Take These Three Steps When Your Child Turns 18

If your child has reached the teenage years, you may already feel as though you are losing control of her life. This is legally true once your child reaches the age of 18 because the state considers her to be an adult with the legal right to govern her own life.

Up until your child reaches 18, you are absolutely entitled to access your child’s medical records and to make decisions regarding the course of his treatment. And, your child’s financial affairs are your financial affairs. This changes once your child reaches the age of 18 because your now-adult child is legally entitled to his privacy and you no longer have the same level of access to or authority over his financial, educational and medical information. As long as all is well, this can be fine. However, it’s important to plan for the unexpected and for your child to set up an estate plan that at least includes the following three crucial components:

1. Health Care Proxy with HIPAA Release

Under the Health Insurance Portability and Accountability Act, or HIPAA, once your child turns 18, her health records are now between her and her health care provider. The HIPAA laws prevent you from even getting medical updates in the event your child is unable to communicate her wishes to have you involved. Without a HIPAA release, you may have many obstacles before receiving critically needed information, including whether your adult child has even been admitted to a particular medical facility.

Should your child suffer a medical crisis resulting in her inability to communicate for herself, doctors and other medical professionals may refuse to speak with you and allow you to make medical decisions for your child. You may be forced to hire an attorney to petition to have you appointed as your child's legal guardian by a court. At this time of crisis, your primary concern is to ensure your child is taken care of and you do not need the additional burden of court proceedings and associated legal costs. A health care proxy (also called a health care power of attorney or Advance Directive, depending on your state) with a HIPAA release would enable your child to designate you or another trusted person to make medical decisions in the event she is unable to convey her wishes.

2. Durable Power of Attorney

Like medical information, your 18-year-old child's finances are also private. If your child becomes incapacitated, without a durable power of attorney you cannot access his bank accounts or credit cards to make sure bills are being paid. If you needed to access financial accounts in order to manage or resolve any problem, you may be forced to seek the court's appointment as conservator of your child.

Absent a crisis, a power of attorney can also be helpful in issues that may arise when your child is away at college or traveling. For example, if your child is traveling and an issue comes up where he cannot access his accounts, a durable power of attorney would give you or another trusted person the authority to manage the issue. An alternative may be to encourage your child to consider a joint account with you. However, this is rarely recommended because of the unintended consequences for taxes, financial aid applications, creditor issues, etc.

3. Will

Your child owns any funds given to her as a minor or that she may have earned. In the catastrophic event that your child predeceases you, these assets may have to be probated and will pass to your child's heirs at law, which in most states would be the parents. If you have created an estate plan that reduces your estate for estate tax or asset protections purposes, the receipt of those assets could frustrate your estate planning goals. In addition, your child may wish to leave some tangible property and financial assets to other family members or to charity.

While a will may be less important then the health care proxy, HIPAA release or durable power of attorney, ensuring that your child has all three components of an estate plan can prevent you, as a parent, from having to go to court to obtain legal authority to make time-sensitive medical or financial decisions for your child.

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Is It Better to Use Joint Ownership or a Trust to Pass Down a Home?

When leaving a home to your children, you can avoid probate by using either joint ownership or a revocable trust, but which is the better method?

If you add your child as a joint tenant on your house, you will each have an equal ownership interest in the property. If one joint tenant dies, his or her interest immediately ceases to exist and the other joint tenant owns the entire property. This has the advantage of avoiding probate.

A disadvantage of joint tenancy is that creditors can attach the tenant’s property to satisfy a debt. So, for example, if a co-tenant defaults on debts, his or her creditors can sue in a “partition proceeding” to have the property interests divided and the property sold, even over the other owners’ objections. In addition, even without an issue with a creditor, one co-owner of the property can sue to partition the property, so one owner can force another owner to move out.

Joint tenancy also has a capital gains impact for the child. When you give property to a child, the tax basis for the property is the same price that you purchased the property for. However, inherited property receives a “step up” in basis, which means the basis is the current value of the property. When you die, your child inherits your half of the property, so half of the property will receive a “step up” in basis. But the tax basis of the gifted half of the property will remain the original purchase price. If your child sells the house after you die, he or she would have to pay capital gains taxes on the difference between the tax basis and the selling price. The only way to avoid the tax is for the child to live in the house for at least two years before selling it. In that case, the child can exclude up to $250,000 ($500,000 for a couple) of capital gains from taxes.

If you put your property in a revocable trust with yourself as beneficiary and your child as beneficiary after you die, the property will go to your child without going through probate. A trust is also beneficial because it can guarantee you the right to live in the house and take into account changes in circumstances, such as your child passing away before you.

Another benefit of a trust is with capital gains taxes. The tax basis of property in a revocable trust is stepped up when you die, which means the basis would be the current value of the property. Therefore, if your child sells the property soon after inheriting it, the value of the property would likely not have changed much and the capital gains taxes would be low.

In general, a trust is more flexible and provides more options to protect you and your child, but circumstances always vary.

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Does Your Estate Plan Include An Unnecessary Bypass Trust?

A once-popular estate planning tool may now cost families more in taxes than it saves. Changes in the estate tax have made the “bypass trust” a less appealing option for many families. If your estate plan includes a bypass trust not drafted by this office, you should reconsider its necessity because it could be doing more harm than good. (Our office typically drafts bypass drafts that are “disclaimer funded,” meaning they will only be used when necessary to save taxes under current tax law).

When the first spouse dies and leaves everything to the surviving spouse, the surviving spouse may have an estate that exceeds the state or federal estate tax exemption. A bypass trust (also called an “A/B trust” or a “credit shelter trust”) was designed to prevent the estate of the surviving spouse from having to pay estate tax. The standard in estate tax planning was to split an estate that was over the prevailing state or federal exemption amount between spouses and for each spouse to execute a trust to “shelter” the first exemption amount in the estate of the first spouse to pass away. While the terms of such trusts vary, they generally provide that the trust income will be paid to the surviving spouse and the trust principal will be available at the discretion of the trustee if needed by the surviving spouse. Since the surviving spouse does not control distributions of principal, the trust funds are not included in the surviving spouse's estate at his or her death and will not be subject to tax.

In 2013, estate taxes changed dramatically and now very few people are subject to federal estate taxes. Currently, the first $5.45 million (in 2016) of an estate is exempt from federal estate taxes, so theoretically a husband and wife would have no estate tax if their estate is less than $10.90 million. The estate tax is now also "portable" between spouses, accomplishing the same purpose as a bypass trust. This means that if the first spouse to die does not use all of his or her $5.45 million exemption, the estate of the surviving spouse may use it (provided the surviving spouse makes an "election" on the first spouse's estate tax return).

One problem with a bypass trust is that the surviving spouse does not have complete control over of the assets in the trust. The surviving spouse's right to use assets in the trust is limited and requires the filing of accountings and separate tax forms. In addition, if the trust generates income that is not passed to the beneficiary, that income can be taxed at a higher tax rate than if it wasn't in a trust.

Another problem is that a bypass trust can actually cost more in capital gains taxes than it saves in estate taxes. When someone passes away, his or her assets receive a step-up in basis. When an asset is in a bypass trust, it does not receive a step-up in basis because it is passing outside of the spouse's estate. If the assets are sold after the surviving spouse dies, the spouse's heirs will likely have to pay higher capital gains taxes than if the heirs had inherited the asset outright.

A bypass trust can still be useful in some circumstances If your estate is greater than the current federal estate tax exemption, a bypass trust is still a good way to protect your assets from the estate tax. In addition, some states tax estates at thresholds much lower than the federal estate tax, and a bypass trust may help in those states. For other people, these trusts have other uses besides avoiding estate taxes.

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6 Things to Ask Before Agreeing to Be a Trustee

Being asked to serve as the trustee of the trust of a family member is a great honor. It means that the family member trusts your judgment and is willing to put the welfare of the beneficiary or beneficiaries in your hands. But being a trustee is also a great responsibility. You need to go into it with your eyes wide open. Here are six questions to ask before saying “yes”:

1. May I read the trust?The trust document is your instruction manual. It tells you what you should do with the funds or other property you will be entrusted to manage. Make sure you read it and understand it. Ask the drafting attorney any questions you may have

2. What are the goals of the grantor (the person creating the trust)?Unfortunately, most trusts say little or nothing about their purpose. They give the trustee considerable discretion about how to spend trust funds with little or no guidance. Often the trusts say that the trustee may distribute principal for the benefit of the surviving spouse or children for their “health, education, maintenance and support.” Is this a limitation, meaning you can't pay for a yacht (despite arguments from the son that he needs it for his mental health)? Or is it a mandate that you pay to support the surviving spouse even if he could work and it means depleting the funds before they pass to the next generation? How are you to balance the needs of current and future beneficiaries? It is important that you ask the grantor while you can. It may even be useful if the trust's creator can put her intentions in riding in the form of a letter or memorandum addressed to you

3. How much help will I receive?As trustee, will you be on your own or working with a co-trustee? If working with one or more co-trustees, how will you divvy up the duties? If the co-trustee is a professional or an institution, such as a bank or trust company, will it take charge of investments, accounting and tax issues, and simply consult with you on questions about distributions? If you do not have a professional co-trustee, can you hire attorneys, accountants and investment advisors as needed to make sure you operate the trust properly

4. How long will my responsibilities last?Are you being asked to take this duty on until the youngest minor child reaches age 25, in other words for a clearly limited amount of time, or for an indefinite period that could last the rest of your life? In either case, under what terms can you resign? Do you name your successor or does someone else?

5. What is my liability?Generally trustees are relieved of liability in the trust document unless they are grossly negligent or intentionally violate their responsibilities. In addition, professional trustees are generally held to a higher standard than family members or friends. What this means is that you won't be held liable if for instance you get professional help with the trust investments and the investments happen to drop in value. However, if you use your neighbor who is a financial planner as your adviser without checking to see if he has run afoul of the applicable licensing agencies, and he pockets the trust funds, you may be held liable. A well-respected Massachusetts attorney who served as trustee on many trusts used a friend as an investment adviser who put the trust funds in risky investments just before the 2008-2009 stock market crash. The attorney was held personally liable and suspended from the practice of law. So, be careful and read what the trust says in terms of relieving you of personal liability.

6. Will I be compensated?Often family members and friends serve as trustees without compensation. However, if the duties are especially demanding, it is not inappropriate for trustees to be paid something. The question then is how much. Professionals generally charge an annual fee of 1 percent of assets in the trust. So, the annual fee for a trust holding $1 million would be $10,000. Often, professionals charge a higher percentage of smaller trusts and a lower percentage of larger trusts. If you are doing all of the work for a trust, including investments, distributions and accounting, it would not be inappropriate to charge a similar fee. However, if you are paying others to perform these functions or are acting as co-trustee with a professional trustee, charging this much may be seen as inappropriate. A typical fee in such a case is a quarter of what the professional trustee charges, or .25 percent (often referred to by financial professionals as 25 basis points). In any case, it’s important for you to read what the trust says about trustee compensation and discuss the issue with the grantor.

If after getting answers to all these questions you feel comfortable serving as trustee, then by all means accept the role. It is an honor to be asked and you will provide a great service to the grantor and beneficiaries.

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How to Choose a Trustee

If you create a trust, you will need a separate person or institution, called a “trustee,” to manage the trust either now or in the future, depending on the type of trust. Choosing the right trustee is crucial to making sure your wishes are carried out. The choice is important because being a trustee can be a difficult job, with a trustee’s duties including making proper investments, paying bills, keeping accounts, and preparing tax returns.

A trust is a legal arrangement through which a trustee holds legal title to property for another person, called a “beneficiary.” The trust document will name the trustee, although there are several different types of trusts. The simplest one is a revocable living trust in which the person who creates the trust maintains control of the trust while he or she is alive. In this situation, the trust document will name a successor trustee to take over after the original trustee dies or becomes incapacitated. Other trusts – such as an irrevocable trust or special needs trust – may have a separate trustee from the start.

The law isn’t very strict about who may serve as your trustee, as long as the person is legally competent, meaning he or she is over 18 years of age and is capable of managing his or her own affairs. The main consideration when selecting a trustee is picking someone who is trustworthy. The trustee has a duty to manage the trust in the beneficiary’s best interest. The trustee does not need legal or financial expertise, but he or she must have good judgment. In the case of a special needs trust, the trustee should have knowledge of federal benefits programs.

Another consideration is that the trustee be able to manage the trust for an extended period of time. Your choice of trustee should be someone who will likely be around for a long time and who has the time to devote to trustee duties. It is important that the trustee be of sound mind and body.

If you don’t know anyone who meets these qualifications, you can look into hiring an independent trustee. This can be an individual or an institution with no beneficial interest in the trust. Some examples include: a bank or trust company, a professional trustee, an investment advisor or manager, an investment banker, an accountant or a lawyer. In addition to being independent, a professional trustee will usually have experience and expertise in managing trusts. If you aren’t comfortable with having a stranger manage the trust, it may be possible to choose a family member and a professional trustee as co-trustees. The downside to hiring an independent trustee is that the trustee will charge a fee, which is usually a percentage of the trust.

Whomever you choose as trustee, it is important to revaluate your choice every few years. The person who is right today may not be right tomorrow. Your attorney can help you determine who is the best trustee for you.

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