

ESTATE PLANNING FOR PEOPLE WHO HAVE PETS

WILLS, PET TRUSTS AND PET PROTECTION AGREEMENTS

By Rachel Hirschfeld, Esq.

Have you asked your clients whether they have pets? If you have, and if they say yes, they are probably concerned about the continuing care of their companion animals. As their “trusted advisor” you can offer several solutions: a Pet Trust, the Pet Protection Agreement¹ (“Agreement”) and a Will. This article is a guide to the basic elements and what you should include.

Because it is relatively new, the concept of legally enforceable documents that protect pets² has been covered in the mainstream press mostly as novelty or farce. The scant coverage provided has been dominated by “infamous” cases such as those of Leona Helmsley and Oprah Winfrey—celebrities who provided millions of dollars in trust for the care of their animals.

What’s not as widely covered is the silent explosion in like-mindedness among many Americans who may not be as well-heeled as those celebrities but who are nevertheless just as interested in providing continuing care for their dearly loved pets, if only they knew it was possible.

Two statistics should be instructive:

- As reported in Business Week, in 2009, Americans will spend \$52 billion on their pets, up from the \$41 billion spent in 2007. Nearly a 27% increase over three

¹ TM & © 2008 Pet Protection Agreement, LLC. All rights reserved. Patent Pending.

² Rachel Hirschfeld, *Ensure Your Pet’s Future: Estate Planning For Owners And Their Animal Companions*, ELDER’S ADVISOR, Marquette University Law School, Vol. 9, No. 1, 2007, at 155,.

years.

- The Humane Society of the United States estimates four million dogs and cats are euthanized at shelters each year, nearly 9,600 per day.

Clearly the market for pet-related products and services is heading higher and at a considerable clip. While it is likely that the number of animals euthanized each year is comprised mostly of ill, lost, feral or irresponsibly abandoned animals, it is just as likely that a considerable number of domestic pets are unwittingly condemned because their owners did not think—and were not advised—to make arrangements for them.

Today, people live longer, have more pets, and treat them more like family than ever before. One question that has begun to arise is who looks after a companion animal if the owner becomes sick, disabled or dies. Family members and friends can be a source of tremendous support, but even if well-meaning, they may not be able to follow through in caring properly for a surviving pet. Informal commitments might collapse for various, unanticipated reasons such as allergies, work schedules, lease restrictions, the responsibility of extended families, and incompatibility with other pets—thus the need for legally enforceable documents that secure a pet's continuing care.

There are three concepts to consider: a client may use all three or choose to simply use the Pet Protection Agreement and/or Pet Trust. The Will alone is simply insufficient for detailed care.

I. A Will. Many people believe a pet's care can be guaranteed in a Will. They are mistaken. A Will is valid only after death. It is usually not read until after burial. What happens to the pet in the meantime? A Will does not permit the owner to provide detailed instructions for the pet's care. Nor may the owner direct the management and disbursement of funds throughout the pet's life. Good intentions notwithstanding, listing a pet *only* in a Will may result in a tragic situation exactly opposite from what the Pet Owner intended. The beloved pet may end up unattended and uncared for.

II. A Pet Trust. An effective but often complicated arrangement requiring an attorney. If the Pet Owner plans to leave substantial property or funds specifically for the care of pet(s) and believes family or friends will contest arrangements or if the Pet Owner is concerned about remaining with the pets in the event of senility, it is recommended to incorporate the Pet Trust in estate planning documents.

A Pet Trust can ensure that a pet will receive care in strict accordance with the owner's wishes. It can define detailed expenditures for the pet's care in varying amounts and stages and invest funds with a view toward growth of principal for future use on behalf of the pet, heirs, and charitable recipients.

Moreover, a Pet Trust can make certain that the Pet Owner and pet will remain together through the owner's disability. In order to encourage compliance, Pet Owners should strongly consider leaving a portion of the sum that remains in the trust, *pro rata*, to any facilities that keep the owner and pet together. Suppose, for example, a hypothetical Jane Brown spends six years in an assisted living community and four years in an acute-care nursing home. Both facilities permit her cat Lucky to stay with her. Shortly after Jane's

death, Lucky also dies, leaving \$20,000 in the Pet Trust. The assisted living community would receive \$12,000 (60% of the remaining trust assets) and the nursing home would receive \$8,000 (40%).

A Pet Trust is legally enforceable while the owner is alive—even if incapacitated—and after death.

III. The Pet Protection Agreement™. The Pet Protection Agreement, created by the author, is a document whose purpose is to establish continuing care for animals when pet owners are unable to care for them. It is a unique product that incorporates different theories of law into a quick, effective, and affordable way for the pet owner to guarantee the well-being of their pets should the unthinkable occur. It is a “check-the-box, fill-in-the-blank” document with ability to elaborate further details on care instructions and can be completed on line at www.Petriarch.com in 15 minutes with or without the help of an attorney or trusted advisor.

The Pet Protection Agreement is a signed, legally enforceable document between a minimum of two individuals or entities: the pet owner and pet guardian or pet guardian organization. Pet owners are urged to name a shelter or sanctuary as a retirement home that may take ultimate responsibility for the pet.

The Pet Protection Agreement is valid after the pet owner’s *death* and during a pet owner’s *lifetime*.

Common Elements of the Pet Trust and the Pet Protection Agreement

All pet protection documents should include the following nine points of information:

1. Identify The Pet Owner

“Who owns the pet?” is the first question answered in pet protection documents.

Legally, pets are classified as property. Thus, it is important to establish and document ownership so that legal court battles can be thwarted in such cases as divorce or splitting from domestic partners or roommates.

Recent ownership issues faced by Katrina victims who had to leave pets behind have raised awareness about this. Many displaced “Katrina” pets were adopted out because ownership, care instructions and emergency contact information were not available.

2. Identify Pet(s)

In order to ensure positive recognition, identifying the pet in detail is critical. This serves as a precaution that can help prevent the Pet’s Guardian from replacing the original pet with a new one so as to fraudulently extend rights to trust distributions or benefits.

3. Include “All My Pets”

Including the term “all my pets” saves the effort of having to formally amend or create a new document whenever a new pet enters or leaves the family.

4. Funds

Funding is optional and can easily be a percentage of an insurance policy, bank account, 401 K, or even a portion of the sale of a home. Many people choose to leave money or property for the care of their pets.

The following factors should be considered when determining how much money or property to set aside:

- number of pets
- type of animal (the upkeep for horses is often more costly than a cat)
- pet's age
- life expectancy (especially important for pets with long life expectancies such as particular breeds of domestic birds)
- lifestyle—the standard of living one wishes to provide the pet
- cost of living and inflation
- pet's health and present medications
- veterinary care and the need for potentially expensive medical treatment
- services: groomers, walkers, animal-sitters or a professional boarding business
- food and diet
- daily routines
- toys
- compensation for people involved in caring for the pets (such as the Pet Guardian)
- socialization and friends
- travel
- disposition of pet after s/he dies (e.g., burial or cremation and memorial), and
- remainder beneficiaries and charities.

Consider leaving a small bank account in joint names, Pet Owner and Pet Guardian, and give the Pet Guardian instant access to funds in case of emergency. In this way the Pet Owner can test the trustworthiness of the Pet Guardian or Pet Trustee while it is still possible to amend the terms of the Agreement if need be.

5. Pet Guardian

Carefully consider who will physically assume care of the pet when the owner is no longer able to fulfill that role. Also select a successor Pet Guardian in the event that the first is unable or unwilling to care for the companion animal.

6. Name a Shelter or Sanctuary of “Last Resort”

Regardless of how many Pet Guardians and successors are named, the Pet Owner should be advised to name a shelter or sanctuary as a “back-up” because a pet may outlive all the Pet Guardians. If that happens, shelters or sanctuaries can assist in finding a new home for the pet and act as advocate. Usually, shelters and sanctuaries require a fee, and this must be considered as part of a “how much money to leave” equation.

7. Keep Pets Together

One consideration that will have a significant impact on the choice of Pet Guardians is the fact that pets that have been raised together and/or have otherwise bonded are generally happier if kept together.

8. Pet Care Instructions

Include detailed instructions regarding the pet’s care much as a parent, leaving for a long trip, would provide to a babysitter. A detailed document will ease the transition for the pet and the Pet Guardian. On the other hand, it is also important to allow the Pet Guardian to exercise discretion when faced with new circumstances.

9. Remainder Beneficiaries

The remainder beneficiaries can be one or many people and organizations.

It is important that the remainder is left in percentages and not whole numbers. If the Pet Owner has left specific amounts and there is not enough then some will be left out. On the other hand, if there is more than expected then the court may get involved to help decide what is to be done with the excess.

Keep in mind that the remainder beneficiary's financial interest may run counter to the pet living a long life. For this reason, consider including, as a successor Pet Guardian, a shelter or sanctuary that has a stated purpose of caring for animals.

Advantages of the Pet Trust over the Pet Protection Agreement

1. Written by an Attorney

The Pet Trust should be created by an attorney who concentrates in the area of Animal Law, especially, Pet Trusts and Pet Protection Agreements. This is often the easiest route for clients who can afford the time and costs involved.

2. Funding of Substantial or Involved Estates

The Pet Owner's estate may be complicated. Some families tend towards estate disputes. If the client believes that leaving funds and or property for the care of pets might instigate conflicts these issues should be addressed during the creation of the document. Although most estate attorneys are accustomed to constructing estate plans that avoid impending beneficiary disagreements, they may not be informed about how to write a Pet Trust. These days, attorneys, as other professionals, are

specializing more than ever before. Just like you would not go to same doctor for a tooth ache as a heart attack, you should point the client to a specialist for the Pet Trust.

3. Trustee and Trust Protector

The Trustee is mandatory in the Pet Trust. The Trustee disperses funds, as needed or as noted, to the Pet Guardian.

The Trust Protector is not a required role but is recommended if substantial funds and/or property are left for the care of the pet along with possible long term beneficiaries.

The Trust Protector acts as the pet owners' representative to direct and oversee the Trustee and Pet Guardian. The Trust Protector will pass the funds to the Trustee who in turn gives them to the Pet Guardian. One of the key functions of this role is to invest. This is beneficial since there is a separation between who keeps the pets and who keeps the money or property.

4. Pet and Owner Remaining Together

For some, this may be the ultimate in requirements. As the community of Pet Owners age they are more often unable, at some point, to care for their pets. Too often they are suffering from deteriorating bodies or minds.

It is statistically well-documented that seniors and those with health issues derive

substantial benefits from their pets.³ For example, their blood pressure is lowered, exercise and circulation are increased, anxiety is reduced, mental acuity is boosted, and opportunities for social interaction are enhanced. Because pets are also a distraction, they can reduce the owner's stress and loneliness by causing the owner to focus attention on the needs of the pet. Furthermore, it has been reported in the New York Times that the presence of pets in nursing homes increases the longevity of their residents.

A Pet Trust can include paragraphs that make certain that the Pet Owner and pet will remain together through the owner's disability.

Advantages of the Pet Protection Agreement over the Pet Trust

1. Do It Alone or Ask An Advisor

An accountant, trustee, insurance representative, investment advisor, attorney, paralegal and other practitioners concerned with the planning conservation and management of family assets can facilitate in filling-in the Pet Protection Agreement.

The client can even do this by themselves. Basically, an attorney is not required as with the Pet Trust.

The Pet Protection Agreement was created by a team of legal experts including contract attorneys and estate planners, as well as animal shelter and sanctuary directors and includes everything a Pet Owner and companion animal need.

³ Studies on the benefits of pet ownership are available from the Delta Society (the Delta Society's mission is to improve human health through service and therapy animals) at:
<http://www.deltasociety.org/AnimalsHealthGeneralGeneral.htm>.

2. Fast, Easy, Check-Box Document

The Pet Protection Agreement is an easy document to complete. One reason frequently given by many pet owners as to why they have not set up a document that assures continued care for their pet is that it is time consuming and complicated.

3. Affordable

Cost is too often the other reason a pet owner has not set up plans for his animal companion. The cost of the Pet Protection Agreement, under \$50.00, as compared to the average attorney cost for a trust (\$1250.00 and up). Everything a pet owner needs to feel assured that the pets and Pet Guardians transition will be smooth is included in the Pet Protection Agreement. The mission is to ensure that every pet that has found a loving home is guaranteed a secure future.

Tax Issues Arising as a Result of the Pet Trust

There are income, gift and estate tax rules applicable to Pet Trusts.

A. Income Tax

Whether they're created during the Pet Owner/Grantor's lifetime or at the Pet Owner/Grantor's death, pet trusts typically are funded. That is, assets are transferred into the trust to provide for the pet's care. As is the case with all trusts, such transfers won't trigger income tax. However, the usual rules for taxing income earned by trust assets apply to pet trusts. Generally, there are three modes of taxing trust income:

Pet Owner/Grantor pays. If the pet trust is revocable, trust income will be taxed to the Grantor. Similarly, an irrevocable trust can be structured as a grantor trust so the Pet Owner/Grantor will recognize any investment income earned inside the trust.

Trust pays. If the trust assets earn income, which is retained in the trust, the trust will owe income tax. Typically, trusts will pay more tax on a given amount of income than an individual or a married couple would pay.

Beneficiary pays. If the trust makes distributions to a beneficiary, that beneficiary will have to recognize taxable income, up to the amount of taxable income earned by the trust that year. That taxable income will be over and above the beneficiary's other income for the year so it presumably will be taxed at his or her highest tax rate.

Therefore, the income tax rules for Pet Trusts are similar to those for many other types of trusts.

What makes the taxation of Pet Trusts distinctive?

An example can point out some of the differences. Suppose a hypothetical John Smith transfers \$25,000 into a Pet Trust for his dog Soupbone. John names his niece Lynn Smith as trustee; he also names his neighbor Nancy Jones as beneficiary of the trust. John knows that Nancy is a pet lover who will take care of Soupbone if John is unable to care for Soupbone for a limited or for an extended time period. Similarly, Nancy has expressed a willingness to become Soupbone's Pet Guardian after John's death. Therefore, Nancy will assume the role of Pet Guardian as well as beneficiary of the trust.

Assume that the trust income this year is \$1,000 of ordinary income. Lynn, as trustee, distributes \$1,000 to Nancy, the beneficiary. Nancy uses that \$1,000 to pay for Soupbone's food, medical bills, and other expenses. If this is the case, Nancy will have to recognize \$1,000 of ordinary income from the trust distribution this year. Assuming an effective 30% tax rate (state and federal), Nancy would owe \$300 in income tax for taking care of Soupbone. If larger amounts are involved (say, for an expensive veterinary operation), Nancy would have an even larger tax obligation.

Creators of Pet Trusts and their advisors need to take such tax consequences into consideration when the trust is drafted. The trustee might be instructed to invest in such a way as to minimize or eliminate taxable income from the trust assets. Tax-exempt bonds may be a possibility. If the trust assets produce no taxable income, no tax obligation will be passed through to the beneficiary.

In addition, the trustee could be instructed to make the Pet Guardian whole for any tax liability associated with trust distributions. If a distribution is to come out of taxable income and thus will create a tax obligation for the beneficiary of the trust, the trustee could distribute a larger amount so that the excess would cover the tax liability.

Yet another option is to have the trust pay the expenses incurred for the pet. If this is the case, the Pet Guardian will not have to recognize any taxable income. Instead, any income tax associated with the trust assets will be paid by the trust.⁴ The IRS has held in Revenue Ruling 76-486 that

⁴ Some commentators believe that a pet trust is subject to a more favorable tax rate (i.e., married filing separately), but based upon this author's analysis of Revenue Ruling 76-486, it would appear that pet trusts are subject to regular

an enforceable pet trust established under a state statute is taxable on all of its income, regardless of whether any distributions are made for the benefit of the pet beneficiary.⁵

Generally, trust income tax rates are higher than personal income tax rates. However, if relatively small amounts are involved, the impact of paying trust tax rates may be minor. In 2009, for example, a trust will owe only 15% on taxable income up to \$2,300.

A question that might arise is whether it's possible to reduce trust income by deducting pet-related expenses. If the pet is considered an asset of the trust, can outlays to preserve and protect that asset (expenses for food, medical care, etc.) be deducted from trust income?

Unfortunately, this is not the case. The Internal Revenue Code permits deductions for expenses incurred for the production or collection of income. Similarly, expenses incurred to maintain, manage, or conserve property held for the production of income are deductible. However, a pet often is not an income-producing asset. Thus, expenditures for the care of a pet are not incurred for an income-producing asset and are not inextricably related to the normal business of administering a trust, so such outlays probably are not deductible.

trust income tax rates. Revenue Ruling 76-486 provides that a pet trust is subject to the tax rates imposed by I.R.C. § 1(d), which imposes the tax rates applicable to married individuals filing separately. Internal Revenue Code § 641 specifies which tax rates are applicable to estates and trusts, and because it references the tax rates under § 1(d) at the time of the ruling, the rates applicable to married individuals filing separately are also applicable to estates and trusts, not just pet trusts. However, I.R.C. § 641 was subsequently amended for tax years beginning after December 31, 1976 by replacing the reference to I.R.C. § 1(d) with § 1(e), with the effect that estates and trusts, including pet trusts, under the current tax law are no longer subject to the more favorable rates applicable to married individuals filing separately.

⁵ 2 Rev. Rul. 76-486, 1976-2 C.B. 192.

There may be some pet-related expenses that are tax-deductible. Suppose, for example, the Pet Guardian has the pet audition for advertisements or commercials. Additionally, the Pet Guardian might enter the companion animal in pet shows, with the intention of winning prize money and charging breeding fees. If the trustee can document that some costs were incurred with a bona fide intention of producing income for the trust, the trustee may be able to justify deducting relevant expenses. In turn, that would reduce trust income and lower the trust's tax obligation.

B. Gift Tax

Just as the usual income tax rules apply to Pet Trusts, the usual gift tax rules for lifetime transfers to trusts apply to gifts to Pet Trusts. Most transfers to irrevocable trusts are not transfers of present interests so they don't qualify for the annual exclusion. Instead, gifts to Pet Trusts can be covered by the creator's \$1 million lifetime gift tax exemption (\$2 million for married couples who elect to split gifts). If the Pet Trust creator already has used up his or her \$1 million or \$2 million exemption, transfers to Pet Trusts will incur a 45% gift tax.

If the Pet Trust has an individual beneficiary, it may be possible to use the trust creator's annual exclusion (\$13,000 per recipient in 2009) and thus avoid using up a lifetime exemption or paying gift tax. The trustee can send a Crummey notice to the beneficiary, giving him or her the right to withdraw the transferred funds. That can create a present interest, which may be covered by the annual gift tax exclusion.

However, if the trust is drawn up so the pet is the beneficiary, the Crummey process will not be effective. The IRS does not recognize a pet as a beneficiary of a trust. As Rev. Rul. 76-486 points out, a trust beneficiary must be a “person” or “persons.” The Internal Revenue Code says that a person can be any individual, a trust, estate, partnership, association, company or corporation, but animals are not on the list. Without a valid beneficiary, Crummey notices won’t permit the gift to be covered by the annual exclusion.

C. Estate Tax

Again, bequests to Pet Trusts fall under the normal estate tax rules. The federal estate tax exemption rose to \$3.5 million in 2009 (\$7 million for married couples, with good planning), so most bequests to Pet Trusts won’t be subject to federal estate tax, levied at 45%. Some states have much lower exemption levels (New Jersey’s is \$675,000, for instance) so some estates of decedents who leave money to Pet Trusts might owe state estate tax. However, assuming that money left to a Pet Trust would otherwise be left to an heir other than a spouse or charity, there will be no increase in estate tax if money is left to a Pet Trust.

What if a Pet Trust is structured as a Charitable Remainder Trust, as defined in Section 664(d)(1)-(2) of the Internal Revenue Code? In such a trust, an income beneficiary or beneficiaries receives distributions at least annually for life or for a term of years. An irrevocable remainder interest subsequently will be held for or paid to a charity. In Pet Trusts, this charity might be an animal shelter or an animal welfare organization.

In Rev. Rul. 78-105, the IRS considered the issue of whether a Pet Trust can be a Charitable Remainder Trust.⁶ Again, the ruling was that a pet is not a “person,” as defined under the Internal Revenue Code. Distributions from a Charitable Remainder Trust must be payable to or for the use of a person or persons. If a pet trust’s distributions are to be used for the care of a pet, it is not a charitable remainder trust so no estate tax deduction is allowed for the charitable remainder interest.

Similarly, if a trust for the care of a pet is established during the Pet Owner/Grantor’s lifetime, no charitable income tax deduction will be allowed, even if the remainder interest is reserved for a charity. The proposed Morgan Bill, named after a pet collie and introduced in Congress by Rep. Earl Blumenauer (D-Ore.), would permit income or estate tax deductions for lifetime or testamentary transfers to a Charitable Remainder Trust designed to provide care for a companion animal and eventually benefit charity.

Rev. Rul. 78-105 had an interesting conclusion. In some states, a trust for a decedent’s pet is void under state law. If the remainder then passes to charity, the entire bequest may be considered a charitable donation, deductible from the decedent’s taxable estate. The problem with this “solution” is that the charity will be entitled to all the funds and might not spend the money on the decedent’s pet.

Beyond federal estate tax, another issue is whether bequests to Pet Trusts are subject to state inheritance tax. In one Ohio case, decided in 1950, the decedent bequeathed his dog to a friend

⁶ 3 Rev. Rul. 78-105, 1978-1 C.B. 295.

and instructed his estate executor to reserve \$1,000 for the care of the dog, payable to the dog's Pet Guardian/new owner at the rate of 75 cents per day.

The trial court found that Ohio law did not authorize the levy of a tax upon property passing to or for the use of an animal so the bequest to the dog was not taxable. However, any funds remaining at the dog's death would be subject to inheritance tax when they passed to the remaindermen. An appellate court confirmed that no tax was due on a bequest intended for the care of a dog because it was not property passing for the use of a "person, institution or corporation."⁷ Therefore, the estate was told to pay inheritance tax upfront on the \$1,000 bequest and eventually file for a refund, after it was determined how much actually went to the remainder beneficiaries.

Conclusion

Companion animals have come to play an increasingly significant role in the modern family. It is well documented that people in general, especially seniors and those living with disabilities live more fulfilling lives when they live with pets, and the importance of pets should not be dismissed as mere luxury or eccentricity. Pets develop routines and become accustomed to the lifestyle they enjoy with their Owners. Our goal should be to ensure that every pet that has found a loving home is guaranteed a secure future.

The Pet Protection Agreement and Pet Trust are ideal tools to help Pet Owners and their pets remain together, establish procedures for legally transitioning pet ownership, and ensure that pets are cared for by a chosen Pet Guardian.

⁷ 4 95 N.E.2d 779 (Ohio Ct. App. 1950).

Over two-thirds of all Americans consider their pets to be family members, making a Pet Trust and/or Pet Protection Agreement a logical imperative. No one likes to see pets consigned to a shelter when their owners are unable to care for them. It is painful to think of leaving family behind. There is no greater sense of security than knowing all beloved members of your family have been provided for, whether they are two-legged, four-legged, or feathered. Their devotion is unconditional. You will be doing a great service for your clients when you help them adequately secure their pets' futures.

Rachel Hirschfeld is the creator of the Pet Protection Agreement and the Hirschfeld Pet Trust, the catalyst for which was Ms. Hirschfeld's beloved dog, Soupbone. She is an appointed member of the New York State Bar Association's Special Committee on Animals and the Law, the New York City Bar Association's Committee for Legal Issues Pertaining to Animals and the Animal Law Committee of the American Bar Association. Ms. Hirschfeld is a frequent author and lecturer on Pet Trusts, Pet Protection Agreements and estate planning, and has appeared in national media, including The New Yorker, ABC's Nightline, CNN, CBS the Early Show, the Today Show, the Wall Street Journal, Cat Fancy Magazine, Newsday, the New York Sun, Dow Jones, the Bottom Line Retirement and the National Academy of Elder Law Attorneys' Journal. Ms. Hirschfeld works closely with animal shelters throughout the United States including the ASPCA, Humane Society of the United States, BideAWee and North Shore Animal League to name a few. Ms. Hirschfeld can be reached at 1-877-773-7778 or rachel@Petriarch.com. See www.Petriarch.com and www.PetTrustLawyer.com.



The Soupbone Angel

**“My mission is to ensure that every pet
that has found a loving home
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