Overview of Issues

Lifetime Planning and Estate Planning

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INTRODUCTION

Estate planning involves planning for many contingencies, including:

• Should you become incapacitated, who will manage money and assets for you and your family; who will make health care decisions for you?

• When you die; who will become the guardians of your children; who will manage money and assets for your children; who will handle your affairs upon your death?

Estate planning also involves tax planning, retitling of assets and balancing many competing planning goals. A good estate plan starts with the following basic documents:

• Will
• Revocable Living Trust Agreement
• Durable Power of Attorney
• Health Care Patient Advocate Designation

Before reviewing how these documents work together, a brief review of Federal estate and gift tax planning issues is set forth below.
CURRENT OVERVIEW OF ESTATE AND GIFT TAX RULES, INCLUDING FEDERAL PLANNING ISSUES

• Effective January 1, 2013, Congress passed new tax legislation which provides for new, permanent planning rules governing estate and gift taxes.

• Since 2002, our estate and gift tax planning rules were in a state of flux, changing (temporarily) year to year.

• While our new rules are “permanent”, a new Congress can always pass new legislation changing our planning rules yet again.
Planning Rules for 2013 and Beyond

Key Federal planning rules which took effect automatically on January 1, 2013, are as follows:

• In 2013 and after, the cap on assets that may be transferred free of estate tax is $5,250,000 (compared to the 2009 cap of $3,500,000 or the 2011-2012 cap of $5,000,000), indexed for inflation. For 2014, this exemption amount is $5,340,000.

• In 2013 and after, the top estate tax rate will be 40%. The top estate tax rate in 2009 was 45% and the top estate tax rate in 2011-2012 was 35%.

• As of 2014, each person now also has the opportunity to make a gift of up to $5,340,000 of assets during each person’s lifetime. This “lifetime allowance” is in addition to the $14,000 per donee annual gift allowance that each person has as well. Note that the lifetime allowance is essentially a "future use" of the $5,340,000 exemption from estate taxes.

• At a person’s death in 2014, assets may be transferred at death at a complete “step up” in basis (to current fair market value) which enables the beneficiary of such assets to sell the assets at the date of death and not incur capital gains tax. Alternatively, if the beneficiary chooses to hold the assets received, the beneficiary’s basis in the assets is set at the fair market value as of the date of death of the decedent.

• In 2013 and after, the gift tax rate for “lifetime” gifts in excess of $5,250,000 (indexed for inflation) is 35%. For 2014, this exemption amount is $5,340,000.
1. WILLS

A Will can be used to designate guardians for your children, name your personal representative (formerly called an executor) and distribute your assets. However, if you pass assets at your death on to beneficiaries that you list in a Will, you will encounter the following problems:

• Wills must be probated. This means that the Will must be filed with the probate court and you may need court approval to distribute assets. The probate process increases legal fees and increases the length of time to distribute assets. On average, if a person has not executed a Revocable Living Trust in addition to a Will, the cost to probate an estate runs between 1% and 5% of the assets in the probate estate, depending upon the size of the estate and the types of assets held in the estate.

• The probate process is public and as such, the value of your estate and what the estate is comprised of will be public (i.e., part of the probate court’s records, which are open to the public).
Wills (continued)

• Assets which pass to a minor child will require the court appointment of a representative to manage the assets for the child for the time that the child is under the age of 18. At age 18, the minor then has complete ownership of the assets as of the age of 18.

• By passing your assets by Wills, as opposed to Revocable Living Trusts, you may incur estate taxes that could have been possibly avoided or substantially reduced. For 2014, you and your spouse can transfer up to $10,680,000 in assets to your children or other donees if you each execute and properly fund Revocable Living Trusts. Alternatively, if you transferred your estate assets by Wills only, there would not be any estate tax due on the death of the first spouse to die. However, on the death of the second spouse, the total amount of estate assets that you would be able to transfer without incurring estate tax liability is $5,340,000.
2. REVOCABLE LIVING TRUSTS

A Revocable Living Trust is a document that is created during the lifetime of the maker (the “Settlor”) of the Trust. The reason it is called a “revocable” trust is because the Settlor of the Trust has continuous control of what goes in and out of the Trust and how the Trust assets are invested and used, provided that the Settlor is also one of the “Trustees” of the Trust. A Trustee manages the Trust assets and handles Trust distributions.

During the Settlor’s lifetime, all assets titled in the name of the Trust are owned by the Trust, but reported for income tax purposes under the Settlor’s social security number. The Settlor may move assets into and out of the Revocable Living Trust during his or her lifetime with no adverse tax effects.
REVOCABLE LIVING TRUSTS (continued)

Typically, the Revocable Living Trust is used to do the following:

• Hold the assets placed in the Trust so that the same can be managed by the Trustee in cases where the Settlor cannot manage the assets, but still permitting full management for the Settlor while capable. For example, if a person becomes disabled (either temporarily or permanently), trusts are used to manage the persons assets for them and for their family members.

• Help reduce estate taxes at the death of the Settlor. Current 2014 tax rates cap at 40%.

• Distribute assets to a surviving spouse and children. For example, a typical Revocable Living Trust gives the surviving spouse the right to the Trust income and the right to invade Trust principal. Upon the death of the surviving spouse, the assets then pass to the children, but are held in trust pursuant to the directions set forth in the Trust. Assets can be held and distributed over any time frame you select and for any purpose that you select (i.e. support, health, education, etc.).

Once the Revocable Living Trusts are created and signed, the assets of the Settlor and his spouse are then retitled in the names of the respective Trusts. For example, the marital home may be placed in the wife’s Trust. The investment accounts of the husband may be placed in his wife’s Trust. The life insurance on the husband’s life may be placed in the husband’s Trust. The key in setting up a successful estate plan is not only the proper drafting of the estate plan documents, but also the proper funding of the documents by retitling the assets in the Trusts in a manner so as to avoid as much estate tax as possible while, at the same time, provide for flexibility and for liquidity for the decedent’s surviving spouse and children.
3. DURABLE POWERS OF ATTORNEY

This type of document is used to designate a representative to make business and financial decisions and to sign business and financial documents for you during your lifetime. The representative is empowered to make decisions involving finances, real estate, and banking, unless the document limits such authority.

The term “durable” means that the document may be used to allow the representative to make such decisions even when the person who made the power of attorney becomes incapacitated.

- However, a power of attorney ceases effect at a person’s death -- i.e., it may no longer be used after the person who made it dies.

- The person’s personal representative (formerly the executor), as designated in the person’s Will, then takes over with regard to asset management, etc., at the person’s death.

- If a person also had a Revocable Living Trust, the work of the personal representative would be significantly reduced because a great deal of the work would be shifted to the Trustee.

Finally, this document is also used to make guardian selections if the individual can no longer manage his or her affairs.
4. HEALTH CARE PATIENT ADVOCATE DESIGNATIONS

A Health Care Patient Advocate Designation (frequently referred to as a “living Will”) is used to designate a representative to make health care decisions on your behalf, but only if you are incapacitated or unable to do so.

• This type of document must be executed in strict conformance a State’s statute which governs such designations.

• You can give total discretion to your representative to weigh all of the pros and cons of your health situation and make decisions.

• Alternatively, you can specify what types of treatments you do not wish to be subjected to, such as artificial life support.

• If you regain the capacity to make educated health care decisions, you are back in control of the decisions -- this document only becomes effective if you cannot make educated health care decisions.
COMMON MYTHS AND MISUNDERSTANDINGS ABOUT ESTATE PLANNING

Many people believe that they do not need estate planning documents, that their estate is not large enough to plan for, or that they have already handled any estate planning issues by transferring assets from single to joint ownership. The following is a short review of some of these myths and misunderstandings:

• **Myth: By holding assets jointly, you can avoid probate.**

Generally, any interest in a joint asset does in fact pass to the survivor, but the value of the interest in the asset (i.e., held with anyone other than your spouse) will result in the asset being included in your estate at a value of 100% of the asset. The IRS will assume that the other person did not pay fair market value for the asset or, alternatively, that the asset was not the subject of a properly documented and valued lifetime gift.

• **Myth: Life insurance death benefits (the “face value”) will not be taxed on my death.**

Life insurance death benefits will not be taxed for income tax purposes at your death. However, the death benefits will be included in your list of estate assets for calculating potential estate taxes. Accordingly, all life insurance policies that you have, including term policies, group term policies, variable and universal policies, whole policies and accidental death policies will be included in your estate for calculation of applicable estate taxes.
KEY LIFETIME PLANNING DECISIONS

• Individuals – Bill Pay, Banking, Investments
  o Power of Attorney
    □ Full Power of Attorney
    □ Limited Power of Attorney
  o Benefits of Using a Trustee
    □ Family Member/Friend
    □ Professional Trust Company

• Business Owners – Management of the Company
  o By Power of Attorney
  o By Trust Management
  o By an Integrated Succession Plan
QUESTIONS?

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