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Three Compelling Reasons to Establish Your Estate Plan

A married couple, whether they have children or not, should have an estate plan for a variety of reasons. For purposes of avoiding various taxes, avoiding disputes, and managing one's assets, a well-designed estate plan is essential to ensure the orderly transfer of wealth and assets after death – the estate plan can provide peace of mind, ensure that taxes and disputes are minimized, and establish a mechanism for management of assets. This article will discuss the advantages of establishing an estate plan now and why these documents are important in the orderly transfer of your wealth and assets.

1. Taxes

Until the end of calendar year 2009, there was a federal estate tax on estates over $3.5 million at rates ranging up to 45%, and a Massachusetts estate tax on estates over $1 million. In 2010, there presently is no federal estate tax, although Congress will presumably act to reinstate the federal estate tax before the end of this year. The Massachusetts estate tax remains in place. **This summary will use the $3.5 million federal "exemption amount" from 2009 for purposes of illustration, and will proceed on the assumption that a federal estate tax will in fact be reinstated by the end of 2010, although at what levels is uncertain. If Congress fails to act before the end of 2010, in 2011 the federal estate tax will be reinstated at the level it was at in year 2000, with a $1 million exemption amount and a maximum rate of 55%.**

Each individual is allowed to shelter the $3.5 million "exemption amount" from estate taxes, but estate property over that amount is subject to estate taxes. Basic estate planning calls for the establishment of trusts using the $3.5 million estate tax exemption amount twice, once for the husband and once for the wife, by means of revocable trusts for each spouse.

The two primary deductions from estate taxes are the unlimited estate tax marital deduction and the unlimited estate tax charitable deduction – property left to the surviving spouse and property left to charities is exempt from estate taxes at both the federal and state levels.

The marital deduction is the most-utilized tool to achieve this tax savings. By using a formula marital bequest in each trust, each spouse shelters the $3.5 million "exemption amount" from estate taxes in a "credit shelter trust" or "family fund" for the benefit of the spouse and surviving issue, and leaves the remainder of their property to the surviving spouse pursuant to the provisions of a "marital deduction" trust. The amount in the credit shelter / family trust is exempt from taxation in the decedent's estate and in the estate of the surviving spouse and in the estates of any surviving children. And any growth in the value of assets in the credit shelter / family trust is similarly immune from further estate taxation - it has "cleared" the estate tax. Assets which will probably appreciate in value should be placed into the credit shelter / family trust (and not into the marital deduction trust, any remaining assets of which will be exposed to taxation on the death of the second spouse) for this reason.

Good estate planning therefore entails advising a couple that each spouse should own roughly 50% of their assets to ensure that, to the greatest extent possible, neither spouse "wastes" their estate tax exemption. For example, if a couple has $4.3 million in assets, consisting of a principal residence, a vacation home, various investment and retirement assets, and life insurance, and $3.2 million of that amount is owned by the husband, if the wife dies first she does not own enough property to fully utilize her \$3.5 million federal estate tax exemption amount. The exemption amount is “wasted” in her estate since she does not own enough property to fully utilize it.

Additionally, if either spouse has life insurance on his or her life, the proceeds of those policies can be placed beyond the reach of estate taxes if the policies are owned by an irrevocable life insurance trust which is not controlled by the insured or any members of the family. If an existing life insurance policy is assigned to the irrevocable trust more than three years before the insured party’s death, the value of the policy will not be included in the insured party’s taxable estate (and there is no three-year wait if an entirely new policy is purchased by the trustees of the irrevocable trust after the trust has been established). Often, if life insurance is owned by the insured, it is the value of such a policy that increases the size of a decedent’s estate beyond the threshold amount and results in an estate tax becoming due. By having the trust own the policy, inclusion of the policy’s value in the taxable estate can be avoided, perhaps altogether avoiding imposition of the estate tax.

2. <u>Disputes</u>

Transferring a decedent’s property at death can be a stressful and at times argumentative process at a time when family members are grieving. A well-thought-out estate plan, with a “pour over will” and revocable trust with the tax provisions discussed in 1., above, can avoid this sort of problem (and “funding” of the trust during lifetime can go even further towards avoiding this stressful situation). Good estate planning often involves suggesting to the family that once an estate plan has been designed, drafted and signed, the basic provisions of the plan be discussed with all family members, even children (if they are old enough to understand) to avoid resentments and disputes down the road. If everyone understands what the estate plan calls for well ahead of time, it makes the implementation of the plan after death that much smoother. And funding of the revocable trust during lifetime, by transferring ownership of various assets into the trust while the principal is alive and well, can go even further to ensure that disputes are avoided and that privacy is maintained (assets in a funded trust are not subject to probate court jurisdiction, and do not have to be inventoried in the probate process). While transfer of ownership by right of survivorship (e.g., a husband and wife owning their principal residence as "tenants by the entirety" or owning bank accounts as "joint tenants" so that title to the asset automatically transfers to the survivor at death) is simple and avoids having the assets inventoried in the probate court, and often appears to be an attractive method of estate planning, that method can sometimes negate effective tax planning.

3. Management

If a couple is approaching "old age," with the prospects of disability, infirmity and death, the need to have a well-thought-out mechanism in place for management of the family's wealth becomes readily apparent. No one wants to see an elderly family member struggling with the management of his or her assets while dealing with failing memory (or worse) or physical infirmity. By implementing an estate plan that is designed, drafted and signed when both spouses are relatively young, competent and coherent, a plan can be put in place to manage the assets when either spouse becomes disabled or passes away. There are three key issues to keep in mind when deciding whom to name as "fiduciaries" for the estate plan:

(a) The Executor of each spouse's Will should be a trusted family member or close friend who can be relied upon to ensure that probate assets are transferred into the decedent's trust with a minimal amount of administrative headache and court work.

(b) The trust should have at least one "deep pocket" Trustee, or a requirement that the Trustees obtain a surety bond, to ensure safety and security in management of the trust assets. One of the Trustees should have expertise in the keeping of books and records, management of an investment portfolio, management of, and experience, in various estate and income tax matters, and the ability to provide for physical custody of various valuable assets. This speaks to the desirability of a deep pocket Trustee, normally a financial institution or a trusted professional advisor. Or, alternatively, the trust document should provide the Trustee with the authority to hire and pay for legal, financial and tax counsel to assist in management of the trust.

(c) Conversely, one of the Trustees should also be a trusted family member or close associate with sensitivity to the needs of the family beneficiaries. Performing the various fiduciary obligations associated with a trust involves a mix of professional and personal qualities that often requires a Trustee to behave almost as a parent would, with sensitivity to the needs of each of the various family beneficiaries.

Estate planning is often delayed for reasons ranging from a wish to avoid confronting issues that deal with the end of life to a false sense that "we can deal with this later." There is no time like the present to fully inventory all of your assets and liabilities, decide how you wish to pass your family's wealth and assets on to your children and grandchildren, and to discuss designing an estate plan with your attorney to ensure that your property passes through the generations as you want it to.

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