Revocable Trusts and Estate Planning

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Revocable Trusts are established while individuals and married couples are living, as a key cornerstone of an estate plan. What is an estate plan? Basically it is a plan (1) to provide protection in the event of disability, and then (2) to pass on your property after death. The idea is to carry out your wishes and help to avoid family strife in the process. It is an opportunity for you to make a set of bylaws for your family, to smooth out some of the rough edges as disabilities occur and the generations advance. Along the way, you can hold down probate costs and estate taxes, or even eliminate them.

Your estate at death is your property, divided into two parts: (1) your Probate Court estate and (2) your property that does not go to the Probate Court before it goes to your heirs. Your Probate Court estate includes any bank and brokerage accounts in your name alone. The part of your estate that does not pass through your will or go to the Probate Court includes: jointly held property (if the other joint owner survives you), as well as property passing through a revocable trust established prior to your death. With an estate plan and some adjustments in the way you "title" your property, you can decide whether your estate will go through Probate Court. Remember that a will only works in Probate Court. Joint property and revocable trusts operate outside of the Court supervision process, and are considered to be will substitutes. By planning ahead you can choose which approach you prefer.

Whether a part of your estate goes before the Probate Court or not, the tax authorities consider all your property to be part of your estate when they decide whether you owe any taxes at your death. Remember that estate taxes imposed at death are (1) different from, and (2) in addition to, income taxes.

Estate taxes consider both (1) the estate you pass on after your death, as well as (2) gifts you make while you are living. It covers both your estate at your death and gifts made during your lifetime. The basic total amount you can leave to your heirs without an estate tax is $1,000,000 as of January 1, 2011. If you gift $500,000 while you are living, then you can leave another $500,000 after your death beginning in 2011 (because $500,000 plus $500,000 equals $1,000,000 which is the basic total amount you are allowed to leave estate tax free as of January 1, 2011). If you decide not to give away anything while you are living, then you can leave all $1,000,000 to your heirs after your death without having to pay a federal estate tax.

On top of this $1,000,000 exemption beginning 2011, there are other deductions and exemptions to protect property from the tax. For example, you can give away $13,000 each year to any number of people--for example $13,000 to one person and another $13,000 to another person, all in the same year. When someone gives you something on your birthday, that is what he or she is doing as long as he or she does not give you more than $13,000 in a given calendar year and also as long as possession was transferred (remember that incomplete gifts are not gifts even though they create expectations and potential disputes). A couple can double the amount to $26,000 per

child or grandchild or other person per year because a husband and wife can each give $13,000 per child or grandchild or other person (assuming a gift tax information return is filed at the same time the 1040 income tax return is filed for that year). So, your mother and father together could have given you $26,000 each year, and done the same thing for your brother or sister as well, all without tax consequences. None of this annual gifting "whittles away" at the basic $1,000,000 total estate tax exempt amount.

Under current law, the estate tax will not be imposed for deaths occurring in the year 2010. (In the year 2010 gifts will be taxed at the income tax rate of the person making the gift. Also, in 2010, a new capital gains tax is imposed, with certain exceptions, on property sold after an owner has died, to take the place of the estate tax in 2010.) Then in 2011 (and most people figure on living that long) the estate tax exempt amount goes down, like a roller coaster ride, to $1,000,000 as of January 1, 2011 (unless further federal legislation is passed in the meantime, and efforts to do so have failed to date). Congress could also change its mind and reduce the exemption due to economic conditions and need for more revenue. For example, at the end of the recession in the early nineties, Congress considered a bill to decrease the estate tax exemption to $200,000 (but the bill ultimately failed).

On top of the lifetime $1,000,000 exempt amount (as of 2011) and the $13,000 per year per person exemptions, you can also give away as much as you want above that, without paying any tax, as long as you are married to the person you are giving the money to. You can give your spouse as much money as you want to (1) while you are living and also (2) at your death, without being taxed (with certain restrictions just prior to death). This allows husbands and wives to reposition assets to achieve estate planning goals. Another type of tax exempt gift you can make is to a qualifying charity. An additional type of tax exempt gift is a check written directly to a school, doctor or hospital for anyone's education or medical expenses and there is no dollar limit for this, for gift and estate tax purposes, as long as the check is written directly to the school, doctor or hospital. There are also tax qualifying plans for college savings to look into if a child or grandchild has not reached college age yet.

It is also important to know that you can take steps in advance, other than gifting, to protect an estate which may be above $1,000,000 (for deaths after 2010). And remember, people often underestimate what they own and what value the IRS will put on their property at their death.

Even numbers-conscious people often underestimate their assets when they are first asked what they own--before they list what they own with estimated values for each major item. Remember to include (1) your retirement benefits, (2) your life insurance death benefits, (3) the value the IRS would put on your business, (4) the fair market value (not the property tax valuation) of your real estate and personal property, including out-of-state property, and (5) everything else (including furniture, furnishings, jewelry, and even all exercise equipment in the attic).

If you have a taxable estate above $1,000,000 as a married couple, you can have revocable trusts drafted in a certain way to preserve the $1,000,000 federal estate tax exemptions for both you and your spouse, regardless of who dies first--as long as you do it before either of you dies. That way you would pay zero federal estate tax on up to $2 million in property. However, if you use simple wills or have joint property and you leave everything to your spouse--or your spouse dies

first and leaves everything to you--the estate tax after the second of you dies is over $300,000 and could be as high as $550,000. That's the bad news.

The good news is that if your estate is above $1,000,000, whether you are married or single, there are steps you can take in advance to protect your estate at your death. Families can lose real estate, a family business, life insurance or savings carefully built up over the years, for lack of estate planning. If you have a taxable estate, then simple wills and joint property are generally no longer appropriate. Remember also that unplanned estates above $1,000,000 pay death taxes at up to over one-half of every dollar above the exempt amount. Know your options and make your own choices, based on your individual situation and your taxable estate.

Now let's discuss individually the various documents most often used in estate planning: wills, revocable trusts, durable powers of attorney and living wills.

Do you have a will? What happens if you do not have a will or a will substitute? Many people think that the surviving spouse receives everything. This is not true. Depending on whether there are children, stepchildren or parents living, the surviving spouse may receive less. Without a will, your particular concerns cannot be taken into account. With a will or will substitute, you can decide who gets your property. You can name a guardian for a minor child. You can choose an executor who will attend to your financial affairs after your death knowing what you wanted to achieve. You can remember special people. You can leave property to a charity you like. You can have a plan in place for children and loved ones in case an automobile accident or other accident takes your life and at the same time takes your spouse's life.

You can even disinherit a child, but only if you mention that child by name. Remember that a spouse cannot be disinherited--and is entitled to claim at least one third of the real estate and personal property you own at your death as a protection for widows and widowers. Also, remember that a will has to be signed in a particular way. If it is not signed properly, it is totally invalid.

Next let's discuss revocable trusts. A revocable trust can be a will substitute. Think of it as a legal document which creates a place to put your property--think of a revocable trust as a box for money to be put in and taken out of by you as you choose. You can be your own trustee. You can put real estate as well as personal property into it. The income tax authorities consider the property you put in the revocable trust to be your own, so you fill out your Form 1040 income tax return in the same way as before. It doesn't change the way you live. The difference is that when you die, the property you put into your revocable trust while you were living, does not go through Probate Court--it is now in the non-Probate part of your estate. If all your property is in the trust, there are no Probate Court proceedings. The property goes to whomever you choose but your wishes are carried out by your trustee, whom you have chosen to take control of the trust after you die, without Court supervision unless someone requests Court supervision. It is still a good idea to have a will in place, in order to name a guardian for a child, for example, or in case all your property was not put into the trust prior to your death, but otherwise the trust can be a substitute for a will. Using a living trust as a will substitute saves your heirs from the time, expense, public nature and supervision of probate, if that is what you want. Remember also that Court supervision is designed to protect your estate and may be the preferred approach

depending on circumstances. The point is that you decide which approach to take. All trusts are subject to Court review upon request of an interested party.

Some people have a trust built into their will--so it only comes into existence after death. That type of trust is not a living trust. It has Court supervision and requires yearly Court accountings and your trustee, perhaps accompanied by an attorney, goes into Court for hearings. If you set up a trust separate from your will while you are living, and retitled your assets appropriately, then your trustee does not go into Probate Court for accountings unless someone requests Court supervision.

Also, with a revocable trust you can decide what age your children or others will need to be before they receive their inheritance. You may want your trustee to hold the proceeds until your children reach the age of 25 or 30 or any other age you pick. Try to remember what you would have done with an inheritance at age eighteen (18). While safeguarding the assets, your trustee can also provide money as needed for your children for college, to buy a home or for other worthwhile purposes. In addition to tax considerations, revocable trusts can also be a way to help address the issue of what happens to inheritances for children in the event of remarriage of a spouse after your death.

Next, I want to discuss durable powers of attorney. Often there is a period of disability prior to death, so planning ahead for your own possible disability later on may be the most important planning you do for yourself. Have you established durable powers of attorney? There are two types of durable powers of attorney: (1) general powers of attorney including provisions for financial matters and (2) powers of attorney for health care, also called advanced directives. A durable general power of attorney allows someone you pick to pay your bills and make financial decisions for you if you are away on a trip or if you become disabled to the point of being unable to sign legal documents. What if you get sick or have an accident, and become severely disabled and unable to pay your bills? Who is going to make decisions? If you are disabled, who will sign when jointly owned property needs to be sold or refinanced and both signatures are required? Without a durable power of attorney for finances, it would be necessary to go to the Court to establish a guardianship. This requires a Court petition and Court hearing with an attorney appointed by the Court to consider taking the opposing viewpoint. Then the Court issues an order finding you to be unfit, and there is public supervision of your finances and regular Court accountings for the rest of your life. A power of attorney is considered a "guardianship substitute" as long as you establish it before the decisionmaking disability arises. In the old days, a financial power of attorney ended as soon as a person became disabled and could only be used when you went on a trip or other purpose while you were able to make you own decisions. Since 1986, it can help when it is needed most--when you become disabled to the point where you cannot sign legal documents or make basic decisions. All powers of attorney are subject to Court review upon request of an interested party.

A durable power of attorney for health care allows someone else to make health care decisions for you if you are unable to make health care decisions for yourself, because you are sick or have had an accident and are unable to give informed consent for an operation, hospitalization or nursing care and other services at home. Living wills are also an option. Many people would like to instruct the doctor not to artificially prolong their life if there is no hope of recovery. This can

be done in New Hampshire with a living will. As with all estate planning documents, a living will has to be done in a particular way as required by the law, and it has to be done while you are able to make the decision. Health care powers of attorney and living wills are very personal decisions that can have a tremendous impact on your life and physical comfort. Remember to include specific instructions in your health care power of attorney concerning access to medical records and other matters of importance to you. In some ways the health care powers of attorney and living wills are the most important estate planning decisions of all.

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