ESTATE PLANNING FOR FEDERAL EMPLOYEES

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The Law of Estates and Trusts
Planning · Administration · Litigation

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Mr. Beckett focuses his practice on estate and trust planning, administration, and litigation. He has been published in various state and national publications and is a frequent presenter on topics relating to estate and trust law. Mr. Beckett received his B.A. from Wittenberg University in 2008; and his J.D. from Washington and Lee University in 2011. He was admitted to the Maryland Bar in 2011 and has practiced in Maryland since 2011.

Mr. Beckett served on the law review at Washington and Lee University and was a Burks Scholar Writing Fellow. He served as a law clerk with the Honorable Pamela White in the Circuit Court for Baltimore City. He is a member of various local and national bar associations.

ARTICLES

Lawyers of the firm have published articles on tax and other topics related to their professional interests, including: "*Medicaid Planning for Maryland Family Lawyers,*" MARYLAND BAR JOURNAL, Vol. 49, No. 2 March/April 2016 (Co-Author with Phyllis J. Erlich); "*Self-Settled Asset Protection Trusts for Married Couples in Maryland,*" Steve Leimberg's Asset Protection Planning Newsletter (April 2015); "*The Terms of the Trust: Extrinsic Evidence of Settlor Intent"* ACTEC JOURNAL, Spring 2014 (Co-author with Anna Katherine Moody); *"Benevolent Benefactors Be Aware: Changes in Medicaid Policy Result in Fairer Treatment of Gifts,"* MARYLAND BAR JOURNAL, Vol. 47, No. 3, May/June 2014 (Co-author with Laurie S. Frank); *"Is this the Death of Ahlborn? The Self-Defeating Expansion of States, Authority to Seek Reimbursement Under the Medicaid Secondary Payer Act,"* NAELA NEWS, February/March 2014 (Co-author with Jason A. Frank). *Resisting the Contractarian Insurgency: The Uniform Trust Code, Fiduciary Duty, and Good Faith in Contract,"* ACTEC JOURNAL, Winter 2010; *"Asset*

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Protection and Tenancy by the Entirety," ACTEC JOURNAL, Spring 2009; *"Perfect Ambiguity: The Role of the Attorney in Maryland Guardianships,"* MARYLAND JOURNAL OF CONTEMPORARY LEGAL ISSUES, 1996.

PRESENTATIONS

Lawyers of the firm participated as a lecturers in various continuing education programs for lawyers, including: "*Contested Guardianships*" (NAELA Maryland-DC Chapter 2017); *"Transmittal of Issues from Orphans' Court to Circuit Court"* (Judicial College of Maryland 2016); *"ABA Section of Real Property, Trust & Estate Law Domestic Asset Protection Trust Planning: Jurisdiction Selection Series"* (eCLE, ABA 2015); *"Document Drafting for the Elder Law Practitioner"* (MSBA 2015); *"Orphans' Court Judges' Orientation,"* (Judicial Institute of Maryland 2015); *"Maryland Trust Act,"* (MSBA 2014); *"Heirs, Legatees and Related Issues,"* (Judicial Institute of Maryland 2013); *"Estate/Tax Implications of DOMA after the Windsor Case"* (MSBA 2013); *"Asset Protection, An Overview for Maryland Estate and Trust Lawyers,"* (MSBA 2013)*; A Beneficiary's Right to Information,"* (MSBA 2012); *"Trust Litigation: The Enforcement of Beneficiary Rights,"* (MSBA 2011); *"Asset Protection: An Overview for Maryland Estate and Trust Lawyers,"* (MSBA 2010); *"Back to the Future, Schoukroun and the Spousal Election,"* Hot Topics in Elder Law, (MICPEL 2009); *"A Match Made In Heaven – Using Tenancy by the Entirety for Creditor Protection Without Sacrificing Estate Planning,"* (MSBA 2009); *"Asset Protection – A Guide for Maryland Estate and Trust Lawyers,"* (MICPEL Advance Estate Planning Institute 2006); *"Revocable Inter Vivos Trusts,"* (MICPEL 2004 and 2006); *"Valuation Discounting,"* (MICPEL 2003; MSBA 2002 and 2003); *"Business Valuation,"* (MICPEL 1998); *"Family Partnerships,"* (MICPEL 1996); *"Avoiding Probate - Will Substitutes,"* 1996; *"Basic Estate Planning,"* (MICPEL 1993).

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ESTATE PLANNING FOR FEDERAL EMPLOYEES

Estate planning is an exercise in setting goals and objectives, then implementing a plan to meet those goals and objectives. To do it correctly, a plan must be fashioned to each individual situation rather than force the situation into a predetermined "solution." Nevertheless, there are common parameters to all planning. This outline is intended to give you an introduction to some of these parameters.

A. Probate vs. Non-Probate Considerations

We are bombarded from all sides with advice to "avoid probate" -- What is "probate" and should we take steps to avoid it? The term "probate" originally referred to the process of proving that a document was a person's true last will. Today, probate refers to the process of property being transferred by a will, or in the absence of a valid will, under the intestacy laws. The intestacy laws govern the passing of property from a decedent to his or her heirs.

Not all property is transferred by virtue of the will or the intestacy laws. For example, a husband and wife may own real estate (or other property) as tenants-by-the-entirety. This means that at the moment of death, the surviving spouse becomes the sole owner of the property. The surviving spouse does not "inherit" the property because of a will or the intestacy laws. The surviving spouse "inherits" because the title of the property dictated this result. Similarly, bank CDs, IRAs, and other accounts may provide for a beneficiary who will receive the property at the death of the primary owner. These arrangements "avoid probate" because the property passes by virtue of the underlying contract. Those who recommend prefabricated estate planning "packages" based on avoiding probate, usually use a funded grantor trust -- the "living trust."

Avoiding probate avoids the probate fee. Today in Maryland, the probate fee is usually not an element driving the estate plan: the fee on a $499,000 probate estate, for example, is $500. Avoiding probate may speed up distribution, although other factors normally control the timing of closing a probate and nonprobate estate -- for example whether a federal tax return is due. Various trusts can be used as an effective device in tax planning, although the probate-avoiding aspect of the trust is not the important aspect of the trust for effective tax planning.

Historically, probate has not been a major problem for Marylanders. Indeed, Maryland has simplified administrative probate provisions. Also, probate offers certain benefits – primarily laws that protect the rights of creditors and legatees and others concerned with a decedent's estate, whereas those protections may not exist outside of probate. Generally, the substantive law of wills does not cover revocable trusts or other probate avoidance mechanisms.

B. Death Taxes

Generally, there are two types of death taxes that may apply to Maryland residents: (1) Inheritance Taxes and (2) Estate Taxes. Because of changes in the law occurring over the past 20 years, these taxes, while still important, affect far fewer individuals and estates than was previously the case.

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1. An inheritance tax is a tax on the transfer from a decedent to another. The State of Maryland abolished inheritance tax on the right of many relatives of a decedent to inherit: as of 2018, there is no inheritance tax for spouses, children, stepchildren, parents, stepparents, and siblings. There is no tax on any lineal descendants, so no grandchild bears a tax (but a stepgrandchild does bear a tax). There is a 10% tax on the right of all others to inherit. Additionally, there is no inheritance tax regardless if the relationship of the bequest(s) have $1,000 or less in value combined.

2. An estate tax is a tax based on the transfer of the accumulated wealth of the decedent. The federal death tax is an estate tax imposed on the assets controlled by the decedent and transferred at the time of his or her death. [There is also a federal gift tax based on a uniform tax rate to "catch" the value of wealth transferred before death.]

Following the enactment of the federal "Tax Cuts and Jobs Act" in late 2017, each taxpayer has a gift/estate tax credit which "translates" to $11.2 million of assets that may be transferred at death or during life without triggering a tax. The amount protected will increase with inflation until January 1, 2026, when the credit will revert to pre-2018 levels (in 2017, the credit was $5.49 million/individual, roughly half its current value). The effective tax rate beyond the sheltered amount can climb as high as 50% when the Maryland estate tax is factored in (see below). The unused credit of the first spouse in a married couple to die can be preserved for the surviving spouse by filing an estate tax return with an appropriate election. This is referred to as "portability." As a consequence, a married couple can shield approximately $22.4 million with the federal unified credit.

Maryland has a separate estate tax from the federal tax (but no gift tax), and the rules relating to this tax have changed drastically since 2014. Since 2015, the Maryland tax exemption had been increasing annually to match the federal credit amount. However, in its 2018 session, the General Assembly responded to the 2017 changes in federal law by establishing a $5 million exemption amount for decedents dying in 2019 and later. This amount will also be "portable" between spouses, much like the federal unified credit, although the mechanics of this portability are not yet clear given the newness of the law.

Married couples may transfer unlimited amounts between themselves without a gift or estate tax because of the marital deduction. [This general rule does not apply to transfers to non-U.S. Citizen spouses, but special trusts can be designed to qualify such transfers.] Additionally, the first-to-die spouse can transfer his or her unused federal gift/estate tax credit to the surviving spouse via making the appropriate election on a timely-filed federal estate tax return.

Additionally, there is a $15,000 per donee annual federal gift tax exclusion as well as gift tax exclusions for direct pay of tuition and medical expenses. Note that even annual gifts above the $15,000 per donee amount do not necessarily trigger a tax (until one's gift/estate tax credit is fully used up). As stated, there is no Maryland gift tax.

C. Trusts – What They Are

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Trusts are legal entities -- fictitious "persons" created and recognized as entities separate from the trust beneficiaries (similar to corporations which are fictitious "persons" separate from its shareholders). Indeed, a trust is an arrangement where legal ownership vests in a trustee and equitable ownership vests in a beneficiary. Trusts may be created for many purposes, including use for estate planning.

Generally, trusts are catalogued as inter vivos (created while living) and testamentary (created by a will). Inter vivos trusts may be revocable or irrevocable. Testamentary trusts, of course, only come into being at death so they are usually irrevocable at death but, like all wills, changeable by a competent person until death.

Irrevocable inter vivos trusts are often used to "own" insurance policies so that the death benefits can remain outside of the federally taxable estate. This device is necessary because the federal definition of "estate" puts a large premium on whether a decedent controlled an asset at death. If you retain the right to change beneficiaries, to borrow on the policy, and other life insurance powers seen as elements indicating you "control" the asset and therefore your estate will be taxed on the death benefit. If, on the other hand, an irrevocable trust "owns" the policy, the death benefit may escape tax.

Another type of inter vivos trusts is the "living" trust. It is a funded revocable trust. Generally, the creator (the "grantor") of the trust is the initial trustee and beneficiary. The trust provides for a successor trustee if the grantor/trustee becomes incompetent and upon the grantor/trustee's death. Because most living trusts provide for a successor beneficiary at the grantor's death, the living trust avoids probate. Like the testamentary trust, the living trust can be drafted to preserve the federal and state estate tax credit/exemption equivalent amounts. Another type of inter vivos trust is the unfunded revocable trust. This is commonly used as a disability-planning tool in conjunction with a durable power of attorney (discussed below).

The testamentary trust is created by the language of the will and becomes effective after the death of the decedent. Like the living trust, the testamentary trust can be drafted to preserve the federal and state estate tax credit/exemption equivalent amounts.

D. Using Trusts in Estate Planning

For many years, trusts were viewed primarily as a “tax dodge” tool in estate planning. Trusts can be used to leverage the federal estate and gift tax credits and the state estate tax exemption amount to minimize or avoid taxation as wealth passes from person to person and generation to generation. This remains an important use of trusts.

However, with the more taxpayer-friendly laws that have been enacted, other uses of trusts have come increasingly into focus. Historically, one of the most important uses of trust was to protect inheritances from the beneficiaries’ creditors. A unique American creation, the “spendthrift” trust is not subject to the claims of its beneficiary’s creditors under the theory that the funds in the trust do not belong to the beneficiary, but instead are held by the trustee, and in

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fact never properly belonged to the beneficiary to begin with. Accordingly, instead of leaving an inheritance outright to a beneficiary, the inheritance can pass into a trust with spendthrift provisions for the benefit of that beneficiary and enjoy a high degree of protection. This planning technique is especially useful for beneficiaries who are in high-risk professions (e.g. doctors, entrepreneurs) and for those who might be engaged in contentious litigation in the future (including divorce litigation).

The "trade-off" for leaving a beneficiary's assets in trust, traditionally speaking, was that the beneficiary had a reduced ability to control those assets. However, again legislative changes have come into play. Under the law of most states, a beneficiary can serve as his or her own sole trustee and still enjoy the asset protection aspects of the trust. One can leave the beneficiary's inheritance in a trust that permits distributions at the trustee's discretion for the beneficiary's "health, education, maintenance, and support" (HEMS) (a relatively broad distribution standard), name the beneficiary as his or her own trustee, and as long as proper spendthrift provisions are included, the trust assets may not be attached by the beneficiary's creditors nor included in his or her taxable estate (as long as the beneficiary/trustee adheres to the HEMS standard).

In addition to creditor protection planning, inter vivos and/or testamentary trusts can be used to provide for beneficiaries with special needs. Many special needs beneficiaries are dependent on means-tested government benefits programs such as Supplemental Security Income (SSI) and Medicaid. Leaving an inheritance to such a beneficiary outright will often both cause that beneficiary to be ineligible for his or her benefits and subject the inheritance to the beneficiary's high costs of care. The inheritance should instead be left in a discretionary "special needs" or "supplemental needs" trust that would not offset public benefits or render the beneficiary ineligible for such benefits.

Additionally, in certain instances, a beneficiary may transfer his or her own assets into a "first party" special needs trust (the so-called "d4A" individual trust or "d4C" pooled trust, named after the provision of the Social Security Act providing for them) while still remaining eligible for public benefits. However, these first-party trusts are required to pay any funds remaining in the trust at the beneficiary's death to reimburse the state for its care expenditures.

Trusts have a wide variety of uses. For example, another major use of trusts is to protect minors and/or young adults from taking outright ownership of their inheritances. They are extremely useful tools to accomplish both financial and non-financial objectives.

E. Planning With Retirement Assets (the Thrift Savings Plan)

One of the most important assets available to federal employees is the Thrift Savings Plan (TSP) retirement account. For a long-time federal employee, this may be the most significant asset outside of a home. A major advantage of the TSP is that it defers taxation on income, permitting assets to grow tax-free growth within the account. (There are, in fact, two kinds of TSPs—the traditional TSP and the Roth. This handout focuses on the more common traditional TSP.)

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At death, assets remaining in a traditional TSP do not pass according to the terms of your will (or a revocable trust, or other estate planning documents). They may only pass as a non-probate asset via beneficiary designation. This requires the account holder to complete form TSP-3, "Designation of Beneficiary." The beneficiary designations listed on this form are generally revocable and changeable. A participant in the TSP to name anyone as a plan beneficiary without first obtaining consent from the spouse. (However, a spouse's consent is required to opt out of the default spousal survivor annuity under FERS and CSRS.)

There are several tax considerations at play. First, it is almost always preferable to designate an individual (or trust—more on this below) as the beneficiary of your TSP. Absent such a beneficiary designation, the TSP will pass by a "default" order that goes to a surviving spouse, or if none, to the account holder's children, or if none, to surviving parents. If none of those individuals are alive, the TSP will be paid to your estate. Under IRS rules, the estate would have to withdraw the entire amount of the TSP within five years of your death. Since the traditional TSP is taxed as it is withdrawn, this usually has the effect of increasing the average rate at which the TSP is taxed (as opposed to drawing the TSP out over a longer period at lower marginal rates).

In naming an individual as a beneficiary, there are different rules depending on the identity of the individual. If a surviving spouse is the beneficiary, the TSP can be converted into a beneficiary participant account (BPA) in the spouse's own name or rolled into the spouse's own retirement account. The BPA will begin making required minimum distributions based on the date that the employee would have turned 70 ½, but are calculated based on the participant's age.

If the beneficiary is someone other than a surviving spouse, the funds cannot be retained in the TSP or converted to a BPA. Instead, the payments must be made directly to the beneficiary or to an inherited individual retirement account (IRA). The funds cannot be "rolled over" into the beneficiary's regular IRA or other retirement plan. However, transferring the funds to an inherited IRA still provides tax-preferred treatment, as the inherited funds can be drawn down (and taxed) over a "stretched" period—over the course of the beneficiary's life expectancy.

A trust may be the beneficiary of a TSP. A properly drafted trust can combine the tax advantages of an inherited IRA (namely, the "stretch" treatment for taxable distributions) with the creditor protection provided by spendthrift provisions. Additionally, when planning for special-needs individuals,

F. Disability Planning

At common law, a power of attorney was revoked by the incapacity of the principal. Therefore, powers of attorney were useless as a planning device for a disability involving incompetency. Every jurisdiction has enacted legislation to permit instruments to provide for powers of attorney to survive disability. These powers of attorney that survive disability are commonly referred to as durable powers of attorney.

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Generally, durable powers of attorney come in two varieties: those that take immediate effect and those that "spring" into being due to a future event, such as the later disability of the principal. Because of the difficulty that a "springing" power can cause -- needing to prove the disability at a later date to the satisfaction of a banking or similar institution -- those taking effect immediately may be more effective if later needed. Another approach would be to structure the triggering event springing the power so that it becomes effective by the unanimous consent of trusted family members. Another technique is to use a non-springing power but one that is held in an escrow-type of arrangement until a physician's certificate is produced.

Durable powers of attorney tend to be long and detailed. This is caused, in part, by the rule that powers of attorney are read narrowly by the courts and if a power is no explicitly stated, it is deemed not given. This issue is often examined by the IRS in the context of gifting under a power of attorney.

Since 2010, Maryland law has provided a statutory framework for powers of attorney. Generally speaking, to be valid a power of attorney must be notarized and executed in the presence of two witnesses (one of which may be the notary). Maryland law also provides a statutory form power of attorney. Banks and other third parties are required to treat a properly-executed statutory form power of attorney as valid.

Inter vivos trusts are also used as tools to provide for future disability. Indeed, because the trustee takes title to property, trusts are generally preferred vehicles if disability appears to be a certainty, especially if one's financial affairs have complexity. Sometimes unfunded trusts ("standby trusts") are used in conjunction with a durable power of attorney in order to fund the trust.

G. Health Care Directives

In 1993, Maryland enacted a new health care decisions act. Under the act, a competent adult may deal with future health care issues by one of three methods (i) written instructions authorizing withholding or withdrawal of care, (ii) a written appointment of an agent to make decisions on one's behalf, and/or (iii) an oral statement to a physician leaving instructions or appointing an agent. Additionally, if one has not appointed an agent or left instructions, a surrogate may be appointed to act as an agent for an incompetent person. The law lists an order of priority for such appointment.

The law has since been revised, most substantially in 2010. There is now a two-part standardized form Advance Directive promulgated by the State of Maryland. Part I allows you to select a health care agent. The agent is the person authorized to make decisions on your behalf when you have been certified by your medical provider as unable to make or communicate such decisions.

Part II is the “living will,” which is an expression of your wishes regarding life-sustaining procedures. The living will specifically addressed whether your medical providers should apply

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life-sustaining procedures when you are in one of three statutorily-defined medical conditions where recovery is highly unlikely: a persistent vegetative state (generally, the condition of permanent unconsciousness), a terminal condition where death is imminent, and an end-stage condition (an advanced, progressive, and incurable condition resulting in complete physical dependency—advanced Alzheimer's can be an example of an end-stage condition).

H. Long-Term Care Costs

Given the aging population and the rising cost of long-term care, it is no surprise that an increasingly popular subset of estate planning is long-term care planning, or Medicaid planning. As of this writing, the daily rate for many nursing homes in Maryland exceeds $300/day. Contrary to popular belief, neither Medicare nor most group health insurance policies cover a significant portion of these costs. (Medicare covers a limited amount of nursing care following certain types of hospital stays, but generally does not cover more than 100 days' worth, and even then does not cover the full daily rate for the full 100 days). Consequently, the biggest threat to many individuals' wealth is not death taxes, but the threat of long-term care costs eroding their wealth.

Long-term care planning is a practice area that looks at potential sources of financing the costs of long-term care. These sources include private long-term care insurance as well as public benefits programs such as the Veterans' Administration's "Aid and Attendance" program and Medicaid. Although originally a poverty program, Medicaid has become the single largest payer of long-term care costs in America. Because of its origins as a welfare program, Medicaid imposes very strict financial tests on applicants before they can qualify for subsidies. In Maryland, an individual can have no more than $2,500 in "countable" resources while a married couple can have approximately $120,000. Certain assets, such as equity in a primary residence (up to a limit) and a prepaid funeral plan, are not "countable." Once an individual qualifies, however, Medicaid will pay the difference between his or her monthly income and monthly cost of care in a nursing facility. (Note that assisted living facilities do not usually qualify for regular Medicaid benefits, although there are other Medicaid programs—often with more restrictive eligibility criteria—available to pay for assisted living care for certain applicants.)

To dis-incentivize people from intentionally impoverishing themselves (e.g. giving away their assets to their children) to qualify for Medicaid benefits, federal and state law impose a five-year "lookback" or "audit" period running backward from the date of eligibility. Any transfers of assets for less than fair market value—including transfers made to most types of irrevocable trusts—made during the lookback period result in severe financial penalties. Despite the highly restrictive financial eligibility criteria, under current law a married couple can save a significant portion of their combined wealth. This type of planning often involves the purchase of a Medicaid-compliant annuity in the name of the non-institutionalized spouse. A single applicant can protect his or her assets for heirs through certain gifting techniques that work within the five-year lookback framework. Additionally, under the Maryland Medicaid program, assets can be transferred into a first-party d4C pooled trust or an individual d4A trust without penalty (for the d4A trust, the transfer must occur before the individual turns 65).

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