A Practical Guide to Estate Planning

Including opportunities to save taxes, minimize administrative costs, and preserve assets.

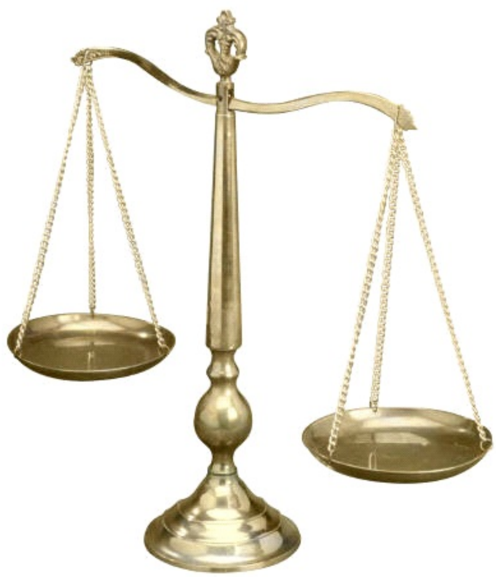

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Table of Contents

This booklet is intended to give general information. Individual situations vary, and each situation should be examined carefully to determine appropriate planning methods. This booklet does not constitute legal advice. For individual planning and drafting of documents appropriate for you, see your estate planning professional.

Introduction

It is impossible for an individual without legal and tax background to effectively plan an estate. On the other hand, it is impossible for a professional with legal and tax background to plan an estate without in-depth knowledge of a client's goals, needs, and overall family and financial situation. Too often, expense or lack of communication prevents clients and estate planning professionals from adequately coordinating personal desires with legal and tax considerations. Without this coordination, an estate plan which carries out individual desires and takes advantage of beneficial planning techniques cannot be designed.

The purpose of this booklet is to provide information to enable you to apply your desires to substantive law. It is not possible for any one memorandum to answer all possible questions about every situation. However, this booklet will discuss the most common issues about management of property if the owner becomes incapacitated, distribution of assets if an owner is deceased, and cost and procedure involved in the transfer of assets to trusts when trusts are utilized. We will describe methods of totally avoiding the requirement of probate, allowing for transfer of assets to beneficiaries with no court involvement. Income, estate, and gift tax issues will be outlined, and methods of minimizing or eliminating tax will be described. Planning opportunities and considerations under current law and as we move toward full repeal of federal estate tax in 2010 will be addressed.

Many people would be unsure or inaccurate in their answer if asked, "What would happen to your assets if you were gone tomorrow?" This *should* be an easy question to answer. It is certainly an important one. We work all of our lives to accumulate assets, and we should have control over where those assets go after we're no longer here to enjoy them. However, due to various rules of law, determining the current estate plan is not always easy. For example:

- Wills do NOT control the distribution of all assets. Many assets are distributed outside of the will, so the plan of distribution in a will does not describe the total plan. Property passing under a will does NOT avoid probate.

- Making lifetime gifts to children can have serious income tax ramifications for both parents and children, particularly if the gifted property has appreciated in value since the parents acquired it, or if the parents' personal residence is gifted.

- If you could no longer manage assets due to incompetency, a court proceeding would be required in order to take over management of your solely owned assets even if your spouse was available to manage assets. Accounting records showing every penny earned and every penny spent would be mandated by the court. These protections may be beneficial, but planning allows each individual to customize the rules that they would want to apply in their individual situation.

- If minor children or grandchildren inherit property and provisions for management of that property are not specified in a will or trust, the child will receive the entire inheritance at the age of majority.

- Although the Tax Relief Act of 2001 repeals federal estate tax for the year 2010, after that, under current law, "repeal" ends and federal estate tax law reverts to law in place prior to passage of the 2001 Act. Including an analysis of tax planning options is an important part of your estate plan.

Following is an Estate Planning Checklist to help determine whether estate planning may be needed. Please answer each of the following questions *YES* or *NO* and write the answer next to the question.

_____________ 1. Has it been more than one year since you reviewed your estate plan, including your will, life insurance policies, and any other documents?

______________ 2. If you or your spouse passed away today, are you uncertain about what would happen to your assets?

______________ 3. Does your will leave property to someone other than your spouse?

______________ 4. Do you have minor children or other people who are dependent on you? If you were not here to provide for them, would they be in financial trouble?

______________ 5. If a death occurred and court approval was required to release accounts for working capital, could it disrupt a farm, business, or overall family financial well-being?

______________ 6. If you became incapacitated, would your family have to go through court proceedings to carry on your affairs?

______________ 7. Do you have children by a previous marriage?

______________ 8. Could your business cause liability due to contract or an accident?

______________ 9. Do you own assets in your sole name?

_____________ 10. Is anyone other than your present spouse listed as beneficiary on any life insurance policy or account?

______________ 11. Would you like to avoid probate of your estate?

______________ 12. May the total value of you and your spouse's assets exceed $1 million at any time between now and 2011? (Include life insurance, pensions, real estate, and any other assets and consider inflation and growth in calculations.)

______________ 13. Do you plan to gift any property prior to death?

_____________ 14. If your current plan of distribution was followed, would assets have to be sold to pay expenses?

____________ 15. Are any members of your family unsure about their economic future in a family business?

_____________ 16. Do you own any property which has substantially increased in value since you originally acquired it, or which has been depreciated for income tax purposes?

_____________ 17. Would potential nursing home expenses create a hardship for your family?

If you answered any of the above questions *YES,* you may be in need of estate planning. *YES* answers indicate potential issues in the areas of tax, cost and delay of probate, or simply lack of a plan which carries out your wishes. Estate planning allows *you* to apply the law to achieve *your* goals, to preserve assets for *your* chosen beneficiaries, and to minimize bureaucracy and administrative expenses.

Estate Planning-Who Needs It?

Wills, trusts, and other estate planning documents can be very important in preserving assets and in ensuring distribution of assets to chosen beneficiaries. Without a will or trust, upon a person's death, that person's assets are disposed of according to state law. State law, called the law of intestacy, may not match what the decedent's desires were as to whom should get the property or how the property should be handled.

Even if current law does match a person's wishes for distribution of his /her estate, intestacy law at the time of that person's death may have changed. Unless a person wants to constantly keep up with changes in the law, it is wise to have a will or trust.

Will and trust provisions are usually accepted as written, and are generally not affected by changes in the law. However, there are some restrictions on what will and trust provisions will be accepted. For example, a spouse cannot be totally disinherited unless specific steps are taken, such as agreements entered into during lifetime where the spouse agrees to total disinheritance.

Without a will or trust, a person has no opportunity to personally select guardians for minor children, to name the person who should manage the beneficiaries' assets until they are distributed at a particular age, or to select the person who should handle the details of distributing the estate. Without estate planning, these important decisions are left to be made by a judge who can only apply statute and attempt to determine what would be reasonable under the circumstances. Most people would prefer to set their own standards and plan for distribution and management of assets. If no special provisions are made, beneficiaries receive their share of the estate immediately upon reaching the age of majority. Through trust provisions, parents can give directions and restrictions on how and when assets should be distributed.

Clearly written wills and trusts can minimize the cost of administering an estate. If a will is used and probate is required, the will tells the probate court what the decedent's wishes were so the court can more quickly and inexpensively approve procedures to carry out those wishes. A trust can be used to totally avoid the probate process, allowing for transfer of assets to beneficiaries with no court intervention. (See chapters on probate avoidance and the living trust.)

Tax planning as part of the estate plan can save significant amounts of money, regardless of the size of the estate. Whether capital gains tax will be recognized on appreciated assets can depend on how those assets are titled or the content of estate planning documents. The Tax Relief Act of 2001 does contain tax relief, but planning is essential to be certain that tax relief applies to you in every way possible.

Provisions can be added to your estate planning documents to prevent unnecessary bureaucracy. For example, the document can provide that if a beneficiary does not survive by at least 60 days, that beneficiary will be deemed not to have survived. This provision could save the cost and delay of probating assets through the estate of the deceased beneficiary to get them to the actual recipient.

A survivorship clause also prevents an unintended distribution of property. Suppose George and Gladys are a married couple with no children, and have no will or trust. Under the law of intestacy, the distribution of property is determined according to the order of death. If an accident occurs and only one spouse survives, the surviving spouse inherits all property. If the surviving spouse lives for only a week due to injuries incurred in the accident, all assets are inherited by the relatives of the second spouse to die, since the predeceased spouse's relatives are not considered heirs of the spouse who survived one week. Since the spouse who survived legally owned all assets, only that spouse's heirs receive an inheritance.

Many states have statutory survivorship requirements, stating that if a beneficiary does not survive for a specified time period, for purposes of distribution, the beneficiary will be treated as if he or she had not survived. However, statutory survivorship requirements are generally only a few days, and the laws are always subject to change. A survivorship clause in a will or trust allows you to establish the amount of time a beneficiary must survive in order to inherit.

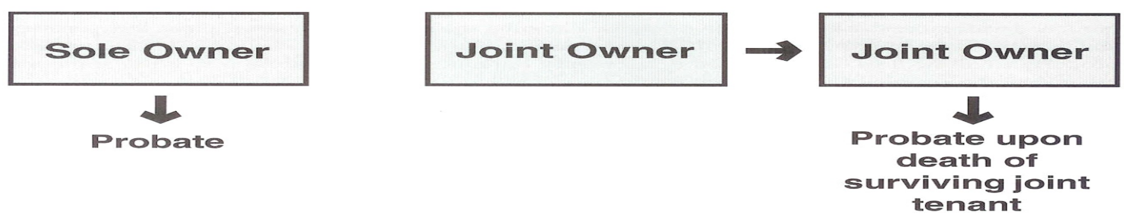
It is very important that wills and trusts are drafted according to statutory requirements, are clearly written, and cover all details of the estate plan since, if ambiguities arise after a death, the person whose document is being discussed is not available to answer questions. Professional help is highly recommended.

Thinking about death, accident, or illness is never pleasant. However, if something does happen, that is not the time for family members to be forced into making important decisions, or to be burdened with excessive administrative details. Planning ahead is much more efficient, inexpensive, and thoughtful than burdening a family during a period of grief. We all work too hard to accumulate property to allow it to be wasted on unnecessary bureaucracy or to allow it to go to someone other than the people or cause of our choice.

Probate Avoidance: A Logical Goal

Most people, if asked, would prefer to avoid the expense and time delay of having their estate probated. According to a national survey, sixteen months is the average length of time involved between a person's death and completion of all paperwork required to conclude the probate process. Some of these delays occur in order to analyze various tax savings opportunities, and to gather information on current assets and outstanding liabilities, and may occur whether probate is required or whether nonprobate techniques are used to transfer assets after death. Other delays occur due to notices and mandatory waiting periods required under probate statute and can be avoided through estate planning.

Although avoiding probate is generally less expensive than probate, avoiding probate does not necessarily avoid all fees. Expense is involved in gathering asset information, paying debts and expenses, tax planning and filings, distribution of assets, and other activity regardless of whether probate is required or not. However, utilizing probate avoidance techniques *does* avoid requirements of signed waivers from heirs, various notices and waiting periods, paperwork required to be filed with the court, and potential court hearings. In many cases, use of probate avoidance techniques is advantageous to minimize expense, but also to implement tax planning methods, prepare for management in the event of incapacity, and to coordinate titling and beneficiary designations on assets so your wishes are carried out.



Various methods of avoiding probate exist. Probate takes place when the owner of property dies. If a joint owner or beneficiary exists for an asset, the asset avoids probate.

Examples of situations where a joint owner or beneficiary exists if one legal owner dies are:

1. *Ownership in joint tenancy with right of survivorship*. Upon the death of one joint tenant, the surviving joint tenant remains the legal owner, and probate is not required. Probate will be required upon the death of the last surviving joint tenant, since no other owner will survive. (See above illustration.)

2. *Life insurance with a named beneficiary*. Upon the death of the insured, the surviving beneficiary is legal owner of the life insurance proceeds and probate is avoided. However, probate is NOT avoided if the insured's estate is listed as beneficiary or if the beneficiary is deceased. Therefore, it is very important to have a primary and a contingent beneficiary listed, so the proceeds are paid to the contingent beneficiary if the primary beneficiary is not available. Then the proceeds still avoid probate. Beneficiary designations may also be used on IRA's, annuities, and various other types of assets.

3. *Accounts payable on death (P.O.D.) to another person upon death of the primary owner*. These accounts work like a beneficiary designation in that ownership rights remain with the person whose name is on the account, and ownership rights are not transferred until the death of the owner. P.O.D. accounts should not be confused with Power of Attorney (P.O.A.) designations which allow another person to sign on the account but do not transfer ownership or avoid probate in the event of the owner's death. Transfer on Death (T.O.D.) accounts work in the same way as P.O.D. accounts, and typically apply to securities.

Although in some situations, all assets can be structured so they fall into the above categories to avoid probate, some issues exist with these methods of probate avoidance.

With joint tenancy, probate is avoided IF there is a survivor. If a husband and wife own all property as joint tenants and they are both killed (e.g., in a common accident), no joint tenant survives and the estate is probated. Even if a joint tenant survives, when the surviving joint tenant passes away, probate is required. Therefore, when husband and wife own property as joint tenants, when one is deceased, the survivor must do estate planning to avoid probate of his or her own estate. A period of grief is not a good time to be in need of estate planning.

Probate could be avoided by the surviving joint tenant by adding other joint tenants as owners of the property. This would avoid probate, since a surviving joint tenant would remain if one joint tenant died. However, most people prefer NOT to add other joint tenants upon the death of their spouse, since this is giving up part ownership in the property. This also makes the jointly held property subject to claims of the creditors of those added as joint tenants.

Tax ramifications should also be considered before entering into joint tenancy with a nonspouse. The exemption from income tax on the sale of a personal residence may be lost if the second joint tenant does not live in the home. Gift taxes should also be considered, since the joint ownership will be considered a gift to the new joint tenant (either immediately or later depending upon exactly how the account is titled and the type of asset involved). Additionally, if property which has appreciated in value is gifted, rather than inherited, substantial income tax benefits can be lost. (See discussion under Death Taxes, State and Federal Income Tax.)

Another issue arises with the use of joint tenancy and payable on death accounts to avoid probate. Many people intend to divide all assets equally among their children or chosen beneficiaries. Even if a will exists that gives all property in equal shares, this will provision does not apply to nonprobate assets. This can cause difficulties in dividing assets equally, since interest can accumulate on accounts, property can appreciate, or dollars from some accounts may be used during lifetime. Even if values are equal initially, values will probably not remain equal and beneficiaries will not be treated equally. Furthermore, if all assets are distributed pursuant to beneficiary designations, no one is authorized to pay expenses, and assets are not available with which to pay expenses.

If an asset is transferred to a child outside the will or trust through titling or beneficiary designation on an account, life insurance policy, or other asset, the child will receive the asset at the age of majority, even though the will or trust provides that children will not receive assets until a later age.

The Living Trust:
Avoid Probate While Maintaining Total Management and Control of Assets

A revocable living trust is a method of avoiding the probate process. If assets are owned by a trust, no court is involved in the transfer of assets upon death. Therefore, no newspaper notices or letters to heirs are required, no records become public, and no statutory waiting periods apply.

It is still necessary to determine what assets exist, to pay creditors, to file required tax returns, and to distribute assets to beneficiaries, but avoiding court proceedings and requirements simplifies and expedites the process.

Probate only arises when the legal owner of property dies, leaving no joint owner or beneficiary. In order for a living trust to avoid probate, ownership of assets is transferred to the trustees (managers) of the trust. Instead of owning property as George and Gladys Clark, the name on the deed, account, security, or other asset is changed to "George Clark or Gladys Clark, trustee(s) of the CLARK TRUST dated ______________."

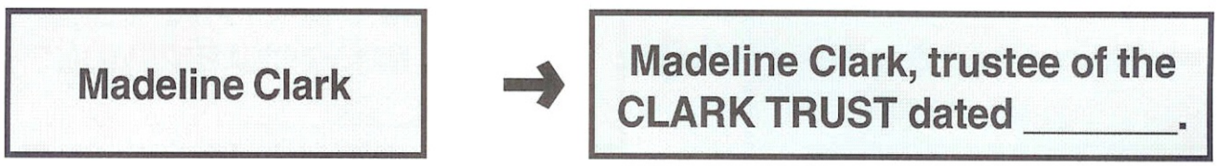
George and Gladys → **George Clark or Gladys Clark, trustee(s) of the CLARK TRUST dated __________________.**

The trustees of the trust own the assets. George and Gladys, as trustees of the trust, have total control over all property just as they did before. George or Gladys could spend money, mortgage, sell or give away assets, or do anything they would do if the trust did not exist. Since the trust owns the property and it is physically impossible for the trust to die, the owner of the assets never dies and probate is never required. If either George or Gladys pass away, probate is avoided and the trust remains as it was before. In most cases, the survivor, either George or Gladys, still has complete control over the assets. The only exception to the surviving spouse receiving total control of all property is if those setting up the trust choose to have someone else manage it or if federal estate tax planning is included in the estate plan.

Upon the death of the survivor, no probate is required since the trust is still the legal owner of the property. According to the provisions of the trust agreement, when both George and Gladys are deceased, the party they named as successor trustee will have the power to distribute the assets of the trust according to the terms provided in the trust. The successor trustee is typically the same person or institution who would be named as personal representative in a will. This should be someone who is capable of completing paperwork, who is responsible with money, and who can get along with the named beneficiaries. The successor trustee can be one of the named beneficiaries, any other individual, or a trust company. If, during lifetime, the original owners of the property decide that they prefer to have someone else manage assets, the role of primary trustee of their trust can be given to anyone they choose. If both spouses agree that only one spouse should have management rights on some or all assets, the trust agreement can provide for management by one spouse solely.

A living trust works well for either married or single people. Joint trusts may be used in situations where joint tenancy would typically be used, but where probate avoidance on both estates is desired. In cases where married couples choose to keep their assets separate, such as when spouses have children from previous marriages or in some cases to implement federal estate tax planning, a separate living trust may be executed by each spouse, with the plan of distribution of each spouse outlined in that spouse's trust.

For single people, the living trust is especially advantageous since the alternative of joint tenancy is usually not practical. If George's mother, Madeline Clark, chose to avoid probate with a living trust, she would execute a trust agreement and change the name on her assets to "Madeline Clark, trustee of the Clark Trust dated ____________________."



The date that the trust was signed is included in the name of the trust to insure that assets are credited to the correct trust.

For purposes of illustration, let's assume that, at this time, Madeline Clark has only one asset-an apartment building worth $200,000. She owns this property in her sole name. Madeline has a will which leaves everything to her son, George. Upon Madeline's death, George takes the will to his attorney and asks what needs to be done. George's attorney explains that various papers must be filed with the probate court so the court can authorize George to manage the property during the pendency of the probate proceeding. Newspaper notices must be published and a waiting period must pass. After the waiting period passes, required tax returns must be filed and taxes paid, and an accounting of activity which occurred since the date of death must be completed. Administrative fees for this process must be paid although there may be no cash available in the estate.

George stares at the attorney and asks, "What do I get for this expense and time delay?" The attorney responds, "You get the court's order saying that the property is yours." George stammers,

"But the property *is* mine. Mom wanted it to be mine, her Will says it's mine, and no one is disputing the fact that it's mine."

George leaves the attorney's office and does nothing. He wonders why anyone would spend money on probate. Then, three years later, George receives an offer from a buyer who wants to purchase the building. The offer is for $300,000, but is contingent upon a quick sale. George is tired of managing the building, could use the cash, and knows that several repairs will be needed soon.

Much to George's dismay, he discovers that he cannot sell the property. The deed to the building is in Madeline's name, and she is in no position to sign a deed transferring the property to the buyer. George returns to the attorney and asks how to clear title so the sale can be consummated. The answer: Probate must be initiated to get George nominated as personal representative with the authority to transfer the property. Initiation of probate procedures and issuance of a document authorizing George to act as the estate representative may be expedited in order to clear title prior to the buyer's deadline. However, George's failure to obtain tax releases may constitute a cloud on title which could take several weeks to clear. In the meantime, George's buyer may be lost. If the sale doesn't go through and George keeps the property, if he ever wants to mortgage it the same title problem will arise. In order to clear title the probate process must be commenced, but substantial additional costs will now be included since tax returns and accounting of all expenses and income must incorporate the entire period of time since the date of Madeline's death. Tax penalties and interest may apply, income tax rates applicable to income earned may be higher than would have been required if returns were filed promptly and planning was done, and time delays will increase administrative costs.

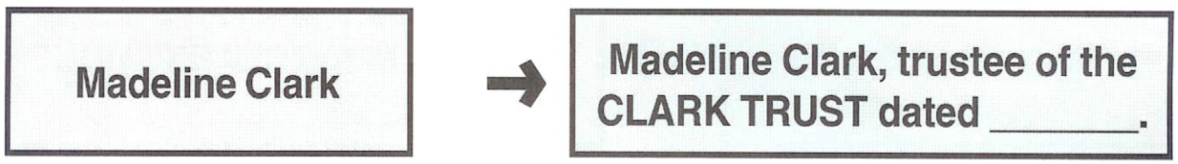
The moral to this story:
Probate cannot be *avoided unless planning is done in advance*.

If Madeline decided, during lifetime, that she wanted to avoid probate on the apartment building, she could use various techniques.

First, she could transfer the property to George during lifetime. If she did this, Madeline would no longer have a legal right to income from the building, and even if George gave her the income from the building, the income would be taxable on George's 1040 and at George's income tax rate. George's creditors could reach the building, and, if George got a divorce, the building could affect the divorce settlement. Additionally, a great income tax advantage would be lost by gifting the property to George rather than letting him inherit it. Possible gift tax ramifications must also be considered before any gift is made. In addition to other considerations, Madeline must keep in mind that, if George predeceased her, the building would be probated through his estate if it had been put into his name.

A second technique which Madeline could use to avoid probate of the building would be to transfer the building to George and herself as joint tenants with right of survivorship. This form of ownership would eliminate probate of the property as long as either George or Madeline survived. However, the concerns outlined earlier regarding putting property in someone else's name such as tax, creditor, and management issues would apply to George's one-half ownership in the property. Whether Madeline changes the name on her deed to George's name solely or to George and Madeline as joint tenants, Madeline will need George's permission in order to mortgage or sell the building.

A third option to avoid probate of Madeline's estate would be execution of a living trust. In order to put the trust into effect, Madeline must sign a revocable living trust agreement, and must execute a deed which transfers the apartment from Madeline Clark to "Madeline Clark, trustee of the CLARK TRUST dated ________________."



George is named as successor trustee of the trust. Pursuant to the trust agreement, George has two duties. If Madeline becomes incompetent as evidenced by written affidavits from two physicians, George would step in and manage the trust assets-in this case the apartment building for Madeline's benefit. This would eliminate the requirement of taking Madeline into court to prove that she is incompetent to manage her affairs. Upon Madeline's death, the legal owner of the property does not die, so no probate is required. The deed shows the trustee of the trust as owner of the apartment building. The trust agreement appoints George as successor trustee so that upon Madeline's death, George becomes the trustee of the trust and has legal authority to transfer the property to the beneficiaries named in the trust agreement. In this case, George is the beneficiary, so he issues a deed which transfers the property from the trustee of the Clark Trust to George Clark.

Tax returns must be filed, but no probate, statutory waiting periods or notice requirements apply, and time requirements and costs of administration are reduced.

If probate avoidance is desired but Madeline does not want to name George as successor trustee, a family friend or other individual or a trust company could be appointed as successor trustee.

A *Living Trust is an estate planning document which:*

- Avoids probate of the estate, so no court is involved.
- Eliminates the requirement of public notices.
- Keeps your plan of distribution private.

- Is acceptable in all states, so avoids probate of out-of-state property as well as property located in the state of residency. (A will requires probate in each state where real estate is owned and in the state where the decedent lived on the date of death.)

- Provides for management of assets by a family member or an institution (whichever you select) if you are unable to manage assets due to health problems and avoids proving incompetency in a court proceeding.

- Helps in organizing lists of assets for personal financial planning and helps beneficiaries in locating assets.

- Allows for optimum tax planning using federal and state income, gift, and estate tax law, yet requires NO extra tax returns or filings.

- Does not affect your ability to manage and control your own property and does NOT require management fees to be paid to anyone unless you *wish* to appoint an outside manager.

As with all estate planning, each person's individual situation and wishes must be analyzed before a decision is made as to the most effective planning technique. In considering living trusts or other probate avoidance and estate planning techniques, it is very important that a professional knowledgeable about living trusts be consulted. Just as an obstetrician may not be the one to do heart surgery, all attorneys are not familiar with the most effective methods of using living trusts.

Living trusts may not be for everyone, but for many, many people, a bit of extra planning now in establishing a living trust can save much time, money, and frustration for loved ones in the future. Estates take a lifetime to create, and can be protected with planning!

Other Estate Planning Documents
(Powers of Attorney, Health Care Directives, Marital Agreements, Instructions for Survivors, Trusts)

In addition to wills and living trusts, various other documents may be used to carry out your wishes, either in case of death or in case of illness or accident. Methods are also available for giving family members an opportunity to learn management of a family business before the business is sold or given to them. Management rights may also be given for limited periods of time in order to free the actual owners for a long-awaited vacation. The following documents are commonly used to accomplish these types of life and estate planning goals.

Powers of Attorney

Powers of attorney give another person the power to act in place of the principal (the person signing and authorizing the power of attorney). The power of attorney can be drafted so that it would only become effective upon the disability or incapacity of the principal, or so that it is effective immediately. However, powers of attorney which only become effective upon incapacity may create issues in determining when incapacity occurs.

The power of attorney allows someone else to handle affairs such as payment of bills, cashing checks, and selling assets. A specific power of attorney may be drafted which grants only very specific, limited powers to the person named as agent (the person given power to act for the principal). This could include the power to manage a particular piece of real estate, or a particular account, investment, or business.

Powers of attorney terminate upon the disability or incapacity of the principal unless the power of attorney is durable, specifically stating that it will remain effective after the disability or incapacity of the principal. Powers of attorney terminate upon death, so are not effective to manage or transfer assets after the principal's death.

Health Care Directives

Health Care Directives contain directions regarding prolonging life by artificial means if the condition is terminal. These documents provide family members or others appointed by the document with authority to make medical decisions for you if you are unable to do so.

Instructions and Location of Information

It is a very good idea for everyone to make a list of assets and directions for loved ones to use in case of death or incapacity. This list can include instructions for funeral arrangements and memorial services, location of documents including insurance policies, deeds, securities, and evidence of other assets, location of bank accounts, and names and addresses of professionals who would have information regarding the estate, including the attorney, accountant, insurance agent, and other financial advisors. Location of the records, safe deposit box, wills, trusts, and any other pertinent documents should also be listed. This is not a legal document, but certainly is a practical one. Some estate planning attorneys provide binders which include copies of estate planning documents as well as pages for instructions and location of information.

Trusts

Various types of trust arrangements may be very beneficial, and can be individually suited to meet each specific need or desire. Trusts are very commonly used when minor children or other dependents are involved, when a business exists which will need continued management, for tax planning purposes, and to avoid or minimize probate.

Living trusts come into being during lifetime, whereas testamentary trusts only come into being upon death. Testamentary trusts do not avoid probate, but are an effective method of providing for management of assets for beneficiaries, and for tax planning. (See chapters on death taxes and on avoiding probate through living trusts.)

Prenuptial/Antenuptial/Marital/Community Property Agreements

(Terminology depends upon whether the agreement is signed before or after marriage, and on the individual state of residency. Since many people move from state to state or own property in more than one state, we will discuss rules applicable to all states here.)

It is important for all married couples to assess the impact of their state law on their situation. If you reside in one of the community property states you share ownership of property with your spouse regardless of whose name is on an asset. In common law states, the name on the title of property affects ownership rights more completely. However, both community and common law states have various rules protecting spousal interests in property. If the effect of your state law is not beneficial for you, you and your spouse may adapt its effect by written agreement. Various types of documents are available, depending upon the individual circumstances and upon whether both spouses are capable and willing to sign an agreement.

If a specific need or concern exists regarding spousal property interests, a solution can usually be found. The law is very flexible for those who plan ahead. Problems arise after incompetency or death has occurred, when the party involved is no longer able to express his/her wishes. An estate planning professional can be very helpful in sitting down with you to analyze your situation and to suggest methods of preventing future issues.

Death Taxes - Current Through Repeal of Federal Estate Tax for the Year 2010

In order to accomplish tax planning which results in the lowest possible overall tax bill, four different types of tax must be considered. Each type of tax has very different and sometimes conflicting rules, so the impact of each type of tax on the individual situation must be balanced before the overall tax effect can be determined.

The types of tax which must be considered before completing any estate plan are:

- State Inheritance and Estate Tax
- Federal Estate Tax
- State and Federal Gift Tax
- State and Federal Income Tax

State Inheritance and Estate Tax

Estate tax is a tax on the estate itself, so the tax is based upon the total value of the estate. In many states no state estate tax is due on estates that are not subject to federal estate tax. However, some states do assess estate tax on smaller estates.

Inheritance tax is applied against the property received by each beneficiary or heir. Tax rates and exemptions usually depend upon the relationship between the decedent and the person receiving the property. Inheritances of spouses and children are typically subjected to fewer taxes than are inheritances of people who are distantly related or not related at all. Many states no longer have an inheritance tax, and several states which did have inheritance tax have repealed the tax. However, individual state law should be reviewed in order to calculate and plan around any potential state inheritance or estate tax.

Federal Estate Tax

Federal estate tax is federal tax upon the estate itself. Many estates are exempt from the tax. A transfer between spouses is always exempt, provided that no restrictions are placed on the interest inherited by the spouse, and provided that both spouses are U.S. citizens. The amount of property which may be transferred free of federal estate tax varies depending upon the year in which death occurs, with exclusions as follows:

Year In Which Death Occurs	Amount Which Can Be Transferred Free of Federal Estate Tax (The Applicable Exclusion Amount)	Highest Estate and Gift Tax Rates (Gift tax exemption remains at $1.000.000\
2002	$ 1,000,000	50%
2003	$ 1,000,000	49%
2004	$ 1,500,000	48%
2005	$ 1,500,000	47%
2006	$ 2,000,000	46%
2007	$ 2,000,000	45%
2008	$ 2,000,000	45%
2009	$ 3,500,000	45%
2010	Federal estate tax and generation skipping transfer tax fully repealed.	Gift tax is the top individual income tax rate.
2011	$1,000,000 – law revers to law prior to Tax Relief Act of 2001	55%

It is easy to assume that tax planning is not necessary with these large exclusions. However, many people underestimate the value of their future estates. Almost all assets are includable in the taxable estate, and substantial appreciation will likely occur between now and the time that the taxable estate will be valued for tax purposes (either the date of death or six months thereafter). Federal estate tax has the highest tax rates remaining in the United States today. Additionally, the Economic Growth and Tax Relief Reconciliation Act of 2001 contains a sunset provision which causes the entire Act, including federal estate tax exclusions, to revert to the law prior to passage of the 2001 Act as of January 1, 2011 unless future legislation extends the 2001 Act. Therefore, if combined estates of both spouses (including life insurance owned by spouses and all other assets) may exceed $1 million by 2011, federal estate tax planning is important.

With appropriate planning, a husband and wife are able to transfer assets using TWO exclusions since each spouse is entitled to transfer their applicable exclusion amount free of tax. However, wills or joint tenancy designations often give all property of one spouse to the other spouse. If the total estate of the husband and wife exceeds the amount of *one* applicable exclusion amount, the effect of an estate plan of this type can be VERY costly. Some planning techniques may be utilized upon the first spouse's death, but methods are much more limited after death than if planning is completed during lifetime.

In order to receive the federal estate tax credits of both spouses, upon the first spouse's death an estate plan can provide that assets be transferred to a credit shelter trust which makes use of that spouse's credit. During the lifetime of the surviving spouse, all income of the credit shelter trust and access to trust principal may also be provided to the spouse as long as Internal Revenue Code requirements are followed. When neither spouse survives, the assets of the credit shelter trust are distributed according to the plan of distribution designated by the estate planning documents of the first spouse to die. Assets retained by the surviving spouse are tax exempt up to the applicable exclusion amount available to the surviving spouse. Using this relatively simple planning technique can save hundreds of thousands of dollars in federal estate tax!!

State and Federal Gift Tax

One method of estate planning is to make lifetime gifts in order to lower the value of the future taxable estate. State and federal gift and income tax ramifications should be considered prior to making any gift. Gift taxes vary from state to state. Some states have no gift tax, others follow the same rules as federal gift tax, and other states have totally different gift tax regulations. Gift tax for the individual state should be checked at the time that gifting is contemplated.

On the federal level, as of January 1, 2003, a gift of up to $11,000 per person per year may be made with no gift tax due, and there is no limit on the number of people who can receive a gift from you. Your spouse may also make $11,000 gifts, so a couple can give up to $22,000 per year to any number of people. The annual exclusion increases periodically, based on inflation indexing. As of 2003, no gift tax is due unless gifts exceed $1 million plus the available annual gift tax exclusions per person per year. These gifts in excess of annual exclusions reduce the federal estate tax exclusion amount on up to the $1 million and create immediate gift tax on any additional gifts. Gift tax returns must be filed for gifts over the annual exclusion amount.

State and Federal Income Tax

In making gifts, keep in mind that the person receiving the gift may forfeit some income tax benefits which are available only on inherited property. This is especially important if the basis (original cost plus improvements minus depreciation) in the property which you are considering gifting is very low. For example, John bought real estate in 1982 for $5,000, and it is now worth $105,000. If John gifts the property to his son, Sam, Sam's tax basis in the real estate is $5,000. If Sam sells the property for $105,000, he will have taxable income of $100,000. If Sam inherits the property upon John's death, if the date of death is prior to January 1, 2010, Sam receives a basis in the real estate which equals the fair market value of the property upon John's death. Therefore, Sam's basis would be $105,000 and if he sold the asset for $105,000, he would pay no income tax on the gain! If the property is used as rental property or is other depreciable property, after inheritance the asset may be re-depreciated using the increased basis.

As of January I, 2010, this benefit will apply to forgive capital gain on up to $1.3 million of inherited assets, plus an additional $3 million of assets inherited by a surviving spouse. If significant amounts of appreciated assets exist, planning is essential to ensure that titling of assets will take advantage of all allowable forgiveness of capital gains tax. Prior to 2010, planning is also important to benefit from all potential capital gains tax planning options.

Tax planning can be incorporated into either a will or a living trust. However, although a will allows for tax-planning provisions, assets transferred by a will must go through probate. If property is held in joint tenancy, probate is avoided but the tax planning in the will is also bypassed. With a living trust, tax planning can be achieved *and* probate is avoided.

Answers to Commonly Asked Questions

1. *What if I change my mind? Can a living trust agreement be changed or revoked?*

Living trusts may be set up in any way that is desired by the person or people putting assets into the trust. Revocable living trusts allow you to amend any provision of the trust or to totally revoke the trust.

2. *If I have a living trust, do I still need a will?*

If all assets are held in the name of the living trust, a will is not used at the time of death. However, a will should be signed in conjunction with a living trust in case an asset is inadvertently left out of the trust. The will simply states that any property not already in the living trust should be transferred to the trust. This document is called a POUROVER WILL since it POURS assets over into the trust.

3. *Does a living trust have to file income tax returns?*

As long as the person or people who put the assets into the trust are the managers of the trust, the individuals will continue to file and pay income tax in exactly the same way they did before the trust was created. Income generated by trust assets is simply treated as income of the individuals, so no extra tax returns are required.

4. *Can a living trust save money on taxes as well as avoid probate?*

Use of a living trust may save on income, gift, estate, and inheritance taxes, depending upon the value of the estate and the makeup of the assets. Other documents may also be used for tax planning, but the living trust incorporates both tax planning and probate avoidance.

5. *When my spouse passed away, no probate was required. Why should I be concerned with probate of my estate?*

Don't be fooled into thinking probate is not required because probate did not arise on the death of the first spouse. It is very likely that no probate was required on the first death since many couples own all property in joint tenancy. This form of ownership allows the surviving joint tenant to inherit property without going through the probate process. However, when only one joint tenant survives, probate will be required to transfer assets up on the remaining joint tenant's death.

6. *How large must an estate be to make a living trust worthwhile?*

One benefit of a living trust is that it allows assets to be transferred to beneficiaries with no court involvement. Prior to executing an estate plan, cost of completing the estate plan and expense of steps required upon disability and/or death utilizing various types of planning tools should be compared. Specific probate fees vary from state to state and from attorney to attorney.

Although administration of a living trust is generally less costly than probate, a trust will not eliminate all fees of administration since, even with a trust, when a death occurs titling must be verified, values determined, expenses paid, and distributions made. The trust does eliminate all court involvement, maintains more privacy than probate, eliminates notice requirements and waivers from beneficiaries, and, in many cases, simplifies implementation of tax planning techniques.

The benefit of a living trust also depends upon the personal desires and goals of each individual. In some cases, regardless of whether dollars can be saved in the long run, an individual may not want to spend time or money completing estate planning during lifetime. The right estate planning tool for you depends upon your personal goals.

In some cases, the desire to keep affairs private and to allow for transfer of assets without waiting periods required in probate may make use of a living trust beneficial regardless of the level of cost savings. The primary goal of any estate plan must be to achieve the individual's desired objective. No minimum estate value is required in order to benefit from a living trust. The type of assets involved and overall goals should be assessed to determine whether a living trust would be beneficial.

7. *What is the cost to set up a living trust?*

Costs of a living trust will vary substantially from attorney to attorney and from state to state, and costs will vary depending upon your particular estate planning needs. Many attorneys will provide an initial consultation at no charge to allow you to meet the attorney and to discuss your individual situation. At the conclusion of that meeting, a cost estimate should be made available to enable you to balance cost vs. benefit.

The cost of a living trust may exceed the cost of a will. However, a comprehensive estate plan, whether a will or trust is utilized, should include an analysis of titling and beneficiary designations on existing assets. Otherwise, the will or trust will not effectively transfer assets to the correct beneficiaries. If this analysis is properly completed, the investment for estate plans utilizing wills or trusts will not significantly differ.

In order for a living trust to work properly, it is important that the law office provide advice and forms to help in changing the name on the title of assets to the trust. It is also important that the living trust agreement is coordinated with a will, a durable power of attorney and various other documents which all work together to accomplish your goals. When comparing costs of living trusts, services provided should also be considered. If letters to transfer assets, consultations, and all documents are not included in the fees quoted, a *bargain* may not be such a *bargain*. Prior to deciding to invest in a trust, you should be aware of total cost involved.

8. *Will a living trust protect my assets from potential nursing home costs?*

Revocable living trusts, which allow you to continue to manage your own assets and which can be revised or revoked at any time, have been discussed in this booklet. Revocable living trusts *will not* shield assets from nursing home costs. Assets held in a revocable living trust will be considered to be your assets for purposes of Medicaid eligibility. Medicaid is the government program which covers costs of nursing home care for those eligible, but eligibility is available only to those whose income and assets are under allowable levels. If you can manage and control assets, the assets are considered as yours for purposes of Medicaid eligibility. Various planning techniques do exist to protect some or all assets from potential nursing home expenses.

Trusts are like any type of estate plan. They *must* be customized to your individual situation. As a client, what you pay for is individual advice and application of tax, probate, and other state and federal law to *your* specific needs and goals.

Estate planning is easy to procrastinate. Protect your assets from unnecessary tax and administrative expenses and delays. Call your estate planner to arrange a personal consultation. Your family will thank you for it!

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