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WILLS, TRUSTS & ESTATES

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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. NECESSARY AND RECOMMENDED LIFETIME DOCUMENTS

A. Durable Power of Attorney (“POA”) for Financial and Legal Matters

(1) This allows you to designate someone to have access to your assets for your benefit if you should become incompetent.

(2) Why have a Durable Power of Attorney? Without a POA the Court may designate someone as your Guardian or Conservator, after an often 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) You must define when the POA becomes effective. The options include: (i) Immediately upon execution; (ii) Upon “incapacity”, as defined in the document; (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); (iii) Statutory Power of Attorney - available in some states and effective for certain circumstances by statute.

(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; (v) Estate planning; (vi) Access to email and internet accounts; and (vi) Accounting to someone other than the person issuing the Power of Attorney.

(d) Because of how much power you are giving someone, developing proper checks and balances is vital, including requiring approval from a third person for certain actions, providing for an accounting to go to other children or friends, or even providing for more than one power of attorney.

(4) If you are not married to your significant other/partner, it is vital you have a power of attorney to set out either how that person will care for you, or where that person fits into the duties and powers of your designated power of attorney in regard to support, decision-making, cost-sharing, etc.

B. Advance Directive for Health Care[1]

(1) History - Karen Quinlan case led to the creation by the States of Living Wills, but the problems in enforcing or using the Living Wills (no way to make the doctors listen or obey them) led to the Nancy Cruzan case and the creation and use of some form of Advance Health Care Directives by the States.

(2) These supersede "Living Wills" which are far more limited in scope and usefullness.

(3) One part of the directive names a Health Care Agent and authorizes your agent to make your health care decisions for you if you are unable to do so yourself.

(4) Absolutely vital if you are not married to your significant other/partner - 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. Can also allow you to designate individuals, including family, that you do not want involved in your health care decisions due to conflict with your spouse, partner or children.

(5) The second part, the "Health Care Instructions" 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.

(6) Bare statutory versions are available at every hospital, or from the Hemlock Society, which is now known as Compassion and Choice, and can be found at www.compassionandchoices.org, and www.caringinfo.org (also www.nhpco.org), the National Hospice and Palliative Care Organization. The versions available at the NHPCO website, in addition to being free, contain explanations and signing instructions. 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 options.

(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

[1] The Maryland form is called an Advance Directive, the Virginia form an Advance Medical Directive and the DC form a Durable Power of Attorney for Health Care. Each state has its own form and variation on these names, but all do essentially the same task. For more information on the Maryland Advance Directive form, go to: http://www.oag.state.md.us/healthpol/advancedirectives.htm or http://www.oag.state.md.us/Healthpol/adirective.pdf. For more information on the Virginia form, go to: http://www.vsb.org/publications/brochure/health.html#eight or http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+54.1-2984 and http://www.tcrh.org/pdf/advdir.pdf.

document is very useful as an attachment to a 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) "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 emergency room and the form can be found at http://www.miemss.org/DNRorder_form.pdf.

(10) 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.[2] More information is also available through the Motor Vehicle Administration at http://www.marylandmva.com/MVAProg/organ/default.htm.

(11) 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 either separate or 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. Can be used to allow children or others not named as a Health Care Agent to have access to information so that your Agent does not become the sole "gatekeeper" of the medical information.

E. Advance Directive for Mental Health Treatment. Allows someone with a prior history, or current fear, of mental health issues to deal with their care while they are still competent.

[2] Similar information for Virginia can be found at www.vatransplant.state.va.us and for the area at www.wrtc.org, the Washington Regional Transplant Consortium.

III. ESTATE PLANNING

A. Transferring Your Assets To Your Intended Beneficiaries

(1) *Gifts during your lifetime*: 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 or being required to file a Gift Tax Return (IRS Form 709).

(a) Gifts can be of cash or "in-kind" - such as cars, boats, etc., or they can be payments to a third party for the benefit of the recipient.

(b) The recipient does not have to be related to you.

(c) A gift in excess of the $12,000 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 and the donor cannot "write-off", that is, deduct, the gift from income taxes, unless it is to a "qualified charitable organization".

(e) "Gifts" of the payment of tuition (even in some circumstances for prepayment of tuition 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.

(f) 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 $117,000 per year.

(g) Forgiveness of a debt is considered income to the debtor and is not exempt from gift tax treatment.

(h) Gifts that do not fit within one of the five exclusions ($12,000 or less per year, tuition, health care, charity and US citizen spouses) are considered "taxable" gifts and must be reported to the IRS each year by filing a Form 709 with your income tax return. These gifts are tracked by IRS, and when they exceed one million dollars, a gift tax of 45% is assessed on the person making the gift. In addition, any part of the one million dollar ($1,000,000) lifetime exemption that is used is added back to your gross estate for estate tax purposes, but any appreciation in the gift is excluded from your estate.

(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. Look for assets that have "JWROS" "JTWROS" or "Joint Tenants" next to the name.

(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, those of the survivor will inherit and those of the first-to-die will not;

(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) May be liable or harmed by joint owner's liabilities.

(iv) For non-spouses, value of jointly owned property will be included in the gross estate of the first to die, even if that is not the person initially owning the property. For spouses one-half of the value is automatically included in the gross and net estate for estate tax purposes.

(c) Alternatives to joint ownership

(i) Tenants-in-Common - co-ownership <u>without</u> survivorship. Look for assets that have "TEN COM" next to the names to denote tenants-in-common;

(ii) QTIP Trust - Qualified Terminable Interest Property Trust - Gives surviving spouse benefit but not control of the ultimate distribution of an asset. A QTIP Trust must be set up prior to re-titling. This kind of trust also has estate tax advantages over leaving assets in trust or directly for children;

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

(iv) Life estate deed (deed to give someone the right to use the property for their life, or other defined period, with the property reverting to the remainder person). Extremely limiting and inflexible to design;

(v) 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.[3]

(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, pensions, IRA's, 401(k), 403(b), 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 most pension benefits.

(c) Primary and contingent designations.

(i) Importance.

(ii) Consequences of not having them.

(AA) Government benefits - "order of precedence"[4].

(BB) Non-Government benefits always have an order of precedence as well, by-passing your Will, Trust and probate,

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[3]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.

[4]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.

although often sending the asset directly to your Estate, and probate.

(d) 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 of receipt of retirement plan benefits:

(i) Spouse v. a non-spouse

(ii) IRA Conduit Trust for qualified plans that allow for life-expectancy payments rather than limit payments to lump sum only. May not be available for a TSP, but under the new Pension Protection Act of 2006, will be available for 401(k) plans, 403(b) plans, and other qualified retirement plans starting January 1, 2007.

(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**[5]; (ii) CSRS[6] (civil service retirement) - **Form SF-2808**; (iii) FERS - **Form SF-3102**; (iv) TSP (thrift savings plan) - **Form TSP-3**[7]; and (v) Unpaid Compensation for Civilian Employees (last paycheck and accrued leave) - **Form SF-1152.**

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

(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) and should be dated.

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[5]Because FEGLI designations cannot be changed by a power of attorney, guardian, etc., always consider the pros and cons of having it owned by, or payable to, a revocable trust, so that the beneficiaries can be modified if you become incompetent.

[6]Includes the designation of the voluntary contribution portion of your CSRS retirement, although does not allow for the "VC" portion to be separately designated. So you cannot leave the survivor annuity to your spouse and the VC benefit to your children.

[7]A TSP can only be modified by you, or someone with a properly executed TSP-4 form, giving Power of Attorney.

(iii) Must be witnessed.[8]

(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[9] 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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[8] Maryland (for soldiers serving outside of the United States), 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 and easily, and often, found invalid.

[9] In D.C. a registered Domestic Partner has the same rights as a spouse in this regard. In order to become registered Domestic Partners in DC, a couple, whether same or opposite sex, must register under the DC Health Care Benefits Expansion Act. Applicants must apply at the DC Department of Health, State Center for Health Statistics, 825 North Capitol Street, NE, Washington DC 20002. Under DC Code, all information contained in a declaration for domestic partnership, with the exception of address information, is open to public inspection. For more information go to: http://doh.dc.gov/doh/cwp/view,a,3,q,573324,dohNav_GID,1787,dohNav,|33110|33120|33139|.asp.

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) Provide guidance to Guardians of minor children on various matters, including visitation with grandparents, education, religious upbringing, etc.;

(iii) Determine whether probate or non-probate assets will be used to pay estate taxes due, so as to insure that those receiving an inheritance either pay their share of the tax, or that the entire tax is paid from the residuary to insure that non-probate assets are not depleted by taxes;

(iv) Create a <u>Trust for Children</u> 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). Often this is the <u>primary</u> reason parents do Wills, to ensure that their children will not inherit money before they feel they will be competent to handle it. Often, money is held for children until 25, 30, 40 or even beyond;

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

(vi) Give guidance to your Trustee on how and when discretionary distributions of trust assets should be made - for the down payment on a house, a wedding, a business, etc.;

(vii) 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;

(viii) 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.

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

(x) Provide for step children;

(xi) Provide for a trust for your pets in Virginia or DC. Maryland does not currently allow for trusts that only benefit a pet, and any such funds must be left as a conditional bequest (ie, $5,000 to my friend, on the condition that she cares for my pet), and even then may not be enforceable.[10]

(xii) Direct the disposition of your body - burial, cremation, etc., and designate an individual to be responsible for the same.[11]

(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;

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[10]Alabama, Alaska, Arizona, Arkansas, California (allowed but unenforceable), Colorado, District of Columbia, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Ohio, Oregon, Pennsylvnania (effective 11/4/2006), Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin (allowed but unenforceable) and Wyoming currently have statutes allowing for Pet Trusts. A Maryland version of a Pet Trust statute has been proposed but not yet passed.

[11]Under Maryland law the Will does not have to be probated to be an effective directive for disposition of your remains. The Maryland Advance Directive also allows you to name your Health Care Agent, or someone else, to be in charge of your body following your death.

(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.

(h) 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.

(i) A Will may be revoked by:

(i) Destroying it.

(ii) Expressly revoking it in a subsequent Will.

(iii) Marking on it.

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

(k) 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[12] 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.

(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.[13] 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[14] and claims;

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[12]Many states use the term "Executor" for this function.

[13]DC and Virginia 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.

[14]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"

(i) Settling disputes about asset distribution;

(j) Determining family allowances and statutory share claims by spouses and domestic partners (in D.C.);

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

(l) Distributing assets to intended beneficiaries, including children and other outright legatees, or trusts if provided for in the Will;

(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) Small Estates - Maryland allows an estate of less than $30,000 ($50,000 if everything is going to a spouse) to use a small estate procedure that saves considerable time and does not require the same formality as a regular estate. Virginia's small estate procedures are available for estates of less than $50,000, and DC's in estates of less than $5,000;

(o) 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;

(p) No modified/unsupervised probate in Virginia for estates in excess of $50,000;

(4) Criticism of probate.

(a) More expensive due to 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.

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income tax return and an estate tax return.

(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 appropriate 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[15] must be created (drafted, signed, etc.) during your lifetime. A properly worded and executed durable power of attorney may allow your appointed attorney-in-fact to create an RLT, even if you are incapacitated.

(b) Assets that would otherwise be considered as "probate" 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

(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;

[15] 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.

(v) Trend towards making RLT's more useful - Virginia has enacted a statute allowing spouses to place tenants-by-the-entireties property in an RLT and still retain the TBE protections.

(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, but should not, 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 2007.

(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 (another 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.[16]

(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 upon your death - separate from Probate.

(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.

[16]Holding the property in a corporation or limited liability company may allow the property to avoid taxation, but could backfire if your home jurisdiction were to change its rules to provide for a lower estate tax threshold.

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

(i) The Exemption amount is 2 million for 2006-2008 and 3.5 million in 2009.

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

(iii) The tax is "un-repealed" effective January 1st, 2011 and the 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 - Flexibility becomes more important.

(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, and requiring a more detailed analysis of where clients live and where they own real property.

(d) To calculate the tax:

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

(AA) The "gross estate" includes:

*Your home[17]
- appraised[18] 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

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[17]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. Sometimes an aggressive estate plan may take advantage of these presumptions by moving assets into the name of an individual who is going to pass first, but may not have an estate tax due at that time.

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

- 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.

(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) Personal exemption - As discussed above, the personal exemption amount for assets not qualifying for the marital deduction or charitable deduction is:

$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 of 46% (plus state tax rate impact) is applied against this reduced amount, with the tax rate (state death tax credit), returning to 55% for 2011 and thereafter.

(v) Capital gain basis of inherited assets -

(AA) Step-up in value is currently available for all inherited assets, regardless of whether any Federal estate taxes are payable, making the basis of such assets equal to their date of death value or alternate valuation value, whichever is used for estate tax purposes.

(BB) In 2010, 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 with 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) Lifetime gifting programs using the annual exclusion gifts.

(v) Other estate planning techniques.

(2) State Death Taxes.

(a) Inheritance tax (Maryland, not DC or Virginia)[19]

(i) Ten percent (10%) tax charged by the State of Maryland to the recipient, unless the Will provides for the Estate (which means the residuary beneficiaries) to pay the tax.

(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.

(iv) Applies to all assets passing from the decedent, except life insurance benefits.

(v) Does not apply if recipient is a spouse (as defined under Maryland law), parent, child, son/daughter-in-law, grandchildren, great-grandchildren or siblings, or a corporation, limited liability company or partnership all whose stockholders, members or partners fall within the exempt class.

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

(vi) Does not apply to step-children if the "step" relationship was not severed prior to death.

(vii) Hits unmarried couples, including same-sex and opposite sex couples, particularly hard, as assets inherited as joint-with-rights-of-survivorship are taxed, regardless of whether any cash to pay the tax is received. Unmarried couples with joint assets should have additional life insurance (not subject to the inheritance tax) to allow them to pay the tax upon their partner's death.

(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.[20]

(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.[21] However, there is a deduction (worth less than a credit) available on the Federal Estate Tax paid for payment of the Virginia Estate Tax. The Virginia Estate Tax has been repealed for individuals dying after June 30, 2007.

(iii) In Maryland there is 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 or more), but some states may not offer that, meaning that estate plans including a QTIP for the surviving spouse may face an unexpected tax at the death of the first spouse.

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[20]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 level by 2006-2008: 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, some for the better (to remove the tax) and some for the worse (institute a lower exemption level).

[21]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.

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

IV. MISCELLANEOUS ISSUES

A. Retirement Assets - Brief review of estate planning issues for 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.

(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 an 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) Under the new Pension Protection Act of 2006, starting on January 1, 2007, all qualified retirement plans will allow a direct transfer from the decedent's account to a "stretch" or life expectancy IRA, a feature that until now was usually only available to IRA holders and not holders of 401(k) and Thrift Savings Plans. At this time we do not know if this new direct transfer rule will apply to TSP accounts.

B. Uniform Transfers to Minors Act / Uniform Gift to Minors Act

(1) The Uniform Gifts to Minors Act (UGMA) and Uniform Transfers to Minors Act (UTMA) both provide methods by which to give gifts of money or other funds to children, whether they are your own, your nieces and nephews, your grandchildren, or other children with whom you have a close relationship. An adult "custodian" chosen by the giver manages the accounts until the child reaches the age of majority. Custodial accounts in some way resemble trusts.

(2) Benefits of UGMA and UTMA accounts include:

(a) The UGMA and UTMA provide convenient, uncomplicated ways to give gifts and otherwise transfer money, stocks, and bonds to minors.

(b) The giver designates himself, herself, or another responsible adult to be the custodian of the account, which means that he or she will manage the money for the minor until the minor reaches maturity and make withdrawals from the account as deemed appropriate. Maryland and Virginia now allow co-custodians with equal decision making authority.

(c) Custodial accounts can be used to fund a child's education.

(d) A UGMA or UTMA custodial account can be used like a trust in order to give nontaxable gifts of money during your lifetime, up to a certain limit, thereby avoiding both gift taxes and estate taxes on the amounts given.

(e) The income from a custodial account is charged to the child. If the child is paying taxes at a lower rate than the parent, this can result in further tax savings.

(f) Custodial accounts are much simpler to establish than trusts, which have more complicated legal requirements and can be more costly.

(g) In regard to UTMA accounts in Maryland, the custodian may transfer the custodial property to a trust for the minor meeting the requirements of IRC §2503(c) that can be created by the custodian (or presumably the original transferor to the custodianship) and the <u>beneficiary</u> can then extend the term of the trust on reaching age 21. This is called a "qualified minor's trust." Three substantial limitations to this power are that the 21 year old beneficiary must agree to the trust, such property cannot have been originally transferred under a will or codicil unless specifically authorized by the will or codicil, and for a lifetime transfer the instrument creating the custodianship must contain a statement in conspicuous type authorizing the custodian to transfer the property to a QMT without a court order.

(3) Detriments of UGMA and UTMA accounts include: CONS

(a) Once you transfer money into a custodial account, you can't take it back, even with the child's consent.

(b) The money in the account is automatically turned over to the "child" once he or she becomes twenty-one, or sooner in some states, regardless of the recipient's maturity. With a trust, the trustee can designate that the beneficiary receive the funds at any age desired by the grantor of the Trust.

(c) The existence of the account can cause a reduction in the amount of financial aid that is available to the child when he or she attends college. Assets held in a child's name weigh more heavily against financial aid eligibility than do the parents' assets.

(d) If a parent uses income from the account to satisfy his or her legal obligation to support a child, the income becomes taxable to the parent, since parents have a legal obligation to support their children.

(f) The UTMA does not allow for you to designate what happens to the money in the account if the child it dies before receiving the money. Under a trust you are allowed to make this determination.

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) Where circumstances (marriage, divorce, birth of child or grandchild, inheritance) change.

(2) If the law, Federal or State, 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 and their contact information.

(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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