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An Overview of The Estate Planning Process

Most clients do not engage in the estate planning exercise for entertainment. Few express the thought, "*What a great day it will be, because I get to talk to my lawyers about dying*."

Estate planning is a process - a goal-oriented exercise. Its focus should be the identification of your priorities and the accomplishment of your goals and objectives. Of course, that means that we must first take the time necessary to examine what your goals may be and prioritize them so that we are certain that we are all aiming for the same target.

Many people (including professional advisers) assume that the primary motivating influence pushing clients to engage in the estate planning process has been the specter of unnecessary estate taxes levied upon the family. Historically, that fear may have been a motivating force to begin an estate planning exercise for may people, but by the time a client has identified his or her goals and objectives, and prioritized them, tax planning is rarely among the most important. The objective then becomes the accomplishment of the high-priority goals, while minimizing the tax impact to the extent possible without sacrificing those goals.

It is fair to say that tax planning should never be the dominant objective in the design of an estate plan. If the only priority which one can specify is to reduce estate taxes, then one simply hasn't thought about it enough. Otherwise, one might consider simply leaving the estate to a favorite charity, which will always be exempt from tax, and see if one is satisfied with that result.

After your objectives have been identified and prioritized, our job as your attorney becomes that of an "educator." We seek to help you understand the alternatives available to support your goals, along with the advantages, disadvantages, costs, and tax impact applicable to each. The purpose is to enable you to make a comfortable and informed decision about the direction to be taken, and to remove any surprises regarding anticipated legal fees, costs, and tax results. Then, with your approval, we become responsible for implementing your choices.

Many people further assume that tax planning is responsible for most of the complexity in estate planning. Now that Congress has increased the estate tax exemption to a level which will remove the estate tax cost as a consideration for most people ($5.25 million in 2013, $10.5 million for a married couple, and indexed for inflation in future years,) many assume that now is the time to simplify their estate plan and rid themselves of those complicated trusts, family partnerships, and other planning vehicles. However, most experienced estate planners will agree that, over the years, most clients have ultimately expressed important priorities which have nothing to do with estate tax reduction, yet involve the use of trusts or other estate planning vehicles to ensure that those goals will be effectively accomplished.

For example, where estate tax avoidance is not a consideration:

- Revocable trusts will continue to be useful

  (with or without prenuptial agreements) to keep non-marital assets separate from marital property after a marriage; or

  to provide for the management of one's financial affairs in the event of incapacity; or

  to reduce the costs of probate and administration in some states; or

  to provide some privacy with respect to the terms of the disposition of one's estate.

- Those with children who are not yet fully mature find trusts to be extremely flexible (i) in their selection of the person or persons (trustees) who should manage the property until the children are grown, (ii) in ensuring that the economic benefits are available to fulfill the support and education needs of the children, and (iii) in specifying what they expect children to achieve (college degree, demonstration of commitment to financial responsibility, etc.) before they are given control of family wealth.

- Those with beneficiaries who are otherwise not well suited to the management of wealth similarly find trusts to be uniquely valuable in providing skilled investment and management services at a very reasonable cost through a trustee while ensuring the long-term economic security of the beneficiary.

- Young couples realize that, if either of them should die prematurely, it is likely that the survivor may remarry. Trusts can provide the surviving spouse with the economic benefits of their wealth, while ensuring that the remainder must eventually pass to their children rather than to the family of the survivor's second spouse.

- Older couples often worry that, if either of them were to die, the survivor might be vulnerable to a much younger suitor with designs on diverting the benefits of the family's wealth to himself or herself. Trusts can reduce such risks.

- Couples with children from more than one marriage will find trusts valuable to ensure that all the children are treated as they intend regardless of which spouse dies first and which survives.

- Many people wish to provide some protection of the family's assets against threats which their children or grandchildren might face - threats arising from possible business reversals, financial challenges, and marital problems. Properly designed trusts are popular to provide one's spouse and descendants with all of the economic benefits of the family's wealth, and even with broad control of the property through serving as trustee, while substantially shielding the property from such threats.

- Where the family wealth includes an ownership interest in a closely-held business, the use of one or more trusts to hold those equity interests can prevent fractionalizing the voting rights, and allow flexibility in selecting the appropriate members of each generation to exercise management control, while ensuring that all of the beneficiaries are treated "equally" as to the economic benefits.

- Where the family includes a "special needs" beneficiary, a properly constructed trust can provide economic benefits in addition to those which may be available through Medicaid or other public support programs, without jeopardizing the beneficiary's eligibility to qualify for such programs.

- Families with "sacred" assets attributable to one spouse's ancestors can use trusts to provide the surviving spouse with the economic benefit of such assets, while ensuring that the ownership will not move outside the appropriate bloodline.

- In some families, there are serious relationship challenges among the family members which make it impossible for them to work together effectively in managing the family's wealth. In such cases, a trust might provide a vehicle by which effective management can be secured through selection of the trustee(s), and one can ensure that family members will share the economic benefits fairly without having to fight those battles.

- Family partnerships or LLCs will be useful

  to hold real estate in other states to avoid probate and death taxes imposed by those states; or

  to divide economic ownership and use of assets among family members without actually fractionalizing the title to the property; or

  to retain centralized management control where the economic benefits are spread among multiple people; or

  to protect assets from the claims of creditors, litigants, spouses, or others; or

  to impact the valuation of appreciated property to avoid income taxes in certain transactions.

In addition, after implementing the income tax changes in the 2012 Tax Act, planning to minimize income taxes has become a more important part of the estate planning strategy.

- Trusts allow investment income to be "sprinkled" among numerous beneficiaries, and subject to income tax in the hands of the beneficiaries who actually receive it. In most families, the surviving spouse may be in a higher bracket, so that a trust can reduce income taxes by providing support for children and grandchildren who are both in a lower tax bracket and not subject to the 3.8% Medicare surtax. If the surviving spouse owns the assets outright without a trust, all the income would be received by and taxable to the surviving spouse is his/her tax bracket. With a trust, income can be distributed to or for the children or grandchildren in their lower tax brackets.

- Property includible in a decedent's gross estate for estate tax purposes will receive a basis adjustment to its fair market value at date of death. That basis adjustment can allow the family to sell and diversify an appreciated investment without any tax on the capital gain, or, with property such as income-producing real estate, allow the family to begin a new depreciation schedule reducing income taxes on rental income. For families owning low-basis property, planning to qualify for that basis step-up upon the death of <u>either</u> spouse will be important.

- As a result of the 2012 Tax Act, a sale of low basis property will generally be subject to tax on the capital gain (federal and state plus Medicare surtax) at an effective tax rate between about 22.4% and about 27.4%. That is a sufficiently large cost to encourage taxpayers to look at charitable remainder trusts and similar vehicles to avoid the income tax burden.

- The use of certain trusts specially designed for the sale of a family business interest to the younger generation without incurring the tax on a capital gain, and without jeopardizing the income tax status of S Corporations, will continue to be a valuable planning tool.

In beginning or reviewing your estate planning exercise, consider whether any of the non-estate tax issues presented in these examples may represent objectives which are important to you. If not, and if you determine that your family is not likely to suffer a substantial estate tax burden, then you may be a client for whom we can greatly simplify things. In that case, one of our objectives as your attorney will be to implement simpler documents which meet your needs at the most economical cost possible.

Finally, estate plans necessarily address a "moving target" and should be reviewed as your family and financial circumstances change over time. Having identified your goals and priorities, they become the foundation for any such review. Any needed changes can be quickly identified in terms of accomplishing those objectives. As a part of our relationship, we hope that our clients will want to rely on us for those reviews and will call whenever questions or challenges arise.