



## FINANCIAL PLANNING

# The Importance of ESTATE PLANNING

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**E**state planning is an important aspect of a family plan for any parent, and it takes on even greater significance for the parent of a child with special needs. This article explores the tax and non-tax reasons why estate planning is important.

There are many components to an estate plan. It may be as basic as a will, power of attorney, and health care proxy carefully coordinated with an individual's assets. It could also be as complex as a special needs trust, insurance trust, family limited partnership, or grantor retained annuity trust. This article focuses on the basics of any estate plan.

### A WILL

Wills are important for multiple reasons. A will allows an individual to select beneficiaries, establish the times at which beneficiaries receive the assets, and the fiduciaries who administer the estate and any trusts created under the will. For the parent of a young child, a will is critical. In the absence of a designated guardian under a will, the court must determine who will be guardian of the person and property of a minor child (i.e., who will raise the child). This is a decision that any parent, but especially the parent of a spe-

cial needs child, must carefully consider. Further, a will is important to ensure that assets are not placed in a child's hands before the child is responsible enough to invest and use the assets prudently.

For the parent of a special needs child, a will is especially important. Leaving assets (by will or through intestate succession—by state law where a person dies without a will) outright to a special needs child can result in the disqualification of the child from receiving Medicaid and other government assistance. With a properly structured will, assets allocated to a special needs child can be held in a trust that does not affect the child's eligibility for these governmental benefits. Under New Jersey law, the trustee for the special needs child's trust could be allowed to use trust income and principal to benefit the child for any reason the trustee deems appropriate. Alternatively, the trust can be structured as a supplemental needs or luxury trust, where the assets can be used for luxury items such as travel, books, and other items that are not provided for by Medicaid. In the state of New York, only the latter, supplemental needs trust, allowing assets to be used for expenses not otherwise covered by Medicaid, will protect the beneficiary's

Medicaid eligibility. Each state's laws and regulations differ, but clearly it is important to have a very careful plan that evaluates how best to protect both the child and the availability of government assistance where appropriate.

A special needs trust can be a trust created during a parent's lifetime or a testamentary trust (i.e., a trust created under the parent's will). The advantage of establishing a stand-alone lifetime trust is that the trust can be used as the recipient of gifts from the parent and from grandparents, aunts and uncles, and others. This gifting can accomplish tax planning for a family. That trust can establish a parent's hopes and goals for a child and his or her care.

One issue that a parent developing a plan must face is how to allocate assets among children, based on the different children's needs. Factors to consider include the potential ability of each child to earn a living, the likely financial needs of each child, and the assets available. A special needs child may be less likely than other children to be self-supporting as an adult, but may also have less of a need for large sums of money, since his or her lifestyle may be modest and at least partially funded by government aid.

One possible solution is to leave a specific dollar amount to a special needs trust (taking care that the appropriate amount will be available to the special needs child before assets are allocated to other children), with the remaining assets divided among the other children. This maximizes the likelihood that the appropriate amount will be available to the special needs child, while making sure that the child with special needs does not receive significantly more than he or she needs (thereby tying up assets until the child's death).

Thought must also be given as to who is best qualified to make financial decisions on behalf of a child. The trustee (and successors) should meet two key characteristics: he or she should be someone who the parent trusts implicitly and someone who has some financial savvy. A third factor important in deciding upon the trustee of a special needs trust is designating someone who is sensitive to the unique needs of the beneficiary.

In developing an estate plan, consideration must be given to the tax consequences of the plan. This is important so that the assets available to pass to a special needs child and other family members can be maximized.

The federal estate tax is imposed on the value of assets less liabilities at the date of a person's death. Currently, the federal estate tax ranges from 45 percent and incrementally increases to a maximum rate of 48 percent. Under recent tax legislation, the maximum tax rate will be gradually reduced to 45 percent in 2009. In 2010, there will be a repeal of the federal estate tax, and the estate tax will return in 2011 with a maximum rate of 55 percent.

There are two important concepts that are critical to understanding how the federal estate tax works. First, there is the unlimited marital deduction, which means that all of the assets one leaves to

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his or her surviving spouse are exempt from federal estate taxes.

The second important concept involves the applicable exclusion. The applicable exclusion permits an individual to leave up to \$1.5 million of assets through a combination of lifetime gifts and testamentary bequests, without paying federal estate taxes on this amount. Congress recently passed legislation that will increase the estate tax applicable exclusion to \$2 million in 2006 and to \$3.5 million in 2009. There will be a full repeal of the federal estate tax in 2010, and a complete return to 2002 law, with a \$1 million applicable exclusion, in 2011. The gift tax applicable exclusion will remain permanently at \$1 million.

In many states there is also a state estate tax that must be considered in connection with planning. Under recent legislation passed in the state of New Jersey, there is a new state estate tax imposed on assets in excess of \$675,000 passing to someone other than a spouse. In New York, the exempt amount is \$1 million.

In connection with an estate plan, it is important for a married individual to take into consideration the tax laws and the potential to minimize taxes by taking advantage of the unlimited marital deduction while maximizing the use of each spouse's applicable exclusion. This will help maximize the monies available to children at the surviving spouse's death. The net effect of this planning is that, with a \$1.5 million applicable exclusion, a married couple with proper planning can leave up to \$3 million transfer tax-free to children.

#### **POWER OF ATTORNEY**

A power of attorney allows an individual to appoint people to manage his or her assets and make investment decisions on his or her behalf. Having this document avoids the necessity of having to go to court to get someone appointed as a guardian if an individual cannot manage his or her own affairs. This document is important for all individuals. It is important for a child with special needs who is capable of making decisions to have a power of attorney giving someone the power to make financial decisions on his or her behalf where appropriate.

A power of attorney can be effective immediately (in which case it is not impacted by a subsequent disability or incapacity). Alternatively, a power of attorney can be prepared so it is only effective on disability or incapacity.

#### **HEALTH CARE PROXIES**

Health care proxies serve two purposes. First, this document asserts an individual's desire to be free from the use of life-sustaining or prolonging procedures and medications if the individual becomes irreversibly or terminally ill. Second, the health care proxy can direct a health care agent appointed to make a wide range of

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medical and health care decisions if the individual is unable to articulate his or her own preferences.

Again, this is an important document for all individuals, including a child with special needs who is capable of appointing an individual to act on his or her behalf where appropriate.


#### INSURANCE

Insurance is an important asset used in connection with an estate plan. Insurance can be used to ensure that sufficient assets are available to provide adequate income to the surviving spouse, to provide for the lifetime care of the child with special needs and to provide sufficient assets to care for any other children until they finish schooling and are able to earn a living. This is critical for a young family with a special needs child who will

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need sufficient assets to maintain his or her care over an extended period of time. The beneficiary of an insurance policy should be coordinated with the estate

plan. If estate taxes are a concern due to the size of an estate, the parents can have his or her insurance owned by and payable to a trust for his or her designated beneficiaries to remove the insurance from the parent's taxable estate.

Estate planning is essential for any parent, but takes on additional significance for the parent of a child with special needs. In addressing the plan, a parent should make sure he or she is being counseled by an attorney with experience handling the sensitive issues accompanying a special needs child. 

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