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PRESENTS...

A COURSE by Ted PERKINS
JD, LL.M., CPA

Estate Planning for the Blended Family



CPE CREDIT - 2.0 Hours

FIELD OF STUDY - Taxation - Interactive Self Study

PROGRAM LEVEL - Basic

PREREQUISITE - None

ADVANCE PREPARATION REQUIRED - None



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Course Summary

After completing this Course, the Student will have achieved an understanding of the issues and considerations involved in planning the estate of a blended family, that is a family in which one or both of the spouses has children from a previous marriage. Potential difficulties are outlined along with suggestions on how to overcome them.

Your Instructor

Edward L. Perkins, BA, JD, LLM (TAX), CPA

Course Content

The Practice Units are as follows:

UNIT ONE - Introduction

UNIT TWO - Ethical Concerns

UNIT THREE - Determining the Dispositional Plan of Each Spouse-Client

UNIT FOUR - Avoiding Contests and Will Conflicts

UNIT FIVE - "Locking-In" the Dispositional Plan of Each Spouse-Client

UNIT SIX – Miscellaneous Issues

Learning Objective

This Course consists of Six Practice Units and several Interactive Exercises. You must complete the Interactive Exercises before going on to the next Practice Unit. The Exercises are not an examination to be graded, but rather are designed to allow you to both test your understanding of the material and to give you interactive feedback as a learning tool as you progress through the Course.

Obtaining Course Credit

At the end of Unit Six, after you will have completed the Course Material, you will be given an opportunity to take the Quizzer. If your score is less than 70%, you may retake the Quizzer as many times as you like until you answer at least 70% of the Questions correctly. In order to receive your Certificate of Completion and your Credit, you must complete the Quizzer and answer 70% of the Questions correctly.

<p>Estate Planning for the Blended Family</p>
<p>Unit One Introduction</p>


A. Definition.

Each of the families in the Case Studies above is a “blended family”, i.e., one in which: (i) one or both of the spouses have previously been married; (ii) one or both have children from that previous marriage, and (iii) in many cases, one in which one or both spouses may bring a significant net worth to the marriage.

What is a Blended Family?

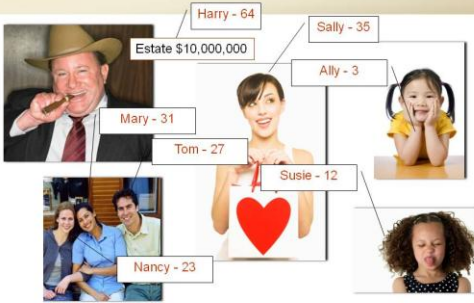
A “blended family” is a family :

- 1 - Where one or both of the spouses have previously been married,
- 2 - One or both have children from that previous marriage, and
- 3 - In many cases, one in which one or both spouses may bring a significant net worth to the marriage.



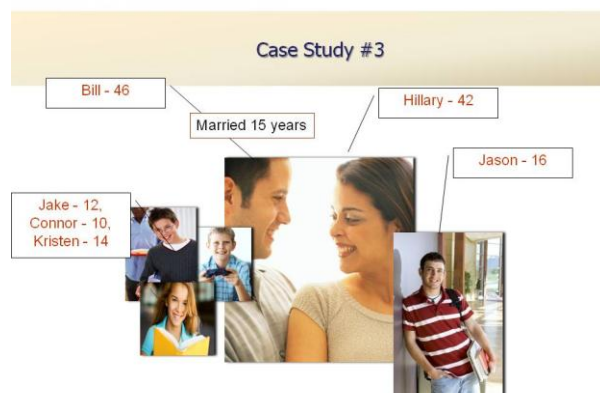
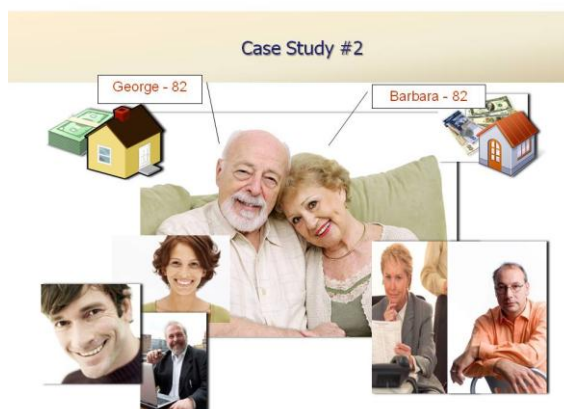
B. Case Studies:

Case Study #1



Case Study No. 1 - Harry and Sally have been married for five years each for the second time. Harry is 64, and has three children by his prior marriage, ages 31, 27, and 23. Sally is 35, and has a child by her prior marriage who is 12. Harry and Sally have one child of their own, age 3. At the time of their marriage Harry owned assets worth in excess of \$10,000,000, including a family business, in which two of his children currently work; Sally had a checking account. Harry’s children don’t particularly like Sally.

Case Study No. 2 - George is a widower and Barbara is a widow. They are each 82 years old. They met at a seniors mixer, fell in love, and they are planning to get married. They each have children in their fifties and early sixties, and they each have a number of grandchildren. They each also own their own homes. They each have significant assets of their own to bring to the marriage.

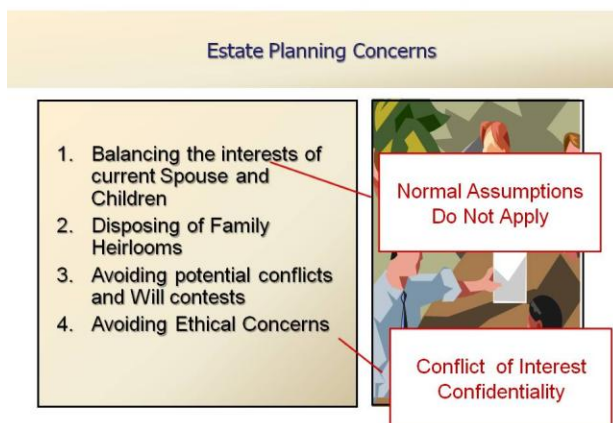


Case Study No. 3 - Bill is 54 years old, and has been married to Hillary, who is 52, for twenty years. During that marriage they have raised Hillary's son, from her prior marriage as their own. The child, who is now 22, was two when Bill and Hillary were first married. Because the natural father of Hillary's son is still alive Bill has never formally adopted the child. In addition Bill and Hillary have three children of their own, ages 18, 14, and 12.

C. Estate Planning Concerns.

There are a number of concerns which may arise in the course of estate planning for blended families.

1. In many cases a client-spouse will be concerned with balancing the desire to provide for their current spouse with the need to protect the interest of the children of a prior marriage.
2. One or both of the client-spouses may bring particular assets to the marriage which they wish to deal with as outside the marital estate;



perhaps wishing to pass those assets in whole or in part to the children of the prior marriage. This might include a family owned business or simply personal items which are regarded as “family heirlooms”.

3. Further, the estate planner should be aware of the potential for conflict between the surviving members of both families once either one or both of the client-spouses have passed away, and the possibility of a will contest.
4. The estate planner should also be aware of the potential ethical issues which may affect his or her representation of the blended family during the estate planning process.

D. Estate Planning Steps.

In planning the estate of a blended family the estate planner’s tasks should include:

1. First, determine how husband and wife wish to dispose of their assets, both on the death of the first of the couple to die and then upon the death of the survivor; and



The infographic is titled "Estate Planning Steps" and features a small portrait of a man in a suit. It lists three steps in red text:

- First, determine the *dispositional plan***
- Second, take steps to insure that the plan, once set in place, *cannot be altered*; and**
- Third, take steps to insure that the potential for *conflict and contest* are *reduced* and, hopefully, avoided.**

Accompanying the text are three photographs: an elderly couple embracing, a man in a suit speaking, and a woman holding a red heart.

2. Second, ensure that that plan, once set in place, is not altered significantly by the survivor or his or her family after the death of the first of the couple to pass away; and

3. Third, take steps to insure that the potential for conflict and contest are reduced and, hopefully, avoided.

Estate Planning for the Blended Family
Unit Two Ethical Concerns

A. In General.

As with any estate planning engagement when an attorney represents both the husband and wife there are ethical concerns which should be addressed.

Ethical Concerns



1. Conflict of Interest
2. Confidentiality

1. In the case of estate planning for a blended family, these concerns are even more of an issue. This is because of the desire of both husband and wife to provide for each other and also for the children from prior marriages I – two interests which may be in conflict.

2. Two areas of particular concern to the estate planner are: (i) the potential for a conflict of interest, and (ii) the need to maintain confidentiality.

B. Conflicts of Interest.

1. Rule 1.7 of the Pennsylvania Rules of Professional Conduct of states:

“(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

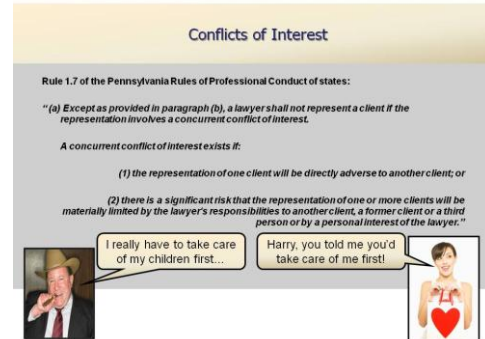
(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law; and

(3) the representation does not involve the assertion by one client of a claim against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.”

2. Under Rule 1.7 of the Pennsylvania Rules of Professional Conduct, an attorney may not represent a client if such representation will be directly adverse to another client.



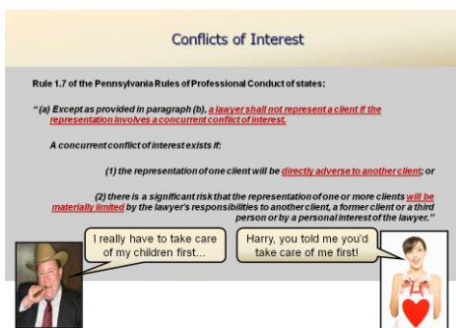
3. If there is a conflict, an attorney may represent both clients if the attorney believes that they can competently represent both parties, there is no assertion of a claim by one of the parties against the other, and they receive informed consent from each client.

4. Comment [27] to Model Rule 1.7 notes:

“Conflict questions may arise in estate planning and estate administration. A lawyer may be called upon to prepare wills for several family members, such as husband and wife, and, depending upon the circumstances, a conflict of interest may arise.”

5. The reasoning of a 1996 Montana ethics opinion takes what may be the most practical and reasonable position regarding the representation of a husband and wife:

“The marital relationship itself is not in most cases adversarial in nature and no conflict inherently exists in representing both parties. Generally speaking, the fact that the clients are married does not materially limit the responsibilities to either client. Therefore, it is not necessary to advise a couple of the possibility of a potential conflict unless there is evidence suggesting such advisement is appropriate.”



The first paragraph of Mon. Op. 960731 states:

“Rule 1.7 does not apply if there is no evidence of conflict between the spouses in the estate planning process. The status of marriage alone is not sufficient to create a substantial potential for a material limitation upon the lawyer's representation of either spouse. If Rule 1.7(b) were applicable merely because the two clients were married to each other, no lawyer could accept representation of the couple without a waiver.”

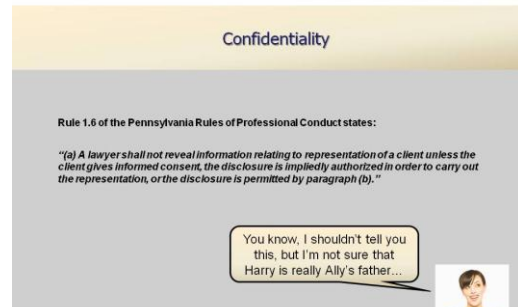
6. A 1995 Florida ethics opinion also indicates that a lawyer who is asked to represent a husband and wife in estate planning matters need not, at the initial meeting, discuss potential conflicts of interest. While a husband and wife may have somewhat different estate planning objectives, the differences do not necessarily involve conflicts that would require them to be separately represented. However, if there are differences between spouses (or other joint clients) regarding the ownership of particular assets, or the nature of their respective interests under wills or trusts, the same lawyer should not represent both.

C. Confidentiality.

1. Rule 1.6 of the Pennsylvania Rules of Professional Conduct states:

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation, or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:



(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate, or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or a civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or,

(6) to comply with other law or a court order.

2. Rule 1.6 of the Pennsylvania Rules of Professional Conduct requires that attorneys maintain confidentiality regarding the information provided to them by clients.
 - a. Absent the informed consent of a client, any such information may not be disclosed to third parties.
 - b. Ethical concerns may arise when one spouse discloses information that may affect the estate plan of the other spouse.
 - c. If the attorney has obtained knowledge that affects the ability to properly represent the one spouse–client, yet it is impossible to impart that knowledge to the other spouse-client because of the duty to maintain the confidence reposed by the first, the attorney may have to withdraw.
 - d. Above all, the attorney may not take action that will in any way be to the detriment of the other spouse-client.
 - e. Rule 1.4 of the PRPC imposes a duty upon the attorney to keep a client reasonably informed about the status of a matter and explain the matter to a client sufficiently to permit the client to make informed decisions. In the case of dual representation situation, this

Confidentiality

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You know, I shouldn't tell you this, but I'm not sure that Harry is really Ally's father...



duty must be weighed along with the duty of confidentiality. The lawyer should explain to the prospective clients the lawyer's duty of confidentiality, which generally shields confidences from disclosure to third parties.

f. The lawyer should also explain that the clients can authorize the lawyer to communicate all material information to each client, including disclosures made by the other client, and should seek such authority.

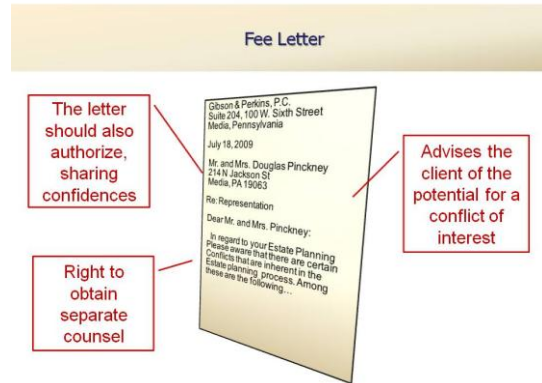
- g. Without this authority a lawyer may be unable to protect the interests of the noncommunicating client should the communicating client give the lawyer confidential information that is, or could be, detrimental to the noncommunicator's interests.

h. In order to be able to advise each client adequately, the lawyer should be able to discuss openly all relevant considerations with each client.

D. Use of a Representation Letter.

1. An attorney may address the problems of conflict of interest and maintaining confidentiality by having the clients execute a Representation Letter prior to the commencement of estate planning engagement.

2. The Representation Letter should include a provision that advises the client of the potential for a conflict of interest in the estate planning process and affirmatively waives such conflict. The letter should also authorize, but not require, sharing confidences that may affect the estate plan of the other spouse.



3. The Representation Letter should also make the parties aware that each spouse may obtain separate counsel.

Estate Planning for the Blended Family
Unit Three Determining the Dispositional Plan

A. Concerns to Address.

The manner in which the client-spouses wish to dispose of their property at death will generally involve consideration of some or all of the following concerns:

1. Do either one or both of the client-spouses have assets they wish to be reserved for the children of the “first family”? Are there any family heirlooms which deserve special consideration?
2. What understanding have the client-spouses reached in regard to:

- a. The share of the survivor in the assets of the first to die;
- b. The relative shares of the children of the prior marriages and of the current marriage in each client-spouse’s estate.

Concerns to Address

1. Do either one or both of the client-spouses have assets they wish to be reserved for the children of the “first family”?
2. Are there any “family heirlooms” which deserve special consideration?
3. What understanding have the client-spouses reached in regard to:
 - > The share of the survivor in the assets (both probate and non-probate) in the assets of the first to die
 - > The relative shares of the children of the prior marriages and of the current marriage in each client-spouse’s estate.

B. Effect of Outside Concerns.

In discussing these objectives it should be determined how they might be affected by:

1. Any property settlement agreement with a former spouse;

Potential Impact

1. Property settlement with former spouse
2. Any Court or Settlement Agreement imposing support obligations
3. Pre or Post Nuptial Agreement

2. Any court or settlement agreement imposed child support obligations;
3. A pre- or post- nuptial agreement between the client-spouses themselves.

C. Estate Planning Steps.

In planning the estate of a blended family the estate planner's tasks should include:

Estate Planning Steps

- *Create the Plan*
- *Then "lock it in"*
- *Take steps to avoid conflict*

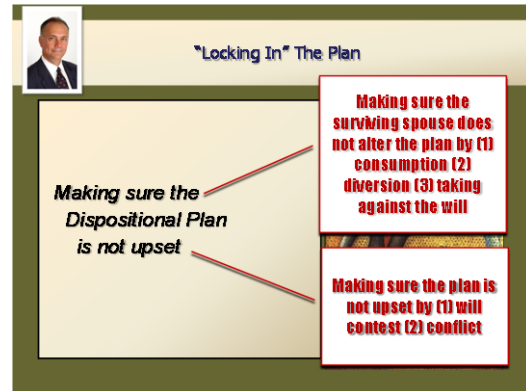
The slide includes a small portrait of a man in a suit in the top left corner. To the right of the text is an illustration of a factory with smokestacks and a large grey money bag with a yellow dollar sign on it, next to a yellow measuring tape.

1. First, determine how husband and wife wish to dispose of their assets, both on the death of the first of the couple to die and then upon the death of the survivor; and
2. Second, ensure that that plan, once set in place, is not altered significantly by the survivor or his or her family after the death of the first of the couple to pass away; and
3. Third, take steps to insure that the potential for conflict and contest are reduced and, hopefully, avoided.


Estate Planning for the Blended Family
Unit Four “Locking In the” Dispositional Plan

A. Overview.

Once the dispositional plan of each client-spouse has been determined the estate planner should take steps to insure that the plan cannot be significantly altered by the survivor or his or her family. These steps could include one or more of the following:



"Locking In" the Plan



1. A Pre- or Post- Nuptial Agreement;
2. A Contract to Make a Will;
3. Joint and Mutual Wills;
4. Joint Trusts;
5. QTIP Trusts and Credit Shelter Trusts;
6. Irrevocable Life Insurance Trusts;
7. Uniform Transfers to Minors Accounts;
8. Section 2503(c) Trusts; and
9. Irrevocable Inter Vivos Trust.

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6. Irrevocable Life Insurance Trusts;
7. Uniform Transfers to Minors Accounts;
8. Section 2503(c) Trusts; and
9. Irrevocable Inter Vivos Trust.

B. Pre- and Post- Nuptial Agreements.

1. In the context of estate planning the purpose of a pre- or post-nuptial agreement would be to define the rights of each client-

spouse in the estate of the other, both in terms of rights waived and rights to be provided for.

Pre and Post-Nuptial Agreements

2. Pre- and Post nuptial agreements are generally presumed to be valid and binding on the parties.

- ✓ Full and fair disclosure of their financial positions
- ✓ Independent Counsel



a. For a pre- or post nuptial agreement to be valid and enforceable, it is mandatory that both parties make a full and fair disclosure of their financial positions prior to the execution of the agreement. See *Stoner v. Stoner*, 572 Pa. 665, 819 A.2d 529, 533 (2003); *Simeone v. Simeone*, 525 Pa. 392, 581 A.2d 162, 167 (1990).

- (1) The full and fair disclosure requirement is not satisfied by a broad description of assets. There must be at least a reasonable estimate of the worth of the assets. See *Ebersole v. Ebersole*, 713 A.2d 103 (Pa. Super. 1998) , appeal denied, overruled in part, *Stoner v. Stoner*, 572 Pa. 665, 819 A.2d 529, 534 (2003).
- (2) Disclosure need not be exact as long as it is full and fair and does not obscure the general financial resources of the parties. See *Mormello v. Mormello*, 452 Pa. Super. 590, 682 A.2d 824 (1996), overruled in part, *Stoner v. Stoner*, 572 Pa. 665, 819 A.2d 529, 534 (2003).
- (3) It is not sufficient that the information is available to the party claiming lack of disclosure. There must be an affirmative disclosure of the relevant financial information unless there is clear evidence that the party already possesses the information.

b. However, because the parties do not deal at arm's length, but stand in a relation of mutual confidence and trust, the highest degree of good faith is required. See *In re Hillegass Estate*, 431 Pa. 144, 149, 244 A.2d 672, 675 (1968).

c. Therefore, a court will give a contract between spouses particular scrutiny because of the special relationship

See *Snaith v. Snaith*, 282 Pa. Super. 450, 453, 422 A.2d 1379, 1381 (1980).

- d. The validity of the agreement does not require that each party be represented by independent counsel. See *Simeone v. Simeone*, 525 Pa. 392, 581 A.2d 162, 166 (1990).
- e. However, advice of independent counsel may protect the agreement from attack on the basis of coercion and establish that each party made an informed and intelligent decision to enter into the agreement. See *McGannon v. McGannon*, 241 Pa. Super. 45, 49, 359 A.2d 431, 434, 435 (1976).

3. Waiver of Rights.

One of the main purposes of a pre- or post-nuptial agreement in the context of the blended family is to waive certain rights which would otherwise accrue to the surviving spouse. These may include the following:

a. The Spouse's Elective Share Rights.

Waiver of Rights

1. The Spouse's Elective Share Rights.
2. The Right to Administer the Decedent's Estate.
3. The Right to Wages and Small Bank Accounts.
4. Insurance Payable to the Estate.
5. To Qualified Retirement Plans.



(1) In Pennsylvania, absent a waiver, the surviving spouse is entitled to 1/3 of certain property of the decedent including property passing under the decedent's will.

(2) In making the election certain other property rights are disclaimed.

b. The Right to Administer the Decedent's Estate.

(1) In certain circumstances the surviving spouse has the right to administer the estate of a deceased spouse.

(2) In the case of an intestacy or where there is no executor named or the named executor is unable to serve the PEF Code gives the persons entitled to the residuary first priority to serve as the personal

representative and the surviving spouse the second priority.

c. The Right to Wages and Small Bank Accounts.

- (1) Wages, salaries or employee benefits up to \$5,000 may be paid by the decedent's employer to the surviving spouse.
- (2) The spouse is entitled to receive any amount on deposit or represented by a certificate of deposit from the bank, savings association or similar institution when the total standing to credit does not exceed \$3,500.

d. Insurance Payable to the Estate.

The surviving spouse is also entitled to receive insurance proceeds payable to an estate up to \$11,000, unless within 60 days following death the personal representative has made a written request for the funds.

e. Qualified Retirement Plans.

(1) ERISA requires that qualified defined benefit plans and qualified defined contribution plans payable at the participant's death must be paid in the form of a qualified joint and survivor annuity.

(2) The requirement may be waived by the surviving spouse by written consent. A key item to remember is that the law requires *the spouse* to waive the right. As such,

this must be accomplished post-marriage.

Spouse's Interest in Retirement Plans



1. Death Benefits must be paid in the form of a **qualified joint and survivor annuity**.
2. A key item to remember is that the law requires **the spouse to waive the right**.
3. A **post nuptial agreement** will not effectively waive rights unless the agreement expressly names another beneficiary

(3) A post nuptial agreement will not effectively waive rights under a qualified plan unless the agreement expressly names another beneficiary or states that the participant has the right to name a new beneficiary.


4. Affirmation of Rights.

In addition to waiving certain rights the agreement may also affirm certain rights or obligations such as the following:

- a. That certain bequests or gifts to the surviving spouse or his or her family members will be made in the will of one or both spouses;
 - b. That the surviving spouse and/or his or her family members will receive a certain level of inheritance (sometimes based upon the length of the marriage) from the estate of the other client-spouse;
 - c. That a life estate will be reserved for the survivor in the principal residence;
 - d. That a certain level of insurance will be maintained with agreed upon designations of the beneficiary;
 - e. That a retirement plan will be maintained with agreed upon designations of beneficiary.
5. In the case where one spouse has significantly more assets than the other and has promised to fund a certain level of inheritance, the agreement could include a provision restricting the lifetime transfer of property which could act to defeat the promise.

Affirmation of Rights


1. That **certain bequests or gifts will be made** to the surviving spouse or his or her family members in the will of one or both spouses;
2. That the surviving spouse and/or his or her family members will receive **a certain level of inheritance** (sometimes based upon the length of the marriage) from the estate of the other client-spouse;
3. That a **life estate will be reserved** for the survivor in the principal residence;
4. That a **certain level of insurance** will be maintained with agreed upon designations of the beneficiary;
5. That a **retirement plan** will be maintained with agreed upon **designations of beneficiary**.



C. Contract to Make a Will.

1. Another way to “lock in” the dispositional plan of the other is by a “Contract to Make a Will”.

Contract to Make Will



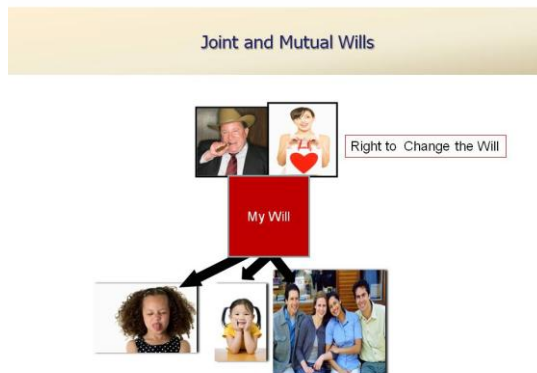
- Should be in writing
- Wills only Changed by Mutual Consent
- Wills to be irrevocable
- Restriction on Lifetime Gifts
- Also applicable to non-probate assets

2. One may enter into a valid contract to dispose by will the whole or any part of his or her property, real or personal, in a particular way.
3. Such a contract must, of course, possess the usual essentials generally requisite for contracts.
 - a. Thus, in order to be enforceable, there must be (i) sufficient consideration, (ii) a meeting of the minds of the parties, (iii) the contract must be certain and definite in its terms, and (iv) the offer must actually have been accepted.
 - b. It is provided by the PEF Code that a contract to die intestate or to make or not revoke a will or testamentary provision or an obligation dischargeable only at or after death can be established in support of a claim against the estate of a decedent only by: (i) provisions of a will of the decedent stating material provisions of the contract; (ii) an express reference in a will of the decedent to a contract and (iii) extrinsic evidence proving the terms of the contract; or a writing signed by the decedent evidencing the contract. See PEF Code Sec. 2701(a)
 - c. Generally speaking, an agreement, supported by consideration, not to make a will or devise property, is valid.
 - d. The statute of frauds applies to and renders unenforceable a promise or agreement to will real estate not evidenced by a writing, but a written agreement to leave at one's death, or to give by will all or a particular piece of real estate complies with and satisfies the statute of frauds.

D. Joint or Mutual Wills.

1. Another means of “locking in” the plan of disposition is to have the client-spouses execute “joint wills” or “mutual wills”.
2. A “joint will” is the will of two or more persons contained in one document; while “mutual” or “reciprocal wills” are the wills of two or more persons with similar dispositive provisions usually in a separate document for each testator.
3. Both joint and mutual wills are considered the separate will of each testator; either testator may revoke their will, and in the absence of revocation, the will will be probated after the death of each.

4. The only remedy is for breach of contract, if a contract existed. A joint will does not necessarily give rise to any inference of a contract or agreement to make reciprocal provisions; it is in effect nothing more than two wills in one instrument. See PEF Code Sec.2701(b).
5. Mutual wills may or may not be revocable at the pleasure of either party, according to the circumstances and understanding upon which they were executed.



a. Even though wills are mutual and made at the same time, this does not prevent revocation in the absence of a clear and definite contract established by proof of an express agreement or unequivocal circumstances.

b. In the absence of a valid contract, the concurrent signing of reciprocal wills, even with full knowledge of the contents, by both testators, is not

enough to establish a legal obligation to forbear revocation.

6. Under the proper circumstances, the survivor, though he or she accepts and enjoys the estate of the other, may revoke the will as to his or her own property.
7. Contracts for the execution of irrevocable mutual wills, which are wills executed where two persons execute separate wills reciprocal in their provisions, are valid when properly proved, and are enforceable.
 - a. the writing must show intent on the part of both parties to give up their right to revocation.
 - b. An agreement expressed by two testators, in the presence of witnesses, that the survivor would bequeath his or her property in accordance with the wills made to effectuate their agreement, has been held to constitute an enforceable contract.

E. Joint Trusts.

1. A "joint trust" is generally an inter vivos trust which holds all or some of the property of the aggregate estate of a married couple in a common

trust for their mutual support and maintenance while they are both alive; and then for the sole benefit of the survivor after the first spouse dies.

2. In addition the trust normally becomes irrevocable upon the death of the first spouse to die. This locks in the disposition of the trust upon the death of the survivor.

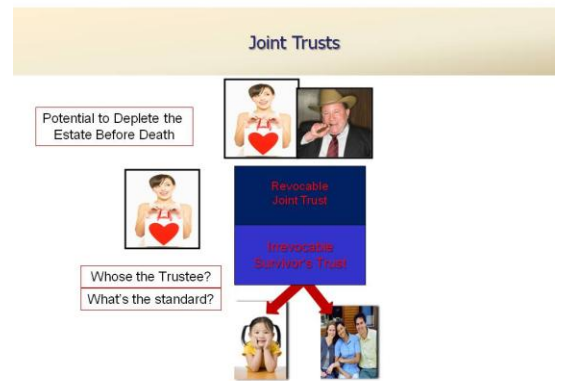
3. To a large degree the preservation of the interest of the remaindermen (usually the children of one or both client-spouses) in the trust will be impacted by the level of access the surviving spouse has to the income and principal of the trust. The estate planner should draft the trust with a clear understanding of how the client spouses wish to balance the lifetime interest of the surviving spouse with the desire to preserve the interest of the remaindermen.

4. The following are some of the drafting options available:

a. Income distributions.

The trust could provide for:

- (1) the mandatory distribution of current income to a specified beneficiary from the inception of the trust. Alternatively, mandatory income distributions could commence when the beneficiary reaches a specified age;
- (2) the required distribution to a specified beneficiary of income for designated purposes (e.g., subject to an ascertainable standard relating to “health, education, support, or maintenance”) and discretionary authority to the trustee to distribute income and corpus for other purposes, with all accumulated income distributed to the specified beneficiary upon termination of the trust; or
- (3) the required distribution of income to any of several beneficiaries for specified purposes (e.g., subject to an ascertainable standard relating to health, education, support, or maintenance) and discretionary



distributions to be "sprinkled" or "sprayed" by the trustee among a designated group, with the distribution of all remaining, accumulated income on termination of the trust to the several beneficiaries on the basis of a prescribed allocation formula.

b. Principal distributions.

The trust could provide for:

- (1) the mandatory distribution of corpus at a specified age of a beneficiary (or the distribution of portions of the trust corpus upon attaining various age levels), with interim distributions required for specified purposes (e.g., subject to an ascertainable standard relating to health, education, support, or maintenance);
- (2) the mandatory distribution of corpus at a specified age of a beneficiary (or the distribution of portions upon attaining various age levels), with interim distributions to this beneficiary solely within the trustee's discretion (i.e., not subject to an ascertainable standard); or
- (3) the mandatory distribution of an allowable portion of the corpus at a specified age to each of several beneficiaries, with interim distributions of corpus permitted to be sprinkled among a designated group of beneficiaries within the trustee's discretion (i.e., not subject to an ascertainable standard).

c. Uni-trust Interests.

The trust could provide:

- (1) The beneficiaries distribution right in terms of a uni-trust interest, i.e., based upon a percentage of the value of the trust; such interest to be paid out of income first and then out of principal.
- (2) For example:

"In each taxable year of the trust, trustee shall pay to or for the benefit of settlor an amount (hereinafter the

"unitrust amount") equal to ten (10%) percent of the net fair marketvalue of the trust principal, determined as of the first day of each taxable year of the trust (hereinafter the "valuation date")."

d. Power of Appointment.

- (1) The power of appointment is a valuable estate planning tool which can be incorporated into a trust, usually in the form of a special power of appointment.
- (2) Through a power of appointment, the "donor" of such a power can confer upon another person the power to alter the donor's dispositive scheme and, thereby, to make adjustments for developments that were not (and, often, could not have been) anticipated at the time the original transfer into trust was made.
- (3) A power of appointment is, in general, a right allowing a person other than the trust grantor to direct the disposition of property which he does not own.
- (4) A power of appointment is created by granting to a person the authority to direct the disposition of such property or, in some instances, power to remove/replace trustee. Such a power can enable the holder (or "donee") of the power to designate future recipients of the benefits of the trust.

e. Ascertainable Standard.

Understanding the legal definition of the terms "health", "education", "support", and "maintenance", which are often used to define a trustee's discretion in regard to trust distributions is important. Those definitions as provided in the Restatement of the Law, Third, §50, follow:

f. "Health", "Medical Care".

- (1) Without more, references to "health," "medical care," and the like in the terms of a discretionary power may be useful to inform beneficiary expectations or guide an inexperienced trustee, but presumptively they provide merely for health and medical benefits

like those normally implied by a support standard.

- (2) Thus, if the intention is to assure the beneficiary some special form of care which is not cost efficient, further elaboration would be helpful.
- (3) Even a grant of extended discretion is likely to make it more difficult, if the trustee does not act generously, for a beneficiary to compel a trustee to follow a particular course of action.

g. "Support and Maintenance".

- (1) The terms "support" and "maintenance" are normally construed as synonyms, even when this treats the terms as redundant.
- (2) Probably the most common guides used in grants of discretion, these terms are sometimes accompanied by a reference to the beneficiary's accustomed standard of living or station in life.
- (3) That level of intended support is normally implied from "support" or "maintenance" even without an express reference to the beneficiary's customary lifestyle.
- (4) Whether this accustomed style is expressed or implied, a lower level of distributions may be justifiable if the trust estate is modest relative to the probable future needs of the beneficiary.
- (5) The accustomed manner of living for these purposes is ordinarily that enjoyed by the beneficiary at the time of the settlor's death or at the time an irrevocable trust is created.
- (6) The distributions appropriate to that lifestyle may not only increase to compensate for inflation but also may increase to meet subsequent increases in the beneficiary's needs resulting, for example, from deteriorating health or from added burdens appropriately assumed for the needs of another.

- (7) Also, if a beneficiary becomes accustomed over time to a higher standard of living, that standard may become the appropriate standard of support if consistent with the trust's level of productivity and not inconsistent with an apparent priority among beneficiaries or other purpose of the settlor.
- (8) Furthermore, distributions allowing the beneficiary an increased standard of living may be appropriate if, in light of the productivity of the trust estate, the eventual result would otherwise favor the remainder beneficiaries over the present beneficiary to a degree unlikely to have been intended by the settlor.

h. "Education".

Without elaboration, the term "education" is ordinarily construed as extending to payment of living expenses as well as fees and other costs of attending an institution of higher education, or the beneficiaries' pursuit of a program of trade or technical training, and the like, as may be reasonably suitable to the individual and the trust funds available. Thus, if the intention is to assure the beneficiary, some special form of education additional elaboration would be helpful.

i. "In the discretion of the Trustee".

- (1) The level of discretion left to the trustee by the trust document is also an important consideration.
- (2) Court will generally not interfere with the exercise of the Trustee's discretion when so-called "extended discretion" is implied by the trust language.
- (3) Extended discretion while not empowering a trustee to act "unreasonably" the court will attempt to determine the degree the language manifests an intention to relieve the trustee of normal judicial supervision.
- (4) Wording such as "absolute" or "unlimited" or "sole and uncontrolled" are not interpreted literally; thus a court will not permit a trustee to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power.

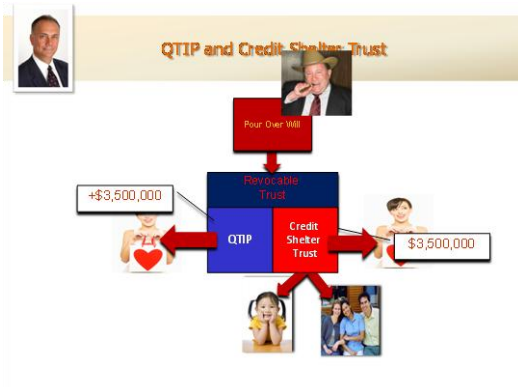
- (5) Choose an Independent Trustee.

In order to avoid family conflicts the choice of an independent trustee outside the family of either of the client spouses should be strongly considered.

F. QTIP/Credit Shelter Trusts.

1. Overview.

- a. Often married couples with estates with potential exposure to the federal estate tax are advised to adopt an estate plan which incorporates so-called “QTIP/Credit Shelter Trusts”.
- b. Under this plan upon the death of the first of a married couple to die assets held by the deceased spouse with a fair market value equal to the federal estate tax exemption (currently \$2,000,000) are used to fund the Credit Shelter Trust and the balance is used to fund the QTIP Trust.



c. The Credit Shelter Trust is designed to benefit the surviving spouse while alive but not be included in the taxable estate of the surviving spouse for federal estate tax purposes.

d. The QTIP on the other hand is designed to qualify for the federal estate tax marital deduction in the estate of the first spouse to die.

- e. The disposition of both trusts upon the death of the surviving spouse is dictated by the terms of the documents, and unless a power of appointment is provided, not left to the discretion of the survivor.
- f. As a result, both the QTIP trust and the Credit Shelter Trust can be designed to provide for the needs of the surviving spouse while they are alive; with their ultimate disposition being dictated by the settler spouse as reflected in the document.

- g. The surviving spouse's access to the trusts while alive is dictated by the terms of each trust and also by the trustee.

2. The QTIP Trust.

- a. The QTIP trust is intended to qualify for the federal estate tax marital deduction under Sec. 2056(b)(7). In order to qualify under that section certain requisites must be met which include the following:
 - (1) the surviving spouse must be entitled to all the income from the trust determined on an annual basis;
 - (2) no other beneficiary may have any rights in the trust during the surviving spouse's lifetime.
- b. Therefore in drafting the QTIP trust the surviving spouse must at a minimum have the absolute right to the income from the trust each year.
- c. In addition the surviving spouse may also have the right to principal as limited by an ascertainable standard or left to the trustee's discretion.
- d. The right to withdraw the greater of 5% or \$5,000, a year (the so-called "5&5 Power") could also be provided for.
- e. The surviving spouse may but does not have to be the sole trustee of the trust.
- f. While the property remaining in the trust upon the survivor's death is included in the estate of the surviving spouse, its disposition is as provided in the trust itself.

3. The Credit Shelter.

- a. The Credit Shelter Trust is generally designed to be held to some extent for the benefit of the surviving spouse, but not be subject to inclusion for tax purpose in the surviving spouse's estate upon their death.
- b. Unlike the QTIP trust:
 - (1) Access to the trust can be made available to both the surviving spouse and other beneficiaries as well during the surviving spouse's lifetime.

- (2) There is no requirement that income be distributed on an annual basis.
 - c. If the surviving spouse is the sole trustee of the trust the trustee's discretion as to trust distributions should be limited by an ascertainable standard such as "health, education, support, and maintenance".
 - d. If the surviving spouse is not a trustee, or serves as the Co-trustee with an individual holding a "substantial adverse interest in the trust" full discretion is allowable.
 - e. Upon the survivor's death the property remaining in the Credit Shelter Trust is disposed of as provided in the trust itself.
4. Transferring Assets Between Spouses.
- a. In order to insure that the Credit Shelter Trust is fully funded upon the death of the first of a married couple to die, each spouse would ideally own assets with a value equal to the amount of the federal estate tax exemption (currently \$3,500,000), in their name alone.
 - b. In certain cases therefore the estate planner will recommend asset transfers between the spouses to insure each spouse owns sufficient assets in their name alone.
 - c. The estate planner should remember that if the assets transferred would have been non-marital property in the hands of the transferor spouse the transfer will convert the property into marital property subject to equitable distribution in the event of divorce.

G. Irrevocable Life Insurance Trust.

- 1. An irrevocable insurance trust is a trust which both owns and is the beneficiary of life insurance.
- 2. Upon the death of the insured the insurance is paid to the trustee of the trust and then held and administered as provided in the trust document.

3. Such a trust could be utilized to provide for either a spouse or children in a manner which is funded (as long as the premiums are paid) and also irrevocable.

H. Transfers for Children

1. Uniform Transfers to Minors Accounts.

a. Most states have enacted the Uniform Gifts to Minors Act (UGMA), which was replaced in many jurisdictions by the Uniform Transfers to Minors Act (UTMA).

b. Under these acts:

- (1) Careful attention must be paid to this Uniform Act as locally enacted because significant variances may have been included by the state legislature.
- (2) A custodian is entrusted with the management of the property (including collecting and investing the income from the property and reinvesting the proceeds); however, the minor has indefeasibly vested equitable title to the property.
- (3) Legal ownership of the property vests in the child at age 21 (or at a younger age where legal capacity is reached earlier, as determined under state law).
- (4) The transfer of securities and other properties is facilitated.
- (5) Before the minor reaches the age of majority the property may be used for the support, maintenance, education, and benefit of the minor.

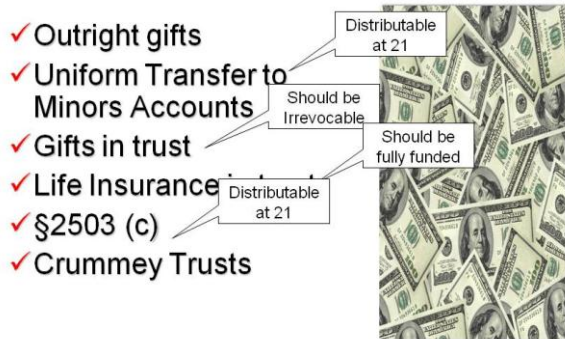
c. Various mechanical rules are provided covering accounting procedures, the “prudent man rule” for investing, the appointment of a successor custodian, and the right of the minor at age 14 to demand payments for his or her support, maintenance, and education.

2. Section 2503(c) Trusts.

a. Section 2503(c) provides an annual donee exclusion for gifts “other than gifts of future interests in property.”

- b. If, for example, a transfer is in trust, with the trustee having discretion as to the distribution of trust income, the donee-beneficiary will have received a future interest (rather than a present interest) for purposes of this gift tax exclusion provision.
- c. Therefore, the annual donee exclusion will not be available for gift tax purposes in this context.

Inter Vivos Transfers



d. provides an exception to this rule, however, making available the annual donee exclusion if the property and income from the transferred property (1) may be expended by, or for the benefit of, the donee before his or her attaining the age of 21 years, and (2) will, to the extent not so expended (i) pass to the donee at the time he or she reaches age 21, and (ii) be payable to the donee's estate (or as he or she may appoint under a general power

of appointment) in the event the donee dies before reaching age 21.

3. Irrevocable Inter Vivos Trust.

A funded inter vivos irrevocable trust may be used to shift property value and income to younger-generation beneficiaries. Income may be shifted through the use of an irrevocable trust, for example, to:

- a. build an educational fund for a child;
- b. provide current income for an adult child; or
- c. provide current income for an aged parent (with the principal thereafter distributable to a younger generation member).

Avoiding Conflicts and Will Contests

A. Potential Problem Areas.

1. Personal Effects.

- a. The disposition of personal effects should be carefully planned. A standard clause giving the personal effects to the surviving spouse could potentially upset children from the prior marriage.
- b. Execution of a Memorandum Clause specifically disposing of such items is recommended to avoid such disputes.

2. Occupation of Personal Residence.

- a. If the surviving spouse does not inherit the personal residence, provisions should be made for the terms of his or her occupancy after the death of the first of the married couple to pass away.
- b. This could include a life estate or merely the right to remain in residence for a short period after the date of death.

3. Funeral and Burial.

- a. Providing specific funeral and burial instructions could avoid unnecessary conflict during a stressful time.

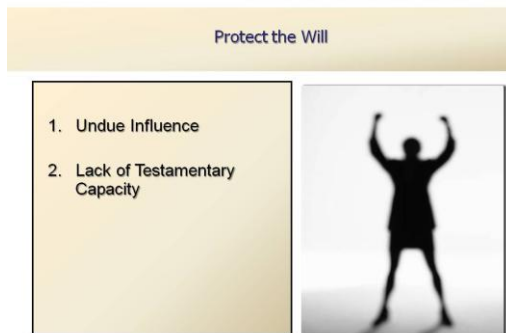
- b. One sensitive issue may arise if one client-spouse wishes to be buried with a prior deceased spouse.

4. Custody of the Children.

- a. Assuming the child has not been adopted by the mixed parent, the child's custody remains an issue until such time as he or she reaches the age of majority.
- b. If the child's birth parent is alive, he or she will be given priority over all other parties seeking custody.
 - (1) If a showing can be made that the surviving parent is not appropriate or if an order severing all parental rights has been entered, then the family court has the ability to determine the child's legal custodian.
 - (2) Otherwise, the surviving parent will receive custody of the child.
- c. In the event the surviving parent does not receive custody of the child, the deceased parent may provide for the appointment of the child's guardian and conservator via testamentary instrument.
 - (1) Selecting the appropriate custodian for the child, during the parent's life is essential to estate planning.
 - (2) If the parent fails to do so, not only is there a strong risk of litigation between the families of the child's mother and father, but custody might be awarded to someone other than the person preferred by the deceased parent.
 - (3) A discussion with the parents of a mixed household is necessary to determine if the surviving parent is suitable, willing and able to take custody of the decedent's children.

B. Protecting the Will.

1. Overview.



One of the obligations falling to the estate planner is protection of the executed estate planning documents from challenge by disappointed family members.

Generally if the challenge is in the form of a will contest the basis will either be:

- a. undue influence, or
- b. lack of testamentary capacity.

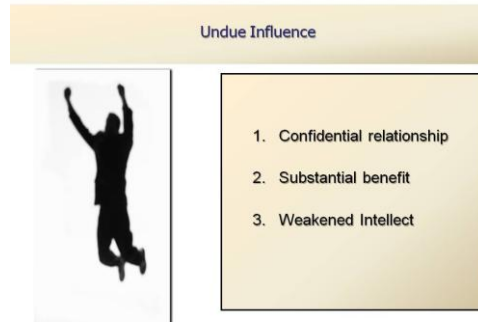
It is the estate planner's job to create a record in order to effectively defend the documents if challenged.

2. Nature of Undue Influence Allegation.

- a. Undue influence exists wherever, through weakness, ignorance, dependence or implicit reliance of one on the good faith of another, the latter obtains an ascendancy, which prevents the former from exercising an unbiased judgment.
- b. To set aside a will on the ground of undue influence, there must be a demonstration of imprisonment of the body or mind, fraud, threats, misrepresentations, circumvention, inordinate flattery, or physical or moral coercion, which destroys the testator's free agency.
- c. Where a contestant seeks to prove undue influence indirectly, there must be a demonstration that:
 - (1) the proponent was in a confidential relationship with the decedent,
 - (2) the proponent received a substantial benefit under the will, and

(3) the decedent was of weakened intellect when the will was executed.

d. The existence of confidential relations between the testator and a beneficiary, standing alone, does not constitute undue influence.



e. Undue influence operates to render a testamentary instrument ineffectual. However, where undue influence has been exercised, the entire will is not necessarily void.

3. Lack of Testamentary Capacity.

a. The PEF Code.

It is provided by the PEF Code that: "Any person 18 or more years of age who is of sound mind may make a will." 20 Pa. C. S. § 2501.

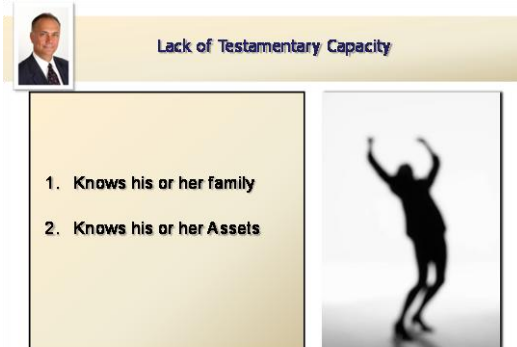
b. Nature and Measure of Capacity.

(1) Generally a person is deemed to have testamentary capacity if he appreciates, in a general way, who his relations are and what property he possesses, and indicates an intelligent understanding of the disposition he wishes to make of it." *Olshefski's Estate*, 337 Pa. 420 (1940).

(2) A testator's capacity to make a will must be tested as of the time the will was executed, although evidence of capacity or incapacity near the date of the will is admissible as tending to show the existence or lack of capacity on that date. *Lawrence's Estate*, 286 Pa. 58 (1926).

(a) Adult, who had mental developments, habits, and intellectual attainments of a child of about five years, and who, according to psychiatrist, had a general knowledge of what property he possessed and his next of

kin, but who did not have a full knowledge of his estate and kindred, did not have "testamentary capacity" to execute will.



Lack of Testamentary Capacity

1. Knows his or her family
2. Knows his or her Assets

(b) It is well settled that knowledge of the nature and extent of one's assets is essential to a determination of testamentary capacity. In the absence of such knowledge, the testatrix lacks testamentary capacity, and the instrument executed in the absence of such capacity will be inadmissible.

c. Where the testator's mind was clearer some days than others, the question is what it was when he executed will.

d. An insane person's will is invalid unless made during a lucid interval:

(1) Evidence of a general condition of testamentary incapacity does not negate the possibility of a lucid interval.

(2) Evidence that a testator was insane but had lucid intervals is insufficient to sustain a will in the absence of an additional showing that the lucidity of mind existed at the very time of the execution of the will.

e. The capacity necessary to execute a will is not as great as that required to transact ordinary business. *Cohen Will*, 445 Pa 549, 284 A.2d 754 (1971).

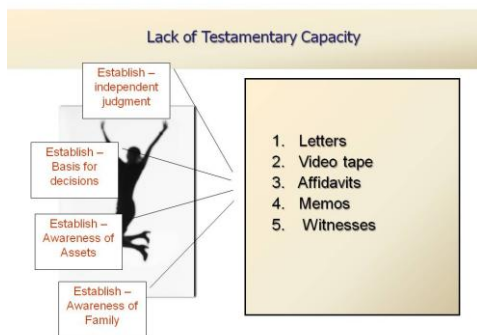
f. A lesser degree of mental disability is necessary to invalidate a will than would be grounds for acquittal from a criminal charge, since a testator need not be shown to have been insane in order to invalidate his or her will.

4. Creating the Record.

a. Extrinsic facts and circumstances which throw light on the issues of capacity and undue influence are admissible.

- b. Declarations of a testator made at the time of the execution of his will or at a time so connected with the testamentary act as to justify an inference that they indicate the state of the testator's mind when the will was executed are admissible.
- c. As result a record which can assist in demonstrating the capacity of the testator and his independent mind should be created; perhaps including the following.

(1) A letter of explanation, preferably hand written, explaining first that the testator recognizes the makeup of his family and the nature of his assets and at the same time explaining why the testator did what he or she did in terms of the estate planning documents;



(2) A videotaped discussion with the testator on the same points;

(3) Affidavits of treating physicians and lay people; and

(4) Your own contemporaneous memorandums.

- d. During the execution process before the witnesses: review the will with the testator, asking him or her to confirm that they understand the document and it reflects their intent; also include the discussion of a demonstration of the testator's awareness of the nature of the family and the nature of the estate; then obtain the affidavits of the witnesses confirming capacity.

5. Use of In Terrorem Clause.

a. The purpose of an *in terrorem* clause is to discourage will contests by providing that anyone who contests a will forfeits his or her legacy or bequest.

1. Contests this Will or, in any manner, attacks or seeks to impair or invalidate any of its provisions, hereof,
2. Claims entitlement to any asset of my estate by way of any written or oral contract (whether or not such claim is successful),
3. Unsuccessfully challenges the appointment of any person named as an executor or a trustee,
4. Objects in any manner to any action taken or proposed to be taken in good faith by my Executor, whether my Executor is acting under court order, notice of proposed action or otherwise, whether such objection is successful or not,
5. Objects to any construction or interpretation of my Will, or any provision of it, that is adopted or proposed in good faith by my Executor,
6. Unsuccessfully seeks the removal of any person acting as an Executor,

b. Such a clause is “unenforceable if probable cause exists for instituting the proceeding.” 20 Pa. C.S. §2521.

7. Files any creditor’s claim against my estate that is based upon a claim arising prior to the date of this Will (without regard to its validity),
8. Claims an interest in any property alleged by my Executor to belong to my estate (whether or not such claim is successful),
9. Challenges the characterization proposed by my Executor of any property as to whether it is separate or community (without regard to the ultimate resolution of the merits of such challenge),
10. Challenges the position taken by my Executor as to the validity or construction of any written agreement entered into by me during my lifetime,
11. Attacks or seeks to impair or invalidate any of the following:
 - a. any designation of beneficiary for any insurance policy on my life;
 - b. any designation of beneficiary for any pension plan or IRA account;
 - c. any trust which I created or may create during my lifetime or any provision thereof;

c. Remember, unless there is something of significant value provided for the person in the estate plan there will be nothing to lose if a will contest is brought.

- e. any transaction by which I have sold any asset to any child or children of mine (whether or not any such attack or attempt is successful),
 12. Conspires with or voluntarily assists anyone attempting to do any of these things; or
 13. Refuses a request of my Executor to assist in the defense against any of the foregoing acts or proceedings.
- B. All legacies, bequests, devises and interests given under this Will or any trust created by me, at any time, to a person who engages in the activities listed in paragraph A. above shall be forfeited as though he or she had predeceased me without issue, and shall augment proportionately the shares of my estate going under this Will to, or in trust for, such of my devisees, legatees and beneficiaries who have not participated in such acts or proceedings.
- C. Expenses incurred as a result of any contest or other attack of any nature upon any provision of this Will shall be paid from my estate as administration expenses.

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