The Estate Update

A newsletter provided for the benefit of the clients and friends of
The Peninsula Center for Estate Planning and Elder Law

A message from the Firm:

Hello and Happy Summer from your friends at TPC. We have been very busy and loving (almost) every minute of our days here. We have the most wonderful clients! I came out of the conference room just yesterday after meeting with a new couple and commented to Barbara, "[t]hey are the nicest people." And just as I said it, I realized that I say the same thing after almost every meeting. I don't know how we are so blessed to get to work with such wonderful people, but we are, and I am thankful.

You will see some new faces around the office beginning in September. We will have two part-time people joining our family here. Teresa Clemons, who has been our bookkeeper for the past 2 years, will be taking on additional responsibilities as our marketing director and office manager. And, Vanessa Steltenpohl, a recent graduate of the William & Mary Law School, will be working with me in the Elder Law Clinic at the Law School and also here in the firm as an associate attorney. We are excited to have both here with us and are looking forward to continuing to bring all of you and others in our community the very best in estate and elder law services. Thank you so much for allowing us to be of service to you.

In this issue we will discuss asset protection options as well as the dangers of putting your planning on hold. As a reminder for those of you having children or grandchildren going off to college this month, the College Power Pack is a must. Stay safe and healthy!

Helena

Asset Protection: What You Really Need to Know

By Helena Mock

What do we mean when we talk about "asset protection?" In some cases we are talking about protecting assets from our own creditors or from future estate taxes. In other cases we are talking about protecting our own assets from the high costs of home health and long-term care. And, in some cases we are talking about protecting assets we leave to our children from their creditors, from their spouses, and from their spouse's creditors. The key in all cases is that the person you want to protect cannot have unlimited access to the assets you want to protect because if you can get to the assets, so can your creditors.

In this article, we will focus on protecting your own assets from your creditors for either estate tax or long-term care purposes. The best vehicle for doing this is the Asset Protection Trust. Virginia law does allow a settlor (also referred to as a "grantor") to create a self-settled spendthrift trust which is shielded from the reach of creditors. In order for the assets to be protected, the trust must be a "qualified self-settled spendthrift trust" as defined under Virginia law. The law requires that: (1) the trust is irrevocable; (2) the trust is created during the settlor's lifetime; (3) there is, at all times when distributions could be made to the settlor, at least one beneficiary other than the settler to whom income and/or principal may be distributed; (4) the trust has at all times at least one qualified trustee; (5) the trust instrument expressly incorporates the laws of the Commonwealth of Virginia to govern the

validity, construction, and administration of the trust; (6) the trust instrument includes a spendthrift provision that restrains both voluntary and involuntary transfer of the settlor's qualified interest; and (7) the settlor does not have the right to disapprove distributions from the trust.

Asset protection plans can only protect against potential future liability, not liabilities that have already been incurred. This is not only true from an ethical standpoint, but also from a legal one, because the law provides that any transfers made once a liability has been incurred will be deemed to be fraudulent. Further, for Medicaid purposes, there is a five-year look-back period. Any transfers made to a trust or otherwise within five (5) years of applying for Medicaid are deemed to be fraudulently made for the purpose of qualifying for Medicaid. Therefore, pre-planning is essential. If you wait until there is a need for long-term care, it's too late.

The Asset Protection Trust is a self-settled irrevocable trust that is created to hold certain assets and, as a result, you are no longer deemed to own those assets. You must give up control over the assets in the trust. You can, however, name someone who would have access to the trust assets for the benefit of your children or whomever you choose to name as beneficiary(ies). Additionally, in some cases you can give that person the discretionary authority to make gifts to you of the principal of the trust. For this to work, however, that person cannot be a close relative (i.e. spouse, sibling, child) but could be an in-law, cousin, or more distant relative.

You may choose to retain an income interest in the trust such that you and/or your spouse would receive all of the income generated by the assets in the trust on a regular basis. And you may elect to characterize the trust as a "grantor trust" for income tax purposes, which means that all of the taxable income generated by the trust would be taxed to you even if not entirely distributed. Certain types of income such as capital gains are generally not distributed. Thus, if a property valued at $100,000 was placed in the trust and then later sold for $150,000. The additional $50,000 generated by the sale would not be considered income for trust accounting purposes and would not be distributed to you. Instead it would remain in the trust but still be taxed to you as a capital gain on your personal income tax return.

You could also elect not to treat the trust as a grantor trust. In this case, any transfer of assets into the trust would be considered a taxable gift for gift tax purposes, but the income generated by the trust would not be taxed to you. If using the trust as a Medicaid planning vehicle, you may not wish to retain an income interest and instead allow the income to be distributed to your children or to simply accumulate in the trust. Note, however, that income that accumulates in the trust will be taxed to the trust at the trust's higher tax rate.

As the funding of any irrevocable trust essentially requires you to give up the benefit and control of the assets in the trust, it is important that we first discuss issues such as your cash flow needs, which requires an analysis of your monthly income and expenses, and your comfort level with giving up control of your assets and how much you trust your children. You may choose to keep some of your assets outside of the trust for liquidity purposes.

Virginia law does permit the termination of an irrevocable trust where the grantor and all beneficiaries agree. It is also possible to grant an independent person (someone unrelated to you) the power to terminate the trust under certain circumstances or simply in that person's discretion. This person is commonly referred to as the Trust Protector. Because these trusts are irrevocable, they completely disappear from your financial statement since the assets owned by the trust no longer belong to you. For financing purposes, this may make it difficult to

obtain additional loans because you can no longer show the property as an asset. However, for asset protection purposes, the fact that the assets no longer belong to you completely removes them from the sight of any potential creditor.

To learn more about whether the Asset Protection Trust might work for you, please contact us.

Putting Your Plan on Hold

By Barbara Armstrong

I recently assisted a client with updating his estate planning binder. He wanted to have his estate planning documents in order so that his son would have as smooth a transition as possible when it was time for him to take over the trust. We began talking about the importance of planning and finalizing documents because you never know when something might happen. I told him my concerns regarding clients who have not followed up with finalizing their documents. He shook his head. He then shared with me a story. He said that he and his wife were headed back from California to the East Coast on a 747 when they noticed that the plane began to turn. The next thing they heard was the captain saying that the plane's fuel was spilling and that the plane would be making an unexpected landing on a runway in Colorado. Our client knew this runway was too short for a 747, but kept calm. A bit later, the captain came back on and said that there was a problem with the operating gear and to brace for landing. As he and his wife got into brace position, he looked at his wife and said "[a]re we ready?" In other words, was everything done in the event that something would happen to them?

At any time, anything can happen to anyone. We recently had a client who continued to put off finalizing his documents. One day his wife called to say that her husband had an accident and was in the hospital on life support. He didn't survive. Several weeks later, his widow came in and finalized her own planning because she did not want her children to go through what she was going through.

We have also had to help a spouse or child obtain guardianship and conservatorship because there was no power of attorney or medical directive in place when the individual became incapacitated. This process is very expensive and time consuming.

These are, of course, difficult things to think about, but you certainly don't want to leave your spouse or children with a mess. Proper planning is not only smart, but it will also bring you and your family peace of mind. As one of our wonderful clients said recently after they had finalized their documents, "[n]ow I can go on with the business of living." Planning doesn't mean that anything will happen to you. Rather, it means that you can live in peace knowing that you are protected JUST IN CASE something does.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from his or her tax advisor based on the taxpayer's particular circumstances.

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