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Essentials of Estate Planning for the Professional Athlete

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ESSENTIALS OF ESTATE PLANNING FOR THE PROFESSIONAL ATHLETE

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I. INTRODUCTION

Thurman Munson was the captain of the New York Yankees. A former American League Most Valuable Player, Munson led the Yankees to playoff and World Series victories. The All Star catcher's play was characterized by his toughness behind the plate. On August 2, 1982, he was at the peak of a career that could have put him in the Hall of Fame. It all ended that afternoon when Munson died in a private plane crash in Ohio.

Larry Gordon was a starting linebacker for the division champion Miami Dolphins during the 1982 football season. The 29 year-old was an established National Football League star, enjoying his high income earning years. He played in the Super Bowl of January 1983. On June 25, 1983, he died while jogging in Arizona.

Hank Gathers was a basketball player of almost limitless potential. While playing for Loyola Marymount University in 1990, he led the nation in scoring. Everyone knew he would bring his team to the NCAA tournament and then be selected early in the National Basketball Association draft. He did not. He died before any of it could happen.

Reggie Lewis was the heir to Larry Bird as leader of the Boston Celtics. During the 1992-1993 season, Lewis was diagnosed as having a heart condition. After the season, the condition seemed to stabilize and Lewis started light workouts. Unfortunately, Lewis collapsed and died just as he began to play in a pick-up game.

In representing or advising professional athletes, it is never too early to think about estate planning. The goals of estate planning and financial planning are similar: to preserve as much of the athlete's assets as possible for the athlete's enjoyment during life and to provide, at death, for the athlete's beneficiaries in a way which fits family goals.

This Note is not intended to be exhaustive. Rather, it is a brief outline of some of the basic components of estate planning which may arise in the professional athlete's general situation.

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Many of the concepts mentioned here, particularly those dealing with taxes, are highly technical and subject to changes in the law. Accordingly, the practitioner should be alert for any changes in these concepts before finalizing the athlete's estate plan.

II. Domicile

The athlete's domicile, or legal residence, is important for estate planning. Domicile determines the power of a state to tax worldwide income, gifts and estates. Domicile also dictates voting districts and many other legal rights, privileges and obligations. Given the truly national (and international) scope of professional sports, athletes who grows up in one state, play their career in another state, and live the off-season in still a third state are not uncommon.

Domicile may be defined as actual residence within a state, combined with the intention of making that state one's permanent home. In order for the professional athlete to avoid having more than one domicile, it is important to be clear in both establishing the athlete's domicile and relinquishing any prior domicile.

A. *Establishing A New Domicile*

Once location has been selected, the first step in establishing domicile is for the athlete to obtain a place to live there. This can be a house, a condominium, a co-operative apartment, or a rental unit. If a rental unit is selected, it is best to have a written lease for a fixed term - the longer the better.

The following is a list of steps to make it clear that the athlete is establishing a new domicile:

- If possible, file a formal Declaration of Domicile with the local clerk of court.
- Transfer church, temple, social club, civic club, country club and any other membership to the new domicile. Many of these organizations allow non-resident members.
- Send change of address cards to all persons who send mail. Include credit card companies, subscriptions, creditors, debtors, life, health, casualty and liability insurance companies and friends. The athlete should be sure to use the new domicile address on all papers calling for residence.
- Athlete-owned businesses, ranging from restaurants to conglomerates, should be operated from the athlete's domicile.
- Register to vote with the local Supervisor of Elections.
- Obtain and keep a driver's license and register all automobiles in

the new domicile.
• File federal income tax returns with the Internal Revenue Service Center for the new domicile. Any state or local tax returns required by the new domicile must be filed.
• Transfer bank accounts, brokerage accounts and the contents of any safe deposit boxes and any other personal property to the new domicile.
• Spend as much time as possible at the new domicile. More time should be spent there than anywhere else. Ideally, it would be best to spend six months or more each year in the new domicile.

B. *Relinquishing Previous Domicile*

As noted, many professional athletes work at their sports in places apart from their homes. The work locations can often change either by choice, trade, or other circumstances. Accordingly, relinquishing a domicile is every bit as important as establishing a new one. The following is a list of steps to make it clear that the athlete is relinquishing a domicile:
• Let the taxing authorities in the former domicile know that a new domicile has been acquired.
• Stop filing resident income tax returns with the old domicile. Any returns needed should be filed as a non-resident.
• Keep contacts with the old domicile to a minimum.
• Limit business activity in the old domicile.
• Make a will noting the new domicile.

None of the above may be conclusive in showing establishment of a new domicile or relinquishment of a previous one, but a court will consider the above factors when determining the athlete's intent concerning domicile.

III. MARITAL AGREEMENTS

All marriages are part business and part pleasure. Today, the business aspects - getting, managing and using assets - are more important to the professional athlete than ever before. This is a function of several factors, including the increase in compensation and endorsements paid to professional athletes, the increase in the number of second and third marriages, longer life expectancies, large values of assets and changing social ideas about marriage.

Marital agreements can be made before (ante-nuptial) or after (post-nuptial) marriage. These agreements are used to define arrangements between spouses if the marriage ends in divorce. Marital agreements can also determine the rights and duties of a surviving spouse upon death of the other. Because of these uses, some of the most common rights a spouse may have, such as alimony, spouse's share at death and other post-death rights, are frequently involved.

In some divorces, courts can give alimony to either spouse. This alimony can be paid out in many payments or one lump sum. Generally, courts will set alimony awards on the basis of the spousal conduct, the ability to pay, the lifestyle established during marriage, the term of marriage, the age and physical and emotional condition of each spouse, the financial resources of each spouse, the time necessary for either party to get enough education or training to find employment and the contributions of each spouse to the marriage.

In some states, one of the most important rights surviving spouses possess is the right to an automatic statutory share of the deceased spouse's estate. This is sometimes called the elective share or dower. The elective share usually consists of an amount equal to a percentage of the fair market value of the estate, calculated at the date of death, less the total amount of all valid claims, mortgages, liens, or security interests against the estate.

The typical marital agreement is a written contract between two spouses or proposed spouses. A marital agreement can be useful for simply and clearly setting forth the rights of each spouse to the other's property, whether purchased before or after the marriage. These agreements are also a way for the spouses to list their assets for each other so it is clear which property is subject to the agreement. They may also decide that during the marriage each spouse can have complete ownership and control of his or her own property, including all property received after marriage. Among the benefits listed above, a marital agreement may be enlarged, amended, or canceled at any time by mutual consent. Marital agreements must be carefully negotiated and drafted. Requirements for these agreements will vary from state to state. The following is a list of general guidelines:

• The agreement must be fair. Neither party should overreach. Each party should have an equal say in the agreement. The negotiations and final agreement should reflect a give-and-take process.
• Be certain the parties understand what they are giving up. Supervise full and fair disclosure of all property. The property disclosure should be separately listed and attached to the agreement. Assets should be carefully described and valued. If an asset is difficult to set a dollar figure on, estimate it on the high side.
• Each party should have an independent lawyer. Both lawyers

should approve and sign the agreement. Naturally, both parties should likewise sign the agreement.

• Suggest a "cooling-off" period after the agreement is signed and before the marriage takes place. This gives the parties some time to get used to the idea of the agreement as well as time to reconsider it.

• The agreement should specifically and clearly deal with all rights of either spouse that are being changed or waived.

IV. Life Insurance

Life insurance is an important part of any estate plan. Given the youth and good health of most professional athletes, life insurance can be obtained at low cost.

In the event an athlete dies, insurance proceeds are a quick source of cash to the athlete's family and help to replace the income the athlete would have otherwise earned. Proceeds can be used to pay debts, taxes and bequests. This is especially useful for the athlete with a large estate and little liquidity. Life insurance also provides funds for trusts for members of the athlete's family. These trusts can be used to help raise and educate young children after the loss of the athlete/parent.

Types of life insurance include term, whole life, survivorship, variable life, and universal life.

Term insurance is used for a limited time and has no cash value to borrow against. Proceeds are payable only at the insured's death and, therefore, are not ordinarily used for any other financial planning purpose.

Whole life insurance is more permanent. The premiums are paid over the life of the insured or are prepaid earlier. Though the premiums are higher than term insurance, whole life insurance has a cash value which can be borrowed against. Whole life insurance provides both an insurance portion paid at death and, in contrast to term insurance, a cash value portion useable during life.

Survivorship insurance insures the lives of two people and is only payable at the death of the second person. The premiums are lower than whole life because this insurance covers two lives and the premiums are paid out over a longer time. Survivorship insurance is usually purchased to pay estate taxes. With proper planning, the estate tax may be eliminated upon the first death by utilizing the unlimited marital deduction, discussed below. This being the case, the insurance proceeds will not be needed to pay estate taxes until the survivor's death. Consequently, some people prefer to keep premiums low and purchase insurance which will not be paid until both spouses die and the proceeds are needed to pay estate taxes.

Variable life insurance is similar to whole life except that the cash value varies because the insurer invests the cash value in assets which fluctuate, such as securities. Variable life insurance is a useful hedge against inflation.

Universal life insurance offers either term or whole life insurance, with the underlying cash value invested in funds which, like variable life, hopefully (but with no guarantee) will keep pace ahead of inflation.

Accidental death insurance is an important consideration in any determination of life insurance needs for the professional athlete. Since these proceeds are only paid in the event of death by accident, premiums are low. This is especially appropriate for professional athletes because, at the typical athlete's age and level of health, it is much more likely that death will occur by accident rather than by natural causes. Often, accidental death coverage is made part of conventional life insurance as an additional benefit.

Once the appropriate type and amount of life insurance are determined, an examination should be made of the possible use of an irrevocable life insurance trust. The irrevocable life insurance trust allows the athlete to exclude all life insurance proceeds from estate taxes. If an existing policy is placed in such a trust, the athlete must live at least three years after transferring the policy. The preferable method is to place cash in an irrevocable trust which allows, but does not require, the purchase of life insurance on the life of the athlete. Once the insurance is purchased, premiums are paid with funds the athlete periodically contributes to the trust. Upon death, the insurance proceeds may be used to care for family members, purchase assets from the athlete's estate, or pay estate taxes. The irrevocable life insurance trust helps establish a stable, irrevocable, and estate tax-free fund for the athlete's beneficiaries

V. WILLS AND TRUSTS

The cornerstone of estate planning is the consideration, drafting and customizing of the athlete's will and/or trust.

A. *Wills*

A will is a written document which passes title to property owned in the athlete's individual name through the athlete's beneficiaries. Wills have many uses:

• A will names the persons to receive the athlete's property at death.
• A will can be used to put property in trust for the benefit of family members who are unable to manage property on their own. A trust for the benefit of young children can play an important role in the athlete's will. If there is no will, property may pass by intestacy directly to the athlete's children at death and, if those children are minors, court supervised guardianships need to be created. This is generally more expensive and complicated under the athlete's will.
• A will can name a guardian to take custody of the athlete's minor children. This is an important function for wills of athletes who are often engaged in their sports while raising young children.
• A will can name a person, bank, or trust company in charge of the athlete's estate. The person or institution is called a personal representative or executor. The functions of this fiduciary include location of the athlete's property, payment of taxes, claims, and expenses of the estate, protection of the interests of the athlete's beneficiaries, and ultimate distribution of the estate to those beneficiaries.
• A will can direct from which assets taxes, expenses, claims, and other charges against the athlete's estate are to be paid.
• Wills are used to take advantage of estate tax deductions and credits, discussed in detail below.

B. Revocable Trusts

Just as a will can help the athlete save taxes and achieve family goals, so also can a revocable or "living" trust. A trust is a contract between a grantor and a trustee. That contract is, essentially, a list of instructions, outlining for the trustee what to do with the property transferred to the trust. For example, the athlete can order the trustee to pay all income from the trust to the athlete during life and, at death, to hold the property for, and pay the income to the athlete's spouse, children, or both.

Revocable trusts have many of the same advantages as wills and, because they take effect as soon as created (unlike wills which only take effect at death), have some extra advantages.

A trust can set up a system to handle money matters during the athlete's life. This can be especially significant to the athlete whose career is limited, thereby making long-term asset management more important. The athlete can grade his trustee's performance during life. If that performance is not acceptable, the trustee can be replaced. Use of a professional trustee, such as a bank or trust company, should be of special importance to the athlete who travels frequently and, for entire seasons, does not have time to personally administer his trust. If desired, the athlete can serve as co-trustee with such a professional trustee. The property in the trust can provide support without additional legal procedures if the athlete should have a serious career-ending injury. Many athletes are in the public eye. The property in a trust is not subject to probate (done through a court and open to public inspection) upon death. The trust, therefore, can be a more private way of distributing the athlete's property. The trust can be changed or amended at any time during the athlete's life. Because a trust puts the system for dealing with property at death in place, costs (such as lawyers' fees, accountants' fees and expenses) and delays can be reduced.

VI. Federal Estate Tax

The federal estate tax looms large in any discussion of estate planning for professional athletes. This tax, imposed on the fair market value of all property owned at death, can have the single most substantial impact on the athlete's estate plan.

Federal estate tax is a tax on the value of property passing from decedents to beneficiaries. At death, the federal government allows transfers of property to whomever we wish, but taxes our estates for the privilege. The estate tax is calculated on the "taxable estate," which is the gross estate less deductions and exclusions. The tax rates currently range from 18% (taxable estates under $10,000) to 55% (taxable estates over $3,000,000).

A decedent's "gross estate" includes real estate, personal items such as automobiles, jewelry, household furnishings, stocks, bonds, royalties - everything, tangible or intangible, wherever situated. In addition to individually owned property, the gross estate also includes most jointly owned assets, accounts "in trust for" others, transfers with retained life interests, property in revocable trusts, property subject to certain powers of appointment, certain transfers made for insufficient consideration, and proceeds of life insurance.

Because estate tax rates are so high and because many professional athletes have large estates, it is important to consider the athlete's potential estate tax liability and integrate it with the estate plan, including the marital and charitable deductions and the unified credit against estate taxes.

A. *Marital Deduction*

When figuring the taxable estate, an unlimited deduction is allowed for property passing from a decedent to a surviving spouse. Utilization of the marital deduction should be considered if the athlete is married and has a taxable estate over $600,000, because it is an opportunity to defer estate tax on the death of the first spouse.

Marital deduction property can be given to the surviving spouse in a variety of ways: directly to the spouse under a will, by right of survivorship in jointly owned property or "in trust for" accounts, by contract (such as life insurance or IRAs), or under a marital trust. A marital trust may be established under the athlete's will or revocable trust.

Marital trust rules are simple. The trust must give the surviving spouse all income, yearly or more frequently, during the surviving spouse's lifetime. The trust must give the spouse an unlimited power to name the person or persons to whom the trust property passes at the survivor's death, or the trust may be in the form of a Qualified Terminable Interest Property (QTIP) Trust, under which the decedent, by will or trust, directs the disposition of the trust property following the spouse's death. Because of this feature, a QTIP trust should be considered by the athlete with a young family who is concerned that his spouse may remarry and begin a new family.

There is no estate tax on marital deduction property in the estate of the first spouse to die. Any property remaining, however, is taxed in the estate of the second spouse at its then fair market value. Accordingly, use of the marital deduction actually results in a deferral of estate tax. This can be especially beneficial to the young athlete whose spouse's long life expectancy indicates many years of use of the marital property.

B. *Charitable Deduction*

Many athletes are involved with charitable work during their careers. There are several charities geared to athletes and athletics, for example, the Baseball Assistance Team. Continuation of charitable work can benefit the athlete in his estate plan. Just as property passing to a spouse is deductible from estate taxes, so also is property passing to a qualified charity. As with the marital deduction, there is no limit to the amount of charitable deduction allowed.

A charitable deduction can take several forms. It can be property given directly to a charity or in trust. The trust may be only for the benefit of a charity or part for charity and part for other beneficiaries. This type of trust is called a split interest gift. Split interest gifts can take two forms. One form is called a charitable remainder trust, in which one or more beneficiaries receive income for a certain number of years or for life and, at the end of the term, the balance of the trust is paid to the designated charity. The second form of split interest gift is a charitable lead trust, in which the charity receives income for a certain number of years and, at the end of the term, the balance of the trust is paid to the individuals named. In cases of the charitable remainder trust and charitable lead trust, a partial estate tax deduction is allowed for the interests left to the charity.

The charitable lead trust can be of particular attraction to the young, highly compensated athlete. The lead trust can reduce or even eliminate estate taxes on property passing to non-charitable beneficiaries later. The lead trust can also create an income tax charitable deduction for the athlete now, while the athlete is highly compensated and the income tax benefit is most meaningful.

The estate tax charitable deduction generally should be explored with all athletes. It can be particularly attractive to single athletes where the marital deduction is not available.

C. *Unified Credit*

Gifts to spouses and charities are deducted from the athlete's taxable estate. These gifts lower the taxable estate and, consequently, the amount against which the tax is computed. The unified credit, on the other hand, reduces the tax directly. This credit (called "unified" because it also applies to gifts) is currently $192,800, eliminating estate taxes on $600,000 worth of property.

Proper "sheltering" of the unified credit can save thousands of estate tax dollars. For example, assume A dies in 1993 leaving an estate of $1,000,000. His will leaves his entire estate to his wife. She has no separate property. Upon A's death, his estate receives a marital deduction for the full $1,000,000 passing to his wife. However, on his wife's death (also in 1993), if her estate has no other deductions, her estate pays $153,000 in tax.

Suppose instead that A does not give everything outright to his wife, but, by will or trust, places $600,000 in a trust which pays income (and principal, if needed) to his wife during her life. Upon her death, the trust is to be distributed to their children. The balance of A's estate ($400,000) is given directly to his wife. The estate tax consequences in A's estate are identical: no tax is due. The difference occurs in his wife's estate. At her subsequent death, her estate is only worth $400,000. Since she is now left with less than $600,000, her estate tax is zero and the $153,000 in estate taxes has been saved.

D. *Generation-Skipping Transfer Tax*

Because of the relatively young age of professional athletes, discussions of grandchildren and taxes involving them may seem far-fetched. But no tax planning is complete without mention of the generation-skipping transfer tax, particularly because of the size of many athletes' estates and the high rate of tax they face.

Generally, when a person transfers property to his child, that transfer is subject to gift or estate tax. Likewise, property passing from that child to his child is subject again to gift or estate tax. However, a transfer from a person to his grandchild is subject to a gift or estate tax *and* a generation-skipping tax.

The generation-skipping transfer tax is designed to prevent avoidance of gift or estate tax which would have otherwise been payable had the property been transferred first to the intervening generation and then transferred again to the grandchild. Current law subjects generation-skipping transfers to this tax at the highest rate of estate tax regardless of the size of the transfer.

There is a significant exemption from generation-skipping tax. Each individual can transfer up to $1,000,000 of property free from generation-skipping tax. This $1,000,000 exemption is similar to the $600,000 unified credit exemption. With proper planning, a husband and wife can shelter $2,000,000 in assets from the generation-skipping transfer tax. Since generation-skipping transfers are taxed at the highest estate tax rate, the tax savings achieved by proper use of both exemptions is quite large. There are also a number of ways by which the $1,000,000 exemption can be leveraged, resulting in even greater savings, for example, by using a transfer designed to achieve "multiple skips."

VII. Other Considerations

Some final considerations in planning an athlete's estate are addressed below. These considerations, while not applicable to every case, may arise frequently enough to be considered.

A. *Check Gift Tax Issues*

As a part of your estate plan for the professional athlete, be sure to inquire whether there have been any past taxable gifts. Taxable gifts are gifts in excess of $10,000 to a non-spouse per donee per year. Gifts to spouses are not taxable. When athletes sign lucrative contracts, it is not uncommon to make significant gifts to family members. If so, gift tax returns (IRS, Form 709) may need to be filed. If a gift totals less than the unified credit equivalent of $600,000, then no gift tax is paid but the gift reduces the amount of unified credit available at the athlete's death.

Generally, annual exclusion gifts of $10,000 per donee per year can be useful in leveling-off a large estate. However, in the case of the professional athlete, consideration of annual exclusion gifts may not be warranted because the athlete may have already made large gifts and because the time during which an athlete accumulates assets is very compact and those assets will be needed to support the athlete and his family for the rest of the athlete's life.

B. *Avoid Ancillary Administration of Estates*

As discussed in the domicile section of this article, many athletes change their domicile in the course of their careers. Be sure to check if the athlete owns real property in states other than his domicile. If so, the athlete should consider placing that real estate in a revocable trust, corporation or some vehicle other than individual ownership, so as to avoid ancillary probate proceedings at death. Owning property in the name of a revocable trust, for example, while having no tax impact, obviates the need to pay costs of transferring property in other states upon death.

C. *Consider the Spouse's Estate Plan*

When working on an estate plan for the professional athlete, determine the estate planning situation of the athlete's spouse. While the spouse may have separate counsel and you may prefer to deal with the athlete separately, it is still important to be sure the spouse also has an estate plan. This is particularly important if the spouse either does not have sufficient assets to shelter the unified credit equivalent or, even if the spouse has sufficient assets, "wastes" the credit by giving it directly to the athlete.

D. *Present An Ergonomic Estate Plan*

Make the estate plan user-friendly. Use plain English. Utilize graphs and charts. Professional athletes, particularly team sport athletes, are familiar with the use of graphs and charts and will likely prefer a visual approach to estate planning.

E. Follow up Periodically

Once the estate plan is in place, monitor it frequently. Athletes often have substantial changes in salaries, bonuses and other compensation, which can create immediate need for change to the athlete's estate plan. Also, the young age of athletes means that any estate plan must consider additions to families.

VIII. Conclusion

A well prepared estate plan can serve many purposes, especially for the professional athlete. It can safeguard the assets of the athlete after death. It can provide for the care of the athlete's spouse or the education of the athlete's children. It can reduce or even eliminate estate taxes. It can continue charitable work begun during life.

The elements of an estate plan can be as varied as the assets it covers: the will and trust form the central parts of the plan. Within these documents, assets can be given to beneficiaries, estate taxes provided for (and saved) and the unified credit and deductions fully utilized. The will and trust, however, are only the center of a much larger family asset picture. This includes consideration of factors such as the use of marital agreements, selection of domicile, and benefits of life insurance.

Professional athletes, despite their youth, need to plan now to care for their families in the event of death. As the business of professional sports grows larger and compensation of athletes increases, the value of a properly crafted estate plan increases.