THE ESTATE PLANNER

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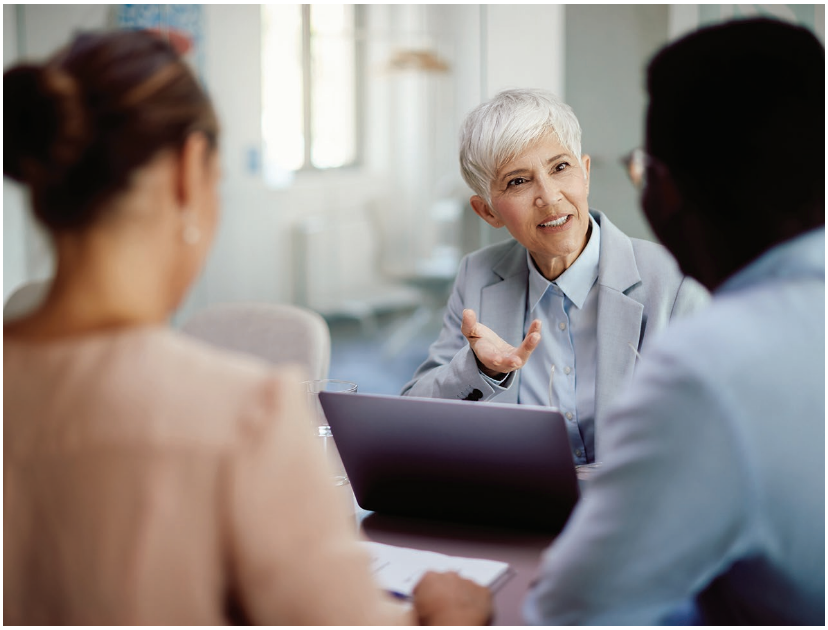
Pay attention to securities laws when planning your estate

Do your assets include unregistered securities, such as restricted stock or interests in hedge funds or private equity funds? If so, it's important to consider the securities law implications of various estate planning strategies.

Securities laws in a nutshell

The federal securities regulation regime consists of four main laws:

- The Securities Act of 1933, which is designed to protect investors by imposing registration and disclosure requirements on public offerings of stock. Several exemptions from the requirements exist, including private placements that meet certain specifications.
- The Securities Exchange Act of 1934, which applies to trading of securities in the secondary market and prohibits some activities, including insider trading, fraudulent trading and market manipulation.
- The Investment Advisers Act of 1940, which requires investment advisers to register with the U.S. Securities and Exchange Commission (SEC) and comply with certain regulations designed to protect investors.
- The Investment Company Act of 1940, which obligates investment companies (such as mutual funds, closed-end funds and unit investment trusts) to register with the SEC and comply with applicable regulations. There's an exemption from these demands — typically relied on by hedge funds and private equity funds — for companies that don't make public offerings of their securities and limit participation in the fund to either 1) no more than 100 investors, or 2) qualified purchasers.



To avoid the time and expense of registering a securities offering with the SEC, many companies take advantage of an exemption that allows them to raise capital in an unregistered offering. The most commonly used exemption is Regulation D, Rule 506, which exempts offerings of an unlimited amount of securities, provided several conditions are met, including limiting purchasers to 1) any number of "accredited investors" and 2) up to 35 nonaccredited, "sophisticated investors." Purchasers in these transactions receive "restricted securities," sales of which are subject to holding periods, volume limitations and other restrictions.

Potential estate planning issues

Transfers of unregistered securities, either as outright gifts or to trusts or other estate planning vehicles, can raise securities law issues. For example, if you gift restricted securities to a child or other family member, the recipient may not be able to sell the shares freely. A resale would have to qualify for a registration exemption and would likely be subject to limits on the amount that can be sold.

If you plan to hold unregistered securities in an entity — such as a trust or family limited partnership (FLP) — be sure that the entity is permitted to hold these investments. The rules are complex, but in many cases, if you transfer assets to an entity, the entity itself must qualify as an "accredited investor" under the Securities Act or a "qualified purchaser" under the Investment Company Act. And, of course, if you plan to have the entity invest directly in such assets, it will need to be an accredited investor or qualified purchaser.

Accredited investors include certain banks and other institutions, as well as individuals with either 1) a net worth of at least $1 million (excluding their primary residence), or 2) income of at least $200,000 ($300,000 for married couples) in each of the preceding two years.

A trust is an accredited investor if:

- It's revocable, the grantor is an accredited investor, and certain other requirements are met,
- The trustee is a bank or other qualified financial institution, or
- It has at least $5 million in assets, it wasn't formed for the specific purpose of acquiring the securities in question and its investments are directed by a "sophisticated person."

FLPs and similar family investment vehicles are accredited if 1) they have at least $5 million in assets and weren't formed for the specific purpose of acquiring the securities in question, or 2) all its equity owners are accredited.

Qualified purchasers include individuals with at least $5 million in investments; family owned trusts or entities with at least $5 million in investments; and trusts, not formed for the specific purpose of acquiring the securities in question, if each settlor and any trustee controlling investment decisions is a qualified purchaser.

Complex rules

Federal securities laws and regulations are complex, so a full discussion of them is beyond the scope of this article. If your assets include unregistered securities, consult your advisor to be sure your estate planning strategies comply with applicable securities requirements.

Watch out for short-swing profit rule

The insider trading laws generally make it unlawful for insiders — such as officers, directors and more-than-10% shareholders — to trade the company's stock for their benefit (or recommend such trading to others) on the basis of material nonpublic information (MNPI). Insiders are required to report their holdings and certain transactions involving the company's securities to the SEC.

In addition, under the short-swing profit rule, an insider's profits generated by the purchase and sale of the company's securities within a six-month period may be recovered by the company.

The rule is intended to discourage insider trading, but it applies regardless of whether the insider possesses any MNPI. The rule may affect certain transfers for estate planning purposes. For example, if you sell securities to a trust for which you're the trustee and certain immediate family members are the beneficiaries, then transactions by you or the trust within the following six months may be subject to the rule, placing your profits at risk.

Where should you keep your estate planning documents?

If you're reading this, you've likely put a great deal of time, effort and expense into designing and implementing an estate plan that meets your goals. But unless your loved ones know that these documents exist — and how to find and access them — your well-laid plans can be derailed. Following are some tips on how, and where, to store critical estate-planning documents.

Handle an original will with care

There's a common misconception that a photocopy of your signed last will and testament is sufficient. In fact, when it comes time to implement your plan, your family and representatives will need a signed original will to accomplish that purpose. Typically, the original document will need to be filed with the county clerk and, if probate is required, with the probate court as well.

In many states, if your original will can't be produced, there's a presumption that you destroyed it with the intent to revoke it.

What happens if your original will isn't found? It doesn't necessarily mean that your will won't be given effect, but it can be a big — and costly — obstacle.

In many states, if your original will can't be produced, there's a presumption that you destroyed it with the intent to revoke it. Your family may be able to obtain a court order admitting a signed photocopy, especially if all interested parties agree that it reflects your wishes, but this can be a costly, time-consuming process. And if the copy isn't accepted, the probate court will administer your estate as if you died without a will.

Storage options

To avoid these issues, be sure that your original will is stored in a safe place and that your family knows how to access it.

Storage options include:

- Leaving your original will with your accountant, attorney or another trusted advisor and ensuring that your family knows how to contact him or her.
- Storing your original will at home (or at the home of a trusted family member) in a waterproof, fire-resistant safe, lockbox or file cabinet and ensuring that trusted family members know the combination or have access to the keys.

What about safe deposit boxes? Although this can be an option, you should check state law and bank policy to be sure that your family will be able to gain access without a court order.

In many states, it can be difficult for loved ones to open your safe deposit box, even with a valid power of attorney. It may be preferable, therefore, to keep your original will at home or with a trusted advisor or family member. If you do opt for a safe deposit box, it may be a good idea to open one jointly with your spouse or another trusted family member. That way, the joint owner can immediately access the box in the event of your death or incapacity.

Note that it's generally advisable not to make photocopies or duplicate originals of your will. If you amend your will, having these outdated copies floating around can create confusion or, worse, an opportunity for someone to attempt to use an outdated will.

For powers of attorney, living wills or health care directives, originals should be stored safely, but it's also critical for these documents to be readily accessible in the event you become incapacitated. So, for example, you might want to avoid keeping these documents in a safe deposit box, where they won't be accessible outside of banking hours.

Consider giving copies or duplicate originals to the people authorized to make decisions on your behalf. Also consider providing copies or duplicate originals of health care documents to your physicians to keep with your medical records.

Other important documents

Original trust documents should be kept in the same place as your original will. It's also a good idea to make several copies. Unlike a will, it's possible to use a photocopy of a trust. Plus, it's useful to provide a copy to the person who will become trustee and to keep a copy to consult periodically to ensure that the trust continues to meet your needs.

Shred outdated docs

One last thing to keep in mind when you revise your estate plan: destroy any revoked or outdated documents. Doing so will help avoid confusion or family conflicts. Your estate planning advisor can help you manage all your estate planning documents.

Helping a disabled loved one with an ABLE account

Estate planning can be tricky for a family that includes a disabled loved one. Why? Because the family doesn't want to lose eligibility for means-tested government benefits, such as Medicaid or Supplemental Security Income (SSI).

A Section 529A account — better known as an ABLE account because it was created by the Achieving a Better Life Experience (ABLE) Act — generally won't affect the beneficiary's eligibility for Medicaid and SSI, which limits a recipient's "countable assets" to $2,000 with a few exceptions.

What are the specifics of an ABLE account?

Under the ABLE Act, you may contribute funds to a designated account that grows without current tax erosion, much in the same way that 529 plans operate. Furthermore, there's no tax on distributions paid for qualified expenses.

Currently, more than 40 states and the District of Columbia have established ABLE accounts for residents. If you live in one of the handful of states that doesn't permit ABLE accounts, you can create one in a state that allows nonresidents

However, there are complications related to other programs. If a disabled individual meets SSI or Medicaid requirements and is receiving benefits from either, or both, he or she is still eligible for an ABLE account. An ABLE account's funds don't count toward the limits on personal assets for these public benefits.

to participate. Fees paid to administer the account generally are minimal.

Bear in mind that an ABLE account may be used only to benefit an individual who experienced a disability prior to the age of 26 and who satisfies certain Social Security criteria. Therefore, it's not available to every disabled person.

An ABLE account can be managed by its beneficiary. However, these responsibilities typically are handled by the parents, a professional or another person acting under a power of attorney.

How are ABLE accounts funded?

Funds in an ABLE account are invested through options authorized by the applicable state. Investment changes may be made twice a year, and only one ABLE account can be set up for a qualified individual.

Normally, an ABLE account is funded through a series of annual contributions. These contributions are tied to the annual gift tax exclusion, which is indexed for inflation. (The gift tax exclusion amount for 2022 is $16,000.) Plus, lifetime contributions are limited to the amounts imposed by the individual state for 529 plan accounts. These limits are generally at least $250,000 — and can exceed $500,000.

If the assets in an ABLE account exceed $100,000, the beneficiary's SSI benefits will be suspended until the total drops below this threshold. However, Medicaid eligibility will not be affected by the account's amount.

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Also, be aware that contributions to an ABLE account aren't tax deductible. Some individual states have carved out limited state income tax benefits for these accounts.

What are the distribution rules?

If the funds in an ABLE account are used to pay for qualified expenses, the payouts are exempt from income tax. Qualified expenses must go toward maintaining or improving the health, independence or quality of life of the beneficiary. These include basic living expenses for education, food, housing and health care.

However, if withdrawals are made for nonqualified expenses, the portion of the distributions attributable to earnings is subject to tax at ordinary income rates, plus a 10% penalty tax is imposed on that portion.

Is an ABLE account right for you?

If you have a disabled family member you'd like to provide for, an ABLE account may be a viable option. Talk to your estate planning advisor to determine if an ABLE account is right for your situation.

ESTATE PLANNING RED FLAG

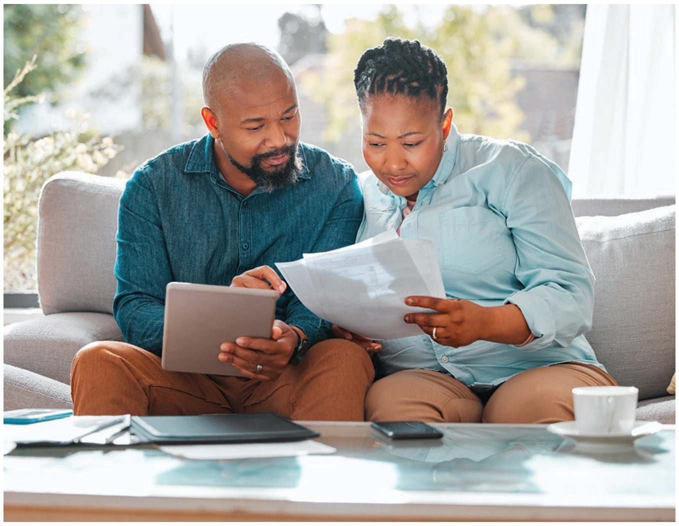
You're taking periodic payments from an IRA or 401(k) plan

A tax-advantaged savings plan, such as an IRA or 401(k) plan, is designed to help you fund your retirement. But to the extent that you don't need the funds during your golden years, they can be a valuable supplement to your estate plan. To preserve the tax-deferred growth of these funds, it's best to avoid early withdrawals (before age 59½), which can trigger a 10% penalty, on top of ordinary income taxes.

If you need to take early withdrawals, it's possible to avoid penalties under limited circumstances. One way to do so is to take a series of substantially equal periodic payments (SOSEPP) over your life expectancy or the joint life expectancies of you and your designated beneficiary. But if you go this route, be sure you understand the rules to avoid potentially costly pitfalls.

To calculate the payment amount, you can

1. Divide your account balance at the end of each year of your life expectancy or the joint life expectancies for you and your beneficiaries according to IRS tables,
2. Amortize your account balance over a period of years based on applicable life expectancy tables and a "reasonable" rate of interest, or
3. Divide your account balance by an IRS-prescribed annuity factor.



Be aware that payments under method number one fluctuate, while methods numbers two and three result in fixed payments. Also, in the case of an employer-sponsored retirement plan that permits SOSEPPs, you must leave your job before payments begin.

Once you start periodic payments, they must continue for at least five years or until you reach age 59½, whichever is longer. If you modify the amount of a payment or make any other additions to or distributions from the account, the arrangement may be disqualified, triggering tax penalties and interest on all previous payments.

Talking with Your Parents about Their Estate Planning

There are uncomfortable conversations and then there are uncomfortable conversations. The good news is that these heart-to-hearts don't have to be that way. In fact, they can increase everyone's comfort level.

When are some memorable times that you talked to your parents about money? When you were first negotiating your allowance? Buying a car? How to pay for college—or maybe how to recognize the possibilities and the pitfalls of buying your first house?

Notice anything about those topics? They're mainly about you and your money concerns—as they should be. But what now? What about your parents? Specifically, what about your parents' future and how their resources fit into that future? (And, yes, your future, too.)

Sometimes seen as "difficult" or even distasteful, such conversations are important to have and can benefit everyone. They can be conducted without the urgency a health emergency might bring, for example, and even open up new possibilities about continuing to build the lives of everyone in the family. Compassion, honesty, knowledge, and plenty of time are keys.

Your parents have always had your best interests at heart. And how they think about their estate is one more step in helping you live the best life possible. You know they want to help you, even though this topic might feel more awkward than teaching you how to swim or ride a bicycle. Even in cases where relationships aren't on the best footing, having the conversations can help everyone better understand the challenges and solutions.

What do you need to consider when talking with your parents about their estate planning?

Lead with their interests in mind. Ask your parents: What are your plans when you have the time and resources to step away from your careers and other responsibilities? Travel? Dig deeper into hobbies or other passions? Even start another career? Of course, you might already know what those are, but not necessarily. There might be others they haven't expressed. Be sincere. Be sure they know that your interest really is in their well-being as they get older and how they plan to make the most of that stage of their lives, including securing their legacy.

Don't be in too much of a hurry. Allow time. As you can see, it's unlikely that this topic will be covered in one conversation. Depending on your age and the ages of your parents, getting started sooner rather than later is the best course. Some of the discussions can be informal; others might require a more organized "sit down" with a family attorney or other professional. They could be ongoing for some time. Are they really worth your time and that of your parents? The short answer is yes. Ideally, you and your parents will all become more secure in how the future can unfold—and learn more about each other and become closer than ever. You'll also gain insight into how to think about your legacy.

Include your siblings, if you have any. It's critical that everyone who will be directly involved in any inheritance have the opportunity to be heard. Ideally, everyone would participate in the discussions at the same time. That can also include spouses or partners. Group phone calls or Zoom sessions can summarize other discussions, clarify possible outcomes, and answer questions. Those talks also allow individuals to clarify their interests. Maybe your sister doesn't want a specific property or piece of artwork, even if she was enthusiastic about them in the past. It wouldn't be surprising if your parents have hung onto that thought as something special to her. Or maybe two siblings want the same thing. Use this process to work it out.

Be prepared. Do some research on key issues, talk to your friends, and your own financial and family advisors. Write down your questions, concerns, things you don't understand, or financial topics that people might understand *in general* but not down to the nitty gritty—how to use various powers of attorney, for example, or advance directives. And, if your parents bring up their estate planning before you do, you'll be ready to talk about the topic in a productive way. If your parents resist, try to find out why, back off for a time with compassion and understanding, but don't give up. They will no doubt begin thinking about everyone's interests in different ways and from different perspectives, even if they haven't done so before.

Remember that we're here to help and that we know how to help. Working with families, family offices, and successive generations is a special part of our practice and expertise. Please get in touch for more information or just to talk about specific challenges and opportunities your family might be facing. Please call 312-900-0150 to speak directly with one of our attorneys.