SUMMER 2018 NEWSLETTER

Dear Clients and Friends:

In this newsletter, I discuss recent changes to federal estate tax law, the use of your trust as a beneficiary of your IRA, New Hampshire's adoption of the Uniform Power of Attorney Act and the duty of trustees of New Hampshire trusts to inform and report.

ESTATE TAX UPDATE

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. The new law makes sweeping changes to the income tax rules and the transfer tax rules. The transfer tax rules govern the taxation of estates, gifts and generation-skipping transfers and are the subject of this article.

The lifetime exemption for gifts and estates is doubled from $5,000,000 to $10,000,000 per person, adjusted for inflation since 2011. For gifts made and deaths occurring in 2018, the inflation-adjusted exemption is expected to be in the range of $11,200,000 per person. The generation-skipping transfer tax exemption is similarly increased. If a transfer exceeds the applicable exemption, the tax rate remains unchanged at 40%.

It is important to note that these exemption increases are temporary. On January 1, 2026, the exemption amounts revert back to $5,000,000 per person, adjusted for inflation since 2011 (projected to be in the range of $6,000,000 to $6,500,000 per person).

The very beneficial "basis step-up" regime, under which the income tax basis of an inherited asset is adjusted to the asset's fair market value on the date of death, remains in place. This allows heirs to sell appreciated assets without incurring a capital gains tax.

There are no changes in the rules for the gift tax annual exclusion. Each year a person may make annual exclusion gifts without eroding the lifetime exemption as long as the gifts are considered to be of present interests. For 2018, the annual exclusion amount is increased from $14,000 to $15,000.

The other gift tax exclusion we deal with in estate planning is the exclusion for a lifetime gift to a spouse who is not a citizen of the United States. For 2018, this exclusion is increased from $149,000 to $152,000.

For most families, the primary tax goal in estate planning will be maximizing income tax basis benefits and, while additional estate tax planning may not be necessary, an estate plan update may allow for reduced capital gains tax in the future. For some families, minimizing estate tax will still be the primary goal; these families should consider additional planning to utilize the increased exemptions before they expire.

Either way, if your estate plan has not been reviewed within the last five years, we recommend that you have your estate plan reviewed in 2018.

USING YOUR TRUST AS A BENEFICIARY OF YOUR IRA

Naming the beneficiary to your IRA account is an important step toward meeting your legacy goals. Unfortunately, many IRA owners take little notice of this step in their financial planning. Consequently, they create situations that do not maximize the benefits their IRA savings might offer these beneficiaries.

Many IRA owners, in recent years, have embraced the concept of the Revocable Trust — sometimes called a Living Trust or Inter Vivos Trust — as the answer to all their estate-planning concerns.

While we won't discount the effectiveness of these trusts for certain estate issues (a special needs beneficiary, Qualified Terminal Interest Property Trust or Asset Protection Trust, for example), in most instances a trust is a poor choice for an IRA beneficiary. In

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fact, the bias is in favor of leaving the assets outright to the intended beneficiaries unless there are some exceptional circumstances compelling IRA owners to leave the assets to a trust. That's because the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) rules naming individuals as beneficiaries offers greater flexibility for carrying on the life of the IRA through "Stretch IRA" techniques.

The more limited options when a trust is your IRA beneficiary will include the following:

1. IRA OWNER DIES BEFORE THEIR REQUIRED BEGINNING DATE

- Lump-sum distribution.

- Five-year rule, which depletes the IRA during a five-year period that begins on December 31 following the death of the IRA owner. The entire account must be distributed by the end of the fifth year.

- Inherited IRA for the trust with distributions based on the age of the oldest trust beneficiary and using the Single Life table. That life expectancy will be reduced by one in each subsequent year. Using the age of the oldest trust beneficiary is only available if the trust meets the requirements of a valid "look-through" trust.

2. IRA OWNER DIES AFTER THEIR REQUIRED BEGINNING DATE

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- Inherited IRA for the trust with distributions based on the age of the oldest trust beneficiary and using the Single Life Table. That life expectancy will be reduced by one in each subsequent year. Using the age of the oldest trust beneficiary is only available if the trust meets the requirements of a valid "look-through" trust.

- If the trust is not a valid "look-through" trust, then the distributions are based on the owner's single-life expectancy (term-certain).

The trust must meet the following requirements in order for it to qualify as a designated beneficiary (a “look through” trust) and allow the life of the oldest trust beneficiary to be used in calculating post death required minimum distributions (RMDs):

- The trust is a valid trust under state law.

- The trust is irrevocable or will, by its terms, become irrevocable upon the IRA holder's death.

- The beneficiaries of the trust are identifiable from the trust instrument.

- Certain documentation has been provided to the IRA trustee, custodian or issuer.

Once these rules are satisfied, the IRA custodian, under direction of the Trustee, can usually make the payments to the trust for distribution to the individual beneficiaries. If the trust fails to qualify as a designated beneficiary, the; IRA will either be paid out under the five-year rule if the IRA owner dies before their required beginning date, or over the remaining single-life expectancy (term certain) of the IRA owner if the IRA owner dies after their required beginning date. The required beginning date is April 1 of the year after the year an IRA account holder turns age 70 1/2.

The IRS has recently indicated that a trust that allows for the payment of debts and or administration expenses of the estate may not qualify as a "look-through" trust. If those estate debts and expenses are paid off from the time of the death of the IRA account holder up to September 30 of the year following death, the trust may qualify as a "look-through" trust.

The IRA account holder may want to have the document examined to see if it still qualifies as a "look-through" trust if they have already named their trust as beneficiary. If not, the IRA account holder may want to amend the trust or create a new one. The IRA owner may want to seek tax or legal advice to determine what course of action is best suited to their individual needs since there are various options available for the trust document to avoid this pitfall.

The many rules regarding using a trust as a beneficiary of an IRA make this a cumbersome process that will not allow beneficiaries to disclaim their interest in the IRA, to use their younger life expectancies for calculating RMDs or to have a hand in the management or investment choices of their inheritance. Granted, there may be family estate planning issues where it is appropriate that the management and investment choices by the individual beneficiaries should be limited.

When a trust becomes an IRA beneficiary, taxation is an issue that needs to be discussed with me or your tax advisor. Trusts are subject to a separate tax-rate schedule that applies only to trusts and estates, or income that is not paid out to the Trust's beneficiaries. This can happen in certain complex trusts or in any cases where not all of the income received by the trust is paid out to beneficiaries in the current year. These trust income tax brackets on any undistributed income rise rapidly, reaching the highest tax rate of 37 percent for taxable income over $12,501. By contrast, when an individual is named IRA beneficiary, the top income-tax bracket of 37 percent applies only to taxable income over $500,000.

Let's look at an example to help illustrate this point. The IRA owner (age 68) leaves the IRA to the trust with several beneficiaries instead of to the surviving spouse, decreasing the tax-deferred compounding, and growth of family wealth. When a non-spouse (the trust) inherits an IRA, RMDs begin the year following the year of the owner's death with the single-life (term certain) life expectancy. This means you never get a new divisor from the Single-Life Table each year; instead you subtract one from the original divisor. When a trust inherits an IRA and it is a valid "look-through" trust, distributions are based on the age of the oldest trust beneficiary, using the single-life table (term certain). The oldest beneficiary of the trust in this example is the spouse who is 70 years old the year following the owner's death. The single life divisor is 17.0. This means the IRA inherited account will be emptied in 17 years ending tax-deferred compounding, because there are end dates in Inherited IRAs. The spouse could live more than 17 years and therefore outlive the IRA. If the spouse dies 10 years into it, the account will still be emptied in the next 7 years, not allowing the next generation, usually the children, to "Stretch" over their own single-life term certain life expectancy. If the spouse had instead inherited the IRA outright, they would take RMDs using the Uniform table. The Uniform Table divisor for a 70 year old is 27.4, and you get a new divisor from the table each year. This would have left an IRA, not an Inherited IRA to the next generation. Those non-spouse beneficiaries would then set up Inherited IRAs and take RMDs based on their single-life (term certain) allowing them to "Stretch" the IRA over their usually longer life expectancies.

I welcome the opportunity to work with you and your financial advisor to help create an IRA strategy designed to help you achieve your desired result.

NH UNIFORM POWER OF ATTORNEY ACT

New Hampshire has recently adopted the Uniform Power of Attorney Act ("Act"). Notable provisions include the following: (1) the designated agent's presumption of durability unless otherwise indicated; (2) the use of the term "incapacity" when describing the principal's inability to manage their affairs; and (3) the designated agent'(s) general authority on matters specifically related to banks and other financial institutions, such as modifying and terminating accounts, contracting for the financial institution's services, or receiving financial statements. The Act also creates a statutory form that has been uniformly criticized for not clearly expressing powers an agent has, substituting instead statute references which grant powers. The use of statute references in the statutory form makes it difficult for agents to understand what powers they actually possess under the power of attorney as it requires agents to study the state statute. The new statutory form is optional, not mandatory. Therefore, it appears Attorneys will continue to utilize their own forms after careful consideration of additional powers granted under the Act.

TRUSTEE DUTY TO INFORM AND REPORT-PLEASE KEEP ACCURATE RECORDS!

The manager of a trust ("trustee") has a duty to *inform* and *report* to the beneficiaries of the trust. The duty to *inform* includes an

initial requirement to notify the beneficiaries within 60 days after a formerly revocable trust becomes irrevocable (usually after the trust creator's death) or within 60 days after a successor trustee accepts the duties of trusteeship. The duty to *report* includes an annual requirement to deliver a trustee's report to current beneficiaries. However, the state statute allows contingent beneficiaries to obtain reports unless the trust waives this requirement. Most of my trusts waive this requirement that contingent beneficiaries receive the annual report. Regardless, the annual report should be prepared, even if the trustee and current beneficiary are the same person. The notice and reporting requirements do not apply to a revocable living trust provided the trust creator is alive and serving as trustee.

The trustee also has a general duty to keep the qualified beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for the beneficiaries to protect their interests. The definition of "qualified beneficiary" includes both current beneficiaries, and the contingent beneficiaries who would inherit if a current beneficiary died or the trust was dissolved. There are two exceptions to this general duty. First, the trust document might include a statement to the opposite effect, instructing the trustee, to the extent permitted by law, to refrain from distributing information about the trust to the contingent beneficiaries. Again, most of the trusts I draft contain this restriction. Second, the trustee may decide that a beneficiary's request for information is unreasonable under the circumstances. However, not all information may be withheld. Regardless of what the trust document says about the subject, the trustee must provide a copy of the portions of the trust document that are necessary to describe the beneficiary's interest to any beneficiary who makes the request. In addition, the trustee must provide a trustee's report to current beneficiaries, and other beneficiaries who request it, at least annually. This report serves to provide a minimum amount of essential information about the trust to the beneficiaries.

A trustee's duty to report is met by delivering a trustee's report to each current beneficiary of an ongoing trust, and other beneficiaries who request it, at least annually. A current beneficiary is someone who is able to receive distributions from the trust at that time – whether mandatory or in the discretion of the trustee. As stated above, the other beneficiaries are entitled to a trustee's report upon request. The annual trustee's report must include an up-to-date list of trust assets and liabilities accompanied by a ledger showing all receipts and disbursements during the prior reporting period, including the source and amount of the trustee's compensation (if any). There is no statutory form for this report, although it should be detailed enough to satisfy the curiosity of a reasonable beneficiary and to completely inform the beneficiary of all activities of the trust in which their interests have been affected. Since any dispute would be reviewed by a Judge of the New Hampshire Probate Division of the Circuit Court. I recommend that trustees follow a format that closely matches probate accountings.

TIME TO UPDATE!!!!!

If it has been more than five years since you last met with me to review your estate plan, I recommend you make an appointment to see me to discuss recent changes in New Hampshire probate law and federal estate tax law. Clients that each have a trust who have not met with me since 2012 should contact me as soon as possible. The pre 2011 trusts include an estate tax provision which likely is not necessary, but which can complicate the administration of your estate plan after the client's death. Changes in Federal estate tax law as discussed above have afforded clients (especially married clients) the ability to greatly simplify their estate plan if they wish.

For questions regarding the contents of this newsletter please contact me.

Sincerely,

Michael L. Wood