ESTATE PLANNING 101

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I. THE BASIC ESTATE PLAN

A. ***Last Will and Testament***.

1. Disposition of Assets.

An individual determines who will receive his probate assets upon his death in his Will. The terms of a Will do not control the disposition of non-probate assets. Non-probate assets are assets which, by law or contract, pass to a designated beneficiary. Non-probate assets include life insurance, property owned as joint tenants with right of survivorship, retirement plans, payable-on-death accounts, and transfer-on-death property.

2. Executors and Administration.

A Will allows the person making the Will, called the testator, to choose an individual or an institution such as a bank, called the Executor, to handle the administration of the testator's estate. The Executor usually has broad powers by the terms of the Will which permit the efficient administration of the estate. Without a Will, the probate court will determine who (an Administrator) will administer a decedent's estate. The Executor's duties in the probate of an estate include notifying the heirs and creditors of an individual's death, collecting and valuing the decedent's assets, filing an inventory of the assets with the probate court, safeguarding and managing the assets, selling and/or investing the assets, determining and paying the decedent's debts, determining and paying the decedent's taxes, filing the estate tax returns when due, distributing the assets according to the terms of the Will, and accounting to the probate court and the beneficiaries under the Will. An Executor normally retains the services of an attorney to complete the probate process. The Executor is entitled to compensation for the Executor's services, which ranges from 1% to 4% of the value of the probate assets, and 1% of the value of non-probate assets. In addition, the attorney hired by the Executor will charge legal fees which can be relatively modest for simple estates, or many thousands of dollars for more complex estates.

3. Guardians.

A Will allows a testator to choose a guardian for his or her minor children. The age of majority in Ohio is 18. Without a Will, the probate court will determine who will serve as guardian.

B. Durable General Power of Attorney.

A Durable General Power of Attorney allows an individual, called the principal to name another person, called the attorney-in-fact, to make financial and business decisions for the principal. A Durable General Power of Attorney can help avoid the costly and time-consuming process of pursuing a court guardianship or conservatorship if an individual becomes mentally

incapacitated. In addition, a Power of Attorney can be a convenient tool if an individual is unavailable to take care of a particular matter for any reason.

C. Living Will Declaration.

A Living Will Declaration is a document by which an individual makes a declaration that he or she does not want death artificially prolonged, and authorizes his or her attending physician to continue, withhold, or withdraw life-sustaining treatment, when he or she is in a terminal condition or permanently unconscious state. It also usually directs the declarant's physician to issue a do not resuscitate (DNR) order. A Living Will Declaration includes an option for the declarant to be an organ and tissue donor.

D. Durable Power of Attorney for Health Care.

A Durable Power of Attorney for Health Care is a document by which an individual designates an agent to make health care decisions for him or her if he or she is unable to make such decisions for himself or herself.

II. THE REVOCABLE LIVING TRUST

A. What is a Trust?

A Trust is a fiduciary and legal relationship in which an individual who establishes the Trust, called alternatively the Grantor, Settlor or Trustor (for our purposes, we'll use the term, Grantor), transfers legal title of the Grantor's assets to a Trustee, who holds and manages the trust property for the benefit of one or more beneficiaries in accordance with the provisions of the Trust document and the provisions of state law. During the Grantor's lifetime, he may be the Trustee and/or the beneficiary of the Trust. A Trust can either be funded during the lifetime of the Grantor, or unfunded until the Grantor's death, at which time assets "pour over" into the Trust pursuant to the terms of the Grantor's Will or by beneficiary designation.

B. *When Do You Need a Revocable Living Trust?*

1. Management of Assets for Young Descendants.

A Trust may be used to prevent children from inheriting assets before the children are mature enough to wisely manage the assets. With simple Wills, the children would receive assets at age 18, and prior to the children reaching age 18, periodic reports to the probate court would be required of the guardians. The Trust allows a Trustee to use the trust assets for the benefit of the children as they grow up, but delays the outright distribution of the assets until a later age to be determined by the Grantor (parent). This type of Trust can be beneficial to young families with significant assets.

2. Protection from In-laws and Other Potential Creditors.

A Trust may be used to protect assets for children. A Trust will ensure that assets stay in the family, instead of passing to a son or daughter-in-law upon the death or divorce of a child. In addition, assets left in Trust for children will generally be protected from the children's creditors because of special spendthrift provisions included in the Trust.

3. Probate Avoidance.

A fully funded Trust avoids the delays and costs inherent in the probate process. While generally beneficial to all individuals, they are most helpful to elderly individuals with significant assets. There are other ways to avoid probate as well. Life insurance, assets with designated beneficiaries, and assets held as joint tenants with right of survivorship all avoid probate. In addition, property interests titled payable-on-death (POD) or transfer-on-death (TOD) also pass outside of probate.

4. Avoid Guardianship/Conservatorship.

A Trust can provide for the management of assets while the Grantor is living but is incapacitated. Without the Trust or a Durable General Power of Attorney, a family member or friend would have to apply to the probate court to be appointed guardian or conservator, and that person would be required to make periodic reports to the probate court and obtain approval of the probate court with respect to any actions relating to the guardianship or conservatorship.

5. Multiple Probate Proceedings.

If an individual owns out-of-state property, ancillary probate will be required in the state where the property is located. Placing such property in a Trust will avoid this significant and additional cost and delay.

6. Second Marriage Problem.

A Trust allows a Grantor to leave assets in the Trust for the second spouse's benefit during the second spouse's lifetime but also require distributions to the Grantor's children upon the second spouse's death. With a simple Will, the second spouse has the right to amend the Will after the decedent's death, potentially cutting out the decedent's children.

7. Special Situations.

Trusts can be used to provide for children with special needs or disabilities who may be unable or incapable of managing their own assets. In addition, such trusts may be drafted in a manner which will allow the special needs beneficiary to continue to be eligible for any government benefits to which he or she may be entitled.

8. Protection from Creditors Post-Death.

Asset held in a trust will not generally be subject to the creditors of the Grantor after the death of the Grantor.

C. Common Misconceptions About Revocable Living Trusts.

1. They Save Estate Taxes.

Any assets owned by a Revocable Living Trust will be included in the Grantor's taxable estate. However, such Trusts can include special provisions to minimize or reduce estate taxes for a married couple (see III.A., below).

2. They Save Income Taxes.

Income-producing assets in a Revocable Living Trust are subject to income taxes as if the Grantor owned the assets individually.

3. They Protect Assets From the Grantor's Creditors.

A Revocable Trust does not prevent creditors from reaching assets to satisfy claims against the Grantor during his lifetime.

III. TAX SAVINGS TRUSTS.

A. ***A-B Trust Planning (aka Credit Shelter Trusts, By-Pass Trusts, Family/Marital Trusts, etc.).***

When Do You Need an A-B Trust?

In 2011 and 2012, the federal estate tax exemption is $5,000,000. Accordingly, a married couple with assets in excess of $5,000,000 should consider an A-B trust, which would, in effect, double the exemption to $10 million. In addition, the exemption is scheduled to be $1.0 million in 2013 and thereafter, unless Congress extends the larger $5.0 million exemption. There is no significant disadvantage to employing an A-B trust with the possible exception of legal fees incurred to prepare the trust document. Perhaps, the most significant advantage of employing an A-B trust arrangement is that an individual will avoid as much as $1,750,000 of federal estate taxes. Although the concept of "portability" now allows a surviving spouse to take advantage of his or her predeceased spouse's unused federal estate tax exemption, A-B trust planning in advance of the death of the first spouse may still provide significant estate tax savings to the family because the growth on the exemption amount will also escape federal estate taxation upon the death of the surviving spouse. See attached diagram for planning with an A-B trust.

B. Irrevocable Insurance Trust.

When should you consider an Insurance Trust?

A married couple with assets in excess of $10,000,000 with life insurance as a substantial asset of the estate should consider an irrevocable insurance trust as an add-on to A-B trust planning. In addition, unmarried individuals with assets in excess of $5,000,000 with life insurance as a substantial asset of the estate should consider an irrevocable insurance trust. The utilization of an irrevocable insurance trust in the estate plan allows an individual to avoid estate tax in the amount of approximately 35% of the face amount of the life insurance policy. See attached diagram for planning with an irrevocable insurance trust.

C. Gifting Programs, Irrevocable Gift Trusts, Charitable Remainder Trusts, GRITs, GRATs, GRUTs, QPRTs and FLPs.

Married couples with non-insurance assets in excess of $10,000,000 and unmarried individuals with non-insurance assets in excess of $5,000,000 may wish to consider these other more sophisticated estate tax minimization opportunities which, in the appropriate circumstances, may achieve additional federal estate tax savings beyond the A-B trust and the irrevocable insurance trust.

IV. BASICS OF GIFTING

A. ***Annual Exclusions Gifts***

The federal gift tax (there is no Ohio tax on gifts) rules allow a donor to make gifts with a value of up to $13,000 each year to an unlimited number of other persons, whether relatives or not, without impacting the lifetime gift tax exemption or the estate tax exemption, and there is no requirement that such gifts be reported in any manner. If a husband or wife makes a gift, one-half of the gift may be treated as coming from the non-donor spouse. This is referred to as "gift-splitting." If a donor makes a gift to another person during the year having a value in excess of $13,000, a gift tax return on Form 709 should be filed by April 15 of the year following the gift, even if a spouse consents to gift-splitting, which is evidenced by electing such treatment on the gift tax return.

B. ***Lifetime Exemption***

In addition to annual exclusion gifts, the federal gift tax law allows a **lifetime exemption** for each donor of $5,000,000. A non-donor spouse may agree to gift-splitting and use his or her lifetime exemption in such manner.

C. *Educational and Medical Expenses*

The federal tax laws also provide that any payments made on behalf of an individual as tuition directly to an educational organization for the education or training of that individual or directly to any person who provides medical care to that individual shall **not** be treated as gifts, regardless of the amount. Therefore, parents, grandparents, and others may pay directly any tuition expenses for any level of education, such as prep school, college, and graduate studies, which will not be counted as gifts, in addition to making annual exclusion gifts to the same beneficiaries.

D. *Section 529 Plans*

A 529 Plan is an education savings plan operated by a state or educational institution designed to help families set aside funds for future college costs. A contribution to a 529 Plan qualifies as a "present interest" and therefore is eligible for the gift tax annual exclusion of $13,000. In addition, the law allows the donor to "frontload" the gift tax annual exclusions by using the exclusions for up to four years succeeding the actual year of the gift. For example, a donor may make a contribution of $65,000 this year to a 529 Plan for a child and use this year's and the next four years' annual exclusions to shelter the transfer from gift taxation. A grandparent who is currently paying tuition costs can also fund a 529 Plan for a grandchild. In the event that the grandparent dies before the grandchild completes his or her education, the 529 Plan will be a source of funds to assist the student pay for his or her education.