, or in the client's financial or family situation. Any such change, whether in the law or in the client's personal circumstances, might alter the premise upon which certain decisions may have been made in creating the original plan. These changed circumstances might include a change in the client's level of wealth, a change in marital status, the births of additional children or grandchildren, the death of a family member, or a change in the client's health. Thus, the estate plan should be re-evaluated to determine if it should be revised to accommodate the new circumstances.

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***Dedication:*** *This chapter is dedicated to my wife, Lori, and my daughter, Julie, for their love and inspiration, and to the memory of my son, Bradley.*



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