

makes sense for you. This is a tax-efficient way to make charitable contributions that you're going to make anyway. **TH**

### SOCIAL SECURITY Hotline

## Increase Benefits And Get a Deduction

If you chose to start receiving your Social Security benefits early, at age 62, you may regret it when your normal retirement age arrives and your monthly benefit is lower by 20% or more from what it would have been had you waited to receive it.

But, even in this case, it's not too late to get the larger benefit. By filing a "withdrawal of claim" with the Social Security Administration (SSA), you can give up the smaller benefit you claimed at the earlier age. You can then take the larger benefit you are entitled to at the later age.

Of course, you will have to repay to the SSA the earlier benefits you received. In the year that you do so, the SSA will issue you a Form 1099 reporting your benefit for the year as a negative number—equal to the amount it paid you for the year minus the amount of benefits you repaid to it for the prior years.

**Tax saver:** This negative number is deductible on your tax return—giving you a deduction for your repayment.

**Alternative:** You can look at your prior years' tax returns, figure out how much tax you actually paid on the Social Security benefits you repaid, and claim a tax credit for that amount.

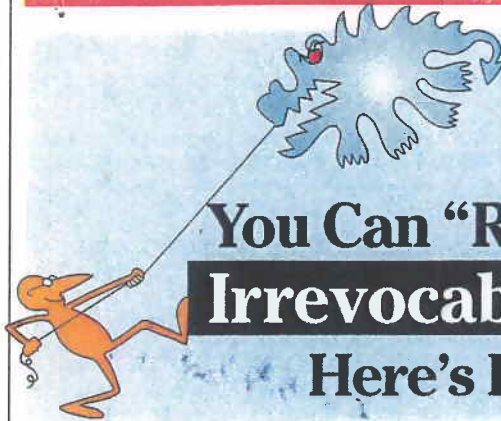
You can claim either the deduction or the credit, whichever has the greater cash value.

For details about the deduction and credit, see IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.

For more information about filing a "withdrawal of claim" with the SSA to increase your benefits, consult an expert Social Security adviser.

Bob Carlson, editor, *Bob Carlson's Retirement Watch*, Box 970, Oxon Hill, Maryland 20750. Monthly. \$79/yr.

## ESTATE PLANNING HOTLINE



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## You Can "Revoke" an Irrevocable Trust Here's How...

Trusts come in two basic types—*irrevocable*, meaning that you can't amend, revoke, or change the trust...and *revocable*, sometimes referred to as a living trust, which can be amended by the person who set it up, or revoked entirely. Can an irrevocable trust, which by definition means "nonchangeable," ever be changed? Surprisingly, the answer is yes. *What you need to know...*

### it was a mistake

Creating an irrevocable trust requires something of a crystal ball—you have to specify in advance what the trust should do with your assets, to whom the assets should eventually be given, in what amount, and when. Unfortunately, even the best crystal ball gazers sometimes get things wrong. *Examples...*

- While you were happily married and had two wonderful children, you set up an irrevocable trust to hold life insurance with your family as beneficiaries. Years later, you find yourself divorced and remarried, with a new family that you also want to take care of. Meanwhile, one of the children from your first marriage is a spendthrift and the other is wealthy and doesn't need any money from you—or one of them is getting divorced or has judgments against him and you want to protect assets within the trust from these threats.

- You specified in the trust that your children were to receive money outright at a certain age, say 30. Now, you want them to receive

funds staggered over various ages. Perhaps you have come to realize that obtaining a large sum all at once will prove to be a disincentive to them to get a job or otherwise become productive.

- Upon reading your trust years after it was completed, you find that the attorney who drafted the document made a drafting error or did not incorporate the terms you had wanted.

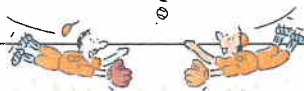
Many people believe that, once established, an irrevocable trust is absolutely irrevocable. Lawyers usually tell their clients that unless it can be shown that the client was "incompetent" at the time the trust was created, there is no recourse. Both are unaware of any way to "undo" the trust. Because of recent developments, as well as creative ways to apply old laws, this is not so. Ways to amend any kind of irrevocable trust or to get around an otherwise "unrevocable" situation...

### set up a new trust

In certain states (e.g., Delaware and New York), if a trustee has unfettered discretion to "invade" principal, the trustee can take the funds in one trust and pour them

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into another trust created with the terms you now desire. As long as the new trust does not impinge on the rights of income beneficiaries (such as the right to receive a certain amount of income) from the old trust, changes can be made to affect the rights of remainder beneficiaries, those who ultimately receive property when the new trust terminates.

No assent by the beneficiaries of the old trust is required and no court approval is necessary.

**Example:** A person sets up an irrevocable trust for his spouse to receive income for life, with the remainder of the property that was put into the trust to be distributed outright to his two children when the spouse dies. Where state law allows it, the person can create a new trust in which the remainder is not immediately distributed but rather doled out to the children over time.

**Caution:** This strategy may expose the new trust to a lawsuit—the child who would receive less

#### MORE FROM Gideon Rothschild

### Types of Irrevocable Trusts

•**Testamentary:** Established under your will, this trust becomes effective upon your death to help you minimize your estate taxes, preserve your wealth, and provide for your spouse and children.

•**Charitable:** Established during your lifetime or under your will, this trust enables you (and your spouse) to receive income for life while ultimately benefiting the charity of your choice.

•**Life insurance:** Created during your life to hold life insurance and, upon your death, to pass proceeds to your named beneficiaries without any estate taxes.

•**Special needs:** Established to pay expenses above and beyond those covered by government programs for individuals who are suffering from various disabling conditions.

from the new trust than the old may sue (this has not yet been tested in court).

**Going forward:** Using the “new trust” approach with an irrevocable trust raises potential tax exposure for income, generation skipping, and gift tax consequences that need to be addressed with a tax adviser.

### change by consent

Under common law and many state statutes, you can change the terms of a trust by obtaining the consent of *all* beneficiaries and the trustee. Doing this requires court approval. And, where beneficiaries are minors, guardians must be appointed to protect their interests.

You need to demonstrate to the court that the change in the trust is in everyone’s interest and is needed to accomplish a common objective (e.g., protecting family assets).

**Example:** One of the beneficiaries might be a disabled child who would not qualify for government benefits if his portion of the trust is distributed to him. With the consent of the other beneficiaries, the trust might be amended to provide for a continuing trust that would not disqualify the disabled beneficiary from receiving government benefits.

**Caution:** The case law of the state in which you reside controls what’s needed to meet this standard.

### selling out

Another strategy is to sell the assets that are in the original trust to a new trust as a way to reduce the amount of money subject to the old terms and to create a new pot subject to new rules.

•**Life insurance.** In the past, it was not clear, unless one received a private letter ruling from the IRS, whether a sale of a policy from one trust to a new one was tax free. A new IRS revenue ruling (Revenue Ruling 2007-13) now endorses this approach if both trusts are grantor trusts (trusts treated under the tax law as owned by the person who set them up). The sale must be done while the grantor is still alive.

**Example:** Say you created an irrevocable life insurance trust in which you instructed that proceeds from the policy be distributed equally to your two children when you die. Now, however, one child has become wealthy in her own right, so you want all the funds to pass to the other child. There is a \$5 million term policy on your life with no cash value in the trust. The annual premium for the policy is \$10,000, and six months have elapsed. The trust can sell the policy to a new trust for fair value, which in this case would be 50% of the annual premium, or \$5,000. You would fund the new trust with enough to buy the policy. The old trust would retain the sales proceeds, \$5,000, and distribute them according to the terms of the old trust, while the policy’s death benefit, \$5 million, would have been shifted to a new trust and eventually distributed according to the new terms.

•**Closely held business or real estate.** Say an irrevocable trust is holding a noncontrolling interest in a closely held business or in real estate and you no longer like the terms of the trust. In such a case, a noncontrolling interest in the business or the property can be sold to a new trust that contains more favorable terms.

Since the interest is illiquid, the value of it when sold to the new trust is less than the pro rata value of the entire interest (a valuation discount is applied). And, since there will be no interest in the business or real estate left in the old trust, this maneuver will freeze the value of the old trust (it will hold the sales proceeds) and put the future growth (any appreciation on the assets) in the new trust.

**Caution:** With both “selling out” strategies, there are capital gains tax issues to take into account. Work with a knowledgeable adviser. **TH**

### ...COMING IN TAX HOTLINE

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- New world of estate planning.
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