ESTATE PLANNING GUIDE

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I. INTRODUCTION

A. WHAT IS "ESTATE PLANNING"?

Historically, estate planning was considered as planning to provide for the orderly and systematic transfer of one's wealth to heirs and beneficiaries; but today, estate planning also encompasses planning for incapacity, making provisions for long term health care, and retirement planning.

If you are like most people, you have spent years working long, hard and smart to accumulate wealth and property. You expect to live the rest of your life in comfort and leave the balance of your estate to your heirs. But there are many obstacles which could prevent you from controlling the distribution of your assets.

B. GOALS OF ESTATE PLANNING

A good estate plan has four basic goals:

1. To ensure you maintain your standard of living and that you will be properly provided for throughout your lifetime;

2. To make sure that your wealth reaches the individuals or organizations you select, in the manner in which you choose, with minimum shrinkage from federal and state transfer taxes and administration expenses;

3. To allow you to select who will handle various administrative and management functions on your behalf, both during your life and after your death; and

4. To control your family's future.

C. BASIC STRATEGIES OF ESTATE PLANNING

By following a number of strategic planning steps, you may be able to minimize or even eliminate estate taxes and settlement costs and insure your assets are distributed according to your wishes. Those steps are as follows:

1. Goal Evaluation

Determine whom you want to inherit your assets and how you want your property distributed. Once your objectives are clear, you can incorporate strategies designed to help meet your individual goals.

2. **Estate Inventory**

List all of your holdings and place a fair market value on the assets. Subtract the sum of your debts from the value of your assets to determine your gross estate. This is the amount you could leave to your heirs.

3. **Will and Trust Preparation**

Your will or a revocable trust is the cornerstone of your estate plan; it will determine who will receive your assets and how those assets will be distributed.

4. **Family Gifts**

Lifetime gifts to your family can reduce your taxable estate and provide personal satisfaction. An individual can transfer up to $12,000 per person each year without reporting the gift or paying taxes, as will be discussed later.

5. **Charitable Giving**

Contributions to a qualified charity may result in a current income tax deduction, can be made gift tax free and may reduce estate taxes.

Estate planning strategies often involve more than just executing a will. You can also make: (a) arrangements for the accumulation and handling of assets while you are alive and upon your death; (b) draft "inter vivos" trusts to manage your assets during and after your lifetime to support your children until they are of age, and to shelter your estate from taxes; (c) utilize gifts to people or charities to reduce taxes; (d) incorporate life and disability insurance into your plan to provide liquidity; and more.

As stated above, the first step in your estate plan is to determine what your goals are with respect to your estate. For example, do you want any of your assets to go to charity or for your children's education? Who would be a good candidate to serve as your personal representative and as your children's guardian? If something were to happen to your entire immediate family, what should happen to your property?

The second step in estate planning is to take an inventory of your assets, including your home, jewelry, stocks and bonds, bank accounts, insurance, retirement plans, and real property, and to note how they are owned. Then, take a similar inventory of your debts and liabilities. This can be done by using our comprehensive estate planning questionnaire, which we will be happy to supply to you without any cost.

At this stage, you also need to consider the tax ramifications of your plan, and how to minimize estate shrinkage. Then you must determine the best vehicles to carry out your plan, including wills, trusts and other estate planning tools.

II. EVERYONE HAS AN ESTATE PLAN - VOLUNTARY OR INVOLUNTARY

The basic transfer vehicles from which you can choose when planning your estate are as follows: The first possibility is "intestate succession," which amounts to having no estate plan. The second possibility is to execute a last will and testament, or possibly create a living trust. Some people might add the use of "will substitutes" as an additional transfer technique. Will substitutes include such assets as life insurance, qualified retirement plans and jointly held property, all of which pass to designated beneficiaries by operation of law and outside of your will or intestate succession. These will be discussed in more detail later.

A. WHAT HAPPENS IF YOU DIE WITHOUT A WILL?

If you die without a will (or "intestate"), the courts will take control of your estate and distribute your assets according to the intestacy laws of the state in which you reside at the time of your death. In other words, the Legislature becomes your estate planner when you die intestate, through a series of statutes which provide for the administration and distribution of your estate. The statutes are designed to accomplish the desires of a majority of a state's citizens and may not match your goals. For example, in New York, if you do not have a will and you are married but without children, your spouse will receive your entire estate. Likewise, if you do not have a will, and you are married with children, your spouse will receive $50,000 and one half of the remainder of your estate and your children will receive the other half of the remainder.

Another disadvantage, and particularly so where your spouse has predeceased you, is that the court will appoint a guardian for your minor children with respect to their share of your estate. The court may not name an individual or individuals that you would want to take responsibility for your children; and, having a court appointed guardian can provide complications in estate management. For example, any money used to pay for your children's education, clothing and living costs would require prior approval of the court, *even where your spouse is the guardian*. The law further requires annual accountings of income and expenses to the court, and investment of the funds by the guardian will be limited to choices approved by the court. If the guardianship should last for any significant length of time, the investment limitations imposed by the court may not allow the children's funds to grow at an acceptable rate.

Also, without a will, the court will appoint a "personal representative," or "administrator" of your estate. This may be a relative if one is willing or able to serve; or the court will appoint an administrator of its choice. Since your personal representative will cost your estate a percentage of the estate assets in commissions, most people find comfort in selecting someone they know and trust to oversee the administration of their estate.

Finally, if you die intestate, your estate will not have the benefit of any tax planning to minimize the oftentimes confiscatory effects of federal and state death taxes.

B. PROBATE AND NON-PROBATE ASSETS

Most estates include probate assets and non-probate assets (previously referred to as "will substitutes"), and you should be aware of the impact of both. Probate assets are those owned in your own name which require a determination by the court as to where the assets should go (i.e., a bank account or residence titled in your name alone).

Non-probate assets are those which transfer automatically to another person or designated beneficiary upon your death. Examples of non-probate assets include:

- Assets held in a revocable living trust.
- Assets held jointly with your surviving spouse, or with another as joint tenants with a right of survivorship.
- Proceeds of an insurance policy where beneficiaries are named other than your estate.
- Balances of retirement plans, Individual Retirement Accounts, or Keogh accounts and tax deferred annuities, which may be payable to designated persons rather than your estate.

For those assets which go through probate (or administration), probate involves two procedures:

1. First, the Surrogate's Court in the county where you reside determines whether a particular instrument is your will and whether it will be held to be valid to transfer your assets. If you die intestate, the court determines your legal heirs by reference to the applicable state law on intestate succession.

2. Second, the court oversees the process of settling your estate, including:

- Supervision of the actions of your personal representative, either your executor or administrator.
- Ruling on the legitimacy of any creditors' claims against your estate.
- Supervision of the transfer of your remaining property to the beneficiaries named in your will, or to your heirs if you die without a will.

- ➢ Overseeing a guardian's use of any property which is left to minor children, until they reach the legal age of majority. (18 years of age in New York)

Court supervision of the probate process helps ensure that the directions left in your will are carried out properly. The probate process can take as little as seven months or as long as several years (for example, if your will is contested or if you own additional property in other states). A properly drafted estate plan, which is kept up to date, will minimize probate delays and expenses. It can provide for the prompt appointment of executors, guardians and trustees, payment of expenses and taxes, settlement of claims, continuation of business interests and the avoidance of will contests and unsubstantiated claims.

III. WHAT ARE THE ALTERNATIVES?

A. WHY YOU NEED A WILL

One of the most effective ways to direct the distribution of your property according to your own wishes is to make a will. However, many individuals assume that wills are only for very wealthy people, or are only for people who want to set up trusts or save estate taxes. The fact is that whether you are young or old, married or single, are parents or not, if you have financial assets, you generally should have a will.

Unfortunately, three out of four Americans die without leaving a will, probably because no one enjoys contemplating his or her own death. However, if you have worked hard throughout your life to build a solid financial foundation and to provide for the security of your family, shouldn't you be the one to decide how and by whom your assets will be distributed after your death?

The primary reason for making a will is to provide instructions on how your assets are to be distributed among your beneficiaries. A will is a written document which:

- ➢ Outlines how you wish to distribute your assets including specific gifts of your tangible personal property.

- ➢ Designates an executor or personal representative who is responsible for taking inventory of your property, preserving your estate, paying creditors, administrative expenses and death taxes, and disposing of the remainder of your property among your beneficiaries.

- ➢ Appoints guardians for minor children in the event of the death of both parents.

- ➢ Establishes trusts to protect assets in special circumstances.

You can use your will to establish a testamentary trust (also called a "trust under will"), that will ensure your assets are held, managed and distributed in the manner which you specify. You can

direct that the "trustee" of this trust manages certain assets for the benefit of your family and/or other beneficiaries, and distributes trust income and principal at specific times and in the manner you have set forth in your will. For example, if you are concerned that your spouse may remarry after your death, you can create a trust that provides income and principal for your spouse during his or her life, but preserves the remaining principal for your children upon his or her death. Likewise, if you are leaving assets to children, you will want to use a trust to ensure that they do not receive the funds until they reach a certain age or level of maturity, and then only for certain purposes such as support, maintenance and education as you specify.

B. AVOIDING PROBATE

There are certain reasons why you may wish to avoid probate:

- ➢ If you desire privacy, trust documents are generally not filed with the court (but be aware of exceptions, such as when a "pour over" will is used).
- ➢ If you own property in more than one state which will require an expensive "ancillary" administration in the other jurisdiction.
- ➢ To provide for uninterrupted management of your assets.
- ➢ To avoid certain probate expenses and undue administrative delays.
- ➢ To provide a certain sense of relief, knowing that everything has been taken care of prior to your death.

An effective way to avoid probate is by employing a "revocable living" trust, which can provide for the management of your assets during your lifetime and for the proper disposition to your beneficiaries upon your death. You may change or revoke the terms of the trust at any time and may designate anyone you like–a professional manager, your spouse, or a child–as trustee. This type of trust is also useful if you become incapacitated and/or incompetent, because the trustee will be able to manage your assets and provide for your needs without court intervention.

IV. ESTATE SETTLEMENT COSTS AND TRANSFER TAXES

There are two obligations which must be paid from your estate before your assets can be fully distributed to your heirs–administrative costs and estate taxes.

A. ADMINISTRATIVE COSTS

Administrative costs vary widely from state to state, but usually are estimated at 3-8% of an estate's gross value. The biggest administrative costs are executor's fees and legal fees, but there are also filing fees, appraisal fees, publication fees, bond fees and legal costs for unexpected legal

services such as will contests and real estate transactions. Before proceeding further, it is important for you to understand the basic Federal and New York State transfer tax systems in general; and in particular, two key estate tax provisions–the unified credit and unlimited marital deduction, which form the basis of many estate planning strategies.

B. ESTATE TAXES

1. The Unified Gift and Estate Tax System

The estate tax is an *excise* tax on the transfer of property from a decedent. Under federal law, a unified transfer tax is applied cumulatively to all gifts that are made during an individual's lifetime and then to all assets that are owned at death. This is a single, progressive tax.

The federal estate tax is a tax levied on all property interests each individual owns or has rights to at death. Property interests are taxed based upon the fair market value of the property at the date of death. These property interests include not only property passing under your will or by state laws of intestate succession, but also property known as will substitutes which pass by operation of law. As previously mentioned, these include real property held in joint names, joint bank accounts, retirement plans, and insurance policies. In particular, death proceeds from a life insurance policy owned by the decedent on his or her life, or policies in which the decedent-insured had certain "incidents of ownership" are also included in the gross estate.

Whether or not your estate goes through probate, it will be taxed depending upon the size of the estate and whether or not your spouse survives you. It is a common misconception that assets which avoid probate, such as life insurance, pension benefits and jointly-owned property with a right of survivorship, are not taxed in your estate. In summary, your estate, for federal and New York estate tax purposes, includes:

- Property held in your own name.
- Half of the value of property you hold jointly with your spouse.
- The full value of property you held jointly with others than your spouse, unless you can overcome the presumption that you provided all the consideration.
- The face value of life insurance you own on your life or over which you hold "incidents of ownership" (regardless of the beneficiaries).
- Property over which you have a general power of appointment.
- Pensions, IRA's, annuities and other plans owned by you with a death benefit to others.

These items together comprise your "Gross Estate," which equals the value of all property subject to estate taxation.

2. The Unlimited Marital Deduction

A married couple can defer any or all federal and New York estate taxes on the death of the first spouse by passing an unlimited amount of property to the survivor, provided the recipient spouse is a United States citizen. At the death of the surviving spouse, however, taxes will become due and payable on the full value of the combined estates. Since the surviving spouse is only entitled to an individual unified credit, the estate will receive only a single federal exemption on property valued up to the applicable amount exempt, depending upon the Date of Death. Thus, use of the unlimited marital deduction to defer federal and New York estate taxes at the death of the first spouse will result in additional estate taxes due nine months after the death of the surviving spouse. However, there are planning opportunities to minimize these estate taxes and provide liquidity to pay them. We will discuss these opportunities in detail.

V. THE USE OF TRUSTS IN TRANSFER TAX PLANNING

A. WHAT IS A TRUST?

A trust is basically a fictional legal entity which is created by an agreement, under which arangement, an individual you select, known as the *trustee*, holds and manages property for your *beneficiaries*. You, as *grantor*, *settlor* or *creator* of the trust, dictate the terms of the trust, and the trustee is responsible for carrying out your written instructions as set forth in the agreement.

Thus, a trust is a legal arrangement through which you give property to your trustee to manage and use for the benefit of whomever you name. There are two main types of trusts:

- *Testamentary*, which go into effect when you die.
- *Living* ("*inter vivos*"), which take effect during your lifetime. Living trusts may also be *revocable* or *irrevocable*.

Trusts are vehicles to provide for certain actions to take place with the best possible consequences - both tax and non-tax. Inter vivos trusts should generally be prepared in conjunction with a "pour-over" will to ensure that upon your death any remaining assets in your name inadvertently left outside the trust will be transferred into the trust for distribution to your designated beneficiaries in accordance with your wishes as expressed in the trust instrument.

The living trust is funded by transferring the title to all or a portion of your assets into the trust name. If the trust is *revocable*, you retain complete control of the assets and can change the terms of the trust at any time. If it is *irrevocable*, you give up all rights to the property and cannot amend the trust terms.

B. TYPES OF TRUSTS

The following are more detailed descriptions of some of the more common types of trusts:

1. Revocable Living Trust

In addition to the benefits set forth above, a revocable living trust can ensure your own personal and financial welfare in the event that you become incapacitated during your lifetime. You will be able to select someone to make decisions and act on your behalf should you become incapable of making your own management decisions. In addition, you may appoint a professional manager, maintain complete control over the trust property, receive income from the trust, transfer property to your heirs, provide privacy for your family and reduce estate settlement expenses.

2. Irrevocable Living Trust

This is a method to transfer *ownership* of an asset without giving the recipient unbridled access to the money or property. If you relinquish all rights to income and principal from the trust, as well as the power to change the trust agreement in any manner, the asset will *not* be considered part of your taxable estate. You name the recipient of the assets, including income and principal beneficiaries. Because the transfer is considered a gift to the trust, a gift tax may be imposed unless the transfer qualifies for the previously discussed gift-tax annual exclusion, or you use some or all of your "unified credit."

3. Irrevocable Life Insurance Trust

One popular use of an irrevocable living trust is to have the trust own the life insurance policies on your life, thereby removing the proceeds of such policies from your taxable estate. If the death benefit proceeds will not be included in your taxable estate, they will be available to provide liquidity to accomplish estate objectives. The cash may be used to buy non-liquid assets from the estate or loan money to the estate, thereby eliminating any need for distress sales of estate property or excessive borrowing which might be needed to pay estate taxes.

4. Minor's Trust

If you and your spouse both die, a testamentary minor's trust can hold your assets for your children or grandchildren until they reach a certain age, provide management of the assets and pay income and principal as you direct for such purposes as their support, maintenance and education.

5. Charitable Trusts

Charitable remainder trusts can help an individual obtain income tax deductions, increase diversification of an investment portfolio without incurring an immediate capital gains tax,

increase cash yield generated by assets, and decrease the size of the estate. They work best for older individuals who find themselves holding low yielding, highly appreciated assets and who have charitable giving objectives. Assets are transferred by an individual to a trust and then sold to be reinvested in higher yielding assets. Generally, an individual and perhaps a spouse receive income for life with the remainder going to a charity after the death of the last income recipient. The value of the property given to the trust is often replaced for the heirs with a life insurance policy in an irrevocable life insurance trust. A charitable lead trust provides a charity with the income from your principal, paid over a certain amount of time, after which the remainder passes to your heirs at greatly reduced transfer tax costs.

6. Supplemental Needs Trusts

This type of trust is created to provide for someone who is or may become eligible for governmental assistance. Some individuals who suffer from either mental or physical illness or disability are eligible for benefits that help to provide for medical care, housing, food, and other types of care. Oftentimes the governmental regulations are very strict as to the amount of assets and income the recipient of such benefits may have.

A supplemental needs trust is designed to provide for benefits and life enhancement activities that are not provided by governmental assistance. The trust is drafted to make sure that the loved one is not disqualified from governmental assistance because the individual has too many assets or too much income. This is a very important planning tool for those concerned that the benefits a loved one receives may be jeopardized after you are gone.

C. ADVANTAGES AND DISADVANTAGES OF LIVING TRUSTS

A revocable trust arrangement generally offers several advantages over a will. It can help you:

- ➢ Manage and protect assets during your lifetime.
- ➢ Provide continuity in the management of your affairs after your death.
- ➢ Control how and when assets are to be distributed.
- ➢ Avoid the costs and delays of probate.
- ➢ Ensure privacy in the handling of your affairs.
- ➢ Reduce taxes and/or expenses when properly designed.

While there are many benefits to trusts, there are also some disadvantages. Most trusts and particularly *irrevocable* trusts, involve some degree of loss of flexibility or control over your assets and trusts are initially more expensive to prepare and implement than wills.

VI. POWERS OF ATTORNEY AND HEALTH CARE PROXIES

An essential part of current estate planning is appointing individuals, known as "fiduciaries," to act on your behalf. In a will, a fiduciary is called an "executor," and in a trust, the fiduciary is called a "trustee." In addition, there are other methods to appoint individuals to act on your behalf during your lifetime as the need arises.

Through a "Power of Attorney," you can appoint another individual, (an "Agent"), to transact business in your name. The laws regarding Powers of Attorney were amended in January 2009, and the new provisions took effect on September 1, 2009. The new law provides that all Powers of Attorney are Durable, that is, that the authority you give your Agent to make banking, real estate, and all other transactions in your name lasts beyond any disability or incompetency you may suffer. There were many major changes made and these should be thoroughly discussed with your attorney.

The statutory form Power of Attorney now includes two forms, the first is a form which provides for specific powers (other than gifting or transfers) that your agent can use to act on your behalf. The second form is the Statutory Major Gifts Rider, (SMGR). The SMGR is an important component of your Power of Attorney. It addresses the ability of your Agent to make transfers or gifts of your property to other people, including the Agent. The SMGR is an optional form. Both the Power of Attorney and the SMGR can be modified and tailored to meet your specific needs. In an effort to avoid abuses by the Agent, new, Special Proceedings, have been provided, so that the actions taken by an Agent are subject to further review and inspection.

The revised Power of Attorney is designed to avoid the costly and complicated guardianship procedure which is required under Article 81 of the Mental Hygiene Law, where an individual becomes incapacitated for any number of reasons including accident, disease or merely the natural process of aging. It can also prevent any difficulties involved with management of your affairs while a guardianship is pending and before a guardian is appointed by the court. However, a word of caution is advised because a Power of Attorney and SMGR grants enormous rights and powers to your Attorney-in-Fact.

One duty which cannot be performed by an Attorney-in-Fact is the performance of health care decision-making. If you wish to have someone available to make health care decisions in the event that you are unable to do so yourself, you should also consider executing a Health Care Proxy and a Living Will.

VII. CONCLUSION

Estate planning encompasses a number of different subject areas, and it is not without complexity. The most effective way to begin the preparation of an effective estate plan is to meet with a qualified planner, and to begin assembling the information necessary to formulate the plan.

GLOSSARY

Administrator - A person appointed by the Surrogate's court to manage the estate of a person who dies intestate.

Agent - The person who is given and accepts the authority to act on behalf of someone else through a Power of Attorney.

Beneficiary - A person designated to receive the income or principal of a trust or estate.

Bequest - Personal property given to another by will. Compare with "Devise."

Codicil - A document which adds to or changes a will. Its execution must comply with the formalities required for the execution of a will.

Decedent - A deceased person.

Devise - Real property given to another by will. Compare with "Bequest."

Estate - An interest in assets and personal property; also the legal entity which manages and distributes a decedent's property.

Estate Tax - The transfer tax paid to IRS and New York State by the administrator or executor of a decedent's estate out of the assets of the estate itself.

Executor/Executrix - A person appointed by a testator in a will to carry out the provisions of the will. A woman acting in such a capacity is an "executrix." A "coexecutor" acts as executor together with another or others. See "Personal Representative."

Fiduciary - A person in a position of trust or confidence. The fiduciary is bound by a duty to act in good faith. Examples of fiduciaries are trustees, executors and administrators.

General Power of Appointment - The power to decide who should receive assets and when.

Grantor - A person who makes a transfer of property. The term is commonly used to describe a person who establishes and transfers property to a trust. See "Settlor" and "Trustor."

Guardian of the person and/or property of a child - A person legally appointed by the court to manage the rights and/or property of a minor. A "guardian *ad litem*" is appointed by the court to prosecute or defend an action for a minor.

Heir - A person entitled to inherit a portion of the estate of a person who has died without a will. In New York, this person may be known as a distributee.

Intestate - Dying without a will.

Legacy - A transfer of personal property by a will.

Living ("Inter Vivos") Trust - A trust which goes into effect while the settlor is alive.

Personal Representative - An executor or administrator charged with marshaling assets, paying bills and taxes, and ultimately distributing an estate.

Pour Over Will - A will used to transfer assets to a trust which already is in existence. Very often it is used in conjunction with a Revocable Living Trust to dispose of those assets not previously placed in the trust.

Power of Attorney - A document in which you, the Principal, authorize a person to act as your Agent and provide specific powers that your Agent can use to act on your behalf. (As of September 1, 2009, to include gifting or transfer powers, you must also complete a Statutory Major Gifts Rider.)

Principal - The person who executes a Power of Attorney, authorizing an Agent to act on their behalf.

Probate - The proving of the validity of a will.

Settlor - The creator of a trust.

Statutory Major Gifts Rider - Beginning September 1, 2009, an optional form that is required to accompany a Power of Attorney if the Principal wants to grant the authority of their Agent to make gifts or transfers of the Principal's personal or real property.

Testament - A will.

Testamentary Trust - A trust established by a will which begins after the testator's death.

Testator/Testatrix - A man who makes or has made a will. A "testatrix" is a woman who makes or has made a will.

Trust - A legal relationship where property is transferred to and managed by a person or institution for the benefit of another.

Trustee - The person or institution entrusted with the duty of managing property placed in trust. A "co-trustee" serves as trustee with another. A "successor trustee" becomes trustee upon the happening of a named future event.

Trustor - One who creates a trust. Also called a "Grantor" or "Settlor."

Will - A legally executed document which explains how and to whom a person would like his or her property distributed after death, and appoints personal representatives to carry out the management and distribution of assets.

This brochure is provided for informational purposes only. While every effort has been made to ensure accuracy, it cannot be relied upon as legal advice. Applicability of the legal principles discussed may differ substantially in individual situations, and you should consult with your legal advisor.