# THE IMPORTANCE OF A WILL AND GENERAL ESTATE PLANNING TOPICS

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**THE IMPORTANCE OF A WILL**
**AND**
**GENERAL ESTATE PLANNING TOPICS**

PAGE


INTRODUCTION 1

CONSIDERATIONS IN DRAFTING A WILL 1

WHEN SHOULD YOU REVIEW YOUR ESTATE PLANNING DOCUMENTS? 2

WHAT IF YOU DIE WITHOUT A WILL? 3

"NON-WILL" DOCUMENTS 4

TEXAS HOMESTEAD LAWS 7

LIFETIME TRUSTS - REVOCABLE MANAGEMENT TRUSTS AND IRREVOCABLE TRUSTS 7

GIFTS TO CHILDREN AND GRANDCHILDREN 8

MARITAL PROPERTY AGREEMENTS 10

ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES 10

INCOME TAX SURTAX 11

ESTATE PLANNING - USE OF BY-PASS TRUST 11

INTEGRATION OF LIFE INSURANCE, EMPLOYEE BENEFITS, IRAS, AND FINANCIAL DEPOSITS INTO YOUR ESTATE PLAN 14

PROBATE AND POST MORTEM ESTATE PLANNING 16

SUMMARY 16

OPERATION OF A SIMPLE WILL (CHART) 17

OPERATION OF A BY-PASS TRUST WILL (CHART) 18

COMMENTS AND ADDITIONAL INFORMATION 19


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# INTRODUCTION

A properly prepared Will can provide for the orderly distribution of your assets upon your death no matter how large or small your estate may be. It can also eliminate many problems and misunderstandings in the final settlement of your financial and personal affairs. A Will is an important part of every Estate Plan.

A Will covers many contingencies including taking advantage of your right to shelter assets in your estate from federal estate tax (subject to the limits discussed on page 10, *et seq*.) A Will can also avoid legal pitfalls in the transfer of title to your real estate or personal property. Most importantly, an Estate Plan gives you the opportunity to decide *exactly* how the property you have acquired during your lifetime will be distributed following your death and allows you to choose those whom you wish to enjoy the fruits of your lifetime's efforts, including charitable or religious organizations you may wish to benefit.

# CONSIDERATIONS IN DRAFTING A WILL

**Executor**: Texas statutes allow for an "Independent Executor" to be named in your Will. This person collects the assets, prepares an estate inventory, pays the estate debts and tax, distributes the assets of the estate to the proper beneficiaries, and in general, "probates" your Will without a bond and free of strict supervision by the court. This greatly reduces the expense and delay associated with probate in Texas and most other states if you die without a Will. The surviving spouse is normally named first in this capacity and an adult child, trusted family member or friend as successor. Sometimes a "corporate fiduciary" may be named as final successor in the event all named individuals fail to serve or unusual needs arise which require a disinterested, professional institution to serve as Executor.

**Trustee**: A "trustee" is an individual or corporate entity holding property placed "in trust" for the benefit of another person (the "beneficiary") for a period of time specified in a Will or trust document. *For example*, in the event of the premature death of both parents, a trust is normally created under the parents' Wills for their minor children. This trust can specifically provide funds for such things as medical and education expenses. An individual or corporate entity must be appointed as trustee to manage assets for minor children until they reach the age specified in the trust to receive the property outright. A trustee for a minor child does not have to be the same individual selected to serve as "guardian of such child's person or estate." In most instances, a qualified adult may be trustee of his or her trust.

**Guardian**: Selection of a "guardian of the person for a minor child" is one of the most difficult, and important decisions a parent must make. In Texas, with minor exceptions only one guardian of the person is appointed to serve at a time. A successor guardian should also be named in the event the first guardian divorces, dies, resigns or is unable to serve. You can provide for such contingencies through a

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separate written "declaration." Many people fail to take into account the tremendous physical adjustment resulting from new members suddenly being thrust into a household through a guardianship situation. The burden of managing large sums on the children's behalf can be overwhelming for a guardian when added to this physical adjustment. This is especially true for a guardian who also has children who do not have the same financial security as that of your own children for whom you have provided under your Will. The person you consider best equipped to raise your children may not be the best money manager or diplomat. You may therefore want to name different parties to handle your children's finances (trustee) and supervise their physical person (guardian of the person).

**Contingent Minor's Trust**: Should both parents' deaths occur while their children are minors, a trust for their benefit until they reach a specified age is a necessity to avoid an expensive court created (and supervised) guardianship of the child's estate. Furthermore, if your youngest child is already 18 at the time of both parents' deaths, creation of a trust for his or her benefit would allow educational expenses to be paid from the trust until the child is beyond normal college years and may encourage the child to obtain a quality education instead of living off his or her inheritance.

**Beneficiaries:** You should decide the person(s) you want to inherit your property (spouse, children, grandchildren, parents, siblings, friends, charities) and how it should be divided (all, different percentages, specific assets or dollar amounts). You should also consider alternate beneficiaries if the person(s) first named do not survive you.

## WHEN SHOULD YOU REVIEW YOUR ESTATE PLANNING DOCUMENTS?

You should review your plan at least **every three to five years** to ensure that it continues to meet your needs as your individual circumstances change. Estate plans should also be reviewed whenever new tax laws are passed by Congress. Read the major provisions of your documents, the cover letter, diagrams and other explanatory information provided when your documents were prepared, and discuss them with your spouse and other family members. Common reasons to review and possibly revise your plan are:

- Major changes have been made to our federal tax laws. (See changes to estate and gift tax laws under the 2010 Tax Act discussed on pages 10-11.)

- You have changed your mind concerning beneficiaries, executors, trustees or guardians named in your documents.

- Your state of residence has changed or is likely to change.

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- Your marital status or that of a family member has changed.
- Your estate value has increased significantly due to appreciation, receipt of a large gift or inheritance or retirement payment, or has been depleted.
- A death or birth has occurred in your family.
- You are considering making gifts to family members or charities.
- You have retired or are considering retirement.
- You have reached or are nearing age 70 ½ and are planning for distributions from an IRA or other retirement plan or annuity.
- Your life expectancy or that of a family member has been shortened due to illness or anticipated incapacity (such as Alzheimer's).
- You are considering forming a new business, selling or making changes in the structure of your business, or passing a business on to another generation.
- You have purchased or are considering purchasing a substantial life insurance policy or annuity.
- You have purchased or are considering purchasing real property outside Texas.

If you have questions or believe changes are necessary, you should contact a qualified estate planning attorney. **Do not attempt to make changes to your documents yourself**. The same formalities must be followed as when your documents were first prepared.

## WHAT IF YOU DIE WITHOUT A WILL?

**No flexibility is available under Texas law in the distribution of your assets if you die without a valid Will.** Your surviving spouse may often receive a smaller share of your real and personal property than expected. *For example*, "community property" owned jointly by you and your spouse would be divided into two shares, your spouse's share passing to your spouse, and your share passing to *your children* (if all of your children were <u>not</u> born of your spouse,) or if all children were born of **both you and your spouse**, then 100% to your surviving spouse. A "Guardianship of the Estate" would probably have to be created for each minor child to hold his share of such property.

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The court will appoint someone to handle your estate if you die without a Will. This "administrator" is entitled to compensation set by Texas law and approved by the court. Your administrator must also seek prior permission from the court before entering into transactions with your property, including routine acts like paying utility bills and distributing money to your spouse and children for their support. The administrator also must account to the court for each and every receipt and disbursement and file a formal accounting with the court at least once a year. Generally, an attorney is also retained to advise the administrator and prepare the many documents required throughout this process.

If a minor child (under age 18) is entitled to receive property from your estate, a guardianship may be created in the probate court, even if the minor is your child and your spouse (the minor's parent) survives you. The court may appoint a person called a "guardian of the child's estate" to take care of your child's inheritance based upon what the court thinks best. This person could be your spouse, a prior spouse, a friend, relative or a complete stranger selected by the court.

The guardian of a minor's inheritance (estate) is entitled to compensation. The guardian must generally seek prior permission from the probate court for each transaction involving the minor's property, including paying for school expenses and buying food and clothing for the minor. Again, an attorney is normally retained to advise the guardian and to prepare the many documents which are required to be filed with the court throughout this expensive and time-consuming process. The guardian must account to the court for each and every receipt and disbursement and must file an annual accounting report, usually prepared by the attorney. When the minor reaches age 18 all of the property must be turned over to him or her no matter how immature or ill-equipped he or she may be to handle property.

## "NON-WILL" DOCUMENTS

A Will is only one part of your comprehensive Estate Plan. Since your Will only becomes effective when you die, other documents are necessary to provide a means of making financial and medical decisions on your behalf during your lifetime. Because the laws governing these lifetime documents change, they should be reviewed periodically and replaced as needed. These documents become void when you die.

### Statutory Durable Power of Attorney

This document provides a means for your financial affairs to be managed without interruption following your disability or incapacity or at any other time you may elect. The person you appoint as "attorney-in-fact" can *either* act legally on your behalf *at any time after it is signed*, or only after you become legally incapacitated or disabled, depending upon your selection in the document.

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This document should be retained in your possession or under your control or in the possession of someone who can be trusted to act dispassionately in the event of family discord over your ability to competently manage your own affairs. If this document and others described below are held in your safe deposit box, one or more persons named to act under those documents should be included on the list of persons authorized to enter the box so they can obtain the original documents they will need to act on your behalf if you cannot physically access the box yourself.

In the event you should become incompetent, proper use of a durable power of attorney may make a guardianship with its attendant legal fees and court costs unnecessary. After September 1, 1993, powers of attorney executed in Texas are no longer required to be recorded in the person's county of domicile prior to their being effective for use.

## Medical Power of Attorney Designation of Health Care Agent

Since 1991, any competent adult may execute a Medical Power of Attorney Designation of Health Care Agent for appointment of another person to make health care decisions for you in the event of your incapacity or inability to communicate such decisions yourself. Although your agent would be authorized to make a wide variety of decisions on your behalf under this document, the agent may *not* consent to voluntary inpatient mental health services, convulsive treatment, psycho surgery, abortion or neglect of your person through the omission of care primarily intended to provide for your comfort. These decisions must be made by the "guardian of your person."

Although the medical power of attorney is especially useful in naming a specific individual to give medical treatment authorization and avoid conflict between family members, it must be in an authorized format and executed only after you have read *and understand* a "disclosure statement" prescribed by Texas law. For these reasons, as well as the interplay between this document and a "Living Will" which you may also sign, a qualified attorney should be consulted prior to execution of such a document.

## HIPAA Authorization

Under the Health Insurance Portability and Accountability Act (HIPAA) the Privacy Rule regulations were established for the use and disclosure of medical information. This has caused the medical industry to be extremely careful in releasing your medical information to anyone other than you without proper authorization. The written HIPAA authorization allows you to designate an agent to receive and obtain your medical information from doctors, hospitals and other medical professionals. This HIPAA authorization document is *separate* from the Medical Power of Attorney and serves a different purpose. Generally, an agent designated under your valid Medical Power of Attorney *cannot* obtain your medical information. Therefore, it is important

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to execute *both* a Medical Power of Attorney and a HIPAA authorization.

## Directive to Physicians ("Living Will")

If you wish to make known your feelings about the use of artificial life sustaining support measures in the event of a terminal illness, you should do so by signing a "Directive to Physicians," which is prescribed by the Natural Death Act in effect in the State of Texas. Once signed, this directive can be revoked by you at any time. You should consult your attorney about such a document if you wish to make this election to either allow or preclude the use of such measures on your behalf. Texas allows another person to make such decision if you select the type Directive to do so. This procedure adds flexibility to help ensure the Directive is carried out in a humane manner in step with the family's needs and expectations. However, execution of a Directive may effectively revoke the power given to a family member under a Medical Power of Attorney Designation of Health Care Agent to exercise judgment in making health care decisions for you in a serious health situation. Therefore, you should *not* sign a Directive without seeking competent legal advice.

## Declaration of Guardian in Advance of Need

Texas law authorizes persons to designate the person they wish to serve as their Guardian *before they need one.* Similarly, they may also designate those persons who *may not* be appointed as Guardian. Formerly, such appointments in advance of need were only allowed for designation of guardians of minor children. These documents do not replace the need for a court proceeding should someone need a Guardian to be appointed for any reason. Instead, it provides a list of persons in order of succession selected by the individual for whom the Guardian is appointed (the "Ward") which the court must honor, so long as such persons are not legally disqualified from acting in such capacity. The Guardian is appointed by the court upon conclusion of the court proceedings if the court determines one is needed.

## Statement Regarding Anatomical Gifts

By signing such a statement, you can evidence your wishes to donate tissue or organs for either transplantation purposes and/or for medical research. Although such intentions can be indicated on a driver's license, some medical facilities are reluctant to rely solely on the authority of that document. Other organizations, such as the "Living Bank," provide forms to register availability of certain organs in advance of your death, sometimes including online registration. In any event, your family members or others who would be asked for their consent in a time of emergency should be informed of your interest in making such anatomical gifts.

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## Appointment of Agent to Control Disposition of Remains

An appointment of "Agent to Control Disposition of Remains" designates an agent to determine matters related to the final disposition of your remains, your burial and funeral arrangements. The agent designated in this document is also financially obligated to assure payment to the funeral home, crematorium, etc. and the designated agent *must* sign the document indicating acceptance of this responsibility.

## TEXAS HOMESTEAD LAWS

At the death of a spouse, the residential homestead, whether the separate property of the deceased spouse or community property, does not pass unencumbered to the beneficiaries of the decedent's estate as long as the surviving spouse (or the Guardian of the deceased's minor children) uses and occupies the same as a residence. This "homestead right," protected by Texas law can be waived by an agreement *in writing* signed by both spouses, *for example*, in a prenuptial or postnuptial marital property agreement. Texas homestead laws also have a significant impact on creditors' rights for Texas residents, and should therefore be carefully examined in many family and business planning situations.

## LIFETIME TRUSTS - REVOCABLE MANAGEMENT TRUSTS AND IRREVOCABLE TRUSTS

**Revocable Management Trusts:** Revocable Management Trust (sometimes called a "*Living*" Trust) is an arrangement whereby a person (the grantor) transfers property to a trustee who then holds and manages the property for the benefit of the "beneficiaries" (usually the "grantor" and his or her spouse) for their lifetimes, and their children thereafter. These arrangements receive a great deal of publicity as a means of "avoiding probate." Property placed in such a trust is treated for federal income and estate tax purposes as being owned outright by the grantor (and spouse). Therefore, such a trust *does not avoid income tax or estate tax*. It is, however, useful for management and investment purposes and may avoid the need for a guardianship in the event of the grantor's disability. It is also useful when a grantor owns non-Texas real estate (and mineral interests) to avoid probate proceedings in those states upon the grantor's death. These trusts are also especially useful in the event of a grantor's terminal illness, and in keeping accurate records upon second marriages. Any estate tax planning may also be accomplished within the provisions of a Revocable Management Trust in much the same manner as they can under a Will.

**Should a Living Trust be used in place of a Will?** This decision should only be made after discussing the alternatives with a qualified estate planning attorney. There are advantages and disadvantages associated with each document. Please be wary of promoters who state that a Living Trust arrangement is appropriate for everyone.

**Irrevocable Trusts:** An irrevocable trust, by the very name, *cannot be changed*.

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Often, irrevocable trusts are useful in life insurance planning to avoid taxation of the proceeds of an insurance policy in the insured's estate. Generally, the purpose of these trusts is to save income and/or estate tax, and involves the absolute transfer (or gift) of a policy with "no strings attached." A qualified life insurance professional *and* estate planning attorney are both absolutely necessary to develop and implement these trust arrangements in the correct manner so that expected tax benefits are achieved. A special "Separate Property Trust" can also be used which enables the surviving spouse to share in the benefits from policy proceeds after the insured spouse's death *without* the proceeds being taxed in either spouse's estate. Irrevocable trusts also are used in connection with making gifts for the benefit of children or grandchildren.

## GIFTS TO CHILDREN AND GRANDCHILDREN

### Custodial Accounts

Under the laws of most states (including Texas) "minor" children (those under the age of 18) cannot hold title to property in their own name. The Texas Uniform Transfers to Minors Act allows such property to be given to a "custodian" for the benefit of a minor. The custodian acts much like a trustee, with the statute serving as the trust agreement. Banks, savings and loans, credit unions and brokers usually have the necessary forms to easily open these accounts.

*The "custodial" relationship terminates when the child reaches age 21*, whether or not the child is sufficiently mature to handle such property at that time. (Compare this with trusts, which can continue for longer periods up to the lifetime of a beneficiary). Consequently, gifts under The Texas Uniform Transfers to Minors Act are generally of modest amounts. Prior law required such custodial accounts to terminate at age 18. Those prior accounts under the Texas Uniform Gifts to Minors Act *cannot be converted into one expiring at 21.*

Income tax consequences must be considered when making gifts to minors under a "custodial" account. Changes in federal income tax laws provide that unearned income of a child under age nineteen which exceeds $2,100 in 2016 is taxed, for federal income tax purposes, at the *parent's* income tax rate rather than the child's rate as under prior law. Also included are children up to age twenty-four who are *full-time students* and who do not have earned income equal to at least one-half of their annual support. These changes in federal income tax law should be considered prior to choosing one gifting strategy over another.

### Section 529 Plans

A "Section 529 Plan" allows any individual (including a parent or grandparent) (the "Account Owner") to invest money on behalf of another individual (the "Beneficiary") to finance qualified higher education expenses for the Beneficiary.

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The money invested in a Section 529 Plan may be used to pay expenses at any eligible college, university, or post-secondary vocational training institution. Qualified higher education expenses include tuition, room and board, books and supplies, and special needs services.

Although contributions to Section 529 Plans are *not deductible* for federal income tax purposes, such plans have a number of tax advantages. *First*, for federal income tax purposes, earnings on the investments inside the Section 529 Plan can grow *tax-deferred*. *Second*, withdrawals from the Section 529 Plan are *tax-free* so long as they are made for qualified higher education expenses. If a non-qualified distribution is made, the Account Owner is subject to income tax at ordinary rates on the earnings and an *additional 10% penalty* is imposed on such earnings.

*Finally*, for federal transfer tax purposes, a contribution to a Section 529 Plan is treated under the federal tax law as a *completed gift* from the Account Owner to the Beneficiary. Such contributions are considered present interest gifts and qualify for *both* the annual federal gift tax exclusion and the annual generation-skipping transfer tax. Furthermore, an Account Owner *may combine up to five years of annual gift tax exclusions* ($14,000 in 2016) and contribute up to $70,000 in one year (or $140,000 for a married couple) *without* incurring gift tax. However, if the Account Owner dies during this five-year period, a portion of the contribution is treated as part of the Account Owner's estate.

## Outright Gifts

A competent person 18 years of age or above may legally receive gifted property without the necessity of a trust or custodial account. There are, however, a number of reasons, discussed below, for *not* placing property directly in the hands of such "donees," and instead creating a trust.

## Trusts

Placing property in trust for a beneficiary, whether a minor or adult, offers several significant advantages over an outright gift. *For instance*:

- Annual gifts of up to $14,000 (effective in 2016) from any person (donor) ($28,000 per couple) can be placed in a trust and qualify as "annual exclusion" gifts, thereby *avoiding* reducing a donor's lifetime exclusion from gift tax (discussed below).

- A "spendthrift" trust can *protect* the beneficiary's trust property from creditor actions, divorce and other third parties.

- A beneficiary's *special needs* can be provided for, whether physical, emotional or otherwise, without affecting governmental benefits..

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- Trust property can be retained in the family's *"bloodline"* upon premature deaths of beneficiaries or should a beneficiary die without children surviving.

- A family business, ranch or other asset can be managed for the common benefit of all family members.

- Federal estate or transfer tax on trust assets in successive generations of beneficiaries can be *eliminated or reduced* in certain types of trusts.

- "Medicaid" and other available *governmental benefits can be preserved* for certain beneficiaries *without* the prior exhaustion of their trust assets.

- Planning for *second marriage* can be accomplished through trust provisions.

- Certain individuals can be *excluded from sharing* in the benefits from an estate by use of appropriate trust terms.

## MARITAL PROPERTY AGREEMENTS

Unless otherwise agreed upon in writing, *all income* received during marriage by a spouse is the couple's *community property*. Texas law now allows spouses (or those about to be married) to agree between themselves that income from a spouse's separate property (and that spouse's "personal services income") will be the *separate property* of that spouse.

Marital property agreements are useful for identification of property which each spouse brings to the marriage and can also deal with any number of other areas such as homestead rights, rights to employee benefits and individual retirement benefits, guardianship priority, prospective inheritances, a family business, the character of compensation earned by each spouse and income tax. Careful record keeping is essential in preserving the separate character of such property. Independent counsel for each spouse is recommended to ensure that each spouse is fully informed as to the legal consequences of such an agreement.

## ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES

**Three Transfer Taxes:** There are three types of federal transfer taxes: the *federal gift tax*, which imposes a tax on certain inter vivos (lifetime) gifts; the *federal estate tax*, which imposes a tax on property transferred as the result of the owner's death; and the *federal generation-skipping transfer ("GST") tax*, which imposes a tax on certain transfers to persons two or more generations below the transferor's generation.

**Estate Tax and Gift Tax**: Under current federal tax law, each taxpayer has a single

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unified exclusion amount for estate and gift tax purposes equal to $5 million, as indexed for inflation. The indexed amount for 2016 is $5.45 million. For any amount above the estate and gift tax exclusion, the top estate tax and gift tax rate is 40%. An individual's unused estate and gift tax exclusion amount may be "portable" and used by a surviving spouse (see below).

**GST Tax:** The GST tax has a separate exclusion amount for cumulative generation-skipping transfers that is applicable to both lifetime and testamentary transfers. Like the estate and gift tax exclusion, under current federal tax law, the maximum amount is set at $5 million and is indexed for inflation. The indexed amount for 2016 is $5.45 million.

**Portability:** Current federal tax law provides for the "portability" of any unused exclusion amount from a predeceasing spouse to the surviving spouse, referred to now as the "deceased spousal unused exclusion amount". Thus, if a married individual dies during 2016 and does not use the full $5.45 million estate and gift tax exclusion during life or through a Will or Management Trust at death, that individual's surviving spouse may use the first-to-die spouse's "unused exclusion amount" through lifetime gifts or through transfers at the surviving spouse's death. However, portability is only available to the surviving spouse if an appropriate election is made on a timely filed estate tax return (Form 706) for the first-to-die spouse's estate that computes the unused exclusion amount. Note that current federal tax law does not provide for the portability of unused GST tax exclusion.

**Income Tax Basis Adjustment at Death:** Under current law, all inherited property generally receives an automatic adjustment in basis (whether a step-up or step-down) for income tax purposes to its value used for estate purposes as of the decedent's date of death.

## INCOME TAX SURTAX

**Fiduciary Tax Issues and Other Income Tax Matters:** Under the American Taxpayer Relief Act of 2012, a 3.8% surtax is imposed on the net investment income of single persons with adjusted gross income in excess of $200,000 and married couples with adjusted gross income in excess of $250,000 a year. Estates and trusts will also pay this surtax, along with the top marginal tax rates on ordinary income (39.6%) and capital gains (20%), with adjusted gross income of only $12,300 for 2016. However, these top marginal rates are only applicable to single persons and married couples (filing jointly) with adjusted gross income in excess of $413,200 and $464,850 a year, respectively. Accordingly, depending on the income tax bracket of the beneficiaries of the trusts established pursuant to your estate plan, income taxes may be lower if property is held outright and not in trust.

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## ESTATE PLANNING
## USE OF "BY-PASS TRUST" VERSUS PORTABILITY

As discussed above, under the new portability provisions of the 2010 Tax Act, the first-to-die spouse's "unused exclusion amount" is available to be "added on" to the surviving spouse's exclusion amount, without having to place the property in trust, and can be used by the surviving spouse to offset gift or estate taxes that may otherwise apply to the surviving spouse. Any excess of the first-to-die spouse's estate above the exclusion amount can pass to the surviving spouse outright, or in a qualifying "marital deduction" trust, completely free of federal estate tax on the first spouse's death. However, this "*unlimited marital deduction" does not reduce the estate tax to be imposed; it simply* ***delays*** *it until the second spouse's death.* Thus, upon the surviving spouse's death, to the extent the surviving spouse's estate exceeds the available combined exclusion amounts, the estate will be subject to estate tax at a rate of 40 percent.

**By-Pass Trust Provisions**: Despite the portability provisions, there are compelling reasons to include in your Will what is known as a "by-pass trust" that will hold the portion of the first-to-die spouse's estate up to the exclusion amount instead of allowing that amount to pass outright to the surviving spouse to then be includable in the estate of the surviving spouse for estate tax purposes. All or any portion of the trust income and principal may be made available for the benefit of your surviving spouse and/or children. Upon the surviving spouse's death, any remaining property held in the by-pass trust would be distributed without estate-tax to your children or any other recipients you select. **(See below for a discussion of the operation of a by-pass trust arrangement.)** The reasons to consider the use of the by-pass trust, rather than relying on portability, include the following:

- Use of the by-pass trust allows for certainty in the event the tax laws changed by Congress late, or the portable amount is reduced.

- With the by-pass trust, **none** of the appreciation in value of the trust assets between the first spouse's death and the surviving spouse's death **will be taxable** in the surviving spouse's estate.

- The by-pass trust allows the first-to-die spouse's GST exemption (which is not portable) to be utilized.

- The by-pass trust provides asset protection benefits for surviving spouse (e.g. lawsuits).

- The by-pass trust provides protection of the surviving spouse in the event of remarriage (divorce, spousal election at death) and preserves the intended distribution of the first-to-die spouse's assets in the manner set forth in the first-to-die spouse's Will.

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- With the by-pass trust, you do not need to rely on the executor making a timely election for the first-to-die spouse's "unused exclusion amount" on a federal estate tax return in order for the "unused exclusion amount" to be used by the surviving spouse. Compare this with the bother and cost of having to file an estate tax return for certain small and moderate sized estates, when none may have otherwise been required, in order to affirmatively elect for the surviving spouse to receive the deceased spouse's unused exclusion amount.

**A by-pass trust arrangement might be structured as follows:**

- Each Will contains a provision that all or a portion of the spouse's probate estate up to the exclusion amount would pass into trust for the benefit of the surviving spouse and/or children during the surviving spouse's lifetime.

- During the surviving spouse's lifetime, all income generated from trust property could be used for his or her benefit. The trustee also may be given the discretion to use any or all of the principal held in the trust that is necessary to maintain the surviving spouse's "standard of living."

- The surviving spouse may be given a "special power of appointment" to rearrange whom among the children or other beneficiaries may also receive benefits, either during such spouse's lifetime or at death, and in whatever portions such spouse elects. These provisions maintain flexibility in your planning by allowing changes to be made to accommodate changes in your family's circumstances from the time of the first spouse's death until the second spouse's death.

- The surviving spouse may further reduce the ultimate estate tax imposed at the time of the second death by first using the surviving spouse's own share of the community assets (which is outside the trust) for his or her support rather than the income and principal of the by-pass trust since the non-trust property may be subject to estate tax when the survivor dies, whereas the by-pass trust property will not.

- The trustee would in all likelihood be the surviving spouse. A third party (possibly an institution such as a bank trust department or private trust company) or an adult child could be named as a co-trustee or a sole or successor trustee if the family circumstances warrant.

- With flexible language included, the trustees could manage the trust property as the spouses would have during their lifetimes. This means that the trustees could buy, sell, trade and invest the property in any prudent fashion.

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- At the subsequent death of the surviving spouse, *any remaining by-pass trust property* (***including appreciation***) *would be distributed to the children without estate tax.* Therefore, the remaining trust property should pass estate tax-free *both at the time of the first death and at the time of the second death!*

- The trust property could also be used by the children *for their lifetimes*, and then passed on to *their* children, subject to certain limitations, without an estate *or* generation-skipping tax upon the children's deaths. This "generation-skipping" tax planning can be *very* important, as *the tax rate for these transfers is a flat rate equal to the highest estate tax rate.*

- While in trust, the funds are protected for the children from their creditors, and are not subject to division upon divorce. The children may also be given the added flexibility of a special power of appointment to rearrange the ultimate beneficiaries of their trusts.

**Disclaimer Provisions**: "Disclaimer" provisions in your Will can give your surviving spouse a great deal of flexibility in deciding whether to do some additional estate planning following your death. The disclaimer may allow your spouse to benefit from the disclaimed property after it has passed into the by-pass trust. The disclaimer may also be used, instead, to shelter certain assets from being included in the estate of your surviving spouse, *even if a by-pass trust is not included in your Will*, by providing that disclaimed assets pass directly to other beneficiaries such as your children or other family members (if adults). The decision to disclaim or not will be based upon a variety of factors which exist upon the first spouse's death. These may include the age and health of the surviving spouse, mix of assets, probability of appreciation, income needs of the family, liquidity and the prospect of future changes in the estate tax laws.

**A comparison of the operation of a "simple" Will which relies on portability with that of a "by-pass trust" Will plan appears on pages 17 and 18.**

## INTEGRATION OF LIFE INSURANCE, EMPLOYEE BENEFITS, IRAS, AND FINANCIAL DEPOSITS INTO YOUR ESTATE PLAN

Proceeds from a person's life insurance policies, retirement and investment accounts are *part of his or her estate for estate tax planning purposes*. When such person dies, each account will be paid to the beneficiary named in the beneficiary form or signature card governing the account. Each designation must *be consistent with* the person's estate planning objectives. This may require an account to be paid to the trustee under the person's Will to be held in trust for the benefit of a family member, such as a spouse or minor child. The estate planning attorney may recommend language to be used on each account designation to help ensure that the client's wishes are carried out. Proper attention to income tax and other considerations is also important.

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*No payments should ever be made directly to minors or other individuals requiring special care*. Instead, these benefits should be paid to a trustee for such person's benefit. Otherwise, court-appointed guardianships or other expensive management devices will be required to accept and manage such proceeds until the beneficiary attains age 18 or is no longer under a disability.

When *a spouse survives*, designation of the proper beneficiary becomes even more important. The following rules generally apply:

> **Payments to Surviving Spouse:** Payment of death benefits to the surviving spouse would normally qualify for the marital deduction, thereby *deferring* any federal estate tax on such benefits until the death of the surviving spouse. The surviving spouse may also elect distribution options to either accelerate or defer income tax liability on retirement benefits. Such election allows the spouse maximum flexibility in planning future income tax strategies for such benefits. Also, any income tax liability is paid from the benefits passing to the spouse. This decreases the spouse's estate for federal estate tax purposes upon his or her subsequent death, thereby avoiding a federal estate tax of at least 40% on all such income tax liabilities paid by the surviving spouse.
>
> **Payments to a trust to benefit the surviving spouse:** If payment of death benefits is made to a trust for the surviving spouse, the benefits could be managed by professionals or other qualified individuals to ensure that the spouse is properly supported for his or her lifetime, and the children or other descendants of the first spouse to die receive such property upon the surviving spouse's death. This arrangement would assure that the retirement benefits upon the death of the first spouse would not be payable to persons other than his or her own children and descendants upon the second spouse's death. Also, while in trust these benefits are normally exempt from attachment by either spouse's creditors and those of a trust beneficiary. The estate planning attorney may include specific provisions in the deceased's Will to ensure that payments made to a trust under the Will, such as the by-pass trust or a qualifying "marital deduction" trust, qualifies for the same income tax deferral available to individuals when payments are made to them outright.

Because these decisions regarding beneficiary elections have legal, income tax and investment consequences, *each individual should consult his attorney, accountant, insurance and investment advisors regarding these issues*. Periodic review of such decisions is also important to ensure that insurance and employee benefits continue to effectively integrate into the person's overall Estate Plan. This is especially true upon a person's retirement or entry into a new company or business venture.

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## PROBATE AND POST MORTEM ESTATE PLANNING

*Your estate planning does not end with your death.* If you used a competent estate planning attorney to develop and update your Estate Plan during your lifetime, your family should continue to consult with such attorney *following* your death. Having drafted your Will and its attendant tax provisions, the attorney is in a position to help your family with your estate administration (sometimes known as "probate") in the most efficient manner. However, if fee arrangements or other aspects of the attorney's practice are not acceptable, your family may choose to engage *another* attorney who should also be a board certified specialist. **It is important that the estate's attorney is a board certified estate planning attorney who can properly implement the tax savings addressed in your Will.** The estate planning attorney can also help your family take advantage of any additional planning options following your death as well as assist your spouse in updating his or her plan in light of your death.

If the deceased person's Will (or lack of one) does not adequately plan for estate tax reduction, a competent estate planning attorney may be able to suggest certain steps involving a "disclaimer" or other vehicle to create tax savings from an otherwise inadequate Estate Plan. *This planning "after the fact" should not be overlooked*, and may result in substantial tax savings. However, some planning outcomes may not be realized if certain actions are not taken involving a deceased person's estate. **Competent legal advice should be obtained as soon as possible after a death occurs and *always* before the surviving family members withdraw funds from accounts, file claims for life insurance benefits, or make new beneficiary elections or withdrawals on retirement accounts.**

## SUMMARY

No matter your age or size estate you have accumulated, you should have an effective, up-to-date Estate Plan developed with the help of a competent estate planning attorney. Once implemented, your plan should be reviewed and updated throughout your lifetime to ensure that it continues to meet your needs as your circumstances change. If these steps are taken, the property acquired during your lifetime can be enjoyed by the persons you have chosen for generations to come with the least tax and administration expense.

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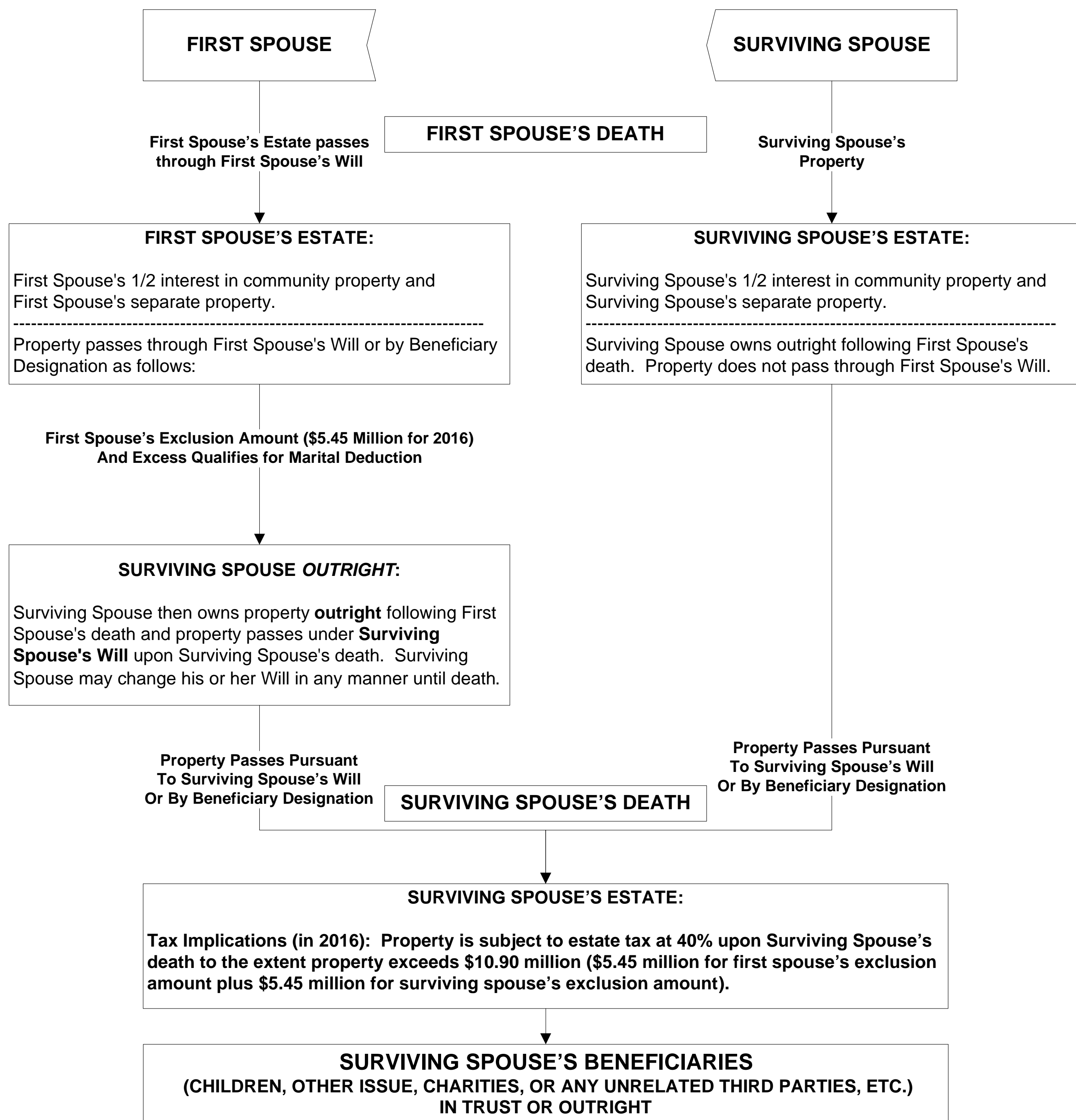
# OPERATION OF A SIMPLE WILL
## Estate of First Spouse Passes Outright to Surviving Spouse




*Surviving spouse may elect to preserve first spouse's exclusion amount for use by the surviving spouse's estate by filing an estate tax return (Form 706) upon the first spouse's death which makes such ("portability") election.

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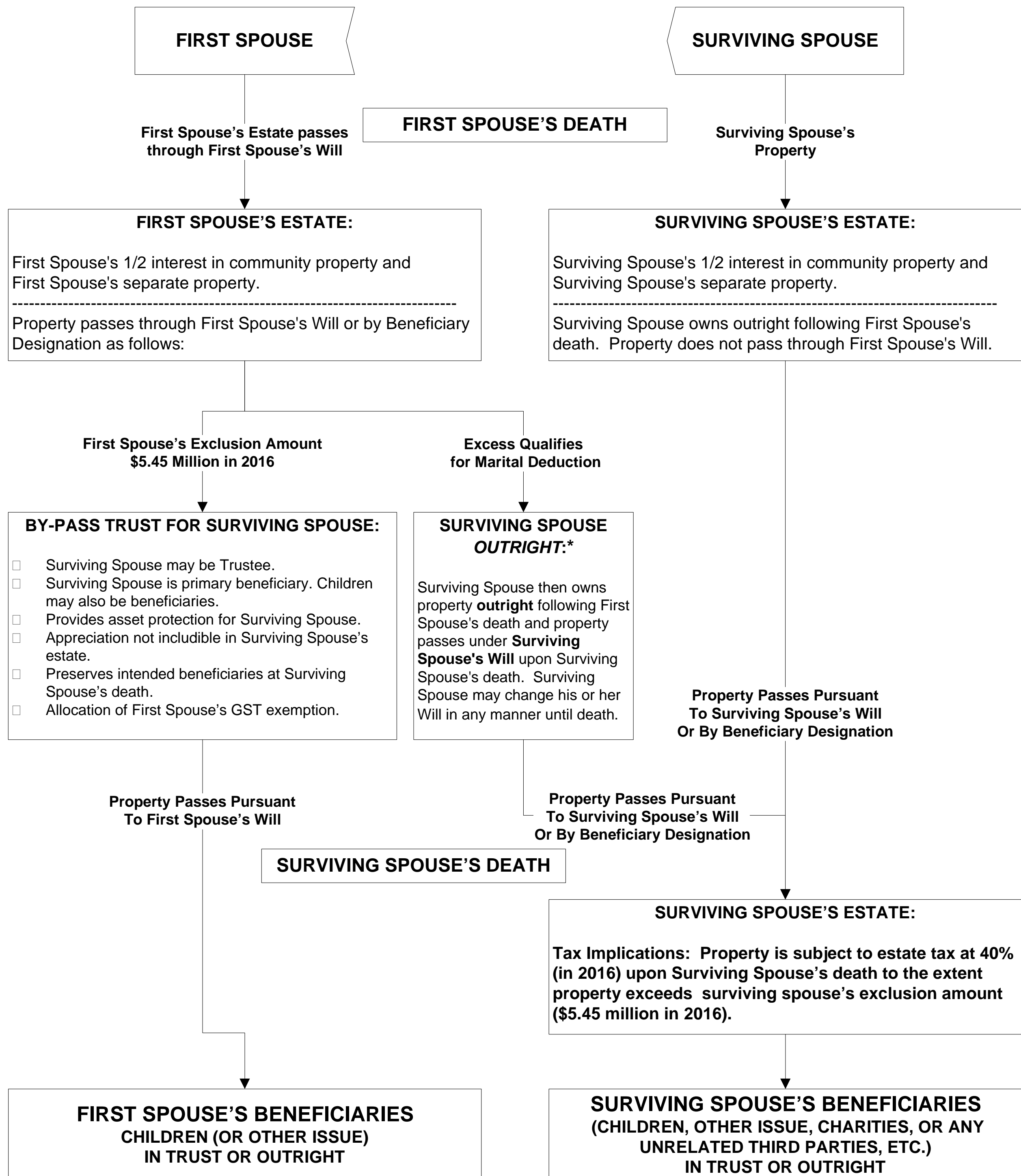
# OPERATION OF A BY-PASS TRUST WILL
## Estate of First Spouse Passes to By-Pass Trust for Surviving Spouse




*** Excess over Exclusion Amount may instead pass to Marital Deduction Trust. In that event, assets would be includible in Surviving Spouse's estate but net assets would pass pursuant to First Spouse's Will.**

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