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ESTATE PLANNING

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I. INTRODUCTORY ISSUES & AGENDA

A. What is Estate Planning - Overview

B. Lifetime Documents and Issues - Powers of Attorney and other documents for health care, finances, decision making and minors

C. Transfer of Assets Other Than By Probate or Trust - Gifting, Joint Ownership and Transfer on Death

D. Testamentary Planning: Probate and Living Trusts - What is probate, what is a Will and do you need a Living Trust?

E. Death Taxes, including Federal and State Issues

F. The Estate Planning Process - from the Yellow Pages to Executed Documents

These are general observations about the law and should not be relied upon as legal advice in any particular situation.

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II. <u>RECOMMENDED LIFETIME DOCUMENTS</u>

A. Durable Power of Attorney (for Financial Matters).

(1) **What is a Durable Power of Attorney?** The Durable Power of Attorney ("POA") allows you to designate someone to have immediate access to your assets for your benefit if you should become incompetent.

(2) **Why have a Durable Power of Attorney?** Without a Durable Power of Attorney, the Court will designate someone as your Guardian or Conservator, after an expensive and time-consuming procedure. That person will often be a lawyer, rather than the person you would choose, who would usually be a family member or close friend.

(3) **What should be in an effective Durable Power of Attorney?**

(a) **When it becomes effective:** You must define when the POA becomes effective. The options include:

(i) Immediately upon execution;

(ii) Upon "incapacity", as defined in the document (and with provisions for dealing with HIPAA problems where a doctor may refuse to speak with a designee until they are named as the power of attorney);

(iii) At some other specified time or event.

(b) **What are the different types of Powers of Attorney?**

(i) General Power of Attorney - for all things - as broad as possible;

(ii) Limited Power of Attorney - limited in scope to a time period (day, week, month, year) or event (real estate closing, specific property or business interest)

(c) It is not enough to grant someone "all powers", and special provisions needed for

(i) Gifts (to spouse, children, issue, charities, Power of Attorney);

(ii) Real estate transfers (often differ by State);

(iii) Choice of Guardian for a possible legal Guardianship over you.

(iv) Changes to retirement assets or beneficiaries; and

(v) Estate planning;

(vi) Accounting to someone other than the person issuing the Power of Attorney

B. Advance Directive for Health Care

(1) **History** - The Karen Quinlan case before the Supreme Court led to the creation by the States of Living Wills which were widely publicized and often used. But the problems in enforcing or using the Living Wills (no persons appointed to make the doctors listen or obey them and they only apply to limited and/or specific circumstances) led to the Nancy Cruzan case, where the Supreme Court allowed the designation of a health care agent, which led to the creation and use of some form of Advance Health Care Directives by the States.

(2) The first part of the Maryland Advance Directive[1] names a Health Care Agent and authorizes your agent, rather than the doctors, to make your health care decisions for you if you are unable to do so yourself.

(3) Absolutely vital if you are not married to your significant other - the only document that will give them the right to participate in your care and treatment, or even allow them the right to be present with you in the hospital.

(4) The second part allows you to direct the discontinuation of some stated and defined therapies or medical attention, including “life sustaining procedures”, feeding and hydration tubes, "heroic medical efforts" and to "pull the plug" if you are in terminal or vegetative condition with no hope of return to a cognitive life.

(5) They must be updated if you move.

(6) Bare bones statutory version are available at all hospitals, or from www.hemlock.org, the Hemlock Society, which is now known as Compassion in Dying, and can also be found at www.compassionindying.org, and www.nhpco.org, the National

[1]Each state or jurisdiction has a different name and a different form. In DC the form is called a Durable Power of Attorney for Health Care, and in Virginia it is called an Advance Medical Directive. These documents all act in the same manner, with differences mostly in form. For ease of discussion we will cite the Maryland Advance Directive.

Hospice and Palliative Care Organization. More detailed and individually tailored documents can be provided by an attorney. Remember that your decisions regarding your care are your own, and do not have to conform to the preprinted categories or decisions.

(7) A more detailed review and consideration of health care decision making can be found at www.agingwithdignity.org, which provides the "Five Wishes" document. Although this is not a "legal" document, according to their website it meets the legal requirements in Maryland, DC and Virginia, as well as about 35 other states. As they point out, regardless of its legal merits (and it should not be relied upon alone), this document is still useful as an attachment to the state's required forms, as it expresses your preferences in detail and provides a helpful guide to families, caregivers and doctors.

(8) Emergency Medical Technicians are not required to follow your Advance Directive, and, in many circumstances, emergency room doctors will not be able to follow them due to practical considerations.

(9) Impact of the new Health Insurance Portability and Accountability Act ("HIPAA") on all powers of attorney.

(10) "Do Not Resuscitate" orders - In Maryland they are issued by Doctors, not by attorneys or yourself. These documents are followed by EMT's and in the ER.

(11) Organ Donation Section - More in depth than your driver's license - organ donation, donation for science and research, medical education (do you want to be a cadaver?). Some Frequently Asked Questions regarding organ donation, cremation, burial, etc., care answered here: http://www.dhmh.state.md.us/anatomy/html/faqs.html and many other questions can be answered at the website for the Transplant Resource Center for Maryland, at http://www.mdtransplant.org/index.asp, including your religion's views on transplantation.

(12) Also review www.abanet.org/aging/myths.html for more information on Living Wills and Advance Health Care Directives.

C. Temporary Guardianship and Health Care Power of Attorney for Minor. This document allows your choice as guardian for your children to care and make decisions for them if you are disabled but not dead.

D. HIPAA Authorization Forms. Additional form added to the Advance Directive to name your Health Care Agent, the successor, and others if you wish, as individuals authorized to receive medical information about you.

III. ESTATE PLANNING

A. Passing Your Assets To Your Intended Beneficiaries

(1) *Gifts during your lifetime*: Starting in 2006, you can gift up to $12,000 per year ($24,000 per year if married and your spouse consents to such gift) to each of as many individuals (whether or not related to you) as you may desire without incurring any Federal gift tax.

(a) Gifts can be of cash or "in-kind", including cars, boats, the Hope Diamond, or they can be payments to a third party for the benefit of the recipiant..

(b) Recipient does not have to be related to you.

(c) A gift in excess of that amount will not usually generate any gift tax but will reduce the donor's exemption from the Federal estate tax and require the filing of a Gift Tax Return.

(d) The receipt of a gift is not taxable income.

(e) The donor cannot "write-off", that is, deduct, the gift from income taxes, unless it is to a "qualified charitable organization".

(f) "Gifts" of the payment of tuition (even in some circumstances for many years to come) to an educational institution or payment of medical expenses to the health care provider are not considered when determining the $12,000.00 threshold.

(g) Transfers of any kind to your spouse (assuming he or she is a US citizen) do not count as "gifts" for these purposes. A US citizen can gift their non-US citizen spouse $114,000 per year.

(h) Payments made to fulfill your legal obligations to your minor children (school, food, shelter, transportation, etc.) do not count as "gifts" for these purposes.

(i) "Gifts" to a 529 Plan that are over the $12,000 limit can be stretched out over the number of years, up to five (5), necessary to fit within the exemption, so that you can make up to a $60,000 contribution to a 529 Plan ($120,000 if married) and not have it count against your lifetime exemption. If you die within the five (5) years the portion of the gift apportioned to later years will be included in your estate.

(j) Forgiveness of a debt is not excluded from the definition of a taxable gift.

(k) Making of "taxable" gifts <u>may</u> improve some state estate tax situations.

(2) *<u>Joint Property</u>*: Joint property with rights of survivorship (but not tenants-in-common) passes pursuant to the property's titling and <u>not</u> under a Will.

(a) Advantages.

(i) Immediate transfer of title.

(ii) No costs or expenses in many cases (transfers to non-immediate family members may be subject to transfer or recordation taxes).

(iii) Do not have to change the deeds to the real property following a death.

(b) Disadvantages.

(i) If the joint owners have different beneficiaries;

(ii) Usually need both owners' signatures to transact business and each joint owner has equal control and access to the asset in question (no "joint ownership for purposes of estate planning");

(iii) Other's liabilities can create loss of your asset or a cloud on the title of your asset;

(c) Alternatives to joint ownership

(i) Tenants-in-Common Ownership - allows ownership of property in pieces. You can own a property in such a way so that your portion will be directed by your will, rather than by the fact that you own it with someone else. The ownership percentages can be any division, not just 50-50.

(ii) QTIP Trust ("Qualified Terminable Interest Property" Trust for surviving spouse during his or her life, then to children or others) - Best if set up prior to re-titling with (new) spouse;

(iii) Payable/Transfer on death ("POD" or "TOD");

(iv) Community Property: Community property laws state that assets are owned equally by the husband and wife if the assets were acquired during marriage while living in a community property state. A deceased spouse's portion of community property is included in his or her estate. If you have community property issues it is vital that you discuss these issues with an attorney from the particular community property state where you own property.[2]

(v) Life Estate Deed - Property can be deeded to allow a lifetime right to reside or use the property (or even to transfer) with the property reverting to the remaindermen after death of the life beneficiary.

(vi) Prenuptial Agreements - A prenuptial agreement, as a contract, will allow you to override the provisions of the jointly titled property, even where the will cannot. Can be executed before or after the marriage.

(3) *Beneficiary Designation Transfers*: Insurance benefits, pension and qualified plan benefits, IRA's, annuities and POD/TOD accounts pass by beneficiary designation and not under a Will. - Where the Will and Beneficiary Designation conflict, the Beneficiary Designation will control.

(a) Regardless of how current or appropriate.

(b) Right of spouse to pension benefits.

(c) Primary and contingent designations.

(i) Importance.

(ii) Consequences of not having them.

(AA) Government benefits - "order of precedence"[3].

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[2] Community property states include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Property acquired by gift or inheritance is not considered community property. Community property usually retains its character if the couple moves from a community property state.

[3] The Order of Precedence for all government benefits it is (a) to your widow or widower; (b) if none, to your child or children in equal shares, with the share of any deceased child distributed equally among that child's descendants, but without regard to their age or any trust provided for your children in your will; (c) if none, to your parents in equal shares or the entire amount to your surviving parent; (d) if none, to the executor or administrator of your estate for the benefit of your estate; and (e) if none, to your next of kin under the laws of the State where you lived at the time of your death.

(BB) Non-Government benefits often have order of precedence as well, by-passing your Will or Trust, as well as probate.

(d) Concept versus detail - for minor beneficiaries - they inherit at 18 or 21 when you would prefer their assets go into a trust to be distributed later.

(e) Income tax consequences.

(i) Spouse

(ii) Non-spouse

(iii) IRA Conduit Trust for qualified plans that allow for life-expectancy payments rather than limit payments to lump sum only. Not available for a TSP and many 401(k) or 403(b) plans.

(f) Government employee benefits needing beneficiary designations, all of which are on-line at http://www.opm.gov/insure/designations/, include: (i) FEGLI insurance - Form SF-2823; (ii) CSRS (civil service retirement) - Form SF-2808; (iii) FERS - Form SF-3102; (iv) TSP (thrift savings plan) - Form TSP-3; and (v) Unpaid Compensation for Civilian Employees (last paycheck and accrued leave) - Form SF-1152.

(g) Some states, including Virginia but not Maryland or DC, have statutes that automatically revoke the designation of a spouse as the beneficiary of "death benefits" or life insurance upon a final divorce. It is likely OPM would not respect such a law, and would require a lawsuit to recover the assets from the prior spouse.

(4) *Will / Intestacy* The principal method of passing assets is through a Will, which directs the distribution of assets titled in the decedent's name alone.

(a) Requirements for a valid Will:

(i) Must be in writing.

(AA) Need not be typed or computer-generated; rather, it can be hand-written.

(BB) Videotaped wills generally not valid, but may be helpful.

(ii) Must be signed (preferably at the end).

(iii) Should be dated.

(iv) Must be witnessed.[4]

(AA) Number of witnesses.

(BB) Qualifications of witnesses.

(CC) Witnesses should not be beneficiaries (MD rule v. DC Rule).

(DD) Witness Affidavits

(b) A properly executed Will is valid from when filed until such time as a "caveat" (that is, a will contest) invalidates the Will due to incompetency, undue influence, fraud or duress.

(c) Safekeeping of the Will.

(i) It can, but should not, be kept in your safe-deposit box.

(ii) Alternative places for safekeeping:

(AA) The lawyer's office

(BB) In a safe at home

(CC) At the local Courthouse.

(iii) Wherever it is kept, it is important that your family knows that you have a Will and where it is kept.

(iv) Copies of a Will are generally not valid; you must have the original - long Court proceeding to admit a copy of a Will.

(d) No one has a right to inherit from you except a surviving spouse who may, if he or she does not like their inheritance under the Will, elect to take a "statutory share" which is generally one-third (⅓) or one-half (½) of your estate.

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[4]Virginia, and other states, do have a provision for establishing a handwritten but unwitnessed will, called a holographic will. It is best not to rely on these types of provisions as they are extremely fact specific.

But there are Family Allowances which can range from $5,000 to $40,000 depending on jurisdiction.

(e) "In terrorem" Clauses - These are provisions of a will or trust that provide for the disinheritance of any heir that challenges any provision of the will or trust. In regard to wills, such a clause is not effective in the state of Maryland as long as there is a good faith or colorable claim that can be made. In any state these should not be relied on solely, as questions of undue influence can still negate the will as a whole.

(f) Other things that a Will can accomplish:

(i) Designate Personal Representatives (Executors), Trustees and Guardians for minors, rather than having the Court select them;

(ii) Create a Trust for Children to extend the age of distribution to a beneficiary from 18 or 21 to whatever later age or ages you select (including piecemeal distributions or distributions of income only from a trust);

__________________________(iii) Decide what, if any, restrictions or checks there will be on the Trustees' powers in dealing with your children's money;

(iii) Provide for the special needs of an elderly or disabled beneficiary without interfering with government assistance programs (commonly called a "special needs trust" or "supplemental needs trust") and these trusts are very technical in nature;

(iv) Provide for children of a prior marriage to ultimately inherit after the death of a subsequent spouse to whom you want to provide lifetime benefits.

(v) Provide for unmarried or same-sex partner to inherit non-joint assets (will not happen otherwise);

(vi) Provide for step children;

(g) If you die without a valid Will.

(i) The Court will determine who will administer your estate (possibly an unrelated attorney);

(ii) The Court will determine who will care for your children (certainly a relative, but perhaps not the one you would have chosen);

(iii) If minor children receive assets the Court must appoint a conservator to manage the assets for them (probably an attorney, usually not a family member);

(iv) All children will be treated equally, even if they have different or special needs;

(v) Stepchildren may be excluded completely;

(vi) Significant others to whom you are not married will receive nothing from the estate;

(vii) Distant relatives would receive assets that you may have wanted to go to friends or charity;

(viii) Your estate may pay unnecessary taxes and expenses.

(g) Relocation to another state.

(i) Take your Will with you and have it reviewed by a local lawyer to be certain that it complies with their rules of interpretation.

(ii) Note that the interpretation of the Will is controlled by where you live at the time of your death, not where it was signed, as opposed to the validity of the Will, which is controlled by the law of the state you were domiciled in at the time you executed the Will.

(h) A Will may be revoked by:

(i) Destroying it.

(ii) Expressly revoking it in a subsequent Will.

(iii) Marking on it.

(i) If you do not have a Will, state law will mandate distribution under "intestacy" to your closest living relatives - unknown uncle cases.

(j) Other than retirement benefits on which no income taxes have been paid, the receipt of an inheritance is not taxable income.

B. Probate

(1) Probate is the court-supervised process that identifies what you owned at death and distributes your assets according to your wishes (via your will) or state law (intestacy or without a will). Assets that pass to others through direct transfers, joint ownership or trusts generally do not go through the probate process.

(2) The probate process starts with the filing of a "Petition for Probate" including the proposed Will, basic information about legatees and heirs and an estimate of the size of the estate.

(3) Probate consists of:

(a) Filing of the Will and establishing whether it is valid as discussed above. All Wills must be filed, whether they will transfer any property or not;

(b) Appointing a Personal Representative[5] and Successors to manage your estate during probate. Usually a family member, does not have to be an attorney, but should talk to an attorney at least once before proceeding;

(i) Personal Representative must be a US citizen, or, if the Personal Representative is the spouse, parent, child or sibling of the decedent, a Permanent Resident Alien.

(c) Creating a list of all "Interested Persons" in the Estate, including heirs-at-law who must be listed and notified even if they are not included in the Will;

(d) Valuing everything you owned at the time of your death as of the date of your death;

(i) Several kinds of appraisals may be necessary, including in-state real property (although tax assessments may be used), all personal property, all limited partnership or close business interests;

(ii) A professional and disinterested third party appraiser is required.

[5] Most states use the term "Executor" for this function.

(e) Getting "bonded" if necessary, or getting a "nominal bond" if the bond requirement is otherwise waived in the Will;

(f) Publishing notice of the Will and Estate in a newspaper of general circulation;

(g) Receiving claims against the Estate - Estates, unlike Maryland or Virginia Revocable Living Trusts, include a cut off for third parties to make claims against the Estate.[6] This period of time is generally 6 months from date of death, as opposed to most statute of limitations which run for 3 years.

(h) Paying or otherwise disposing of taxes[7] and claims;

(i) Settling disputes about asset distribution; and

(j) Determining family allowances and statutory share claims by spouses;

(k) Providing Accountings to the Court to show income, payments and distributions based on the initial values in the Inventory;

(l) Distributing assets.

(m) Modified Administration - Maryland has a form of probate that is simplified for Estates involving consenting heirs and interested persons who are, in the case of Maryland, also closely related. Modified Probate in Maryland reduces the costs and accountings necessary under regular probate.

(n) Unsupervised Administration - In DC most estates with a will can proceed as unsupervised, greatly reducing the time delay and cost of probate. If no heir chooses to "opt-out", as opposed to Maryland's "opt-in" procedure, most estate in DC do not have to file inventory, accounting or final report, only notices that all filings have been made to the heirs and legatees as required by law.

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[6] DC Revocable Living Trust law now allows for a claim cut off period similar to an Estate following publication. It is likely that Maryland will follow this trend and enact similar legislation in the next several years.

[7] Maryland inheritance taxes, discussed below, must be paid whether a probate is opened or not, and a Maryland Information Report must be filed reporting any taxable assets received by someone as a result of the death. Other taxes that must be paid include the last income tax return for the decedent, the "Estate" or "Trust" income tax return and an estate tax return.

(o) No modified/unsupervised probate in Virginia for estates in excess of $15,000. Maryland, DC and Virginia all have provisions for what they consider to be "small estates."

(4) Criticism of probate.

(a) Expensive court costs, attorney's fees, personal representative fees, accounting fees, probate fees, appraisal fees, etc. Attorney and personal representative fees must be based on reasonableness, but must states have a certain maximum they consider reasonable, 3.6% in Maryland, 5% in DC and Virginia.

(b) Distribution is delayed for the claim and accounting process;

(c) Public Record - All probate files, filings and proceedings are open to the public.

(5) Trend among states is to make probate optional or low impact - Maryland (and DC) have a form of probate that is simplified for Estates involving consenting heirs and interested persons who are, in the case of Maryland, also closely related. Modified Probate in Maryland reduces the costs and accountings necessary under regular probate.

(6) Ways to avoid probate - Best Suggestion: **Do not die**. Also look into having assets in joint names, in "POD" or "TOD" accounts, or transferring by conventional beneficiary designations.

(7) Another popular way to avoid probate: **Revocable Living Trust**. These trusts, here called an RLT, are a popular way of avoiding probate. An RLT is not appropriate for everyone and you should consider carefully the pros and cons of an RLT in your particular situation.

(a) The RLT document[8] must be created (drafted, signed, etc.) during your lifetime.

(b) Assets must be transferred into the RLT during your lifetime. A large flaw in many RLT based estate plans is the failure to transfer all eligible assets to the RLT, resulting in an estate that is half probate and half RLT.

(c) Testamentary provisions are contained in the Trust Agreement

[8] Even when using an RLT a Will is used to "pour-over" any assets not titled in the name of the Trust into the RLT during probate.

(d) Benefits of Living Trusts:

(i) Can be used to avoid multiple probates where real property is owned in different states;

(ii) Can be very effective where you desire to have someone else manage your assets currently or in the near future;

(iii) In Estates that will not have to file a Federal or State Estate Tax Return may avoid many of the delays and costs associated with Probate in some states;

(iv) Privacy - Unlike Wills, most RLTs are not made public information;

(e) Problems with a Living Trust:

(i) Cost of creating it.

(ii) Cost and difficulty of transferring assets - real property often must be transferred in and out of the RLT to effect sales, purchases or refinancing;

(iii) Having no assets in your name alone could affect your borrowing power.

(iv) The short time period for creditors to come forward after your death may not apply if there is no probate - However, many jurisdictions are adopting the Uniform Trust Act which provides for such a shortened claims period. DC and Virginia have enacted this legislation and Maryland is slated to consider it in 2006.

(v) If a Federal Estate Tax is due, many of the costs of probate (attorney's fees, appraisal fees) may still be necessary and distribution may be delayed until the payment (7-9 months), and approval (2-12 months), of Federal Estate Taxes.

(vi) Will not shield you from state estate tax due in the state in which the real property sits.

(vii) See the Maryland Register of Wills brochure, *Living Trusts: Get the Facts!*, available from our office or online at http://www.registers.state.md.us/html/livingtrusts.html

C. Death Taxes

(1) Federal Estate Tax.

(a) A tax on your right to transfer your "estate" to your beneficiaries.

(b) Constitutionality of the tax - No double taxation because it is not the same tax twice, but two different taxes (income and estate) one time each.

(c) The Economic Growth and Tax Relief Act of 2001.

(i) Exemption amount increases through 2009 (1.5 million in 2004 and 2005, 2.0 million in 2006, 3.5 million in 2009);

(ii) Repeal effective January 1st, 2010, for one year only

(iii) Tax "un-repealed" effective January 1st, 2011 and exemption returns to 1 million for individuals dying on or after that date.

(iv) Impact on estate planning of "repeal" and "un-repeal" - Estate tax planning has become a moving target and plans must either be based on a best guess or worst case scenario.

(v) Impact on estate planning of State "Estate" Tax - As discussed further below, the 2001 tax legislation removed the credit for state estate taxes paid, dramatically altering the impact of the state estate taxes on standard estate planning.

(d) To calculate the tax:

(i) Determine the "gross estate", that is, the value at the time of death (or later in special circumstances) of assets transferring as a result of your death.

(AA) It includes:

*Your home[9]

[9]The gross value of your house is used to determine whether you must file an estate tax return, although you only pay tax on the net value. In addition, the **full** value of any property, real or otherwise, owned jointly with someone other than a spouse is used to determine the tax unless the third party or estate can show the other person's actual equity interest. For spouses, one-half of the value of joint assets is included in the estate.

- appraised[10] price (or sales price if within 1 year of date of death)

*Other real estate
*Stocks (valued at hi/low average) and Bonds
*Cash, etc.
*Life insurance
- if you have “incidents of ownership" including control or power to name beneficiaries;
- 3-year transfer rule (if you die within 3 years of transfer the insurance is included in the tax estate);

*Retirement benefits (including defined benefit, IRA, Roth IRA, 401k, 403b, 457, Sep IRA, etc.)
*Personal property (cars, art, antiques, jewelry coin/stamp collections - check items separately scheduled for insurance for an idea of what kinds of property you have)
*Lifetime gifts over the annual gift exclusion

(BB) It does not include:

*Gifts within the annual exclusion of $12,000 per year (starting in 2006)
*Qualifying tuition or health care payments
*Life insurance transferred out of your individual ownership more than three (3) years ago

(ii) Reduce the gross estate by funeral expenses, debts (mortgages, accrued but unpaid taxes, etc.), and administration expenses (including attorney’s fees, accounting fees, appraisal fees, probate expenses, taxes), to arrive at the "net value of assets".

(iii) Further reductions may apply:

(AA) Alternate Valuation - To prevent a national catastrophe (9/11 or the stock market crash) to unfairly inflate the value of estates for people who die right before the incident, IRS allows you to revalue the entire estate and, if that total value is less, use that as the estate value for tax purposes.

[10] The property tax assessment may be used in Maryland probate, but not for Federal or State Estate Tax purposes.

(BB) Marital deduction - all assets passing to a surviving spouse who is a U.S. citizen; if the surviving spouse is not a U.S. citizen, a specialized "Qualified Domestic Trust" must be utilized to qualify for the marital deduction.

(CC) Charitable deduction - all assets passing to “qualified charitable organizations”.

(DD) Exemption amount for assets not qualifying for the marital deduction or charitable deduction -

$1,500,000 in 2005
$2,000,000 in 2006, 2007 & 2008
$3,500,000 in 2009
Unlimited in 2010
$1,000,000 in 2011 & thereafter

(iv) The Tax Rate is applied against this reduced amount, starting at 45% and increasing to 47% (plus State tax rate impact), returning to 55% for 2011 and thereafter.

(v) Capital gain basis of inherited assets

(AA) Step-up currently available for <u>all</u> inherited assets, regardless of whether any Federal estate taxes are payable.

(BB) Carry-over basis will apply after the Federal estate tax is repealed, to assets in excess of $1,300,000 plus an additional $3,000,000 for a surviving spouse.

(CC) If no total repeal <u>with</u> a full step up in basis is politically possible, the vast majority of people are better off with a high exemption (6-10 million) and a full step up in basis, as opposed to a total repeal, but carry-over basis that requires payment of the capital gains tax on inherited assets.

(f) The Estate Tax Return Process

(i) Form 706 - This the Estate Tax Return form that is filed, and includes gross and net valuations of all assets, alternate valuations (6 months after date of death), and calculations of tax due based on exemptions, credits, deductions, etc.

(ii) The 706, with payment, is due within 9 months of the date of death, or payment may be made within 9 months and filing of the form extended another 6 months.

(g) No Federal estate tax planning is needed if the net value of assets passing at the death of the survivor of husband and wife does not exceed the exemption amount - keeping in mind the proposed "unrepeal" of the repeal in 2011, returning the exemption to $1,000,000.

(h) If the net value of assets passing at the death of the survivor of husband and wife exceeds the exemption amount for the year of death, the use of "by-pass trusts" and proper asset titling, ownership and beneficiary designations can be utilized to avoid much of the tax. ***See*** Exhibit A-1 (no by-pass trust used) and Exhibit A-2 (using a by-pass trust).

(i) If the net value of assets passing at the death of the survivor of husband and wife exceeds double the exemption amount, other estate planning techniques are available to avoid, or at least to reduce, the tax.

(i) Life Insurance Trust

(AA) FEGLI (and some other group) insurance.

(BB) Term insurance;

(CC) Cash value insurance

(ii) Qualified Residence Trusts.

(iii) Family Limited Partnerships.

(iv) Other estate planning techniques

(2) State Death Taxes.

(a) Inheritance tax (Maryland, not DC or Virginia)[11]

(i) Charged to the recipient, unless the Will provides otherwise.

[11] Connecticut, Indiana, Iowa, Kentucky , Maryland, Michigan, Ohio, Oklahoma, Pennsylvania and Tennessee all retain an independent inheritance tax of some kind.

(ii) Assessed by the decedent's state, not the recipient's state, except for real estate which is assessed by the state where it is situated.

(iii) Payable regardless of whether IRS assesses a tax or not.

(b) State Estate tax - Charged to the estate, unless the Will or a Trust provides otherwise - for decedents dying in 2004, this tax may be partially credited when determining the Federal Estate Tax due.

(i) The Maryland and DC Estate Tax kicks in for gross estates of more than $1,000,000 for 2004 and beyond.[12]

(ii) In Virginia the trigger amount remains the Federal Estate Tax filing amount as noted above. The full tax is due on top of the Federal Estate Tax due, with no reduction due to the removal of the State Death Tax Credit by Congress.[13] However, there is a deduction available on the Federal Estate Tax paid for payment of the Virginia Estate Tax.

(iii) There may be no QTIP treatment available for the surviving spouse for the amount between the State Estate Tax Exemption and the Federal Estate Tax Exemption ($500,000, going to 3.5 Million Dollars), meaning that estate plans including a QTIP for the surviving spouse may face an unexpected tax at the death of the first spouse.

(3) Income Taxes - Receipt of an inheritance is not income, except in the case of certain retirement assets.

D. Retirement Assets

(1) No "step up" for accrued but unpaid income taxes in retirement accounts - income tax unpaid during life of the decedent will still be due.

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[12]In addition to Maryland and DC, the following states have all partially or completely decoupled from the Federal Estate tax, with lower Estate Tax amounts: (i) $675,000 exemption level: New Jersey, Rhode Island, Wisconsin; and (ii) $1,000,000 by 2006-2008 level: Kansas, Maine, Massachusetts, Minnesota, Nebraska, Ohio (pending results of litigation), Oregon, Washington (pending a Washington Supreme Court decision), Connecticut, Nebraska, New York and Illinois. Real property in those states are subject to their estate tax limitations. In addition, Alabama, California, Hawaii, Michigan, Missouri, New Hampshire and West Virginia all have legislation pending to modify their estate tax laws, so for the better and some for the worse.

[13]Other States, like North Carolina, Vermont and Virginia, have kept their tax tied to the amount of the state death tax credit, but disregarded the repeal, so that their tax will be paid in addition to the Federal Estate Tax, thus reducing the Federal Estate Tax due not by the full credit amount, but by the amount, far less, given for a deduction. These states are "partially decoupled" from the federal Estate Tax.

(2) A spouse can inherit an IRA and treat it as his or her own.

(3) A non-spouse can inherit an IRA and will have a annual minimum required distribution ("MRD") based on his or her age and life expectancy. If two or more non-spouse beneficiaries inherit an IRA, the MRD is based on the oldest of the beneficiaries. One way to deal with that is to create separate accounts for each beneficiary.

(4) Not all retirement plans are required to offer a "stretch" or life expectancy payout like an IRA. Many 401(k) plans, and the Thrift Savings Plan cannot be rolled over to a non-spouse beneficiary. The non-spouse beneficiary must take a lump sum payment at the time of death.

IV. SUMMARY

A. Do estate planning.

(1) See an Estate Planner who offers a complimentary initial consultation;

(2) See an Estate Planner that does most estate planning work on a flat fee basis.

(3) If you or your spouse are a government employee, see an Estate Planner who is familiar with government benefits.

B. Importance of periodically reviewing your estate plan.

(1) If circumstances change.

(2) If the law changes.

(3) Otherwise, suggested review time is every three (3) years.

C. Use qualified professionals to counsel you on all of these matters.

D. Agree on a fee structure before any work is authorized and make sure it includes beneficiary designations and asset transfers as necessary

E. Leave a "trail" for your survivors.

(1) Asset schedule (we have an Estate Planning Questionnaire available as an example - Please ask for it if interested).

(2) List of advisors.

(3) Narrative of your intentions.

PLEASE DO NOT HESITATE TO CONTACT US BY PHONE OR EMAIL WITH ANY QUESTIONS OR COMMENTS YOU MAY HAVE.

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