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Planning for Disability with Marital Trusts

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Abstract: The General Power of Appointment Marital Trust, complete with a means of establishing whether a mental disability has occurred, can provide great flexibility in planning for both the near and far future. If one spouse dies when the other spouse is mentally clear and functioning independently, the trust may be maintained or effectively ended by the survivor. On the other hand, if one spouse dies when the survivor needs help with his or her finances, the trust can ensure that help is available to maintain the financial well-being of the survivor even if mental disability has occurred.

For many years, married couples who were comfortably affluent, but not downright “rich,” had established “A/B Trusts” as a standard estate planning practice. The purpose of the “B” or nonmarital trust is to utilize the estate tax exemption of the spouse who dies first, and thereby reduce or avoid federal estate taxation in the estate of the spouse who dies last. Beyond ensuring that the spouse who dies first takes advantage of the exemption, the value in excess of that amount can pass to the “A” or marital trust that provides exclusively for the benefit of the surviving spouse. The transfer to the spouse can use the estate tax marital deduction to defer estate taxation until the surviving spouse dies. Estate plan-

ning attorneys have varied in their recommendations as to how the marital deduction gift or trust might be structured. In general, the typical choices might be an outright bequest to the surviving spouse, a Qualified Terminable Interest Property (QTIP) Trust, or a General Power of Appointment Marital Trust (GP Marital Trust).

Outright Bequest

A direct gift to a surviving spouse was the preferred solution when the surviving spouse would just as soon have no trustee to contend with in the event of the other spouse's death. The spouse who contemplated life as a widowed trust beneficiary regarded the nonmarital trust as a necessary evil worth having to save money for the kids by reducing estate taxes. If no estate tax reduction had been needed, no trust would have been prepared. Even at that, a client with that inclination to control assets might prefer to be the trustee of his or her nonmarital trust. Having a third party as a trustee might be acceptable or might be considered an imposition—that obstacle between me and my money that I tolerate to reduce or avoid estate taxes for the benefit of the kids. With no estate tax savings provided by the marital trust, “let's skip the trust and transfer other assets as an outright bequest,” was the sentiment.

QTIP Trust

At the far side of the other end of the spectrum is the couple who would

both agree to have QTIP trusts, in which the survivor would have only a lifetime income interest in the trust. Perhaps that trust might also feature a discretionary right of the trustee to distribute principal for the health, education, maintenance, or support of the spouse. Nonetheless, however it might be structured, the QTIP trust remains a method of transfer favored by those in subsequent marriages (second, third, etc.) who wish to ensure that their wishes for the ultimate disposition of assets will be honored without any redirection by the other spouse.

GP Marital Trust

Some attorneys may automatically prepare a QTIP trust, even in a first marriage, as a means of qualifying for the marital deduction. However, if the client prefers the marital bequest to be in trust, rather than an outright gift, a marital trust which grants a lifetime and testamentary general power of appointment to the surviving spouse may be a more acceptable solution than the QTIP trust. Either form of marital trust or outright gift to a surviving spouse will qualify for the marital deduction. The marital trust with a general power of appointment confers upon the surviving spouse the right to designate the remainder beneficiaries after the spouse dies. In its least restrictive form, it may also enable the spouse to withdraw all of the trust principal during the spouse's lifetime and thereby terminate the trust. In contrast to an outright bequest, it is established

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with the expectation that it may be needed as a management device for the surviving spouse. Nonetheless, the spouse can undo the trust at will, and compel the trustee to distribute the trust assets to permit the spouse to control the assets through direct ownership. On the other hand, if the trust is effective as an asset management vehicle, the spouse may be content to let it serve that purpose.

Disclaimer Trusts

While some estate planning attorneys maintained the A/B trust structure even as the estate tax exemption continued to increase following changes to the estate tax law enacted in 2001, others favored a more general use of a disclaimer trust. With that format, all assets of a married individual would pass to the spouse, unless the survivor elected to disclaim an amount sufficient to fund a disclaimer trust to the extent of the estate tax exemption available upon the death of the spouse who dies first. For many affluent couples, the combination of an outright gift to the survivor with a fallback to the disclaimer trust may continue to be an effective estate planning strategy to follow.

GP Marital Trust with Disability Provision

In my recent experience, we have identified another use for a GP Marital Trust that seems to resonate with an identifiable segment of our client base. For some time, we have all heard statistical evidence that life expectancy has increased for a majority of the population. Medical advances, technology, and medications now enable individuals who might have succumbed in the past to neutralize or avoid those dis-

eases and conditions that can lead to an earlier death. Financial planners now regularly read (and write) articles which present the prospect that a person who reaches a traditional retirement age might live another 20 to 30 years. And, in the case of a married couple, if both spouses don't make it to life expectancy or beyond, it remains likely that one spouse will.

As a broad demographic group, clients who are in their middle forties to their early seventies—roughly, baby boomers (those born between 1946-1964) and those who are a bit younger or older than baby boomers—may consider more carefully the prospect of survival to an older age. Those in the younger segment have seen, or will soon see, parents decline and die. Those in the older segment have begun to directly experience that decline and those in the middle segment may not be there yet, but they can see it from here. The nature of estate planning is such that the planner must necessarily consider the prospect of an immediate death, as unlikely as that may be as a matter of probability. Whether the first spouse dies relatively sooner or later, the prospect remains that the surviving spouse may be with us for a long, long time. That long survival period may stretch out in a client's mind, abetted by both the rational case for increasing life expectancy and the natural optimism of one who hopes to live to an old age.

As a couple envisions different periods of survival for either of them, it may be useful to consider the old adage that disability by a certain age is more likely than death. The surviving spouse may need the help that the trustee of a marital trust can offer to ensure that

financial life proceeds smoothly even if old age and deteriorating health diminish the spouse's ability to function. It is far better to anticipate that such decline may actually occur, and to plan for it in advance. Otherwise, if it does occur, there will be plenty to do if a family member, such as an adult child, steps in to assist an ailing parent.

The GP Marital Trust thus offers a contingency plan for the widowed spouse. If, following the death of a spouse, the survivor is at an age, or is experiencing a mental or physical condition where assistance is needed and wanted, the GP Marital Trust satisfies that need. On the other hand, if the survivor has no need for the trust after the other spouse dies first, the survivor can exercise the lifetime general power and direct the trustee to distribute all of the assets to himself or herself and terminate the trust. In fact, the executor of the deceased spouse's estate may not even fund the trust if the spouse informs the executor that it's not worth the trouble because he or she plans to withdraw all the assets immediately.

Another point to consider in the planning process is the prospect that the survivor needs help in managing finances, but doesn't want to acknowledge it. We have employed a provision in which the spouse would no longer have the right to withdraw assets if he or she is mentally disabled. We leave the determination of mental disability to the opinion of the survivor spouse's primary care physician. If necessary, the physician is authorized to consult with other physicians or other professionals, such as a licensed psychologist, social worker, or other counselor, to reach a conclusion as to mental disability. While no planning procedure

can guarantee that no future conflict may occur between trustee and beneficiary, the physician's opinion can do a great deal to assure that an objective standard is followed.

The GP Marital Trust, complete with a means of establishing whether a mental disability has occurred, can provide great flexibility in planning for both the near and far future. If one

spouse dies when the other spouse is mentally clear and functioning independently, the trust may be maintained or effectively ended by the survivor. On the other hand, if one spouse dies when the survivor needs help with his or her finances, the trust can ensure that help is available to maintain the financial well-being of the survivor even if mental disability has occurred. ■

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