

## Can the Kids Decide?

August 2011 from James M. Kane, Attorney

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A cartoon in the current issue of The New Yorker magazine (July 11 & 18, 2011, page 32) shows a small child in a grocery store, his mother standing at the shopping cart, with the child stating "I'll stop whining when you stop nagging."

Autonomy versus control. This is a tough balance for any parent in relation to kids, even for estate planning.

This newsletter will not be of interest to every reader, but in some situations, especially smaller estates, it is at least worth a consideration. This is about an option for parents to give their kids the choice in deciding whether to take property outright or in trust. I refer to this as a 90-day withdrawal right.

This option provides by default that the children's property will be held in trust, but with each child having 90-days to take a portion or all the property outright (90 days commencing only after both parents' deaths).

In addition, a safety valve in the written trust provisions (discussed further below) can block the 90-day feature as though it never existed. Thus, if the safety value is used, the trusts will be treated for all purposes (and for tax purposes) as though the child never had a right to withdraw the property in lieu of a trust.

### **When Might this 90-Day Option Be Useful?**

This 90-day option is directed primarily at clients who grapple with the notion of trusts for their children versus giving property outright.

Also when considering the use of a trust one

ideally needs to think about what threshold dollar amount borders on no longer being cost-effective for the operation and administration of the trust (tax return filings, K-1 reporting, estimated taxes, trustee fees, accounting, etc.). My view is this dollar threshold falls in the range of \$250,000 to \$500,000 (as to each child's trust).

However, regardless of a dollar threshold clients may in some situations still opt to mandate trusts for their children and not use this 90-day option.

Tilting in favor of trusts is when the kids likely view the property they get from their parents as a nest egg. That is, the kids are inclined to preserve and safeguard the trust property for a longer-term holding period.

On the other hand, trusts may lean more toward a burden if the kids realistically have an immediate need to spend their funds more rapidly on purchasing a home, tuition for their children, medical expenses, and so forth.

### **The Safety Valve**

There is a safety valve. Giving the kids this 90-day option can later be retracted or limited in amount by the parents, if the change is made before the death of both parents.

First, the client can revise his or her core estate planning document and remove or limit this withdrawal power for any one or more children. Second, the surviving spouse (as to the first-to-die spouse's core estate planning documents) can have a second opportunity to remove or limit the power as to any of the

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children after the first spouse's death.

If a child's withdrawal power is retracted, the property will be held in trust after both parents' deaths as though the child never had this withdrawal option.

### Why 90 Days?

The period of 90 days is a reasonable time period for a child to review his or her circumstances and make the withdrawal decision (after the death of both parents). The number of days can be longer or shorter if a client prefers.

The 90-day window closes on the earlier of (i) 90 days or (ii) the child making the decision before the end of the 90 days.

### Re-Emergence of the Asset Protection

In many states (including Georgia), the asset protection features of the trust (assuming asset protection is designed within the trust provisions) kick back in, or re-emerge, when the withdrawal right closes to the extent of the property that continues in the trust.

The following O.C.G.A. Section 53-12-83 under Georgia law (underlining added) refers to this loss and re-emergence of the asset protection:

The holder of a power of withdrawal, during the period that the power may be exercised, shall be treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power. The lapse, release, or waiver of a power of withdrawal shall not cause the holder to be treated as a settlor of the trust.

By contrast, in some states the withdrawal window taints the property held thereafter in trust so that the trust property remains exposed for asset protection purposes, even after the withdrawal window closes.

For example, under Section 736.0505(2)(b) of

the Florida statutes, after a lapse, release, or waiver of a withdrawal power, the power holder retains the status of trust settlor with respect to the value of the property subject to the lapse. In short, the asset protection does not continue after this 90-day window for a Florida trust to the extent of the value of the trust at the time the child chooses not to withdraw the property.

In reviewing whether a client may wish to include this 90-day option, it is crucial to take into account which state law will apply to each child.

In most instances it is the law that applies to the trust on this question of whether the asset protection continues if child opts to keep the property in trust.

### Tax Consequences:

- If the child opts to leave the property in trust, the trust will be "defective for income tax purposes". The result is that no separate trust income tax return is required. Instead, all trust income, losses, deductions, etc., will be reportable each year on the child's personal income tax return Form 1040.
- This withdrawal option (whether or not the child opts to continue the trust or withdraws the property) will cause the trust property to be includible in the child's estate when the child dies for estate tax purposes.
- The above safety valve, if triggered to eliminate the withdrawal right, may possibly avoid inclusion of the property in the child's estate for estate tax purposes, if the client otherwise used the GST exemption for the trust.

### No Gift by the Child

By choosing to leave the property in trust, the

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child will not be treated as making a gift to the trust for gift tax purposes, but only if under the written terms of the trust the child thereafter holds a limited power of appointment over the trust property. See, for example, IRS Letter Ruling 9030005.

### The Withdrawal Right Language

Below is a 90-day provision that can be included in the trust language for a client's children (thus, in the parents' core estate planning documents, such as, for example, a Declaration of Trust [revocable trust] or Last Will and Testament).

The safety valve language at the end of the following excerpt can help address an unanticipated situation where state law (discussed above) creates problems with this 90-day option.

5.9 In addition to a Beneficiary's limited power of appointment set forth under section 5.2, within a period not to exceed 90 days commencing on the death of the second-to-die as between my wife and me each of my children by giving written notice to the Trustee shall have the right to demand or reject irrevocably a distribution by the Trustee

of any portion or all of the property for such child otherwise to be divided and held in trust for that child as "Beneficiary" under **Article V**, but in no event shall such withdrawal amount exceed the amount to be held in such child's trust at the time the trust is funded pursuant to section 5.2; provided, however, that at any time during her lifetime, to become effective only if she survives me, my wife shall have the power (without judicial approval) to renounce or limit this 90-day power for my children on my behalf by giving written notice to the Trustee.

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