THY WILL BE DONE by Atty. Angelo M. Cabrera

LIQUIDITY STRATEGY IN ESTATE PLANNING

In one blog, my affiliate lawyer, Atty. Donn Rabanes, wrote that pursuing a liquidity strategy in estate planning might be the best option in certain circumstances. In this strategy, an estate owner sells his real property while he is still in good health and the proceeds thereof, he uses for his old age and eventually divides among his heirs. The idea is to limit or even avoid estate tax through the process of liquidating his hard assets and distributing the converted funds during his lifetime. This way, he is able to dispose of his property for value, taking advantage of market conditions instead of his heirs being forced to sell under duress or in a state of haste, which usually results in losses or in some cases, legal liabilities such as when illegal means are employed to dispose of the property.

To some, this approach may seem viable and quite an attractive option because, unlike real properties, liquid funds can easily be partitioned, distributed and transferred with the least complication or government intervention. For instance, it only takes a parent to open a joint bank account with his children to transfer most of his funds to their names. To illustrate, suppose a father opens a 10 million joint account with his four children. By this simple act alone, he will have effectively transferred 8 million of his funds to his children, at 2 million each and continue to have some form of control over the funds as one of the joint depositors. He then can leave instructions that in the event of his serious illness, his children withdraw the entire deposit and open a new joint account without him or divide the deposit among themselves.

However, this process of opening a joint account with the parents and children as joint depositors using the funds of the parents actually involves a donation for which donor's tax should be paid. But there is no law that requires banks to inquire into the basis for the children's inclusion as joint depositors. Neither is there a regulation that requires it to demand the presentation of a deed of donation or donor's tax receipt in approving such transaction. If at all, this may be classified as a covered or suspicious transaction under the Anti-Money Laundering Law by virtue of the amounts involved or perhaps the financial incapacity of the children. However, tax evasion is not among the unlawful activities covered by the said law. Not yet anyway.

So in effect, unless new laws are enacted to capture these transactions for purposes of imposing the proper taxes, the liquidity strategy will continue to be considered by some as a viable option.

But one must be aware of its pitfalls and the need to put in some safeguards. Here are some:

1. Liquidating or converting real properties into cash through a sale is a taxable incident for which either capital gains tax or income tax (plus VAT) is payable. In other words one has to study and compare the tax to be paid if the property were to be sold vis-a-vis the taxes to be paid if the property is inherited. For instance, a real property classified as ordinary asset when sold may be imposed as much as 32% income tax plus 12% VAT. Now compare this with the maximum estate tax of 20% for values in excess of 10M.

2. Ensure that the house or at the very least, the right to its use, remains with the estate owner and is passed on only upon his death. At an age and time when a person no longer has the physical strength or capacity to produce wealth, he cannot risk giving up his abode just to avoid taxes because unexpected and unfavorable circumstances may ensue that could ultimately affect his right to continue to possess and use his house.

3. Make sure that the instruments where the money is invested in is secure and is able to generate earnings in accordance with the objectives and risk appetite of the owner. It would be a total disaster to liquidate one's real assets only to lose everything because of wrong or bad investments. This is where one needs the assistance of a good and trusted financial advisor.

4. Lastly, do not completely give up control of your funds and rely on the generosity of other people, including your children, to support you. Again, circumstances can change. There are ways of setting up the fund in such a manner that it can support you while still around and distributed upon your demise.

In the end, it is always best to do things correctly, properly and legally. Remember, passing on your wealth is probably the last act that you'll do for your children. Make sure you make the right move.

Next week: the insurance option.

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