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Evolutionary Planning: 20 or so Ways to Increase Client Happiness and Value to Your Practice with Planning Techniques (Non-Tax) and Strategic Practice Techniques

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I. ACTIVATING TRUST PROTECTORS

We used to be frightened with trust protectors to amend irrevocable gifting trusts. These powers are essentially providing a broad limited power of appointment to third parties.

Among the concerns: Is this a 2036 power? Will this create undue IRS scrutiny? Well, the Times They are a Changin.

Guess what? A third party trust protector power, if properly set up, is not a 2036 power. It may be a power the powerholder does not want to have, but time to consider it in all trusts.

At this point in our drafting and estate planning practice, we should be considering safety valves to either allow a return of assets to the grantor, or, alternatively, to modify trusts.

Use of these provisions will often result in grantor trust treatment for income tax purposes, which could be excellent planning and should be considered at the initial stage in the planning.

These can be achieved generally either by special limited powers of appointment, broader trust protector provisions, or express decanting powers. Specifically:

a. Briefest approach: third party has a power of appointment

The goal is to allow a third party a non fiduciary right to distribute property to a limited class of individuals, which may or may not include the grantor; example:

> ***"Power of Appointment by Special Power Holder.*** *During my life, the trustee shall distribute the principal to any one or more of my spouse, my descendants, and the spouses of my descendants as the special power holder from time to time appoints during his or her life. I name as the special power holder the first of the following who is from time to time willing and able to act:*
>
> *(a) my friend and attorney, I. M. Ntrouble*

In the above, to allow the grantor to be among the class of possible appointees, the class could be extended to include "descendants of the grantor's parents."

> (b) *my friend and accountant, Hert M. Eeee."*

b. The more elegant and expansive Trust Protector provision, select provisions

Practitioners often draft longer guidelines as to what the trust protector can and cannot do. The following is a sample, with a caveat from us that drafting these provisions seem like predicting who will win the Super Bowl; a bit luck and a bit analysis.

ARTICLE 1
Trust Protector

> (a) *Designation. Dean shall be the initial Trust Protector. During my lifetime, [third party] may appoint any one or more qualified corporations, or any one or more individuals other than Disqualified Person as to me, as the initial Trust Protector, Co-Trust Protector, or successor Trust Protector of this trust or any separate trust created hereunder, to act with or to succeed the then acting Trust Protector consecutively or concurrently, in any stated combination, and on any stated contingency; provided that any such designation may be amended or revoked before the designee accepts office. The powers retained in this paragraph may be exercised by a signed instrument filed with the trust records, and any later instrument shall take precedence over an earlier instrument.*
>
> (b) *Powers of Trust Protector. The Trust Protector may exercise the following powers, at the sole discretion of the Trust Protector:*

(c) *To appoint successor trustees or co-trustees and remove and replace any trustee of such separate trust, in the manner and under the circumstances described in Article 5 hereinabove.*

(d) *To make a determination, upon the request of the trustee, of what constitutes reasonable compensation to the trustee.*

(e) *To change the domicile of the trust.*

(f) *To resign at any time by signed notice to the trustee.*

(g) *Subject to any plan created by me pursuant to the paragraph above, to designate any one or more qualified corporations, or any one or more individuals other than Disqualified Persons, as Co-Trust Protector or successor Trust Protector of this trust or any separate trust created hereunder, to act with or to succeed the Trust Protector consecutively or concurrently, in any stated combination, and on any stated contingency; provided that any such designation may be amended or revoked before the designee accepts office. The powers granted in this subparagraph may be exercised by a signed instrument filed with the trust records, and any later instrument shall take precedence over an earlier instrument. If any plan created under this subparagraph shall conflict with any plan created by me pursuant to the paragraph above, my plan shall prevail, whether it was dated earlier or later than the plan under this subparagraph.*

(h) *To distribute so much of the trust to any one or more of the Beneficiary's descendants, ancestors, siblings, or nephews or nieces in equal or unequal shares, as the Trust Protector shall appoint in writing delivered to the trustee.*

1.2 *Release by Trust Protector. The Trust Protector at any time acting may, by written instrument delivered to the trustee, irrevocably release any of the powers granted to the Trust Protector under this Article. If the Trust Protector irrevocably releases a power, such power shall thereafter no longer be exercisable by the Trust Protector or any successor Trust Protector.*

1.3 *Disqualified Person. The term "Disqualified Person" hereunder shall mean me, any person who has contributed property to such trust, any beneficiary of such trust, the spouse of any beneficiary of such trust, and any individual or entity who would be considered a "related or subordinate party" under Code Section 672(c) as to any of the foregoing such persons, had such person been the grantor of such trust (including without limitation such person's spouse, father, mother, issue, brother, sister, or employee; a corporation in which the stock holdings of such person and the trust are significant from the viewpoint of voting control, and any employee of such corporation; and a subordinate employee of a corporation in which such person is an executive).*

c. <u>Relying on Statutory Provisions to Change Documents</u>

If nothing else, we know how important it is to achieve flexibility IF state statutes allow this. Among the most convenient statutes are the decanting provisions. Documents should be drafted to allow trustees to take advantage of decanting, such as the following:

"Consolidation and Division of Trusts. In addition to the decanting powers granted under Florida Statutes Section 736.04117, the trustee shall have the powers set forth in this paragraph. The trustee may at any time consolidate any trust held under this instrument with any other trust if the beneficiaries of the trusts are the same and the terms of the trusts are substantially similar. Further, the trustee, in the trustee's absolute discretion, may divide a trust (the "initial trust") into two or more separate trusts and may segregate an addition to a trust (the "initial trust") as a separate trust.

Funding. In dividing the initial trust, if the division is to be effective as of my death or as of the death of any other person, the trustee shall fund each separate trust with property having an aggregate fair market value fairly representative of the appreciation or depreciation in value from the date of such death to the date of division of all property subject to the division.

Terms. A trust created pursuant to this paragraph shall have the same terms and conditions as the initial trust, and any reference to the initial trust in this instrument shall refer to that trust. The rights of *beneficiaries shall be determined as if that trust and the initial trust were aggregated, but (1) different tax elections may be made as to the trusts, (2) disproportionate discretionary distributions may be made from the trusts, (3) taxes may be paid disproportionately from the trusts, (4) upon termination the share of a remainder beneficiary (including any recipient trust) may be satisfied with disproportionate distributions from the trusts, and (5) a beneficiary of the trusts may disclaim an interest in one of the trusts without having to disclaim an interest in another trust. In administering, investing, and distributing the assets of the trusts and in making tax elections, the trustee may consider differences in federal tax attributes and all other factors the trustee believes pertinent."*

Select the trust protectors carefully. 1. Someone the settlor trusts because of the broad powers the protector holds. 2. Someone who will not end up having a taxable power of appointment over the trust b/c of protector powers.

Example: Client, wife, transferred $10 million in assets to her husband. Husband later made gift to trust for children and named wife as trustee. Husband named his college roommate as trust protector. Once wife filed for divorce, trust protector removed wife as trustee and named a fraternity brother as trustee of a $10 million trust for children. We ended up in litigation.

Happiness Axiom 1: When clients hear the word "irrevocable and unamendable" they will nevertheless ask you in about T years to change their irrevocable trust. Coupled with exponential changes in technology, expected changes in tax laws, cultural changes, investment, wealth, and attitudes towards charities and money-with-children, documents should build in safety valves to change irrevocable trusts.

II. PROTECTING THE FAMILY'S ASSETS FROM NON-FAMILY MEMBERS; THE IMPORTANCE OF (FUTURE) CREDITOR PROTECTIVE TRUSTS

Typical trust structuring in the 1950s through 1980s for adult children focused on spendthrift trusts, as needed, special needs trusts, as needed, and staggered withdrawal rights for most adult children.[1]

Going somewhat unnoticed, the creative expansion of these boundaries in the last 20 years has been well perceived by clients, and operationally effective when administered.

This creative expansion focuses on the need for trusts for adult children to be protected from spousal claims, and protected from other creditor claims.

a. Drafting Creditor "Shield" Trusts

Consider discussing with the client the use of trusts for the children, with the children as their own trustee or better yet, co-trustee, to provide a creditor protection shield for funds left in the trust not needed for the child's consumption, as the child determines from time to time. Note the use of the word "shield," versus "insulation." These trusts are intended to balance flexibility to the child in terms of access to the principal, with some protection against creditors, although not a complete insulation.

b. How to Structure

For planning purposes, assume the client and planner has determined that a flexible creditor protection trust for adult children is desired. Therefore, the question becomes how close to the edge can the trust be pushed. For example, can the child be trustee? If so, must the standard be a narrow one related to health, support or maintenance? Or should the standard be expanded to "best interests?"[2] Each shift in adding more control to the beneficiary – as trustee, and then pursuant to an unascertainable standard—creates some decrease in creditor protection. How much will depend on evolving state law in this regard. And yet, this is the kind of decision that a client cannot be expected to make in an informed way. The practitioner, based on state law and knowledge of the client's family, has to recommend the format that should be used.

[1] For example, 1/3 at age 25, 1/3 at age 30, and 1/3 at age 35.

[2] "Best interests" is a scary standard for trusts controlled by beneficiaries for tax purposes, but perhaps not for creditor protection purposes.

c. Spendthrift Trusts: Much Ado about (Almost) Nothing, or Is It?

In discussing the creditor protection of trusts, practitioners almost always focus on whether the trust has a spendthrift provision and the protections afforded by the spendthrift provision. This is much like focusing on whether your MLB team finishes in 3rd versus 4th place. Instead, the focus should be on what is necessary to get to 1st place, with emphasis (as discussed later) on the discretionary provisions, trustees, and the absence of certain powers of appointment and withdrawal rights.

The spendthrift provision is relevant, ironically, not for the protection provided, but for its implications when a court holds it to be inapplicable—in that instance, creditors can reach in and often obtain assets then available to a beneficiary. For example, a court might hold that a spendthrift provision is rendered ineffective by an unlimited right of withdrawal, *see, e.g., Frisch*, and then by implication allow a creditor access to the trust property by implying that the creditor can attach (in essence force) the beneficiary's exercise of that right of withdrawal in favor of the creditor (as discussed in section b below).

A spendthrift trust is typified by the following provision:

> *"Spendthrift. No interest under this instrument shall be assignable by any beneficiary, voluntarily or involuntarily, or be subject to the claims of his or her creditors, including claims for alimony or separate maintenance. The preceding sentence shall not be construed as restricting in any way the exercise of any right of withdrawal or power of appointment or the ability of any beneficiary to release his or her interest."*

But what does it mean, really? And how is it differentiated from the protection afforded by a discretionary trust?

d. The Genesis of the Spendthrift Trust

There was a time (during the Telephone Booth Dynasty) when mandatory income trusts, with no discretionary principal, were extremely popular. But now, other than functioning in the QTIP context, the mandatory income trust has fallen out of favor.

Instead, modern trusts are established with discretionary income and principal distributions pursuant to a standard, whether that standard is health, support and maintenance (for tax or non-tax purposes), or welfare or best interests, or in the total discretion of the trustee. The practitioner should be prepared to answer the question as to whether there is greater protection afforded a "spendthrift trust" versus a "purely discretionary trust." While the courts may view this differently, the difference from a protective perspective is marginal.

Here's why.

First, we cannot recall the last time we saw a trust drafted without a spendthrift provision. We would venture to say they are always in there, and they are an accompaniment to the protection offered by the discretionary feature.

Second, with a discretionary trust, the creditor protection is sound provided (1) the trustee does not make any distributions, (2) the jurisdiction does not have *Berlinger* – like rules, discussed, *infra*, and (3) the beneficiary (in the eyes of certain state courts) cannot force the trust to make a distribution (e.g., the beneficiary does not have a withdrawal right, or serve as trustee of a trust with an unascertainable distribution standard).

Third, the spendthrift provision merely prevents a third-party creditor from attaching the income or other interest by substituting himself or herself for the beneficiary of that income interest. For example, assume the beneficiary of a $100 spendthrift trust is entitled to all the income on a mandatory basis. A third-party creditor of the beneficiary cannot substitute herself for the beneficiary to satisfy a debt or creditor interest. However, once the trustee makes a distribution to the beneficiary, the funds are in the beneficiary's hands and can then be reached by the creditor.

With a discretionary trust, created by a third party, the general rule is that a creditor cannot force the trustee to make a distribution. [3] Therefore, the creditor cannot effectively substitute in as the beneficiary. Because no mandatory

[3] *See*, *e.g.*, section 504 of the Uniform Trust Code (regardless of whether the trust has a spendthrift clause, a trust with a distribution standard prevents a creditor of the beneficiary from reaching the beneficiary's trust interest). *See also* section 60 of the Restatement of Trusts (Third) (A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so.) While a creditor could argue "abuse of discretion," we would posit that a reasoned decision against making the distribution would not be an abuse of discretion if the standard is

distributions are required to be made, in a purely discretionary trust, a creditor would have no interest absent the trustee making, or being "required to make," a distribution to the beneficiary.

Happiness Axiom 2: Focus on the discretionary provisions in a trust in determining creditor protection, rather than relying solely on the spendthrift provision for any great creditor protection. For example, as a rule of thumb, a purely discretionary trust, with no mandatory income interest, has in effect more relevant creditor protection than a mandatory income trust coupled with the typical spendthrift provision.

e. But a Spendthrift Trust Does Allow the Trustee to Play a Game

It boils down then to the following. A spendthrift clause in a discretionary trust provides a practical layer of creditor protection in that creditors "may not reach the …distribution …before its receipt by the beneficiary." *See, e.g.,* section 502 (b) of the Uniform Trust Code. This has two practical results.

First, courts (see all case law discussed here) often allow third-party creditors access to trust funds, ignoring fiduciary constraints on discretionary distributions, whenever they find the spendthrift clause is rendered ineffective. Those same courts may ignore the discretion to the trustee and the trustee's fiduciary obligation in exercising that discretion. For example, where the beneficiary and trustee are the same person, subject to a discretionary standard for distribution, the court may conclude that that degree of control renders the spendthrift clause dysfunctional (ineffective is the actual word), and then imply that a third-party creditor can reach into the trust and obtain the trust property. This condenses what is truly a two-step process into one.

Step two should be: Has the trustee exercised, or must the trustee exercise, its discretionary authority? Focusing on the spendthrift clause often causes a court to conclude that it can override this second step. Therefore, right or wrong, practitioners should try to preserve and argue for the application of the spendthrift clause.

Second, if the spendthrift clause is valid, then trustees may then try to use funds for the beneficiary's benefit by making a distribution to a third party, or may make a distribution to a beneficiary that requires the creditor to go after the distribution after it is in the hands of the beneficiary.

If the trustee then makes distribution to a third party for the use of the beneficiary (e.g., to pay down the mortgage on the personal residence that perhaps has already qualified for the homestead exemption), in most jurisdictions the creditor will not be able to pull back that distribution for the creditor's use. However, evolving case law may give creditors greater rights even here, including obtaining a garnishment order under state law. *See, e.g.,* Florida section 736.0504 and *Berlinger, infra*.

Happiness Axiom 3: Using the spendthrift provision, in the event that there are creditors, the trustee can undertake two approaches. First, discuss a compromise on the debt with the creditor since the creditor may be waiting a long time for a distribution to the beneficiary; that compromise could be twenty or thirty cents on the dollar. And second, without a compromise, to consider making all distributions "for the benefit of" (to third parties) of the beneficiary while, at the same time, allowing the beneficiary to enroll in the FBI witness protection program for relocation.

f. How Protective from Tort Creditors are these Trusts?

Generally, English law has provided protection against beneficiaries' creditors in third-party created discretionary trusts.

A recent article by Professor Kent Schenkel, "Trust Law and the Title-Split: The Beneficial Perspective," provides a James Thurber-like stream of consciousness analysis as to why beneficial interests in trusts should not be entitled to the protections afforded under State law. Although his argument has not been accepted by courts, the evolving court attitudes certainly favor eroding the creditor protection afforded by third-party trusts.[4]

"may," not "shall." The Restatement goes so far as to suggest that the existence of a creditor should create a strong argument supporting fiduciary discretion against making distributions. Section 60, Restatement*, infra*, "a trustee's refusal to make distributions might not constitute an abuse as against an assignee or creditor" even when it would constitute an abuse if there had been no creditor.

[4] In this snooze-fest piece, after dragging the reader through a rather dull history on trust law, the author reaches his main argument, that "trusts dodge the intent of the law by shirking legal responsibilities corollary to ownership of property, all to the advantage of the trust beneficiary." Since this argument is directly contrary to what is desired by practitioners and what is

Common law dictates the following. A self-settled trust is entitled to no creditor protection.[5] That is, under common law, one cannot create an irrevocable trust, be the beneficiary, and then argue that the funds are free from that beneficiary's creditors because the trustee has "discretion" whether to make distributions. Evolving state statutes are, in contrast, providing protection to these self-settled trusts, and the level of that protection is discussed in section 6.

Alternatively, a discretionary trust created by a third party ("third-party settled trusts"), such as a parent for the child, is generally entitled to creditor protection as to that (child) beneficiary. Even when the beneficiary is also the trustee, but subject to limited standards as to distribution (such as health and education), that beneficiary's interest may also be protected from the beneficiary's creditors.

The uncertainties develop in that the laws and judicial results are constantly evolving in each of the 50 states, sometimes favoring protecting the beneficiary and sometimes against, as they apply to third-party settled trusts. For example, a jurisdiction may permit a third-party settled trust to have the beneficiary as trustee, allow distribution discretion tied to a health, support, welfare or best interests standard, and still prevent that trust from being attachable by the beneficiaries' creditors.[6]

Consider Illinois law. Illinois law used to be clear that as to a third-party trust, the beneficiary could be trustee and have discretion to make distributions pursuant to an ascertainable standard,[7] while the trust remained free of creditor claims.[8] Illinois law was ambiguous with regard to whether a broad standard, "best interests," with the beneficiary as trustee, protected the beneficiary from creditors.

Demonstrating how state law in this area is rapidly evolving, recently even the limited standard was called into question. In the case of *McCoy v. McCoy* (274 B.R. 751) (2002), a surviving spouse was the beneficiary of a family trust created by the predeceased spouse. The family trust provided, in part:

> *The trustee may in its discretion pay to my spouse, or for his benefit, so much or all of the principal of the Family Trust as the trustee from time to time determines to be required or desirable for his health, maintenance and support. The Trustee need not consider the interests of any other beneficiary in making distributions to my spouse or for his benefit.*

Under Illinois law, the above standard is an ascertainable standard and would facially be considered sufficient to prevent creditor demands that the trustee make a distribution so that the creditor could satisfy its judgment. The court confused the concept of a discretionary trust with that of a spendthrift trust, albeit its error in nomenclature may not be relevant. That is, the court determined that the standard -- whether the discretionary right to principal meant just that -- was whether:

> *"[T]he beneficiary does not have unregulated dominion and control over or right to distribution from trust for the trust to qualify as a valid spendthrift trust."*

The court held that even with an ascertainable standard, the use of the word "desirable" indicated that "the settlor intended Debtor to have complete dominion and control over the corpus." Though the language would be interpreted by most planners as ascertainable, the court held that the standard was not ascertainable. Therefore, the court concluded that a creditor in bankruptcy could obtain the interest in the trust of the beneficiary, and that interest was the entire trust.[9]

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allowed and reflected by State law, by the trust restatements, and by judicial precedent, there should be caution by the practitioner in accepting an argument challenging that conclusion.

[5] In recent years, this common law rule has been eroded with the advent of state laws, such as those of Delaware and Alaska, allowing self-settled trusts to have a certain degree of creditor protection.

[6] By attachable, I mean that a creditor can force the trustee to exercise discretion to make a distribution. Once a distribution is made, a creditor can try to obtain the funds from that distribution.

[7] By analogy to Code section 2041, one related to "health, support, maintenance, and education."

[8] If the Trust had only used the terms "[as] required [for] health, maintenance and support", such a standard limiting discretion would likely be acceptable under Illinois law. *Rock Island Bank & Trust Co. v. Rhoads,* 353 Ill. 131 (1933) (intimating that a discretionary provision would have placed sufficient restriction on the beneficiary if it had used "comfort" alone to limit the beneficiary's access).

[9] Because the Debtor "in bankruptcy has the unfettered ability to possess and own [it]," the trust property is "therefore not protected by the exclusionary language of Section 541(c)(2). *In re Rolfe,* 34 B.R. at 161. Accordingly, the Trust property belongs to the bankruptcy estate and the Trustee will be granted Summary Judgment on Count IV of his Complaint on Count

The *McCoy* holding indicates that under Illinois law, even a standard relating to health, support or maintenance can subject a third-party settled trust to the creditors of the beneficiary. But in those Illinois cases, a key fact is that the beneficiary was also the trustee, a bad fact as discussed in more detail below. Though the court focused on the use of the word "desirable,' I do not think the result could have been eliminated by the use of the word, "necessary," rather than "desirable."

Instead, the focus seems to be on whether the beneficiary was also the trustee. For example, in *Hawley v. Simpson* (Bankruptcy Court, CD Illinois, No. 02-83674, 2004), the debtor's ability to access the trust funds, or to control the timing or manner of distribution, such as in the debtor's capacity as trustee, rendered the spendthrift provision ineffective and made the trust funds available/reachable by the creditor.

Other states' courts also reflect this view. In *Dollinger v. Bottom*, 176 B.R. 950 (N.D. FL 1994), the debtor's interest was in trust to be paid to the debtor as the trustee determined to be for the "support, care, comfort and maintenance" of the debtor. In other words, this trust should have been protected until the trustee exercised its discretion to distribute principal. The debtor was the sole trustee. As a result, the court reasoned, incorrectly (because it was ignoring Bottom's fiduciary duty to the remainder beneficiaries) that "the only one that can guard Bottom from his own improvidence is Bottom himself." This dual capacity, beneficiary and trustee, rendered the spendthrift provision obsolete and allowed creditor access to the trust.

As another example of the judicial confusion caused when a beneficiary serves as the trustee, see *Strong v. Page*, 239 B.R. 755 (W.D. Mich 1999), in which the court invalidated the spendthrift clause when the trustee and beneficiary were the same person, reasoning that there is a merger of legal title. In that case the trust by its terms had terminated, so the trustee was merely holding title pending termination. In that context, the court's holding was correct; but if the trustee were not entitled to distribute the principal except according to a standard (HEMS for example), the court's holding would have gone too far.

Even actions by a beneficiary in his capacity as beneficiary can be interpreted to allow a creditor access to the trust. For example, when a beneficiary dictates the figurehead-trustee's actions (even if the beneficiary has no right under state law to control the trust), that may render the spendthrift clause ineffective and the trust corpus susceptible to creditor attachment. For example, in *Richardson v. McCullough,* 259 B.R. 509 (Rhode Island, 2001), the debtor was not the trustee. In what I would regard as dicta (since the beneficiary had an outright interest in the trust, once the third-party trustee wrapped up administration), the court indicated that the trustee took all actions under the beneficiary's "direct, unsupervised control." "[I]t is clear that the Debtor exercised sufficient control and dominion over the Trust funds to invalidate the spendthrift trust provision," and to make the trust subject to his creditors. *Infra* at 25.

The ultimate judicial or statutory result does not matter too much for the planner. The planner cannot draft for evolving laws in this area. Rather, we have to understand the laws in place at this time, and create a situation for the strongest argument that the beneficiary's interest is free of creditors. Further, we should not hesitate to encourage a beneficiary from resigning as trustee, even after creditor issues arise.[10]

This is a win-tie strategy. If the trust is effective for tort purposes, the beneficiary benefits; if not, the beneficiary is in the same position as if no trust existed. The key here for the practitioner is avoiding over-representing what these trusts do and don't do.

Consistent with the argument made by author Schenkel, *infra,* courts have begun to erode the common law creditor protection of third-party created trusts. There have been specific trends where courts or specific state statutes will force the trustees to make (attachable) distributions to the beneficiaries, even in third-party created discretionary trusts.

These include distributions to satisfy support decrees, whether in the form of child or spousal (primarily ex-spouse) support. *See, e.g., Estate of Creamer*, 41 Pa. D. & C. 377 (2014) (support obligations to a beneficiary's child recognized as exception to spendthrift protection by case and statutory law, and in dicta, similar support obligations to a spouse

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I of the Interveners' Cross Complaint, and on Debtor's Cross Motion for Summary Judgment on those Counts." *Cf.* section 60 of Restatements of Trusts (3rd).

[10] A resignation does not mean there is a fraud on creditors. Given that the whole area on trustee/beneficiary/discretionary principal distributions is uncertain, taking an action that makes the result more certain is not a fraud on creditors. Resigning as trustee is in the whole a different genre than a troubled beneficiary transferring assets from the beneficiary to the beneficiary's spouse.

recognized). *See also Ventura County Dept v. Brown*, 11 Cal. Rptr. 3d 489 (2004) (citing both California statutory and case law as allowing exception to spendthrift protection to provide for support Orders to spouse or child).

The UTC in essence voids the spendthrift protection and attaches the beneficiary's interest, but still requires the creditor to overcome a trustee discretionary distribution standard even if the creditor has a court-ordered spousal or child claim (e.g., the creditor must show that the trustee should exercise its discretion to make the distribution; a showing of an abuse of discretion can force the trustee to make that distribution to the creditor).

For an intelligent (in my view) discussion of what it means for spendthrift protection to be unavailable, see Florida Trust Code section 736.0503 and 736.0504, and *Berlinger v. Casselberry* 133 So. 3d 961 (2013). The Florida statute reflects the public policy of most states in indicating that spendthrift protection is not enforceable against a court-ordered child or spousal support determination. But, according to the court's interpretation of the same statute, the creditor (spouse or child) may not "compel a distribution that is subject to the trustee's discretion or attach or otherwise reach that interest." Instead, (somewhat bizarre) a spouse or child can obtain a writ of garnishment against disbursements made by a trustee.

A garnishment in law can mean two results. First, it can embellish the taste of any argument.[11]

Second, a "writ of garnishment" is an order requiring a third-party to withhold some type of property (usually money) of the defendant's (also called the "garnishee" or "judgment debtor") for delivery to a creditor to whom they owe an overdue debt. It means that the creditor can tell the trustee, in effect, "any time you want to make a distribution to or for the benefit of my deadbeat husband, your beneficiary, you have to give it to me first."

<u>Happiness Axiom 4</u>: Third-party created trusts are intended to preserve separate property as separate property. Those trusts should be effective for those purposes, even under evolving (unfortunately and incorrectly) statutes eroding a certain amount of protection. Judges may look at these trusts in providing equitable reasons for giving the non-moneyed spouse, the other spouse, a greater share of marital property, or increased maintenance amounts. And these trusts may be accessible to pay for unpaid maintenance obligations. To increase protection of these trusts, consider moving the situs and trusteeship of the trust to a jurisdiction that is more protective of these trusts, say Alaska, Delaware or Nevada; and avoid California or Minnesota, for example.

Not all jurisdictions will support this court involvement, but the trend is to provide those distributions.

Further, distributions for tax purposes, to satisfy federal tax liens and amounts due, have certainly been mandated by courts. [12]

Also, the Restatement of Trusts (Third) provides that third parties who provide necessities to or for the benefit of trust beneficiaries may reach the trust interests of the beneficiaries.[13]

In the continuing downward erosion of creditor protection, the Restatement of Trusts (Third) contemplates that the spendthrift and other protection of these trusts should be voided on certain public policy grounds. These would include consistent tortious conduct[14] and direct harm to the trust which is seeking to be protected.[15]

Nevertheless, when advising clients, these trusts are still effective shields, in the event of divorce or for typical third-party creditors bringing tort or contract cases against the beneficiary. The question is then one of structuring.

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[11] Really bad pun there. Okay, that first meaning is nonsense, as you no doubt realize before you read this footnote.
[12] *See, e.g.,* Restatement (First, Second or Third) of Trusts, section 58. See also UTC, section 503.
[13] Restatement (Third) of Trusts, section 59(c).
[14] I would think one tort would be enough, versus "consistent" tortious behavior.
[15] Restatement (3^{rd}) of Trusts, section 59 ("The nature or a pattern of tortious conduct by a beneficiary ... may on policy grounds justify a court's refusal to allow spendthrift immunity to protect the trust interest."). Under the UTC, *infra*, tortious conduct may not be sufficient to erode the protection. *Cf. United Mine Workers of America v. Boyle*, 567 F.2d 112 (1977) (intentional diversion of pension funds not an act sufficient to abrogate spendthrift provision). *But see Sligh v. First National Bank of Holmes County*, 704 So. 2s 1020 (1997) that reaches into a trust when the beneficiary was convicted of a drunk driving felony and a civil judgment thereafter obtained.

g. Drafting Creditor "Shield" Trusts

Consider discussing with the client the various trustee alternatives to provide a creditor protection shield for funds left in the trust not needed for the child's consumption, as the child determines from time to time. Note the use of the word "shield," versus "insulation." These trusts are intended to balance flexibility for the child in terms of access to the principal, with some protection against creditors, rather than completely insulating.

For planning purposes, assume the client and planner have determined that a flexible creditor protection trust for adult children is desired. Therefore, the question becomes how close to the edge can the trust be pushed. For example, can the child be trustee or a co-trustee? If so, must the standard be a narrow one related to health, support or maintenance? Or should the standard be expanded to "best interests?"[16]

Happiness Axiom 5: Because powers of withdrawal or general powers of appointment (express) will under case law allow creditors to access that power, see, e.g., Frisch, infra, eliminate lifetime powers in these trusts for a beneficiary.

The next question is the standard for distribution, as well as the selection of the trustee. The answer is a strange intersection of case law, practitioner bias, and client receptivity.

Case law: do not have the beneficiary as trustee; do not have enforceable beneficiary rights to principal (e.g., avoid the trustee "shall," and favor "may"). The recent Illinois case, *In re Lunkes*, No. 09 B 00583 (Bankruptcy, ND Ill, 2009), highlights this result by holding no spendthrift protection is afforded when the trust instrument has a "shall" direction to the trustee (the trustee "shall" distribute the following amounts to the beneficiary) versus "may."

Practitioner bias: Create absolute creditor protection, versus, the other end of the practitioner bias spectrum; allow the beneficiary essentially unfettered access.

Client receptivity: "I want my children to have access to the funds."

Do you as the practitioner feel like King Solomon? Well, for those of us grey in the temple (hair), we know this is exactly what the clients want-provide them practical advice as to what they should be doing.

Happiness Axiom 6: In drafting the discretionary standard for distribution, make sure to use the word "may" after trustee, versus "shall." Also, given the Illinois McCoy case, infra, I am not as focused on ascertainable standards as I am on who is the trustee. Therefore, revert to an unascertainable standard in most of these trusts.

Happiness Axiom 7: Consider an evolution to a completely discretionary trust. The world of thoughtful trust standards has paradoxically tipped in a toxic direction. In those cases in which the grantors wanted a HEMS standard, a rather limited one related to health, support and maintenance, somehow courts have focused on the "support" aspect of this to achieve rather unintended consequences from the grantor's perspective, especially in the creditor world. Accompany unlimited grantor discretion with careful trustee selection (committee of trustees) and precatory letters of intent.

The question of trustee is then the remaining conundrum. Ideally, we would like it be someone other than the child, the Generation Two (G2 as has become popular estate planning lexicon. We are a funny group of practitioners).

Most clients want it to be the child.

We know from evolving case law that courts could force a trustee, who is also a beneficiary, to make a discretionary distribution to the beneficiary in order to satisfy a creditor. For example, under the Restatement of Trusts (Third), section 60, paragraph (g), the creditor can reach the "maximum amount the trustee-beneficiary can properly take." In the example under that paragraph, the creditors are able to reach out of the trust, when the beneficiary/debtor is the trustee, "the maximum amount of trust funds that [the debtor] may, without abuse of her discretion, distribute to herself for authorized purposes." The spendthrift provision would not offer a restraint, according to the comment in paragraph (g).

Hmmmm. Creates a bit of a conundrum, maze, inconsistency, and other words that mean the same thing. Discussing the options with clients will be much like discussing portability during the life of husband and wife. Client: "So, the question

[16] "Best interests" is a scary standard for trusts controlled by beneficiaries for tax purposes, but perhaps not for creditor protection purposes.

is whether I should try to get an increase in basis in my assets after I am dead, and before my wife dies, versus perhaps saving more estate taxes, but this depends on the law and changes in the law and investment returns and consumptions. You know Lou, it's Friday afternoon, and I am not that gleeful about discussing my mortality. So on the portability issue, I have an idea. You are fired."

Personally, I like the beneficiary as trustee, with the understanding that the beneficiary could resign as trustee prior to a creditor event occurring, or when the trust is created, the beneficiary (who then has creditor issues or who thinks he or she may) can just decline to act. For those clients with adult G2s, this gives the practitioner the opportunity, if the client consents, to discuss the future planning with those adult children.

But even in this case, a court may look askance at the declination or resignation to act and hold that once that power was available, any actions thereafter taken are ignored. *See, e.g., Bottom, infra* (implying that resigning as trustee would be ignored for purposes of determining the trust's creditor protection).

An alternative would be a co-trustee situation, with the beneficiary having participation rights only as to ascertainable distribution decisions, and the co-trustee having rights as to discretionary distributions for "welfare or best interests." *See, e.g., In re Schwan*, 240 B.R 754 (Minn 1999) (holding trust protected from creditors because of co-trustee and because of fiduciary duties to follow terms of trust and distribution standards). *See also McCauley v. Hersloff*, 147 B.R. 262 (M.D. Fla 1992) (Discretion to make a distribution rested in multiple trustees, of which the beneficiary was only one; therefore, spendthrift protection valid. "Moreover, in exercising that discretion each trustee has a fiduciary obligation to the remaining beneficiaries"); Restatement of Trusts (Third), section 60 (no forcing of distributions if the beneficiary is merely a co-trustee, and the other co-trustee has fiduciary obligations to other beneficiaries, which would almost always be the case).

And the most protective strategy? Not naming the beneficiary as trustee at all. Note that not acting as trustee is a good step, but not sufficient if the beneficiary can indirectly appoint himself as trustee. For example, in *In re Baldwin*, Bankruptcy Court, Ohio, No. 2-88-05792 (1992), the court first acknowledged Ohio law that there was no spendthrift protection (and the trust could be poached by creditors) if the beneficiary is the trustee, or if there are withdrawal/revocation rights (the court used "revocation" but clearly also meant withdrawal), or if "the beneficiary has [other] dominion and control over the trust." In that case, the trust limited the debtor to replacing the third-party trustee with a corporate trustee. But then the court hypothesized that the debtor could theoretically create a corporation that the debtor controlled, remove the trustee, and replace that trustee with the debtor-controlled corporation. And in that way the debtor had the ability "to exercise dominion and control over the trust," rendering the trust susceptible to creditors.

Recognize that the courts are generally offended by debtors, and therefore will do whatever necessary to mess with the computer program so that the spendthrift protection, and inability to access the trust, gets an error message; such that the trust becomes available to the creditor for reimbursement.

I tend to think that co-trustee situations are the best today for most trusts, for a variety of reasons: assisting in the administration, allowing tax planning if the co-trustee is a knowledgeable tax practitioner, allowing accountability, providing a sounding board, creating plausible deniability when someone asks a beneficiary for money, avoiding mistakes, and for a few more (that I will not bore you with).

<u>**Happiness Axiom 8**</u>: Going forward, try to have the creditor protection trust for a G2 have both the G2 plus another as co-trustees. If not achievable, live with the G2 as sole trustee and recognize that there may not always be complete creditor protection.

h. <u>The Shelf Product</u>

The practitioner, based on state law and knowledge of the client's family, has to recommend the format that should be used.

<u>Drafting Example</u>: (The Adult Creditor Shield Trust)

Child's Separate Trust

Any trust property allocated for a child of mine subject to the Child's Separate Trust withholding provisions shall be added to or used to fund the principal of a Child's Separate Trust for the child. The trustee shall administer each Child's Separate Trust as follows:

Section 1.01 Discretionary Payments of Income and Principal. During the child's lifetime, the trustee may pay to the child so much of the income and principal as the trustee from time to time considers necessary for the health, education, support, maintenance in reasonable comfort, welfare, or best interests of the child. Any income not so paid in each tax year shall be added to principal at the end of each tax year.

Section 1.02 Power of Appointment at Death. On the death of the child, the trustee shall distribute the principal to any one or more persons or organizations (including the child's estate) as the child appoints by Will, specifically referring to this power of appointment.

Section 1.03 Distribution on Termination. On the death of the child, the trustee shall distribute the Child's Separate Trust not otherwise effectively appointed as follows:

(a) Any Descendant Living. If the child has any descendant then living, to the child's then living descendants, <u>per stirpes</u>; or,

(b) No Descendant Living. If the child has no descendant then living but I have any descendant then living, to the trustee to allocate in shares of equal value for my then living children, subject to the Child's Separate Trust withholding provisions hereof; provided that if a child of mine is not then living but a descendant of the child is then living, the trustee shall distribute the share that would have been allocated for the child, if living, <u>per stirpes</u> to the child's then living descendants.

i. <u>Cutting Back the Creditor Protection Trust to a Creditor "Annoyance" Trust</u>

Further, coordinate the trustee provision so that a child at a certain age can get control over this creditor protection trust, in the child's capacity as a co-fiduciary, or even as sole fiduciary.

<u>Drafting Example: Child as Trustee of Creditor Annoyance Trust</u>

Section 1.04 Trustee of Child's Separate Trust. Notwithstanding any other provision, upon attaining age thirty (30), each child of mine shall have the following powers with respect to the Child's Separate Trust established for the child's benefit under this instrument:

(i) Co-Trustee. The child shall have the right to appoint himself or herself as co-trustee.

(ii) Remove and Appoint. The child may remove any trustee at any time by a signed instrument, but only if, on or before the effective date of removal, a successor trustee (other than the child) has been appointed by that child or at least one trustee will continue to act after the removal.

III. SPOUSAL ASSET TRANSFERS

a. <u>Advocacy of Changing Title Between Spouses</u>

Since 1982, planners have had to discuss with spouses the need to shift assets to the non-propertied spouse to allow for that spouse to have assets to fund the credit shelter trust, in the event that spouse predeceased the other. With portability, that shifting of assets is no longer necessitated to protect use of the exemption. Because of concerns over how a shift in title may affect property rights on divorce, this area of discussion becomes more difficult. Perhaps asset transfers to allow credit shelter funding will be ignored by planners.

b. <u>Funding of the Credit Shelter Trust</u>

Percolating out there in estate planning since 1982 has been the concern about retitling assets to allow the funding of the credit shelter trust at the first spouse's passing. With the estate tax exclusion reaching $600,000 in 1984, planning often required a retitling of assets from one spouse to another to ensure that when the first spouse passed away, there would be sufficient assets to fund that spouse's credit shelter trust.

<u>Example</u>: Circa 1984, husband had assets consisting of a $600,000 house, an IRA of $1,000,000 and marketable assets of $800,000. Wife had no assets in her name. During the estate planning discussion, the planner recommended that

either the house or a portion of the marketable assets be titled in the wife's name, to ensure that wife's $600,000 credit shelter trust was funded in the event she was the first spouse to pass away.

The often glossed-over concern was whether the change in title of assets, from husband to wife in the above, affected the separate/marital/non marital/community nature of the property for divorce purposes. Given the importance of avoiding estate taxes and the justification for doing so pre-portability, that marital concern often took a back seat to the actual need to reallocate for estate tax purposes.

c. Portability

Portability – the concept of allowing the surviving spouse to in essence "inherit" the deceased spouse's estate tax exclusion -decreases the necessity of reallocating assets as between spouses to maximize the use of the estate tax exclusion. A determination of whether to rely on portability is itself a sophisticated analysis, but now the marital/non marital concerns related to asset transfers between spouses needs to be considered further because no longer is it a necessity to transfer assets to ensure full use of the estate tax exclusion.

d. Titling

Titling is possession. And possession is nine tenths of the law, but not one hundred percent. And, titling does not in and of itself determine whether property is marital or non-marital.[17]

Example: During marriage, wife is the sole breadwinner, and titles all earnings in her own name. Despite owning all assets, these assets are marital/community because they were earned in the traditional sense (not from separate assets) during marriage.

The issue that needs to be examined, however, is whether a change in titling transmutes the nature of the property from one classification to another.

Example: If husband brings into the marriage $1,000,000 of separate assets, and during the marriage gifts those assets to his wife, has that gift changed the nature of the property from the husband's separate property to the wife's separate property? Yes, if the husband intends to make this distinction via the gift, possibly no, if the intent is merely to change title for estate planning purposes (discussed below).

e. Linked Together by Marriage, but My Assets Remain Mine

States either classify property as either 'marital property' or 'non-marital property,' or as 'community' or 'separate.' Property classified as marital/community is property that both spouses will in essence share in the event of divorce.[18] Property that is classified as separate is awarded to the owner-spouse.[19]

With spouses retitling their assets for planning purposes as between their trusts, or schedules to their trusts (e.g., in a joint trust, separate property of wife being re-scheduled as separate property of husband), the analysis is whether the transfer results in the property losing its character as wife's separate property.

In making the determination as to whether the character has changed, a court may review whether the parties **intended** to make a gift from the one estate to the other, thereby transmuting from one classification to another.

Therefore, a change in title from (i) one spouse to both spouses jointly, from (ii) both spouses to one spouse, from (iii) one spouse to the other spouse, or from (iv) both spouses jointly to one spouse, will at a minimum garner scrutiny on property division in divorce.

The question then, in 2018 (and since 2012) is whether the practitioner wants to get into the potentially aggravating situation of having to defend a transfer of property when title shifts from one spouse (his or her separate property) to another (is this the new spouse's separate property) for purposes of potentially funding the credit shelter amount at the first spouse's passing.

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[17] The title system to determining property in divorce has been changed by state equitable distribution statutes. *See, e.g.*, Morgan, "When Title Matters: Transmutation and Joint Title Gift Presumptions" 18 Journal on Matrimonial Lawyers 33 (2003). Title has theoretically become rendered inconsequential.
[18] Timing is not critical here, so that in community property each spouse may already own ½ of the property pre divorce.
[19] The courts often find 'equitable' methodologies as an end around, such as awarding alimony, requiring reimbursement, and applying various equitable doctrines, such as marital energies doctrine; that the effort of one spouse helped enhance the value of the non-marital property of the other spouse. Separate property assets are generally defined as property acquired before the marriage, or by gift or inheritance, or are protected under the terms of a valid agreement between the parties.

Post 2012, the answer may be "no."

Happiness Axiom 9: With portability, the absolute funding requirement for each spouse to have $11 million is reduced. Now the practitioner can focus a bit more on the effects of divorce on a change of titling, and perhaps not shift title as often as we used to have to. We suspect that changing title to assets for future testamentary funding will be occurring less frequently in the future.

IV. I LOVE YOU, BUT AM NOT IN LOVE WITH YOU

a. Darth Vader Calling

Really bad "potential" clients remind me of Fawn Leibowitz from Animal House. We are one kiln accident away from being business-engaged to that client for a long time. Where's the malfunctioning kiln when you need one?[20]

One incident I remember quite vividly. A potential client with substantial net worth had requested I advise him as to how most effectively to use the lifetime credit at year end. With this potential client, I discussed partnerships and discounted gifting to maximize the use of the credit. As December approached, I emphasized to him the need to put a strategy in place (if he was going to before year end) as soon as possible so that we could get it done by year- end. He promised he would be right back to me as to whether to proceed or not.

On December 23, my receptionist frantically tracked me down to indicate that Ted (let's call the potential new client by that name) was on the phone and needed urgently to talk to me.

The conversation went something like the following:

"Lou, this is Ted. I am riding on a chairlift at Snow Valley right now; and chatting about estate planning with the dude in the chair next to me. Just met him on the way up the mountain. He indicated that his estate planner recommended blah, blah, blah strategy for use of the credit. I want to know **why we are not doing that**. You never suggested that. What were you thinking, or not thinking? Explain yourself!"

I had this vision in my mind. What was the name of that movie where the chairlift comes crashing down? In addition to this vision, many verbal responses floated in and out of my mind, like detritus and flotsam washing onto a polluted beach. One response was not going to happen, and that was to mollycoddle or vindicate Ted's need to discuss the strategy. My response, instead, went something like the following:

"Ted, at this point, we are going to have to decline your representation. I enjoyed meeting with you [a prevarication, but probably allowed under the 'politeness allows for mendacity' rule] but we will not be able to handle your matters. Have a nice ski trip. Bye."

In hanging up the phone, my mood could not have been better. We underrate the joy of saying no to Darth Vaders.

b. The 90/10 Rule

The 80/20 rule is well known by estate planners: 80% of our revenue comes from 20% of our clients. We are not as focused on the 90/10 rule, primarily because I just made it up.

That rule indicates that 90% of our aggravation in our practice life comes from 10% of our clients, that is, bad clients or bad projects. And by "bad" I mean something a tad more painful than the pain that comes from jamming a sharp stick in your eye.

Since we control variables, new projects and new clients, understanding of the 90/10 rule can actually increase our happiness. But this means we have to be strong and not select those 10% clients or matters.

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[20] For those unfamiliar with the reference, Ms. Leibowitz died in a kiln explosion, while purportedly crafting a bowl for her fiancé, who actually did not exist. Very complicated stuff.

c. Using Common Sense to Avoid the Vortex of Pain

Usually, listening carefully during the initial telephone call, or sending out a questionnaire and reviewing that carefully, will provide clues as to client matters for which a "no" should be immediate.

Examples are common place, such as being the prospective client's third attorney in a representation: "I didn't love them, but in 5 minutes, Lou, I know you are my guy." Hmmm. This was usually the kind of statement heard on a date when I would excuse myself to go to the bathroom, detour and exit through the kitchen, and begin changing my phone number.

Other clues are a bit more subtle, but if we pay attention to the clues, we can do well to avoid certain representations. At the initial meeting, listen carefully to the buzz words and concepts that will make you want to dismiss a potential client. These include the ones on the list below:

i. The prospect has had too many lawyers before you, and may even refuse to name them. Or, worse, wants to consult with you about how and why he should not pay his prior attorney.
ii. The prospect thinks all previous lawyers were "idiots," or makes otherwise derogatory statements about lawyers in general.
iii. The prospect cannot demonstrate he/she can pay for the cost of your services, balks at paying a retainer, and/or asks for a special reduced rate or payment terms up front.
iv. WANTS TO BE NOT JUST A PRIORITY, WHICH ALL CLIENTS ARE, BUT THE SOLE AND PRIMARY PRIORITY. WITH THESE CAPS, DOES IT SOUND LIKE I AM SCREAMING AT YOU? SORT OF LIKE HOW THIS CLIENT MAY SOUND.
v. You do not agree with the prospect's legal position.
vi. You do not believe the prospect is being truthful.
vii. The prospect is VAV (vindictive, angry and vengeful).
viii. The prospect is a family member.
ix. The prospect indicates they know the law and what they want to do, and just wants the attorney to do the front end work for them.

Happiness Axiom 10: Life is short and should be accompanied by smiles, not frowns. We are in control of this emotion and adherence to the 90/10 rule will have a strong influence on getting us to the happy face.

V. MONETIZE YOUR PRACTICE, NOT YOUR LIFE. UNDERSTANDING CORRECT BILLING PRACTICES.

a. Overview

The section discusses billing methodology and practice styles in an effort to solve the following equation -- Imagine a good you purchased - car, TV, hockey stick, fishing pole, boat, plane -- that was so outstanding that after the purchase, you felt good about buying it, regardless of its cost. If we want a longstanding relationship with a client, we want the client to view payment for our services along these same lines. This segment focuses on how our billing protocols can be improved to achieve this level of satisfaction and appreciation.

We practice law because it is interesting, challenging, we are good at it, and we are professionals. We also practice law because it is our business. As our business, we should rightly expect that fees charged should equal fees collected. And a certain amount of indignancy should accompany those fees that go uncollected. But also a certain amount of blame must remain with the practitioner as to uncollected fees. Did the practitioner follow a Best Practice approach in the fee presentation and collection process?

Little useful information has been written in this area as it pertains to estate planning. This paper is intended to be a starting point as to a Best Practices primer on the fee area as it relates to estate planning.

b. Understanding What is Needed to Improve Billing

Pre mortem estate planning refers to tax planning, Wills, living trusts, GRATs, education trusts, and all other matters that we do for clients while they are living. Bills are sent directly to those individuals who have requested our services, to deal with a topic that is very painful, albeit important -- Where does the Property that I have worked Hard for During My Life go when I Die?

It's not hard to understand why clients are reluctant to engage in estate planning. It is not a fun topic. Re-read the prior underlined sentence and ponder it a bit.

Therefore, even when we add significant value, say, saving $5 million in future estate taxes, a bill currently of $25,000 may seem repugnant. A bill currently for $10 may also seem repugnant. It's the process of what they are doing, not necessarily the value added, that is painful for clients to accept.

With that understanding in mind, what are the best billing practices? To understand the answer, one has to begin thinking out of the box as to practices. We should recognize (or agree) that current billing practices are subpar and done because (of what is known, as will be discussed in great detail below, as a status quo bias) they were done before.

Hypothesis 1: There is nothing rational about consumer behavior. As practitioners, we are often not thinking about our billing practices in the most strategic way.

Hypothesis 2: Practitioners spend about 10 % of the amount they should on billing, and disregard its importance to clients' happiness.

Hypothesis 3: Practitioners delay in billing because they know that clients will often perceive their charges as unpleasant and will be unhappy. Delay hurts further.

Hypothesis 4: The following paradigm is the fault of the practitioner, not the client:

Example: Practitioner does an A-B estate plan for a client, and quotes the client an hourly billing rate of $250. The project is done efficiently and within the client's time expectations. The hours spent are less than the practitioner anticipated. The hourly rate is less than others in the area. And the overall bill seems less than what it has been in the past. The clients are still surprised at the amount and unhappy.

Hypothesis 5: Which billing format, attachment 1 or attachment 2, is preferable from a client happiness perspective. Would it shock you if we said that in the vast majority of cases, attachment 2 would be preferable?

Hypothesis 6: Technology has increased the quality, efficiency, and lowered the cost of producing estate planning work product. But this is not reflected in the billable hour concept, nor accepted by clients as an item to bill for. As practitioners, we have not developed a way to charge for technology.

c. Rationality in Consumer Perception to Our Billing

We fail to understand that consumers are not rational when it comes to hourly billing for estate planning matters. Many of us think that if hours are correctly reported, the hourly rate is reasonable, and the project is done timely, the clients will accept the bill as "reasonable" or as "good value."

But fundamentally we are missing a tenet of finance law: that the rational consumer does not always make rational choices, but is influenced by his or her own mental accounting,[21] which often changes rational consumers into irrational ones.

For example, the following example illustrates this mental accounting concept.

Example: You go to the store to buy your favorite movie on a DVD. It is priced at $14.99. While at the store, your best friend mentions that the same DVD is available for $4.99 at the Walgreen's about 15 minutes away. Will you go to the Walgreen's? Compare this to the situation where you are at the Stereo store and the salesperson says the stereo costs $499. Your best friend says the same stereo is available at $489 at the store 15 minutes away. Will you go to the other store? There's no difference financially, but the results have empirically been shown to be different. The consumer's perceptions are different in both situations, reflecting fairness issues. Conclusion: we cannot assume rationality for our client's economic decisions.

[21] In "Mental Accounting Matters," 12 J. Behav. Dec. Making 183-206 (1999), Richard Thaler, one of the leading behavioral economists in the Country, explores the concept of mental accounting. Unlike financial accounting, which consists of numerous rules and conventions that can be explored in a textbook, mental accounting rules – a description of the ways consumers perceive their economic choices—can only be observed by behavior and inferring the rules.

d. Translation to the Hourly Rate

A client may perceive an hourly rate of $350 to be "way too expensive" for someone spending an hour thinking about something. Is that rational (probably not, *see* below). In contrast, the client may perceive a bill for $5,000 for estate planning documents that achieve estate tax savings, creditor protection trusts, management of assets in the event of disability, and so on, as being reasonable.

Meaning, in estate planning (not estate administration or contested litigation), get away from emphasis on hourly billing, and get into the concept of either doing or demonstrating project/value billing as much as possible.

Example: It's not rational: Attorney X recently spent about an hour coming up with an estate planning wrinkle for a client that saved him about $500,000 on a strategy. If the Attorney quoted him an hourly rate of $2,000, and then sent him a bill for $2,000, the client would be upset. If the Attorney quoted him a flat fee of $5,000 to try to implement a strategy that would save $500,000, he may have been absolutely fine with this, depending on the framing of the project and resolution.

A couple that are relevant to how we bill and charge clients:

e. Fairness: Value, Value, Value

Consumers like to perceive themselves as being treated fairly, even when the end result or product or cost is the exact same whether they are being treated fairly or unfairly. Think about an IRS examiner who has two identical cases, both capable of yielding either $300,000 or $500,000 for the government, depending on the level of effort the examiner puts in.

To the extent one taxpayer is perceived as "trying to pull a fast one" on the agent, and the other taxpayer is acting reasonably and perceived to be a straight up kind of person, the agent is more likely to audit the Fast Eddie-prepared return more ferociously than the other. Why? Perceptions of fairness.

Example: You're sitting on the Beach at La Semana in St. Marteen's, hot as the dickens. And thirsty. You're buddy says he is going to buy a beer at the hotel and asks if you want one. You say yes; he asks if you care how much it costs, even if it costs $15? You say no because you know it will cost a lot. The place you are staying is expensive, and you expect that they will charge a lot for their stuff. Your buddy decides not to go. Instead, a bum on a push cart comes buy and asks if you would like ice cold Heinekan's…you think yes…until the bum says, "$15." Why should that guy make so much money from me?[22]

There are many takeaways for us from the perception of fairness that consumers need to feel. First, the hourly rate at any amount will rarely be perceived as fair. Yet another strike in the hourly rate's coffin. But there are beauty marks that we can add to the hourly rate; some obvious, some not so.

I (Lou talking on this one) am a casual guy, but could never understand (and think lawyers are short sighted when it comes to trends) why our profession would want to be casual. A lawyer in a nice suit connotes value, thereby connoting a certain professionalism that carries with it the expectation that the charge for services will be great. Well groomed, manicured, well spoken; all go hand in hand. *Cf.* La Semana versus the bum example above.

Offices and how they look are another aspect of perceived value. As is the lawyer's professional affiliations, speeches, articles, reputation, other clients as references (careful to preserve confidentiality, very important for estate planners), and the substantial level of a typical client.

And, though price should never be a factor in trying to convince a client to use us – "we're cheaper" sounds bad as a marketing technique (ouch!) – letting a client know that the costs for your services will be in the range of what others at your level costs, will add to the client's perception of fairness.

f. Understanding The Consumer's Value Function: One Big Hurt Is Better Than A Series Of Small Hurts

The loss function is convex, meaning that the marginal pain felt by incremental losses is greater than the pain felt by a larger loss. Specifically, as to the losses, the pain associated with the sum of the parts is greater than the pain associated with the whole. Ponder how this applies to a bill:

[22] Example adapted from *Thaler*, *infra*.

1. Every day entry associated with a time is translated into an hourly charge, a loss.

2. A bill with 20 daily time entries results in 20 losses. "Death by a 1,000 Cuts." It is more painful to review than a bill with one entry.

Example: "Consider the case of the pricing policies of the Club Med resorts. At these vacation spots consumers pay a fixed fee for a vacation that includes meals, lodging and recreation. This plan has two advantages. First, the extra cost of including the meals and reaction in the price will look relatively small when combined with the other cost of the vacation. Second, under the alternative plan each of the small expenditures looks large by itself, and is likely to be accompanied by a substantial dose of negative transaction utility given the prices found at most resorts." Thaler, infra, at 192.

What does this mean for our billing? Flat fees are much more preferable because a consumer may get greater transaction utility out of powers of attorney than out of drafting a complicated trust, but when each are broken out, the consumer evaluates each action separately and determines whether each action translates into value equivalent to the cost.

Further, flat fees avoid the marginal pain associated with each hourly "loss."

Thaler notes, **not** in the context of law billing (interestingly):

"[C]onsumers don't like the experience of 'having the meter running'. This contributes to what has been called the 'flat rate bias' in telecommunications. Most telephone customers elect a flat rate service even though paying the call would cost them less."

g. Decouple Having to Have the Consumer Assign a 'Value' to Each Hourly Charge

A decoupling device noted by Thaler is the credit card:

"We know that credit cards facilitate spending simply by the fact that stores are willing to pay 3 % or more of their revenues to the card companies…A credit card decouples the purchase from the payment in several ways. First, it postpones the payment by a few weeks. This delay creates two distinct effects: (a) the payment is later than the purchase; (b) the payment is separate from the purchase. A second factor contributing to the attractiveness of credit card spending is that once the bill arrives, the purchase is mixed in with many others," Thaler, infra (emphasis added).

Takeaways for us: credit cards can be used for a service business. If we decide to go this route, do we pass the cost along to our clients? If we take credit cards, beware of credit card fraud, of which there is no insurance. So perhaps the trade offs are not as positive as we think.

How else can we decouple our services? To the extent we can get clients on a flat retainer, or an annual charge, and include as many services as possible, this will decouple (as will a "project" fee). As a mental exercise, can you decouple one estate planning project into 20 distinct services provided by the documents?

Transfer Tax planning
Income tax planning
Creditor protection
Funeral plans
Protecting assets if child is a spendthrift
Planning for the children's education
Protecting assets in the event of disability
Planning for a child with a disability
Providing health care alternatives
Organ donation options
Guardians for the children
Planning for long term care
Planning for liquidity at a person's passing.
Doing beneficiary designations correctly
Reallocating assets

Planning for college funding
Preserving tax-free nature of retirement planning
Assessing insurance needs
Assistance in a plan to get rid of household stuff
Preserving peace in the barnyard

h. Give of Yourself

What else can we do? Is "discounting" off the hourly rates or bill effective? We couldn't find a discussion of evidence one way or the other that would have indicated that this is effective. From a fairness perspective, clients would certainly view a discount based on a true statement –e.g., Long Standing Client Who does Not Torment Me – in a positive fashion. All consumers like discounts provided the discount is not because the product is so overpriced to begin with that the discount brings the new price to what it should have been originally.

In addition to discounts, another item that is effective, and a bit more subtle than discounting, is that "luxurious gifts can be better than cash," which according to Thaler, is "well known to those who design sales compensation schemes."

What are we doing for clients above and beyond providing them services?

i. Framing

Because people are loss adverse, ponder whether we can achieve better fees by framing fees in the positive, e.g., contingent fees if there are tax savings. For example, if our billing practices were set up so that clients merely had to pay us if they succeeded in achieving tax savings, that would be easier to bill and many of us would now be retired.

Example: In 1984, for A-B plans, we would describe to clients that if we were able to achieve a tax savings greater than without estate plan, we would be paid 20 % of the tax savings, but only at that point. Most clients would be delighted with this option. Sound bad to you? It should not. Consider the average time to payoff for a client age 65 would be less than 20 years. What's the current value in 1984 of tax savings in 2018? In 2018, the credit was, say, 1.5 million. So the savings with an A-B plan could be $750,000. 20 % of this amount would be $150,000. Ignoring the friction associated with transaction costs to collect this amount, the discounted present value in 1984 of $150,000 to be received in 2018 at a 3 % discount rate is $54,906 ($150,000/(1+.03)^34). Yes, we would all be done at this point in our practice. Not only that, but those of us who are older could have monetized our practices and sold these fee arrangements in 2018, without having to work another day. (Importantly, now we have circular 230 constraints.)

To the extent bills are detailed in their descriptions, or projects summarized in cover letters, we should not be afraid to frame in the positive versus the negative. E.g., which sounds better: "Draft of trusts to address estate tax issues;" or "Incorporation of estate tax savings trusts." Or, "Draft of generation skipping trusts" versus "structure of trusts to prevent the payment of estate tax as assets move from generation to generation."

j. I Need a New Car but Cannot Afford It

Clients that should do sophisticated estate planning, such as GRATs, QPRTs, and other advanced techniques, often hesitate to complete such projects for two primary reasons: first, the clients may feel that their own wealth cannot be jeopardized by a current transfer; or second, clients may not want to incur the costs. There are myriad other reasons, some subtle, some not so, such as not wanting kids to have immediate access to funds, not wanting to deal with one's mortality and focus on such advanced estate planning items, desiring to simplify, not complicate, one's life; or feeling good about one's wealth and defining oneself by it.

Practitioners should certainly docket a client's decision for inaction, that is, the client's decision not to proceed with a strategy. But the practitioner should also realize that inaction can be ameliorated, to an extent, by the principles discussed here with regard to billing.

Consider the following. First, for a client that is on the border as to whether to proceed with an advanced planning strategy, or even basic estate planning, a restructuring of the billing protocol can push that client to action. From the principles discussed in this article, we know that there are two basic principles that make billing more palatable to the client: (1) fairness and (2) one large loss is easier to handle than a series of smaller ones that do not add up the large one. In other words, eliminate the hourly rate in the fee quote, which satisfies neither the fairness equation, nor aggregating losses. Hourly rates are perceived as unfair, and each hourly entry inflicts pain. Further, a client does not know the extent of his potential losses with an hourly bill concept, and the client's loss aversion tells her not to go ahead. As a result, instead of the hourly quote, quote the client on a flat fee basis.

Second, break the overall estate planning project into smaller projects, and quote a fee for each project, thereby allowing the client to proceed on a landscaping sort of basis, doing the front estate planning yard this year, the side planning yard next year, and so forth.

Third, make sure you demonstrate to the client the tax and non tax value that will be obtained by the client by completing these projects (*e.g.*, dollars potentially saved, spousal protection for kids, family harmony, or philanthropic desires). As an iteration on the fairness concept, a client that perceives value to the end result of the planning will also perceive the bill as fair.

k. Premium Billing – Ethical and Regulatory Considerations in Billing Practices

Generally, the hourly rate is an accepted – albeit not appreciated by the practitioner or client –method for billing by an attorney. Interestingly, hourly rates have not been called into question under ethical rules, but fees are always subject to a reasonableness structure.

MRPC 1.5(a) provides that a lawyer's fee must be reasonable considering an enumerated list of factors.

Reg. §10.27(a) of Circular 230 provides that a practitioner may not charge an unconscionable fee.

In this section, we examine how and when a practitioner can impose a bonus or premium concept because the results obtained are so GOOD in light of expected outcomes due to the practitioner's unique solution to a difficult issue.

Example: The practitioner develops a financial model for pricing a stream of earnings on lottery winnings, to justify a liquidity discount based on lack of marketability and a synthetically arrived at comparable asset. The practitioner develops this methodology based on substantial capital investment into financial instruments over a period of months, and develops a strategy around certain Tax Court cases holding to the contrary. The practitioner indicates that the set fee for the strategy is $X, independent of the hourly effort and independent of the result achieved. The steps to achieve this are as follows:

First, the concept must be agreed to by the client at the beginning of the representation; e.g., merely asking for a bonus at the end because the result obtained was so good is not a prudent approach. The bonus should be in writing, in an engagement letter signed by the client. However, is the language in the letter sufficient to justify the premium while at the same time not sabotaging the strategy if produced in audit on examination? MRPC 1.5(c) provides that all contingent fee arrangements must be agreed to in a writing signed by the client.

Second, the objective must be defined, but more importantly, what unique talent or recommendation is the practitioner bringing to the equation that justifies the bonus fee.

Example: Structuring a 5 year GRAT transaction, for a 75 year old, with a 5 year SCIN hedge, structured along the same economic lines, and assuming reasonable rate of return objectives (are there any these days?) for the GRAT, can result in a risk free estate tax arbitrage. Structuring a SCIN, taking into account both section 2036 and income tax results, is not generic and can be quite difficult. Achieving the arbitrage, and structuring the actuarial risk premium internally, require unique practitioner skills. This kind of transaction is one justifying a bonus fee.

Third, prohibitions in Circular 230 must be avoided.

Fourth, the client needs to be satisfied with the arrangement. Creative structuring of the payment of the bill is one way to achieve client satisfaction. E.g., with the $Z dollar bonus, can it be structured so that the client's children pay it at the time of the filing of the estate tax return? Or from the property transferred during life if the strategy relates to a lifetime transfer?

The above constraints and steps are important, and to the practitioner engaging in bonus billing for the first time, somewhat daunting. On the other hand, as practitioners we do not shy away from engagements just because they are difficult. Likewise, we should provide the same respect to the business side of our practices, and not shy away from the premium billing concept merely because it is difficult to implement.

The premise and answer must remain the same: if a practitioner is providing a unique strategy to solve a difficult legal equation, that practitioner should be rewarded on more than an hourly basis. Keep in mind that the hourly billing method assumes excellent work for every minute committed to a problem. It does not guarantee success, nor does it pay for work that is beyond excellence – that is, the unique solution to a difficult quandary.

Happiness Axiom 11: For Preferable Billing The Best Practice Summation

1. **Discuss fees during the initial meeting**
2. **Time that discussion for the tail end of the meeting**
3. **Determine a fee quote at the first meeting**
4. **Deliver fee quote in a thought out manner and make sure you believe in and deliver the quote in a way conveying fairness**
5. **Have client provide down payment or retainer before engagement begins**
6. **Understand that Fairness matters to clients – clients want to pay for services that they perceive as Fair**
7. **Many estate planning projects will be perceived as Fair if quoted as a Flat Fee**
8. **To demonstrate Fairness, make sure that all the component parts, and accomplishments, with the estate planning project are demonstrated throughout the project; also, deliver excellent service; also, de-cliché clichés**
9. **Divide estate planning BIG PROJECT into sub projects so that value and accomplishments can be more easily understood**
10. **Value added billing can be considered but must be addressed in the engagement letter (see below)**
11. **Send bills frequently and timely**
12. **On a bill, do not exceed a quoted fee unless explained and discussed with the client during the project**
13. **Connote value in the bill itself and descriptions; spend time with each individual bill**
14. **Make sure to consider the format of the bill that will most easily connote value and which will avoid the Client's Loss Aversion function**
15. **Decouple services and bill, when possible**
16. **Discounting is appreciated by clients, in many situations**
17. **Demonstrate client care throughout the process by prompt service, attention, and non work communications**
18. **Know when you are proposing unique solutions to an estate planning or transfer tax issue that justifies a bonus or premium arrangement**
19. **Consider for unique solutions to difficult projects structuring the engagement as a combination hourly, accompanied with a bonus payment because of the uniqueness of the solution**
20. **Make sure the bonus avoids Circular 230 prohibitions**
21. **Determine how to properly discuss and market the bonus structure to a client**

VI. SOMETIMES DELAY IS A GOOD THING

Take a breath, slow down life, and speed kills. Sometimes.

One of the most useful features in digital communications, one in which the authors use for at least 25% of their emails, is the Delay Delivery Option.

Example: I happen to be on the email system and a client asks me a real interesting question about whether the Credit Shelter Trust can be a grantor trust. I like the question and the mental challenge of answering it. I type an answer; it takes me 15 minutes. The client asked me the question at 1 pm; I am ready to send at 1:15 pm. Do I really want to hit send?

Example: I don't want to bug my associates or colleagues over the weekend, but I have a lot of good thought and emails I draft and want to send. Delay deliver on Saturday to arrive on Monday or later next week.

Example: I have an email that I need to work on three days from now. Send it to myself using Delay Delivery to arrive 3 days when I am ready to work on.

Example: I want to slow down the colloquy that goes with immediate responses. You can answer immediately, but your immediate response can be slowed down thereby slowing down the responses.

<u>Happiness Axiom 12</u>: Learn and use the Delay Delivery option.

VII. <u>TO BE OR NOT TO BE A GRANTOR TRUST</u>

The most interesting uses of grantor trusts in today's environment continues to be as a positive means of estate tax reduction, or as a means of exchanging assets with a grantor trust without triggering income tax.

In many situations it is advantageous to draft a trust so that the trust has one or more of the characteristics that create a grantor trust. A trust designed in this fashion is often referred to as a "defective grantor trust."

Specifically, the grantor must be okay with the concept that he or she will pay income tax on assets that may or may not be available for use by the grantor. Planners should pay attention to this concern — even if it is flawed on a cash flow basis — because it is perceived as important to most grantors.

For example, a grantor who has a $30 million taxable estate still may not feel that he or she is able to bear the "burden" of income taxes on income not received by the grantor. This conclusion, if not logically grounded on fact, is nevertheless real to the client, and planners need to plan for this reaction. A discussion of cash flow, perhaps accompanied by spreadsheet analysis as to cash flow (to demonstrate the real impact of the burden of paying the income taxes without the accompanying cash flow), may be enough to convince otherwise reluctant clients that the grantor trust is a viable estate tax reduction strategy.

a. <u>Unified credit, applicable credit amount, gifting trust</u>

In a straight gifting situation in which the grantor gifts property equal to or in excess of the gift tax exemption equivalent ($11,180,000 in 2018), a gift to a grantor trust is preferable to a gift outright. If the gift is of appreciated assets, the donees will realize the capital gain in the future when the assets are sold. However, if the gift is to a grantor trust in which the grantor retains no interest other than that necessary to make it a grantor trust, then future capital gains will be paid by the grantor instead of the trust. In addition, ordinary income and other taxable income incurred annually can be allocable to the grantor of the trust. This has the effect of increasing the estate-tax-free property in the hands of the donees while decreasing the estate-includible property in the hands of the donor.

b. <u>Grantor retained annuity trusts (GRATs)</u>

GRATs are grantor trusts masquerading as pure transfer tax strategies. Since the GRAT permits payment of both income and trust principal to satisfy the annuity payments the grantor has retained, the GRAT will be treated as a grantor trust for income tax purposes. This means the grantor is taxed on income and realized gains on trust assets even if these amounts may be greater than the trust's annuity payments. This further enhances this tool's effectiveness as a family wealth-shifting and estate-tax-saving device. In essence, the grantor is effectively allowed to make tax-free gifts of the income taxes that are attributable to assets backing the remainder beneficiary's interest in the trust. Consider establishing the distribution to the remainder beneficiaries as a distribution to grantor trusts for their benefit.

c. <u>Sale to a grantor trust</u>

The sale is structured by the owner of the asset, which may be a business interest. He or she initially establishes a trust that is effective as a grantor trust for income tax purposes but that is not controlled by the business owner or otherwise subject to an estate tax taint. The heart of the transaction is a sale between the grantor and a third party — *e.g.,* the grantor's family irrevocable trust. This trust will benefit the grantor's beneficiaries. The adult children are often designated as the original trustees of the trust. As a grantor trust for income tax purposes, there will be no recognition of gain on the sale of the asset to the trust. Thus, the difference between the grantor's basis in the asset and the sales price to the trust will not currently be taxed as a capital gain. Further, the grantor will pay income taxes on the income received by the trust because of the assets the trust owns. In this regard, it is as if for income tax purposes the grantor still owns the assets sold to the trust. Importantly, the payment by the grantor of those taxes will not, under current law, constitute a gift to the trust.

d. <u>Grantor powers</u>

Consider then making irrevocable trusts grantor trusts, with the ability to in effect turn off grantor trust status. In grantor trust planning, consider including the power to substitute. The power to substitute assets, a section 675 (4) grantor trust power, becomes especially important as the estate tax exemption increases and income tax planning becomes more relevant for step up in basis purposes. In many settings, a grantor of a grantor trust may want to substitute high basis assets for low basis assets in a grantor trust, and the substitution power is one way this can be achieved (a purchase agreement is another).

Another grantor trust power that is currently used by practitioners is the power in the trustee or other party (who is a non-adverse party) to add charitable beneficiaries. Consider the value of having the power to name charitable beneficiaries in grantor irrevocable trusts. Having the power to name charitable beneficiaries allows for (1) shifts in property from private to non private to reduce amounts going to beneficiaries[23] and (2) disincentives to beneficiaries to challenge trustee actions. Under section 674(b)(5), the ability of a non-adverse party to expand the class of beneficiaries is a grantor trust power.

We are familiar with disclaiming or renouncing bad powers to turn off grantor trust status; but we may need to have the ability to turn on that status too.

Two possibilities: state decanting statutes, like Illinois, may create the possibility of decanting from a non grantor trust to a grantor trust.

Alternatively, consider having a trust protector with the ability to add grantor trust type powers (power of substitution for example). Query, though, whether the rights of a trust protector are sufficient to constitute a grantor trust kind of power in and of themselves?

VIII. I SELECT DOOR NUMBER 3. CHANGING TRUST SITUS TO MORE FAVORABLE JURISDICTIONS FOR STATE INCOME TAX AND CREDITOR PROTECTION PURPOSES.

This seems to be an easy one, but we should emphasize the importance of this to our clients. Two items: we want to be able to change situs to achieve more favorable administration protection under that state's laws.

And we want to be able to change situs and trustees to take income taxation out of one state and put it in another.

For example, if California imposes trust taxation based, *inter alia*, on trustee residency, we would want our California trustee to have the ability to appoint new, out-of-state, trustees. Sample provisions:

"a. Controlling Law

The validity and effect of each trust and the construction of this instrument and of each trust shall be determined in accordance with the laws of Illinois. The original situs and original place of administration of each trust shall also be Illinois, but the situs and place of administration of any trust may be transferred at any time to any place the trustee determines to be for the best interests of the trust.

b. Individual Trustee Succession

Each acting individual trustee, or the individual trustees acting unanimously if more than one individual trustee is then acting, unless limited in the instrument in which the trustee was designated), may, by signed instrument filed with the trust records, (a) designate one or more individuals or qualified corporations to act with or to succeed the trustee consecutively or concurrently, in any stated combination, and on any stated contingency, and (b) amend or revoke the designation before the designated trustee begins to act. In the event of any conflict or inconsistency between a designation filed pursuant to this paragraph and a designation filed by my spouse pursuant to paragraph 10.4 hereinbelow, the designation filed by my spouse pursuant to paragraph 10.4 hereinbelow shall prevail, and the designation filed pursuant to this paragraph shall lapse to the extent necessary to eliminate the conflict or inconsistency."

Happiness Axiom 13: Have both change of situs and trustee designation provisions in the documents, and discuss the BENEFITS to clients, at a follow up estate planning meeting.

[23] "Gee, my kids really don't need all that money."

IX. "I AM A CHILD, I LAST AWHILE," NEIL YOUNG, CIRCA 1968.

The definition of "child" no longer lasts awhile. Genetic manipulation and choice will occur. Birth mothers, perhaps laboratory mothers, may become more prevalent. We will have to tweak what we mean by "child." We may want to expand the definition of "child."

The following provision, regarded as "state of the art" about 10 years ago, is already outdated. Can you spot the anachronisms?[24]

"1.1 Child and Descendant.

(a) *Child. A "child" of a person means only: (1) a child born to or conceived by the natural mother of the child during the lawful marriage or civil union of the person to the natural mother, unless paternity is rebutted by clear and convincing evidence; (2) a child born to a gestational surrogate engaged by that person or, if the person is then lawfully married or a party to a civil union, engaged by that person's spouse or partner by civil union; (3) a child lawfully adopted by the person prior to that child's attaining age 18; and (4) a natural child of the person, if the person's parental rights have not been terminated and either (i) the person is female or (ii) the person is male and the trustee has been provided legally sufficient evidence of the person's paternity or the person has acknowledged paternity in a signed writing.*

(b) *Descendant. A child of a person is a "descendant" of that person and of all ancestors of that person. A person's descendants include all such descendants whenever born. Except when distribution or allocation is directed to descendants per stirpes, the word "descendants" includes descendants of every degree whether or not a parent or more remote ancestor of a descendant is also living.*

(c) *Child in Gestation. A child in gestation on the date any allocation or distribution is to be made shall be deemed to be living on that date if the child is subsequently born alive and lives for at least 90 days."*

X. THERE ARE ALWAYS NEW WORLDS: ALLOW BENEFICIARIES TO MOVE ABROAD

The world is becoming a much smaller place. Will our clients' descendants continue to be U.S. citizens? Is their security in place? What kind of food considerations will be more relevant in the future? All things considered, we in the United States are doing quite well, but what will the United States be like in 50 years? Consider distribution of funds to allow beneficiaries to move to jurisdictions outside of the United States or to allow distributions for security measures for beneficiaries.

Happiness Axiom 14: Trustee guidance could consider distribution of funds to allow beneficiaries to move to jurisdictions outside of the United States, to allow distributions for security measures for beneficiaries, and also to consider distributions needed to modify food/food production. Can we think of any other? I suspect yes.

Happiness Axiom 15: Consider including in the definition of "support" expenses necessary to provide physical security measures, as well as allowing one to domicile outside of the United States.

XI. SIMPLIFIED SOPHISTICATION VERSUS COMPLICATED UNINTELLIGIBILITY

With rapidly evolving tax and state laws, and the precision needed to accurately create an estate plan and convey our clients' goals, drafting has become even more complex and sophisticated. The *status quo* bias provides that individuals irrationally retain current practices; that is, we have a hard time changing.

That bias is especially true in drafting. Rather than trying to simplify concepts, each time there is a law or tax change, our documents often become more complicated.

We may want to take a step back and consider simplifying our drafting, when the situation allows for it. An example are the tax formula and language we have used in our documents since 1982.

[24] E.g., "maternal", "paternal", "natural child", "females", and so on. Are these terms clear enough anymore?

The two trusts, the three trusts, the multi trust solution for tax planning in Wills (living trusts) for spouses may be correct, but is no longer need to be the default drafting choice. With the credit bouncing around from $1,000,000 to $11,180,000, indexed, who knows what tomorrow will bring. And states have, or don't have, inheritance taxes.

Instead of complicated multi trust drafting, as has been done since 1982, the current environment militates in favor of the single-fund QTIP- eligible trust. It allows a practitioner to achieve tax planning for their client, as well as the following flexibilities:

1. For the portability decision to be decided at the surviving spouse's passing. Estates may want to include 100 percent of the property in the surviving spouse's estate to achieve a step-up in income tax basis. The goal will be either to make a partial QTIP election to create a credit shelter trust out of the non-elected portion (the $11.180 million estate tax exclusion amount) or a full QTIP election to put all the property in the surviving spouse's estate for basis step-up reasons.

2. For state inheritance tax to be avoidable at the first spouse's passing if that state has a QTIP marital deduction, even if that state has a credit that's decoupled from the federal credit.

3. Ease in drafting.[25]

4. Ease in client understanding.

5. Ease in administration until multiple trusts are created (post-mortem).

<u>Happiness Axiom 16</u>: **Recognize the status quo bias, but begin introducing the concept of simplification into your drafting thought process. A place to begin is to replace complicated marital deduction formula with a single fund marital trust, drafted to be QTIP eligible.** [26]

XII. <u>MANAGE CLIENT EXPECTATIONS</u>

Don't schedule an "emergency meeting" if it is not a real emergency. Stick to your scheduling discipline. The meeting issue is similar to the delay delivery option for email – don't create a 24-7 expectation of your availability.

<u>Example</u>: I met with clients over a holiday weekend shortly after their father's death because one of them lived out of town and would be in Birmingham only over the holiday weekend. They were hiring me to modify a trust under dad's will (he had been dead 3 days). When I did not have a draft out after 10 days, they fired me for being slow. I believe I set the stage for their expectation of "immediate gratification" by meeting over Thanksgiving weekend.

Give realistic dates for accomplishing work, whether it is drafting, research, an estate planning proposal, whatever. Stay on time and if you are going to be late, let the client know.

Tell the client the truth. Do Not Ever say – "I'm not sure if I sent you this email" when you and the client know if you did or did not.

XIII. <u>BREAK MULTIPLE PROJECTS UP INTO SMALLER COMPONENT PROJECTS</u>

For multiple client projects (e.g., forming 10 LLCs, doing estate planning documents, doing buy-sell agreements, etc.), break them up into smaller components – partly for work flow management, partly for client's ability to review and process, partly for billing.

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[25] For those of us who enjoy drafting, we know what the 3 trust plan looks like, with a state exempt, a federal exempt, and a federal QTIP trust all being in place. Throw in there a mismatch of remaining GST exemption from the unified credit, and we have a couple more trusts being called for. The client does not have a chance of recognizing the planning; and the drafter has a strong chance of, ummm, poor drafting if he or she hasn't done a lot of these. All these problems are eliminated with a single fund trust.

[26] If erudition requires greater sophistication, then one can add a so-called *Clayton*-flip onto the single fund marital trust.

XIV. TO GIVE CELL PHONE # OR NOT TO GIVE CELL PHONE #?

General rule for me – I do NOT give clients my cell phone # (partly because I don't want to be "on call" 24/7; partly because my cell phone # is super easy to remember – it is one of the few things my dad remembered after he developed dementia).

I also understand that there is an app for your phone that can make it look like you are calling from your office and therefore would not disclose your cell #.

If I break this rule, I make sure the client knows that he/she is special – that I usually do not do so and that I trust he/she will use sparingly. For the most part, clients have respected my rule/have not abused this privilege.

Happiness Axiom 17: Clients want to know what they can expect. If you intentionally or unintentionally create unreasonable expectations, they will be unhappy when you fail to measure up. Do the client and yourself a favor by creating a *reasonable* framework for your interaction with the client and your generation of the work for the client.

XV. FACILITATING FAMILY MEETINGS FOR YOUNGER GENERATIONS

Client's Goals
To communicate family values.
To teach stewardship.
To introduce the topic of prenuptial agreements.
To educate on the use of trusts.
To instruct on various tax considerations in estate planning.
To encourage estate planning as soon as a child reaches adulthood.
To disclose the senior generation's estate plan to avoid "surprises" when Mom and Dad die.
To promote philanthropy.

Your Goals
To meet the next generation and if no conflict, to become their lawyer.
To become the client's "consigliere."
To assist the client in "raising" his/her children to not be trust fund babies.
How to Accomplish?
Have pre-meetings with client to review proposed agenda and to get buy-in on what will be discussed/disclosed.
Decide, with client, if you (the lawyer) should lead or if you should bring in an outside expert.
Decide whether the meeting should be at your office, the client's office or offsite. Your office may be intimidating. Client's office likely will chill open discussion. Offsite could be best option.
Decide if in-laws are in or out of meeting.
Decide if other advisors (CPA, investment advisor, etc.) should be included in the meeting or in part of the meeting. For example, you might combine an investment review with part of the family meeting.

Happiness Axiom 19: The toughest decision a client faces in estate planning is who to name as guardian to raise the children if both parents die while the children are minors. Family meetings are the lifetime corollary to the guardian appointment – this is the way the client can "raise" the children in the adult world. As a result, facilitating family meetings can be one of the most important things you can do for the client. And, if successful, you can pick up another generation of clients.

XVI. WORKING WITH FOCUS

Set aside a day each week to work "away" (at home, in a conference room, etc.). Leave your phone and email turned off so that you can focus for long periods of time on getting the heavy lifting done. Be disciplined about protecting this day. Get your staff on board so that they also are disciplined about it.

Happiness Axiom 20: Finishing projects requires focus. Finishing projects allows you to feel a sense of accomplishment (and avoids feeling negatively about yourself when you do not finish). Finishing projects allows you to bill the client and get paid. Working with focus is a technique that will help you finish!

XVII. BILL – EARLY AND OFTEN

Billing clients is not fun. Billing clients takes time and fortitude. On the 1st day of the year, calendar time each month, early in the month, to start and finish client billing. Also, send reminder statements for past due amounts EVERY month. Be consistent. **Fairness matters and will be discussed in detail at the presentation.**

Happiness Axiom 21: Billing is like exercise. It must be done and leads to good results.

XVIII. LIFE IS SHORT - FIRE BAD CLIENTS

We are not indentured servants. Put another way, we do NOT have to continue representing clients if we do not want to do so. We can fire clients who complain about our bills, clients who complain about our timetable, and clients who are rude to our staff. *In a nutshell, we can fire clients we just don't like (bless their hearts).* These materials address firing clients in the planning arena. Firing clients in a litigation context presents a different approach/rule.

ABA Model Rule 1.16(b) is the ethical rule governing the voluntary termination of the attorney/client relationship.

Build exit language into the engagement letter.

Sample language: No Free Lunch. *"Payment is due upon receipt of our invoice. If you fail to pay an outstanding invoice within ___ days, we may withdraw from the representation with written notice to you."*

Sample language: It's Not You, It's Me. *"If at any time we desire to withdraw from this engagement, we may do so with written notice to you."*

Even if your engagement letter does not address termination, a lawyer should give written notice of disengagement, preferably after you have had a conversation with the client.

The notice should provide the client sufficient time to engage a new lawyer. For example, you should not fire a client on December 15, 2025 just before the exemption will revert to half its level on 1/1/26 because it is unlikely the client would have sufficient time to engage a new lawyer. Likewise, you should not fire a client who is on hospice care and needs his or her estate planning updated.

The notice should include a refund of any fees paid in advance.

The notice should identify any filing deadlines (e.g., gift tax return; estate tax return) and should disclose the status of any work in process.

The notice should recommend that the client engage a new lawyer.

The notice should include the delivery of the client's file (and you should retain an electronic copy of the file).

Happiness Axiom 22: Life is short. What we do is hard. Let's enjoy it more by working only with the clients with whom we choose to work.

XIX. FOR NEAR DEATH PLANNING

If a client is near death and has a grantor trust in place with the power to substitute assets, consider the following:

To get a step-up in appreciated assets inside the trust. Substitute cash or other high basis assets held outside the trust for low basis assets inside the trust. At death, the estate will obtain a step-up in basis for the low basis asset.

At death, the basis for assets is not always stepped up – SHOCKING TO THINK. If the client owns an asset that has gone down in value, then if the client holds that asset at death, the basis will be stepped down. Consider swapping that asset for assets held inside the trust. The assets inside the trust will retain their original basis and the loss will be preserved.

To transfer life insurance and avoid the 3 year rule. As you know, if a client gratuitously transfers life insurance and die within 3 years, the proceeds of the life insurance will be included the client's estate under IRC Section 2035. However, if the client transfers the life insurance for full and adequate consideration, Section 2035 does not apply so no inclusion. Additionally, if the transfer is to a grantor trust, the transfer for value rules should not apply. Consequently, the grantor could swap the policy for assets of an equivalent value and get the life insurance proceeds out of the estate even if death occurs within 3 years.

Caution: to make the above techniques work *without* adverse transfer tax consequences, it is imperative that the swap is for assets of *equivalent value*. For this reason, the trustee should take appropriate steps, including getting appraisals, to make sure the swap is Even Steven.

Happiness Axiom 23: We create irrevocable trusts as a way to shift appreciation down to lower generations and to provide an extra gift to the lower generation – the payment of income tax by the grantor. However, we sacrifice the step-up in basis by doing so. Using the swap power as the "defect" gives flexibility to do near death planning for cost basis.

XX. INCLUDE CHARITIES AS PERMISSIBLE APPOINTEES IN LIMITED POWERS OF APPOINTMENT

This topic gets to the "How Much is Enough" question. Clients frequently are worried about making children, grandchildren, great-grandchildren and more remote descendants too wealthy. Only the client can answer the "how much is enough" question but with the use of custom drafted powers of appointment, the drafter can assist the client in giving future generations direction and options.

When drafting limited powers of appointment, resist the temptation to take the easy way out and limit permissible appointees to descendants of the grantor. Rather, include charities as permissible appointees with language that expresses the grantor's goals.

Sample language:

a. Upon the death of Grantor's child, the balance of the Child's Trust shall be transferred and paid over to such charities and to such of Grantor's descendants (permissive beneficiaries collectively referred to as the "child's Beneficiaries"), in such manner and amounts as Grantor's child may have directed in his or her Last Will and Testament, making specific reference to this testamentary limited power of appointment herein granted.

(i) *In exercising this limited power of appointment, Grantor's child may divide the Trust among the child's Beneficiaries upon such conditions and estates, in such manner (in trust or otherwise), with such powers, in such amounts or proportions, at such time or times (but not beyond the period permitted by any applicable rule of law relating to perpetuities), and subject to such terms and conditions as Grantor's child may specify in his or her Last Will and Testament.*

(ii) *In determining whether this testamentary limited power of appointment has been exercised, the Trustee may rely on a Will admitted to probate in any jurisdiction as the Last Will of Grantor's child, or may assume he or she left no Last Will in the absence of actual knowledge of one within six months after Grantor's child's death.*

(iii) *In exercising this limited power of appointment, Grantor requests that Grantor's child consider whether it is in the best interest of Grantor's descendants to limit the amount of wealth passing to such descendants and whether Grantor would prefer that Grantor's child exercise this limited power of appointment in favor of charities, such as **the University of Alabama,** that Grantor favored during her life.*

Happiness Axiom 24: Effective planning incorporates as many techniques as possible to provide flexibility. By including charities as permissible appointees in limited powers of appointment, the client has the opportunity to say to future generations that transferring wealth to charity instead of family might be the best decision.