WHAT DOES IT MEAN "TO HAVE A GOOD ESTATE PLAN"?
2013

Until the last half of the 20th century, "estate planning" usually meant a will. Few attorneys specialized in estate planning (it seemed too simple) but many attorneys prepared wills as an accommodation to their clients. Attorneys who spent considerable time drafting wills often considered that work a "loss leader," but used the opportunity to build a future, highly profitable probate practice.

As the tax laws became more and more complex, as estates grew in size (partially because of inflation) and as individuals everywhere became less content with the public court system, the legal field of estate planning began to take on more significance and living trusts began to proliferate. The reason is quite simple: **The living trust is the only estate planning tool which accomplishes the three or four most common estate planning objectives: avoiding probate, minimizing or eliminating "death" taxes, providing for deceased heirs, and layering legal protections around the estate for the heirs.**

To the unskilled eye, the living trust looks like a boiler plate document and the perception has arisen that *anyone can do it - just fill in a few blanks*. Lawyers and non-lawyers throughout the United States have gotten on the trust bandwagon. Seminars have been popping up overnight, attracting an unwary public eager to take advantage of the attractive "sales pitch."

As we move into the first half of the 21st century, the "dust" has somewhat settled. The public has heard the sales pitch several times over. They now are beginning to ask the important questions: "Should everyone have a trust?" "What is the difference between a good trust and a not-so-good trust?" "Does my trust take *full* advantage of the law?" "Does my trust do all that it can do?"

Most trusts are designed only to avoid probate.[1] The trust avoids probate because it doesn't "die" when the estate owner dies; it's a separate legal entity that continues uninterrupted **if the estate owner's assets are placed in it before the estate owner dies.** Many attorneys have failed to properly assist their clients in getting assets into their trusts. Most states allow only a small amount of assets outside a trust to pass without probate - $10,000 to $50,000. Some states require a probate of **every** asset outside a trust. A trust won't avoid probate unless the trust is funded.

You can also avoid probate without a trust. Assets such as annuities or life insurance, with a named beneficiary, or accounts (at a bank, brokerage firm, mutual fund, etc.) with a "right of survivorship" can be passed without going through the probate

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[1]Probate means the use of the court system to "settle" an estate; probate usually involves fees (court fees, legal fees, etc.) and time delays.

process. Clients often ask the question of whether those arrangements (i.e., joint tenancy on the title or the use of a beneficiary designation) are better than a living trust or at least as good as a living trust. If the only goal of the estate owner is to avoid probate and if the estate is not large, these planning techniques can be useful.

One of the major pitfalls in estate planning is the use of joint tenancy by married couples, especially when the estate is or will be over the tax-free limit. Although the surviving spouse avoids probate and death taxes when the first spouse dies, the tax credit of the spouse who died first is forever lost! The result is that the final heirs (usually, the children) may have to pay **unnecessary** death taxes!

Even when the estate is under the tax-free limit, many couples don't realize that joint tenancy permits the surviving spouse to thwart the estate planning objectives of the spouse who dies first (because the surviving spouse can change everything). Also, joint tenancy destroys any creditor protection which is otherwise available to a surviving spouse. For these reasons, couples should be cautious about using joint tenancy as an estate planning tool.

In addition to avoiding probate, a living trust has numerous other benefits, some to the estate owner during life, some to the surviving spouse, some to the deceased spouse and many to the ultimate heirs of the estate. In order to fully understand the role of the living trust in estate planning, let's first take a brief look at estate taxes.[2]

The federal estate tax law, which affects estates of all U.S. citizens, covers all assets everywhere in the world.[3] Each person's estate is entitled to a $5.25 million exemption from estate taxes; it is unimportant whether there is one heir or numerous heirs. In addition to the $5.25 million basic exemption there is also an **unlimited** exemption for assets which pass to a surviving spouse or to charity.[4] Estate assets in excess of $5.25 million which pass to persons other than a spouse or charity are heavily taxed (40%). Taxes are due within nine months after death.

Each state has its own laws affecting estates of individuals who are residents of the state at the time of death and/or affecting real estate interests located in that state. Some states impose a separate death tax; some states accept the federal estate tax credit (payable out of the federal tax) but have no separate death tax. A few states impose an inheritance tax on the heirs themselves (payable **after** the federal and state estate taxes are paid).

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[2]This summary is not intended as legal advice; an attorney should be consulted regarding specific tax or legal questions.

[3]The tax laws affecting non-citizens are beyond the scope of this paper.

[4]The unlimited marital deduction is also available when assets are held in trust for a surviving spouse, as long as strict rules are incorporated into the trust.

Example of two hypothetical estate tax computations (one with a will, one with a trust):

WILL		TRUST	
Gross estate at first death	$6,000,000	Gross estate at first death	$6,000,000
Surviving spouse's share	$3,000,000	Surviving spouse's share	$3,000,000
Decedent's share	$3,000,000	Decedent's share	$3,000,000
Expenses (funeral, etc.)	$ 200,000	Expenses	$ 200,000
Adjusted gross estate	$2,800,000	Adjusted gross estate	$2,800,000
Estate tax exemption	$5,250,000	Estate tax exemption	$5,250,000
Federal & state estate tax (at first death)	$ 0	Federal & state estate tax (at first death)	$ 0
Surviving spouse's estate	$5,800,000	Surviving spouse's estate	$3,000,000[5]
Deductions	$ 100,000	Deductions	100,000
Taxable estate	$5,700,000	Taxable estate	$2,900,000
Estate tax exemption	$5,250,000	Estate tax exemption	$5,250,000
Net Taxable estate	$ 450,000	Taxable estate	$ 0
Federal estate tax	**$ 180,000**	**Federal estate tax**	**$ 0**
Tax rate on net taxable estate (after $5.25 million deduction)	40%		
Tax rate (taxable estate)	3.2%		

A living trust does not avoid estate taxes. Estate taxes apply to the **size** of the estate, regardless of whether the assets are in a living trust. However, a living trust can be designed to preserve the two tax credits for a couple (married or unmarried) so that $10.5 million can pass free of federal estate taxes when both spouses or partners are deceased. Because the living trust is one of the tools able to accomplish this planning objective, it is sometimes mistakenly thought of as the one and only way to avoid death

[5]This assumes that the trust has standard provisions to minimize estate taxes.

taxes. Estate tax planning can also be accomplished with a will, but the probate problem remains.

A living trust does not protect assets from creditors (or a divorce) while the estate owner(s) is living. However, creditor protection is available for a surviving spouse or other heir. While many trust designers overlook the value of creditor protection, widows, widowers and heirs almost always appreciate its benefits. The law of trusts provides a unique opportunity to transfer the control and enjoyment of wealth coupled with long term protection. Anyone who has experienced the relief of holding onto an inheritance in a divorce proceeding or in a personal bankruptcy can happily vouch for the results of proper planning!

The definition of a good estate plan depends entirely upon the goals of the estate owner. An unmarried individual without children who intends to leave all of his or her assets to charity may not be concerned at all about death taxes or probate; in such cases, a simple will may be the very best estate plan. On the other hand, an individual, married or single, with or without children, who wants to protect his or her estate for the benefit of heirs in every way possible will most certainly want to have a living trust. When the estate owner's objectives are to reduce or eliminate death taxes, to provide creditor protection (to the maximum extent allowed by law), to protect against divorce or bankruptcy, and to preserve the estate assets for the maximum duration of time, a properly drawn living trust is always the best estate planning tool.

Unfortunately, the overwhelming majority of living trusts are **not** designed to accomplish all potential estate planning objectives. Most trusts are designed to avoid probate; some incorporate estate tax savings for the first generation heirs; very few go beyond the basics. A well drafted living trust should provide various protections for the life of the estate owner(s) (and the survivor), as well as for the life of the heirs. Estate planning can be appreciated for *generations* if it is done thoroughly and competently.