BLEAKLEY PLATT

The Basics of Estate Planning

Introduction

The process of estate planning can be a daunting prospect. Often individuals will avoid the process altogether. Obviously, this is not the best approach since what happens after our death can be tremendously important to those we love who we leave behind.

We have found that the process is easier if it is understood. Below we have provided brief descriptions of what we call the basic estate planning documents and an outline of the basic estate tax provisions affecting estate planning. Our goal is to provide the framework so that clients can begin to plan their estates.

Basic Estate Planning Documents

I. The Will

a. A Will is a document that disposes of all of the assets owned by an individual in his or her name at death. It must be executed in a formal ceremony which meets certain requirements set out under New York Law. Although New York only requires two (2) witnesses, generally, attorneys will have three people witness a client's Will. A Will does not dispose of assets such as retirement assets and life insurance that have designated beneficiaries, or assets held jointly with rights of survivorship or in trust for another.

b. When someone dies the Will is filed by the individuals or institution named in the Will as executors (nominated executors) in the Surrogate's Court[1] in the county where the decedent lived. If the Court finds that the Will is valid and the individuals or institutions nominated as executor are qualified to serve as executor, it will admit the Will to probate and issue Letters Testamentary to the nominated executor(s) who will then have the authority to administer the decedent's estate in accordance with the terms of the Will. The executor(s) will collect the decedent's assets, pay the decedent's final expenses, debts, have estate tax returns prepared (if required) and pay any estate taxes due. Then distribute the estate in accordance with the terms of the Will.

[1] A special court that deals with matters involving decedent's estates, wills and trusts.

c. Why it is important to have a Will:

i. If an individual dies without a Will, his/her property will be disposed of as determined under the laws of the state of his/her residence. State law provisions may not operate in the manner in which an individual would like to dispose of his/her property. In New York, if a person is married, has children and dies without a Will, their estate will be divided between their spouse and children (the spouse will receive $50,000 and 50% of the balance of the estate and the children will receive the other 50%).

ii. Individuals who have minor children will want to appoint a guardian for them.

iii. Individuals leaving substantial sums to their children may not want the children to receive their entire inheritance outright, but might prefer to have the children's inheritance managed in trust for at least some time.

iv. Individuals may wish to structure estate dispositions in a manner that will minimize estate taxes to the extent possible while still disposing of their property in the manner that makes sense given the individual family situation.

II. The Revocable Trust (sometimes referred to as a Lifetime Trust)

a. A Revocable Trust is a trust created during an individual's lifetime for his/her own benefit. The individual may act as the sole trustee of his/her Revocable Trust, have a co-trustee or appoint another individual or a bank or trust company to act as the sole trustee. As the name implies, the individual creating the Revocable Trust (the "Grantor") may revoke the trust at any time. The Grantor also has full access to the assets he or she transfers to the Revocable Trust and may change the terms of the Revocable Trust at any time.

It is a commonly held belief that simply creating a Revocable Trust will save estate taxes. This is not the case. Upon the Grantor's death any assets held in the Revocable Trust will be included in the Grantor's estate for estate tax purposes. The terms of the trust may take advantage of certain estate tax provisions in the same manner as the terms of a Will.

b. When a Revocable Trust may be useful:

i. If the Grantor has real property located in more than one state, transferring the real property to a Revocable Trust will allow the property to be transferred after the Grantor's death without obtaining ancillary probate of the Grantor's Will in the jurisdiction where the property is located.

ii. If the Grantor does not have close relatives (spouse, children, grandchildren, parents or siblings) or does not know the whereabouts of their close relatives, transferring all of the Grantor's assets to the Revocable Trust can avoid the need for probate and hence the delay and expense of searching for remote and lost relatives.

iii. If the Grantor intends to create trusts for children, grandchildren or other beneficiaries that will be in existence for an extended period, doing so under a Revocable Trust may be preferable to creating these trusts under a Will since, in most cases, Court involvement is not required for the appointment of successor trustees. In addition, in some jurisdictions, annual accountings are required to be filed by the trustee with the Court having jurisdiction. If a trust is created under a Revocable Trust, this requirement may be avoided.

iv. During the Grantor's lifetime, the co-trustee or successor trustee of the trust can manage the Grantor's assets and pay their expenses. Although, as discussed below, a Durable Power of Attorney can serve the same purpose. The Trustee of a Revocable Trust may be able to act more effectively and with less delay than an attorney-in-fact.

III. The Irrevocable Life Insurance Trust ("ILIT")

a. An Irrevocable Life Insurance Trust, as its name implies, is a trust which is designed to hold life insurance policies. If the creation of the trust and the purchase of the policies are structured properly, the policy proceeds will be excluded from the insured's estate for estate tax purposes from the time the policy is purchased. It is also possible to transfer an existing policy into an irrevocable insurance trust but there is a three year waiting period before the policy proceeds will be excluded from the insured's estate.

b. Why Irrevocable Life Insurance Trusts are helpful.

i. Generally, life insurance is purchased in order to provide liquidity in the event of death. Some of the reasons there may be a need for liquidity are:

1. For a younger couple, it may be that they have substantial annual income on which their family depends for its expenses but they have not yet had the chance to accumulate assets sufficient to pay those ongoing expenses in the event of the death of one or both of the income producers in the family.

2. The individual may have substantial illiquid business, real estate or tangible personal property holdings that he/she does not want his/her beneficiaries to have to liquidate in order to pay estate taxes

or that will have to be sold at a deep discount if they are liquidated within the nine month period following the owner's death in order to pay estate taxes.

ii. In each of the situations described above, if any insurance policy is owned by an Irrevocable Life Insurance Trust, the proceeds will be available to the insured's family, without being reduced by estate taxes. If the insured is the owner of the policy upon his/her death and the proceeds of the policy are included in the insured's estate for estate tax purposes, a substantial portion of the proceeds can be lost to estate taxes. By putting the policy in an insurance trust the entire proceeds can be available for the family of the insured.

IV. Durable Power of Attorney

a. While, as a technical matter, Powers of Attorney are not estate planning documents, they are generally one of the documents an individual should have and they can be useful in estate planning.

b. When an individual signs a Durable Power of Attorney, he/she gives the person appointed (the "Attorney-in-Fact") the authority to perform various financial transactions on behalf of the individual, including, but not exclusively, banking transactions, real estate transactions and paying bills. In addition, the individual can grant special gift making powers which will allow his/her Attorney-in-Fact to make gifts of his/her property if it makes sense to do so for estate planning purposes.

c. Why a Durable Power of Attorney is important:

i. If an individual become incapacitated, either temporarily or permanently, the Attorney-in-Fact will be able to manage his/her financial affairs.

ii. If an individual has not appointed an Attorney-in-Fact and becomes unable to manage his/her own affairs, it may be necessary to seek Court appointment of a Guardian of the Property. This can be a time consuming, cumbersome and expensive process. The Guardian of the Property will be entitled to compensation and is required to file annual accountings with the Court.

V. Health Care Proxy

a. In this document an individual appoints someone to make his/her health care decisions if he/she is unable to do so for himself/herself.

b. Why a Health Care Proxy is important:

i. A Health Care Agent named in the Proxy will be recognized by health care providers as having the authority to make health care decisions. In addition, if an individual chooses an agent to make health care decisions, he/she will have the opportunity to discuss his/her wishes with the agent.

ii. If a Health Care Agent is not appointed, it may be necessary to seek Court intervention regarding medical decisions.

VI. Living Will

a. In this document an individual sets out in broad terms his/her wishes in connection with end of life health care. These documents are generally broad guidance rather than detailed specific direction.

b. Often a Health Care Proxy and Living Will will be combined into one document.

c. Why a Living Will is important.

i. This document provides guidance to your Health Care Agent and provides support for the decisions made by the Health Care Agent.

Estate, Gift and Generation Skipping Transfer Taxes

I. Federal

a. Applicable Exclusion Amount and Estate and Gift Tax Rates

i. On January 1, 2013 Congress enacted the American Taxpayer Relief Act of 2012 (the “2012 Act”), making permanent an individual exemption of $5,000,000 from Federal Estate Tax (the “Applicable Exclusion Amount”). In addition, the 2012 Act sets the estate tax rate at 40%.

ii. The 2012 Act also provides that the Applicable Exclusion Amount will be indexed for inflation. As a result, for 2013, the Application Exclusion Amount is $5,250,000.

b. Exemption from Generation Skipping Transfer Tax

i. The 2012 Act also permanently increases the amount an individual can give to or for the benefit of grandchildren without incurring a Generation Skipping Transfer Tax.

ii. The Generation Skipping Transfer Tax ("GST Tax") is a tax imposed on gifts to individuals one generation removed from the person making the gift (there are complex rules as to how to make this determination when the individuals receiving the gifts are not related but this is the basic concept).

iii. As with the estate tax, Congress has provided each individual with an amount which will be exempt from GST Tax. Similarly to the applicable exclusion amount, the exemption from GST Tax has been permanently increased under the 2012 Act to $5,000,000 for each individual and the GST Tax is now 40%

iv. As with the Applicable Exclusion Amount, the GST Tax Exemption is adjusted for inflation and so in 2013 the GST Tax Exemption is $5,250,000.

c. New York State Estate Taxes

i. Exemption Amount

1. New York allows an exemption from estate tax of $1,000,000. This is substantially lower than the amount allowed under federal law.

2. The New York estate tax rates range up to 16%.

3. Although the rates are not as onerous as those under federal law the tax imposed can still be substantial and it is worth considering how the tax can be minimized when planning your estate.

VII. Taking Advantage of the Applicable Exclusion Amount

a. As discussed above, Wills and Revocable Trusts can be structured in such a way as to take advantage of the Applicable Exclusion Amount. Doing so is somewhat complicated by the fact that the States generally have different exclusion amounts than the Federal Applicable Exclusion Amount. The new Portability provisions, discussed below, do help in this regard.

b. Credit Shelter Trust under Will

i. Traditionally a married couple would make use of the Applicable Exclusion Amount of the first spouse to die by having each spouse provide in his/her Will/Revocable Trust that, if his/her spouse survived, an amount equal to the unused (any portion of the Applicable Exclusion Amount not used during life for taxable gifts) would pass to a Credit Shelter Trust. The Credit Shelter Trust can provide for the surviving spouse to be a beneficiary. It can also provide for the children to be permissible beneficiaries. Generally, upon the death of the surviving spouse, the assets of the Credit Shelter Trust would be paid out to or for the benefit of the predeceased spouse's descendants. This method allows both the Applicable Exclusion Amount and the appreciation between the first and second spouse's deaths to pass free of Federal Estate Tax.

ii. Since many of the state exclusion amounts are lower than the Federal exclusion amount, using the full Federal Exclusion Amount may cause a states estate tax to be payable upon the death of the first spouse to die. Consequently, a married couple may decide to use only a portion of the Federal Exclusion Amount on the death of the first spouse to die, perhaps to be extent of the state exclusion amount.

c. Use of Portability

i. Under the 2010 legislation, Congress enacted what is commonly called Portability and the 2013 legislation has made Portability permanent. The general concept of Portability is that the surviving spouse may elect to add any unused portion of his or her deceased spouse's Applicable Exclusion Amount to his or her unused exclusion amount. There is a caveat, however: if the surviving spouse remarries and his/her second spouse predeceases the surviving spouse, then it is the second deceased spouse's unused Applicable Exclusion Amount that the surviving spouse will be able to use.

iii. Portability is potentially useful if a married couple decides that they would like to use a Credit Shelter Trust on the death of the first spouse to die, but only for the amount exempt from both state and Federal estate tax.

d. Use of Disclaimer Wills

i. If a married couple would like to maintain flexibility with regard to how much of the Applicable Exclusion Amount is used on the death of the first spouse, they may elect to use Disclaimer Wills.

ii. In a Disclaimer Will, there is a provision that states that any amount disclaimed by the surviving spouse is given to the Credit Shelter Trust. The surviving spouse will have nine months after the death of the first spouse to die to decide how much, if any, of the Applicable Exclusion Amount will be used.

iii. If Disclaimer Wills are used, the surviving spouse may also elect portability for the unused Applicable Exclusion Amount.

e. Election to Qualify only Part of a Qualified Terminal Interest Trust for the Marital Deduction

i. A married couple may also elect that the entire estate of the first of them to die will pass to a trust for the benefit of the surviving spouse, known as a QTIP Trust. The Executor of the estate of the first spouse to die could then decide to use all or a portion of the Applicable Exclusion Amount by electing to qualify only a portion of the QTIP Trust for the full marital deduction allowed for such trusts.

ii. Upon the death of the surviving spouse, the portion of the QTIP Trust which was not qualified for the marital deduction will pass free of estate tax while the portion which was qualified will be subject to tax in the surviving spouse's estate.

iii. This method is a less efficient manner in which to use the Applicable Exclusion Amount than the Credit Shelter Trust, because in a Credit Shelter Trust, the surviving spouse can be a permissible beneficiary of the trust, but need not receive any income if he or she does not need it. In a QTIP Trust the surviving spouse must receive all of the income, thus the income, to the extent not expended, becomes part of the taxable estate of the surviving spouse.

VIII. Lifetime Gifts Exempt from Gift Tax

a. Annual Exclusion Gifts

i. In 2013 each individual may give $14,000 to as many people as they choose without incurring gift tax or using any of his/her Applicable Exclusion Amount. Over a few years this can result in a substantial estate tax savings. Annual exclusion gifts accomplish two things: (1) they remove the amount actually gifted from the donor's estate and (2) they remove all of the appreciation on the amount gifted from the donor's estate. As an example, if a donor gives a gift of $14,000 and that gift is invested at a 5% return; over a period of 20 years that gift will have grown to approximately $35,000. At current rates, that is a Federal estate tax savings of $12,250. Over a period of years and multiple gifts the savings can be substantial.

b. Payments for Educational and Medical Expenses

i. An individual may pay an unlimited amount of another's educational expenses (the payments must be made directly to the educational institution and only for tuition, not books or room and board).

ii. An individual may also pay an unlimited amount of another's medical expenses without incurring a gift tax. Again the payments must be made directly to the provider. The expenses which can be paid include payments for medical insurance.

James T. Ausili
(914) 287-6114

Judy B. Brownstein
(914) 287-6162

Timothy J. Joyce
(914) 287-6117

Mary Ellen Manley
(914) 287-6158

Sheila T. Murphy
(914) 287-6190

Michelle L. Orlowski
(914) 287-6111

Nancy J. Rudolph
(914) 287-6125