



# The Wealth Advisor

## The Debt Ceiling Debate and the Estate Tax, Pets, Guns, and Alimony. . .What Could They Possibly Have in Common?

Volume 5,  
Issue 4

Actually, they do have something very important in common: your estate plan.

In this issue of *The Wealth Advisor*, we will look at what the recent debt ceiling debate can tell us about the estate tax. Then we will look at several specialized trusts designed to solve particular estate planning problems, including trusts for pets, registered firearms and alimony.

### What the Debt Ceiling Debate Can Tell Us about the Estate Tax

The recent debt ceiling debate showed us a lot about how Congress works. There is public posturing and blaming, to be sure, but there is also negotiation behind closed doors that we do not see. There are a variety of elements that are constantly shifting and being discussed until things finally do come together, but there is not a deal until the last piece falls into place. Usually the end result is not something anyone could have predicted, nor what either side would have wanted from the beginning. And no matter how much time there is to make the deal, it seems to always come down to the last minute.

We have seen the same kind of thing in recent estate tax legislation. Just look at the Economic Growth and Tax Relief Reconciliation Act of 2001. The final result could not have been what anyone wanted: the estate tax exemption increased over several years to \$3.5 million, then the estate tax was repealed for only one year in 2010, then in 2011 it was scheduled to revert to a \$1 million exemption. The assumption was that, given so much time to work with, Congress would make the repeal of the estate tax permanent before 2010, and most certainly before 2011.

The House did pass a bill in 2005 that would have made the repeal permanent, but a vote in the Senate was postponed due to Hurricane Katrina and no compromise bill came from that attempt. The House passed another bill in December 2009, but the Senate was consumed with passing health care reform. 2010 arrived with the one-year repeal of the estate tax. Promises were made to

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Cody & Cody, LLC is a law firm dedicated to developing and administering estate plans for our clients. We also assist clients with long term care planning. We have six attorneys that specialize in estate planning. Please see our website ([cody-cody.com](http://cody-cody.com)).

work on the estate tax law throughout 2010 and make any changes retroactive, creating great uncertainty within both the professional community and the public. In December 2010, just days before the estate tax exemption reverted to the \$1 million exemption, President Obama announced a surprise deal: a two-year extension of the federal estate tax with a \$5 million exemption and 35% tax rate.

So, here we are again, this time with a two-year deal. If Congress does nothing between now and January 1, 2013, the estate tax exemption is set to return to \$1 million with a top tax rate of 45%. What will Congress do—and when?

That brings us back to what the recent debt ceiling debate can tell us about the estate tax. There may be a deal, but probably not without a crisis. If there is a deal, it will be at the very last minute, or even past the deadline. There will be surprises. And the uncertainty of it all will be painful for everyone. And it may not be a permanent fix.

We may see something happen on the estate tax this fall when the "super committee" convenes and "gets serious" about taxes and debt. But if not then, then maybe after Labor Day of 2012 (as Congress notices that December 31, 2012, is approaching). Because campaigning will be in high swing then, more likely not until after the November 2012 election. Whether something happens in the "lame duck" session could depend on who won the presidential election and how the balance of power in the Congress will shift. And if not then, then maybe in 2013 and they will talk about making it retroactive. Deadlock still remains a possibility. Does this sound familiar? Yes, unfortunately, it does.

**Planning Tip:** Take full advantage of the estate and gift tax laws we currently have. With Congress looking to "close loopholes" and find ways to increase revenue without raising tax rates, proven estate planning favorites like discounts, short-term GRATs, and charitable deductions may not be around much longer. The current \$5 million gift tax exemption (\$10 million if married) allows you to transfer huge amounts out of your estate, but only until December of 2012 at the latest. We do not know what 2013 will bring us or whether the opportunity will even last until then.

Specialized trusts can take advantage of the estate and gift tax laws currently in place. Trusts designed to solve particular estate planning problems include trusts for pets, registered firearms and alimony.

### **Pet Trusts**

Many who have pets have a very real sense of responsibility to care for them, even after their own deaths. Most states have adopted some form of pet trust legislation that lets you be assured your wishes regarding your pets will be carried out.

When setting up a pet trust, you will need to think about your desires, your pet's needs and how best to accomplish your goals. Consider the following:

- Make sure your pet is identified to prevent a different animal from benefiting from the trust. This is especially important if the pet is valuable or a large

sum of money is involved. This can be accomplished with photos, veterinary records, a microchip, even DNA testing.

- You may want to name different people as the trustee (to manage the funds) and the caretaker. You can name one person to have both responsibilities, but it can be good to divide them and have one person be accountable to the other.
- You may want to require that the caretaker sign an agreement to provide proper care and relinquish care to a successor if the promised care is not provided.
- Name successors in case your initial choices become unable or unwilling to act. Include a sanctuary or shelter of last resort if none of your chosen caretakers survives the pet or is able to serve.
- The trust should define what proper care is. For example, expenses could include food, housing, veterinary and dental care, toys, exercise routines, grooming, compensation for persons caring for the pet and burial/cremation fees. Farm animals, race horses and other large or valuable animals could require a full-time caretaker.
- Liability insurance should be considered to cover any potential damage caused by the pet to persons and/or property.
- If the caretaker is subject to additional taxes as a result of distributions from the trust, you may want to increase the distributions to offset the additional tax liability.
- Consider carefully how much money will be needed to fund the trust to provide for this care. If you don't have the assets, a life insurance policy on your life may be the way to provide the needed funds.
- Will the trust end when the pet dies, or will it continue for the pet's descendants? In some states, that is not an option. What do you want to happen to any remaining funds? Do you want them to go to family members or to a charity?

**Planning Tip:** Will the trust end when the pet dies, or will it continue for the pet's descendants? In some states, that is not an option. What do you want to happen to any remaining funds? Do you want them to go to family members or to a charity?

### **NFA or "Gun" Trusts**

There are four million members of the National Rifle Association (NRA) and an estimated 240 million firearms in this country. Many families also have guns and other weapons as heirlooms that they would like to keep in the family and pass down from generation to generation.

But weapons present some unique challenges. The National Firearms Act (NFA) as well as state and local laws strictly regulate possession of certain weapons and may affect the transfer of permissible weapons. For example, convicted felons, those with a history of mental illness, persons convicted of misdemeanor domestic violence offenses, convicted users of illegal drugs, dishonorably discharged veterans, and persons who have renounced their U.S. citizenship are not allowed to own or possess certain weapons.

When an estate includes firearms or other weapons, the executor must be careful to avoid violating these laws. Transferring a weapon to an heir to fulfill a bequest

could subject the executor and/or the heir to criminal penalties. Just having a weapon appraised could result in its seizure. An out-of-state heir creates even more problems.

A revocable living trust designed specifically for the ownership, transfer and possession of weapons (commonly known as a gun, NFA or firearm trust) can avoid some of the problems or at least make them manageable. A corporation or LLC can also be used to own weapons, but trusts do not require annual filing fees, public disclosure or a separate tax return. Here are some of the main points:

- The trust is the owner of the weapons.
- The trust document must be carefully written to account for the different types of weapons held and comply with the applicable laws.
- The name of the trust, once established, should not be changed. Because the regulated weapon is registered in the trust's name, a change in the name of the trust would require that it be re-registered and a transfer tax paid.
- The trust can name several trustees, each of whom may lawfully possess the weapon without triggering transfer requirements. (Persons not allowed by law to own or have access to the weapons in the trust are not eligible to be a trustee.)
- Weapons can be purchased by a trustee to avoid having to pay a transfer tax.
- Once a weapon becomes a trust asset, any beneficiary (including a minor child) may use it. However, the trustee is still responsible to determine the capacity of the beneficiary to use it.
- Unlike a traditional revocable living trust which can be revoked at any time by the grantor, the Bureau of Alcohol, Tobacco, Firearms and Explosives (BATFE) must approve the termination of a gun trust and the distribution of its assets to the beneficiaries.
- No regulated weapons held in the trust may be transported across state lines without prior BATFE approval.
- Also, since weapon laws vary from state to state, gun trusts may not be valid from one state to another as a traditional revocable living trust would be.

### **Alimony Trusts**

These trusts are often set up to provide income to an ex-spouse under a written dissolution or separation decree/agreement. Here are some of the key points:

- Assets are transferred to the trust as part of the settlement.
- The trust's income is typically paid to the former spouse for a specified length of time, until a specified amount has been paid, or until the ex-spouse remarries or dies.
- The payee (the ex-spouse receiving the payments) pays income tax on the income received.
- After the former spouse's interest has ended, the trust can continue for the benefit of the children from the marriage or terminate.
- The trustee can be a neutral third party who can act as an intermediary between the former spouses.

**Planning Tip:** An alimony trust may be useful for a business owner who cannot or does not want to sell an interest in the family business to make payments to his former spouse or if the business lacks the liquidity to redeem the stock of the former spouse. It can also protect the payee (ex-spouse receiving the income) in the event the payor should die or become financially insolvent before all payments have been made. One downside is that the trust can become under- or over-funded, so care should be taken when creating and funding the trust.

### **Conclusion**

These are just a few of the specialty trusts available to us for estate planning. And as you just read, we are living in interesting times. We currently have an exceptional window of opportunities available to us in estate planning, and we can help you make the most of them. Call us and let's get started.

Regardless of what the Congress does or does not do, control and protection of your assets, improving the predictability of the future, and doing good rather than harm with your accumulated assets remain the principal reasons for doing estate planning.

### **Test Your Knowledge**

1. Congress has the habit of working out legislation with plenty of time to spare.

**True or False**

2. We can confidently predict what changes Congress will make in the estate tax law and when any new law will go into effect. **True or False**

3. If you have pets and die before they do, the city in which you live will provide for them in a loving home for the rest of their lives. **True or False**

4. Any person you ask to take care of your pets will be willing to do so at their own expense for as long as necessary. **True or False**

5. You should consider naming successor trustees and caretakers in your Pet Trust in case one becomes unable or unwilling to serve. **True or False**

6. If you own a gun, you can leave it in your will to anyone you wish. **True or False**

7. Anyone can be a trustee of a gun trust. **True or False**

8. Just like any revocable living trust, you can cancel a gun trust at any time without having to notify anyone. **True or False**

9. Once a gun is in a gun trust, you can take it anywhere you want. **True or False**

10. In an alimony trust, the ex-spouse who makes the payments (not the ex-spouse who receives them) must pay the income taxes. **True or False**

Answers: #5 is True; all of the rest are False.

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