

Leimberg's Think About It

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#377

PLANNING FOR OLDER CLIENTS

*"The Only Difference Between An Old Woman and An Elderly Lady is...
Adequate Income!"*

That saying, which I've used in hundreds of talks over the years, is of course about the importance of having a steady, dependable, and adequate cash flow for what may be a very long period of time. But proper planning for the older client isn't only about having enough money! An elderly individual's failure to properly plan for life contingencies such as disability and incompetency can result in financial disaster.

This issue of **THINK ABOUT IT**, based on a chapter from my book, **THE NEW BOOK OF TRUSTS** (610-924-0515), provides a checklist of some of the tools and techniques that can provide security for older persons, including jointly-held property, durable powers of attorney, standby trusts, self-trusteed revocable living trust, and revocable living trusts with other trustees. I'll also highlight some of the issues to be considered when establishing a trust, and how a well-drafted and administered revocable living trust can be used to ensure financial security for the client, as well as his/her loved ones.

THE THREE KEY GOALS OF A MATURE CLIENT

For an elderly person's financial and estate plan, the three crucial objectives are: security, security, and security! Providing for financial security is an important issue for people with estates of any size. But for those with modest estates – the urgency and significance of planning is even greater than for wealthy or ultra-wealthy individuals.

Regardless of the size of the estate, there are two additional elements that an older person needs for his or her estate plan: stability and flexibility. If your client's present estate plan assures his or her personal financial security, a "comfortable" retirement (as quantified by the client), and allows for contingencies that might arise, then the present plan is a good one.

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But if it does not accomplish all of the above, then more needs to be done. Let us look at a simple scenario for illustrative purposes.

Sam is a retired educator in Pennsylvania. He worked for 40 years for the school system, and he did an excellent job. The school district rewarded him with a retirement income sufficient to enable him to maintain his lifestyle without having to cut corners or do without. Sam's wife died 10 years ago; they had no children. His closest relatives are his wife's two nephews, both of whom live 3,000 miles away on the west coast. Practically all of his close friends have moved away, and there is really no one nearby with whom Sam has a close personal relationship. Sam's estate planning consists of a will prepared by the law firm that represents the school district. Under the will, Sam leaves all of his assets to his nephews in California and Washington, and has named them co-executors.

In addition to Sam's pension, he has managed to accumulate a fairly sizable estate by investing shrewdly over the years. Sam has a savings and checking account at a local bank with which he has been doing business for the past 30 years.

Fortunately, he still enjoyed good health when he retired, and planned to continue his practice of taking one big vacation annually. While vacationing in Hawaii one year, Sam hiked along a trail to get a close-up look at a volcano and tripped, receiving a severe head injury and a fractured hip. The tour director made certain Sam was properly hospitalized, but was never told whom to call in case Sam became ill or was injured.

Sam was eligible for Medicare, and had his social security and Medicare cards in his pocket, but there was no information among his belongings about whom to contact in the event of an accident or illness. Furthermore, Sam's memory was seriously impaired, and he could not communicate well with his doctors. The hospital knew of no one to contact about Sam's condition or how to get money over and above Medicare benefits to pay for his treatment.

Unfortunately, since Sam had failed to take advantage of the various options available to him to plan for or protect his security in an unforeseen situation, he had unknowingly turned over the management of his affairs to the court system.

GUARDIANSHIP AS A DEFAULT OPTION

Sam's situation is an example of what can happen if a client fails to plan properly. Yes, Sam has a will which names his nephews as heirs and co-executors; but he did not anticipate the need to plan for contingencies such as an emergency and incapacity, or to safeguard his own future.

As a result of his accident and diminished capacity, Sam could not manage his own affairs, and someone had to be formally appointed to handle them for his benefit. Under Sam's estate plan, guardianship was the "default" and, unfortunately, only option.

The exact nature of guardianship proceedings varies from state to state and sometimes from county to county; and even the title of the person or institution chosen to manage someone's affairs – called a "guardian," or "conservator," or "committee" in some cases – will differ depending on the jurisdiction in which the legal proceeding is instituted.

Guardianship is almost universally a proceeding to be avoided if possible. The effect of the proceeding is to appoint a guardian to whom (or which, if an institution) all powers with respect to the incompetent person's life are transferred (at least temporarily).

A court-appointed guardian may not even know the incompetent person, much less his or her personal preferences or wishes. Likewise, the hearing judge may never have seen either the incompetent or the guardian before the proceeding.

GUARDIANSHIP PROCEEDINGS

Although the procedure varies from state to state, here's a general outline of what takes place when a guardian must be appointed.

First, it is necessary for someone to bring the matter before the appropriate court. This is usually done by a close family member filing a petition with the court that has jurisdiction (the state in which the person lives or now resides). This can be called the probate court, orphans' court, or surrogate's court.

Questions can arise over who has the authority to prepare the petition if no close relatives are available or in which court the petition should be filed. For instance, should it be Pennsylvania where Sam is a permanent resident, or Hawaii where he is presently hospitalized? If it should be Pennsylvania, how would Sam get back to Pennsylvania for the hearing?

Since the nature of the guardianship proceeding is to declare Sam incompetent (at least temporarily), to a great extent, Sam is deprived of his legal rights; nevertheless, he must be given the right to have his own counsel. Once Sam has been declared legally incompetent and a guardian appointed, he may lose his right to participate in and manage his own affairs – even to exercise his legal, civil, and political rights or privileges.

Sam's physical and mental condition must be evaluated so that medical testimony can be presented and the court can be absolutely certain that Sam is not competent to handle his own affairs. Therefore, a copy of the petition, with notice of the date of the proposed hearing, must be served upon, and (to the greatest degree possible) explained to Sam.

Next, notice must also be given to all other interested parties and relatives (e.g., Sam's nephews) and to the institution in which Sam is currently residing. Usually, the person alleged to be incompetent, in this example, Sam, must be physically present in the courtroom, unless the court is satisfied by medical testimony (or other proof) that his welfare would not be promoted by having him attend the hearing.

Assuming all of the above problems can be overcome and the guardianship proceeding takes place, the court must then decide who should be appointed as guardian for Sam. His only known relatives – his nephews – certainly do not seem to be appropriate, so the court has a very serious decision to make.

The court might be allowed to appoint as guardian any qualified individual, a corporate fiduciary, a nonprofit corporation, a guardianship support agency, or a county agency. A family member or relative might be preferable, but, if the proposed guardian is a major heir of the incompetent person and, in the court's opinion, might be deemed to have a financial interest adverse to the interest of the incompetent person, the potential guardian may be disqualified. Sometimes a court will give preference to a nominee of the incapacitated person. In cases such as Sam's, the ultimate choice most likely will depend solely on the discretion of a person he probably never met: the judge who presides over the hearing.

Although there are circumstances in which the court will appoint a temporary or emergency guardian to serve only in a limited capacity for a limited period of time, if the disabled individual's condition continues, the guardianship will be permanent – with the very serious consequences indicated above.

While the purpose of the guardianship proceeding is to establish a system to meet the essential requirements for an incapacitated person's physical health and safety, protect his or her rights, and manage the person's financial resources until he or she regains ability to do so, the proceeding should certainly be avoided if there is an alternative.

ALTERNATIVES TO GUARDIANSHIP

There are several planning options that Sam could have used to protect himself and that your clients should be considering. The decision as to which option to choose (or more often which combination of options) depends on many factors, including:

1. your client's present financial situation,
2. whether he or she has one or more relatives or close friend available to lend support – whom he trusts and who are willing and able to assist,
3. his or her present physical and mental condition, and
4. the client's personal feelings about managing his or her financial affairs.

JOINT OWNERSHIP OF PROPERTY

If your client has a close relative or a very good friend in whom he/she has complete confidence and trust, one alternative is to place some property/assets in joint names with that individual.

But there are inherent and potentially serious disadvantages under this option. It is important to consider issues such as the possibility that the other person can take your client's property, or that

your client's assets can be subject to the claims of the other person's divorcing spouse and/or creditors.

There are two major types of joint property ownership, tenants in common (each co-owner has a divisible interest and can leave his/her share to anyone he/she wants), and joint tenancy with right of survivorship. Under the second form of joint ownership, at an owner's death, his/her interest passes automatically to the survivor.

When a co-owner other than a spouse is involved and the major objective is the financial care and safeguarding of the client's assets, planners usually suggest that neither type of ownership be used. Certainly, a joint tenancy with right of survivorship should be considered only for relatively small amounts of money (or if the asset value is fairly low and is not expected to appreciate greatly) – perhaps to enable funds to be readily available for a trusted joint owner to use for your client's benefit in the event of an emergency or disability.

POWERS OF ATTORNEY

A second possibility is for your client to give a trusted relative or friend a power of attorney which authorizes the latter, called an "*attorney-in-fact*," to act on his or her behalf. A power of attorney is a legal document and should be prepared by a state licensed attorney who is experienced in estate planning. It can be made as broad or as limited as circumstances dictate, or your client (called a "principal," or "maker of power") wishes.

The client/principal can give the attorney-in-fact rights as varied as to: withdraw money from checking account, access safe deposit box, sell or invest in securities, sell or rent real estate, institute or defend lawsuits, file tax returns, make gifts, fund a revocable trust, authorize the client's admission to a medical, nursing, residential or similar facility, and nominate someone to act as guardian of the client's estate, et cetera.

A power of attorney may be revoked by the client at any time until the earlier of the client's legal incompetency or death (at which time the power ends). It can be quickly drafted by experienced counsel, and does not require assets to be either transferred or re-titled. A power of attorney can be used as a supplement to, or in conjunction with, trust(s) (see discussion below). Furthermore, a power of attorney is a highly useful device on its own – where a client's assets are not sufficiently large to warrant the expense of a trust.

Although powers of attorney can be "general," "limited or special," either a *general "durable" power of attorney* or a "*springing" power of attorney* (discussed below) may be more suitable as a part of an estate plan. If your client decides to revoke a power of attorney, written notice should be given to the person who holds the power, as well as to any financial institutions which had received a copy of the power or had engaged in transactions with your client's attorney-in-fact.

Durable Power of Attorney: Most durable powers of attorney are general powers. This means your client's attorney-in-fact has very broad powers and legal authority to perform almost any

legal act – but only on behalf of the client. (If the power is limited or special, the attorney-in-fact has permission to perform *only* the acts specifically authorized and described in the document.) A general durable power of attorney is one that takes effect immediately upon your client's signing the power of attorney, allows the client to revoke it at any time, but gives the holder of the power, the attorney-in-fact, the right to continue to exercise the powers enumerated in the document even after the client becomes legally incompetent. Powers of attorney are usually presumed to terminate when the principal (the person granting the power of attorney) becomes incompetent. In some states, to make a power of attorney durable, the document must contain the following language (or words with similar meaning):

"This power of attorney shall not be affected by my subsequent disability or incapacity."

Some states (Pennsylvania, for example) have reversed the presumption that a power of attorney terminates upon disability, and consider a written power of attorney to be durable – unless the writing specifically states it is *not* durable. To be safe, the word "durable" should be used in the document so that, regardless of which state law applies to your client's particular situation, the power would continue beyond his or her disability.

Returning to our example, if Sam had a responsible adult child, Sam could have given him/her a general durable power of attorney (with the proper "durable" wording) as a safeguard. Upon receiving notice of Sam's accident, the child (as his attorney-in-fact) could have accessed Sam's bank account and used the funds for his care (as well as manage his other affairs, if necessary) until Sam was capable of acting for himself again.

Springing Power of Attorney: If your client wants to be sure that a trusted person has a power of attorney to act on his or her behalf – but does not want that power to take effect immediately — and only upon his or her disability or incapacity, then a ***springing power of attorney*** should be considered. A springing power of attorney is available in most states and can contain any and all of the provisions that are included in a general power of attorney – except that it will "spring" into being and become effective only *after* the client becomes disabled or incompetent.

How will a bank or other institution know your client/principal is disabled? In most states, it is permissible to specify in the springing power of attorney that the principal will be considered to be disabled if a physician (or two physicians) signs a written certification that the physician has examined the principal and that he/she is incapacitated mentally or physically; and therefore is incapable of attending to his/her business and personal affairs. The physician's certification can be attached to the springing power of attorney and presented to banks or other institutions that might require evidence that the springing power of attorney is legally effective.

Some practitioners do not recommend springing powers of attorney because of the increased potential for disputes with banks or other financial institutions as to whether the principal is disabled and, hence, whether the power is effective. Their reasoning is that the purpose of a power of attorney is to eliminate delays and disputes, and any hindrance that might increase the chances of delays or disputes should be avoided. Furthermore, if the person named as attorney-

in-fact cannot be trusted not to act unless it is necessary, probably that person should not be appointed.

[**Note** that both "Durable Power of Attorney for Health Care" and "Living Will" have been omitted from the sample scenario presented. They are specifically designed for health care and medical treatment purposes only. Therefore, discussions of these documents are beyond the scope of this commentary.]

Revocable Living Trusts

Although a revocable living trust (RLT) is not a stand-alone panacea and should never be implemented without considering the client's overall estate and financial situation – and never without the client's attorney's guidance — it will typically provide the most security, stability and flexibility. There are several types of living trusts from which to choose.

The choice will depend on:

1. the client's present physical and mental health,
2. his or her current financial condition,
3. availability of close friends or relatives upon whom the client can rely, and
4. how much and to what extent the client wishes to remain in control of his or her financial affairs.

The different types of trusts are briefly described below.

Standby Living Trust

If your client wants to remain in complete control of his or her financial affairs, but would like to have a trustee available to take over and manage the assets if he or she is no longer in a position to do so, then consider a standby trust. Here is how a standby trust works:

A trust document, the standby living trust, is prepared by an attorney naming a trustee (a bank or trust company, for example) to take over the management of your client's affairs in the event of disability or incapacity. The client places a nominal amount of money in the trust (perhaps \$100 to "seed" the trust), while continuing to personally manage the remainder of his/her assets.

Simultaneously, the client executes a durable power of attorney that authorizes a specified trustee, as attorney-in-fact, to transfer the client's assets into the trust should he/she become disabled or incapacitated. When disability ends, the client may choose to amend or revoke the trust and resume control of the assets.

The authority given the attorney-in-fact (the specified trustee) can be a "springing" power, if it is stipulated that he or she is to transfer the client's assets to the trust *only* if two physicians certify that the client is no longer able to manage his or her own affairs. The standby trust can, however, provide for the trustee to step in and manage the client's affairs at his or her personal

request. In other words, at such time as the client feels that her/she can no longer (or do not wish to) handle the assets, the standby trust can be activated by the client's written notice to the trustee.

It is important to contact the trustee prior to establishing a standby trust to confirm that the trustee will *accept* the trusteeship. Once the trust is established, the trustee should be regularly updated on the client's asset holdings in order to be in a position to step in and take over the management duties under the trust, if and when necessary. In addition to providing the standby trustee a list of assets, the client should establish a line of communication so that the trustee will be immediately aware of any changes in the client's health or in any circumstances that would warrant taking over. Generally, a bank with trust powers or a trust company is a good choice as trustee for the standby trust, if there are no qualified individuals available to serve as trustee (as in Sam's case).

If Sam had had a standby trust (or a power of attorney, as discussed above), he could have given the trustee information about his vacation plans and arranged a way for them to communicate with each other. In that case, the trustee would more likely have been aware of Sam's accident, could have taken immediate steps to make sure that Sam was properly cared for, and could have made funds available for his care and use.

[**NOTE:** The use of a standby trust in conjunction with a power of attorney is an example of how estate planning documents may serve to meet a client's changing needs. But beware that the arrangement described above will require careful coordination of the documents used, and "orchestration" of the actions of the parties involved by the client's planning team – in order to achieve the client's planning objective.]

Self-trusted Revocable Living Trust

Instead of waiting for disability or incapacity to fund a trust, your client can establish and "fund" (put assets into or title property in the name of) a revocable living trust that is effective immediately. If your client wishes to maintain complete control of his/her assets, the client can be named as the sole trustee. Therefore, the client will be the grantor (the person establishing the trust), the initial trustee of the trust (to manage trust assets), and the current trust beneficiary (to receive trust income).

For example, Sam's trust could be titled "Sam Jones, Trustee of the Sam Jones Trust, dated July 2, 2007, for the benefit of Sam Jones and others (e.g., his nephews)." (Note: If Sam is the only current and future trust beneficiary, as well as the trustee, the trust may not be valid.)

Assets are required to be transferred to the trust either through transfers of ownership to, or by re-titling the assets in, the name of the trust. The transferred assets should be listed in a schedule attached to the original trust document. The trust can stipulate that if the grantor/client becomes disabled – as certified by two physicians (or in accordance with whatever criteria as stipulated in the trust) – the XYZ Bank, named as successor trustee, will take over the management and control of the trust for the grantor/client's benefit.

Because the trust is revocable, the grantor retains the right to amend the trust provisions or terminate the trust and recover trust assets at any time. For instance, he or she can change the beneficiaries or their interests under the trust; remove or nominate trustees; retrieve assets from, or add assets to the trust; or revoke the trust. Because the grantor/ client is the beneficial owner of the trust assets throughout his/her lifetime and always retains the right to change the terms or get the assets back by revoking the trust, for estate tax purposes, the assets in the trust will be includable in the grantor/client's gross estate. However, trust assets will completely avoid the delays and expenses associated with the probate process.

By establishing the revocable living trust immediately, your client will have organized his/her assets placed in trust under the "umbrella" of the trust document. Your client will continue to pay income taxes on trust assets because the trust is for his/her benefit and all trust income will be paid (or attributable) to him/her.

Revocable Living Trust with Separate Trustee(s)

If your client no longer wants the responsibility of managing and investing assets, he/she can transfer property to a revocable living trust under which someone else – an individual, several individuals, or a corporate trustee – will act as trustee(s). If desired, the client can name himself/herself as a co-trustee.

Under this arrangement, the responsibility for the day-to-day management of the client's financial affairs shifts to the trustee(s). By choosing a professional trustee – such as a bank with trust powers or a trust company – your client can ensure professional money management and continuity of trusteeship.

The trust can also provide for the transfer of funds to your client's beneficiaries at his/her death. For example, if Sam had wanted the money he had left to his nephews to be held in trust for them until they were 30 or 35 years old, a bank or trust company might have been a better choice to act as trustee than one of Sam's elderly friends.

ISSUES TO CONSIDER IN SETTING UP A TRUST

There are three basic problems involved in setting up a trust. Two pertain to cost, and one to the selection of trustee.

- **Initial cost.** The initial cost of setting up a trust can range from \$2,500 to \$5,000 (or even higher) depending on the complexity of the client's situation, and the attendant tax implications. The actual cost will vary from location to location.
- **Continuing expenses.** If your client is the sole trustee of the trust, there are obviously no trustee fees. But a bank or trust company most likely will require a fee to serve as trustee, and may charge a fee even for serving as a "standby" trustee while your client is still managing his/her own affairs. (Banks and trust companies usually have a minimum fee schedule, which clients should demand to see and approve before agreeing to use that

institution as trustee.) It is wise to "shop" for a corporate trustee, not only in terms of cost (most fees will be fairly similar but in ultra large estates, fees can be individually negotiated) but in terms of service, investment performance, and expertise.

Even an individual trustee (a trusted friend or relative) may have to be compensated for his or her services rendered on trust matters (especially when they are complex or time-consuming).

- **Trustee problems.** There can be a host of unforeseen problems that may prevent the individual (or individuals) named from serving as trustee(s). So I suggest clients should always list at least two backup trustees for each designated trustee in a trust instrument, and clearly specify how, when and under what conditions the successor trustees will begin to serve as trustees.

There are different issues when a bank or trust company is named trustee. Since trust assets are segregated from the bank's own assets, they should not be affected by a bank's financial condition. But there is still no guarantee of investment performance. Furthermore, your client's relationship with an institution is only as good as his or her relationship with the people who work at that institution.

For these reasons, when a corporate fiduciary (a bank or trust company) is selected as trustee of a revocable trust, your client should retain the right to change the trustee for any reason. If a trust is to continue long after your client's death, an individual co-trustee (co-trustees), such as one (or more) of the adult beneficiaries of the trust, or some other designated person(s), should be given the right to change the corporate trustee to another corporate trustee (of comparable size and investment experience).

USING A RLT TO PROVIDE FOR OTHERS AFTER THE GRANTOR'S DEATH

After your client makes provisions for himself/herself as well as family members or friends during lifetime, the same revocable living trust can be an excellent and flexible vehicle to provide for those persons or institutions after your client's death. Although the trust is revocable during the grantor's lifetime, it becomes irrevocable upon his or her death. This means the client can be assured that his or her wishes concerning the beneficial interest and/or financial security of others named in the trust will be carried out according to the stipulated terms of the trust.

Sam's trust, for example, might provide that his trustee would hold 50 percent of the remaining assets in the trust for each of his nephews after his death. His nephews could receive the entire income from their share of the trust each year, and the principal could be used for their benefit, such as to purchase a new home, or to enter into a new business venture. They could be given the right to withdraw one third of the principal at age 30, an additional third at age 35, and the right to terminate the entire trust at age 40. As long as the trust remained in force for them, the assets in the trust would be protected from their creditors or their spouses. The nephews could also be given the option of continuing the trust past age 40 if they so desire.

Alternatively, Sam could have provided for the principal to be held in trust during his nephews' entire lives, and then paid to his nephews' children following their deaths. He could have further provided that a portion of his trust would be used to establish a scholarship at the university from which he graduated, or used for other charitable purposes of Sam's choosing.

ALMOST NO LIMITS TO WHAT A TRUST CAN DO

The purposes for which a trust can be established, the powers granted the trustee(s), and the flexibility of distribution to beneficiary(ies) provided are limited only by the needs and imagination of the grantor, as incorporated into the trust document prepared by the lawyer, and implemented administered by the trustee.

It is by no means the only planning tool needed by your client and should typically be implemented in conjunction with other estate planning tools and techniques, but it is an important part of an older person's (and for that matter any person's) overall estate plan.

You should urge your client to evaluate his or her particular circumstances, and realistically consider his or her personal needs/wishes and those of the loved ones – and plan ahead.

REFERENCES

The Book of Trusts – 4th Edition, Leimberg Associates, Inc. (610-924-0515 or <http://www.leimberg.com>)

Tool and Techniques of Estate Planning (800-543- 0874)

Tax Planning with Life Insurance (800-950-1216)

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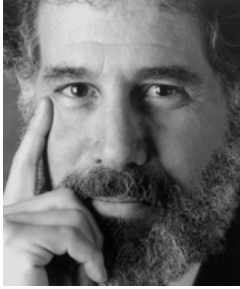
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The Book of Trusts—IV Edition

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