BASIC ESTATE PLANNING CONCEPTS

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I. INTRODUCTION

Prior to being expected to practice in the field, a good Estate Planning Attorney must have mastery of (1) general estate planning concepts, (2) gift and estate tax laws, and (3) the ability and knowledge to draft legal documents which comport to the client's lawful desires. In addition, the attorney should have some level of competency in Surrogate's Court practice, income taxation, elder and disability law, government entitlement programs (Medicaid / Social Security), retirement plans, guardianships, real estate law and corporate law. Estate Planning is not merely a one-time transaction such as drafting a Will or Power of Attorney, but a process may have a lasting impoast for several years and require both continued contact and future modifications.

Estate Planning is not an area of law that an attorney can be expected to start practicing overnight or learn without the assistance or mentoring of another seasoned attorney: The field is rife with potential liabilities, peculiar nuances, and ever-changing laws. Therefore, practicing estate planning law at a high level does not lend itself well to general practitioners who must keep current in multiple fields of practice. However, most attorneys should have at least some level of understanding of estate planning in order to identify problems regarding a client's health, family and wealth issues.

The attorney will be working on extremely important matters, such as a client's health, potential incapacity and disability (Powers of Attorney, Health Care Proxies), death and disposition of bodily remains (Living Wills, Disposition of Remains), distribution of wealth (Gifting, Wills, Trusts, Life Insurance and Retirement Plan beneficiaries),and guardianship of children (Wills, Advanced Guardianship Directives). He or she must provide guidance on minimizing taxes, choosing domicile, transferring property to other family members, preparing for aging, and creating a legacy. The attorney may work with clients with disabled children, second marriages where there are children from a first marriage, single parents, clients with no trusted family members, clients with paramours, and unmarried or homosexual couples. As is the case in most areas of the law, every estate planning client is different, and it is rare to find an "easy client."

Codes and Statutes that every Estate Planning attorney should have available to them (and which are referenced herein) include:

- The Internal Revenue Code ["IRC"]
- NY Estates, Powers and Trusts Law ["EPTL"]
- NY Surrogate's Court Procedures Act ["SCPA"]
- NY Mental Hygiene Law, Article 81

The materials that follow are a general guideline of some estate planning concepts, particularly as they apply to both federal law and the laws of New York. It is far from comprehensive, and is and is best suited to a general practitioner or as a starting point for attorneys considering entering this exciting and complex field of law.

II. LIVING DOCUMENTS

Despite the emphasis placed on lifetime ("**Inter Vivos**") transfers and making preparations for estate distribution after life, the estate planning process begins with preparing for issues that may arise *during life.* It is impossible for a client to know whether he or she will require third party assistance or intervention with his or her daily financial or health care requirements. A comprehensive estate plan begins with the following documents; if these documents do not exist a family member (or the state) will have to commence a **Guardianship Proceeding** on behalf of the affected individual, which can be expensive, time-consuming and intrusive on the individual's privacy.

A. Power of Attorney

A **Power of Attorney** is a form that allows the client, as the **Principal,** to name an **Agent** of his or her choosing to act as the principal's fiduciary and assist with financial affairs. Despite the misleading title, an agent does not need to be a licensed attorney, and a client's legal counsel should typically avoid having themselves named as their client's agent for anything more than a few limited transactions. A Power of Attorney can be extremely helpful during times the client is not available to deal with his own finances, either based on the client's diminished mental capacity (due to dementia or unconsciousness), lack of availability (being outside of the country), or based on the client's lack of interest in maintaining his own financial affairs. Though the Power of Attorney was originally intended merely to assist incapacitated individuals and allow trustworthy individuals to assist in financial transactions on behalf of the principal, its use has since expanded to include large-scale pre-mortem gifting and transfers. The power to make such drastic and all-encompassing financial decisions, such as transferring all of a principal's assets to another individual, should be emphasized to the client at the initiation client consultation and prior to the execution of the document.

The document can be ***Durable***, meaning the agent has control immediately (most appropriate in the case of a trusted spouse), ***Limited,*** meaning effective for a limited amount of time (appropriate for a single transaction or for a limited time when the Principal will be out of the country), or ***Springing,*** meaning it is effective only after some stated event such as becoming disabled (most appropriate when the principal is currently capable to administer to his finances and does not have complete trust in any potential agent). A Power of Attorney can be revoked by the principal at any time, provided he is mentally competent to do so. Because an agent may have the ability to abscond with the principal's property, legal counsel should facilitate an in-depth discussion with the client to adequately determine a list of appropriate agents who are both trustworthy and somewhat adept with financial transactions. It is also crucial to name successor agents, preferably a person who is younger

In September, 2009 New York state implemented legislation that created a new statutory Power of Attorney form. Though a full discussion of this new form is beyond the scope of these materials, based on the immense powers conferred upon an agent it is imperative that legal counsel be familiar with the scope of this document.[1]

[1] New York General Obligations Law §5-1501A

B. Health Care Proxy

A ***Health Care Proxy*** is a document that allows a named agent to make health care decisions on behalf of the principal when she is unable to do so herself. An example is where a person is in the midst of surgery requiring general anesthesia and the attending surgeon would like to do unanticipated additional surgical work, or when a person is no longer mentally fit to choose how to take care of herself. Health care proxies only apply when a person is unable to make his or her own healthcare decisions, and is revocable at any time. If a person will be having surgery a hospital will require the principal to sign that hospital's standard health care proxy; however, once the hospital stay is completed the proxy typically ceases to be effective.

C. Living Will

A ***Living Will*** provides instructions to a health care agent as to whether or not a principal in a "brain dead" state would like to continue artificial hydration, feeding or respiratory mechanisms. Additionally, it will provide instructions as to whether the principal wants "maximum pain and relief" in the form of pain relief medication even if the necessary dosage may inadvertently cease cardio-pulmonary functions. Living Wills effectively "pull the plug," but only if the attending physician believes the principal will not recover cognitive brain functions. Additionally, because medical institutions are loath to face potential liability for not saving lives, a person is almost guaranteed to remain on feeding and hydration machines if they do not have a valid Living Will in place.

D. Advanced Guardianship Directive

An ***Advanced Guardianship Directive*** is a document that names a guardian for minor children when their parents remain alive but are unable to continue caring for those children. While naming a preferred guardian for a minor or disabled child in a Will is essential, such a designation is not typically effective unless the parent is deceased (because the Will shall not be admitted to Probate until after the parent's death). An Advanced Guardianship Directive is an essential component of a comprehensive estate plan for any client with minor children. A person can name both a **Guardian of Custodianship** and **Guardian of Finances**. It should be noted that these are mere preferences: The state is always primarily concerned with what is in the "best interests of the child," thus some Directives may only encompass a desire as opposed to anything that can be legally enforced. Additionally, one parent cannot divest the minor's other parent of custodial rights (only the courts can accomplish this). However, particularly where parents are divorced and one spouse becomes unable to take care of his or her child, it may be possible to name an individual other than the remaining parent as guardian of finances.

E. Disposition of Remains

A **Disposition of Remains** is a document that states a person's instructions for administering to his or her remains.[2] Many people have added this preference to their Wills, but since a Will is not

[2] New York Public Health Law § 4201

admitted to Probate until several weeks after death (at a minimum) these instructions are ineffective for practical purposes. Without a DORA a loved one, already bereaved and facing a multitude of important post-mortem decisions that must be made in rapid succession, may feel pressured to handle the decedent's remains as they see fit. Instructions in a DORA include information on purchased burial plots, and can be anywhere from very simple (*"I desire to have a traditional Catholic funeral and burial"*) to highly detailed (*"I would like my remains to be cremated at the Ecologically Friendly Crematorium, located in Rockland, New York, and have my ashes scattered into the East River on a warm spring day in front of a marching band playing "The Sound of Music"*).

F. Effects of Not Executing "Living Documents": Guardianship Proceedings

Some people, particularly those who do not have close friends or relatives, or people who choose to avoid addressing the very serious issues mentioned above are particularly vulnerable when they have a problem that a Living Document would address. Though a detailed discussion of **Guardianship Proceedings** is beyond the scope of these materials, it should suffice to state that they are some of the least pleasant legal affairs to behold, and can be completely avoided by executing the proper Living Documents.

Guardianship Proceedings are legal proceedings that take place in the county Surrogate's Court, and are conducted to name a guardian to administer to financial and health care decisions for people who cannot do so for themselves: Minor children in need of a guardian of custodianship or finances typically must go before the court.[3] Seriously disabled adults whom a physician declares incapable of handling his or her health or financial affairs are also the focus of these proceedings.[4] In the case of disabled adults the Court will tailor a specific guardianship applicable to the diminished skills of that adult. A former physician suffering from dementia who may still be able to make his own rational health care decisions may only have a guardian appointed for his financial affairs. The opposite may be true of a former accountant or financial planner.

Guardianship Proceedings can be gut-wrenching events to watch. Frequently the disabled individual has to appear in front of the presiding judge at the courthouse. Then, not only does the proposed guardian have to take care of the disabled adult (which is difficult enough), but also has to plead her case to a judge, file papers, and pay legal fees. In the interim the adult's funds cannot be used for these costs, his or her health care decisions are somewhat undetermined, and the Court may or may not choose the guardian whom the adult would have wanted.

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[3] Surrogate's Court Procedures Act ["SCPA"] Article 17, which addresses guardianships of minor children, and 17A, which deals with mentally handicapped children, such as those with severe autism

[4] Mental Hygiene Law Article 81, which deals with adults in need of care, such as an elderly person with dementia

III. **TRANSFERS DURING LIFE: GIFTING**

Any transfer of property during life is known as **Gifting.** A completed gift requires (1) donative intent, (2) delivery, and (3) acceptance of the gift (which is typically assumed). A gift must be a *completed transfer*, meaning the property is transferred to the donee without any strings attached, and the done has no legal right to demand the property be returned once dominion and control has been transferred. For estate planning and taxation purposes, conditional gifts (gifts contingent on a future event transpiring) are incomplete gifts, and therefore not valid transfers.

Since any gift diminishes the donor's assets, taking advantage of gifting can greatly reduce future estate tax issues (discussed later in these materials). Additionally, gifting family heirlooms, jewelry, artwork or other specific pieces of property during the donor's life avoids future disputes over these items when the donor is deceased. The largest hurdle most clients face is accepting that gifted property is no longer within their control; it is important for counsel to be cognizant that while gifting may make financial sense, the loss of this control is often unacceptable to clients, especially elderly clients who may already perceive themselves losing control of many aspects of their lives. A legal practitioner must remember that a client's goals and desires supersede counsel's determination of what is in the best interest of the client.

There are several types of gifts that can be made to other individuals. **Outright Transfers** are the most common, and may include gifts of cash, personal property or real estate. Transfers may also be made to **IRC 529 Education Savings Plans ["529 Plans']** and **Uniform Trusts for Minors Act ["UTMAs"]** accounts; several specific rules apply for transfers to both 529 Plans and UTMA accounts, thus it is important for a practitioner to be familiar with these rules prior to recommending transfers to these plans. Transfers may also be made to trusts. Lastly, a person may pay an unlimited amount for another US citizen's health and education expenses without any adverse gift tax consequences for the donor or the donee, though keep in mind that the donor must make these payments directly to the medical or educational institutions.[5]

A. 529 Education Savings Plans

IRC §529 permits a person to invest funds for another person's higher education. **529 Plans** are a combination of federally-permitted transfers for gift tax purposes which also fulfill a state law component: From a federal perspective, contributing to a 529 Plan allows the funds to grow tax-deferred and be withdrawn tax free if they are spent on **Qualified Education Expenses**,"[6] such as tuition, books, food plans, and student transportation and housing (with some limitations). Any gains not spent on qualified education expenses are assessed a 10% penalty upon withdrawal. From a state perspective investing in a New York state-sponsored plan permits the plan's **Donors** to deduct contribution amounts for state income tax purposes (not federal income tax purposes). Funds held in a 529 Plan do not affect a Beneficiary's ability to qualify for student loans. Contributions to 529 Plans must be invested in one of several pre-arranged investment options - though several investment options are available, these options are not unlimited.

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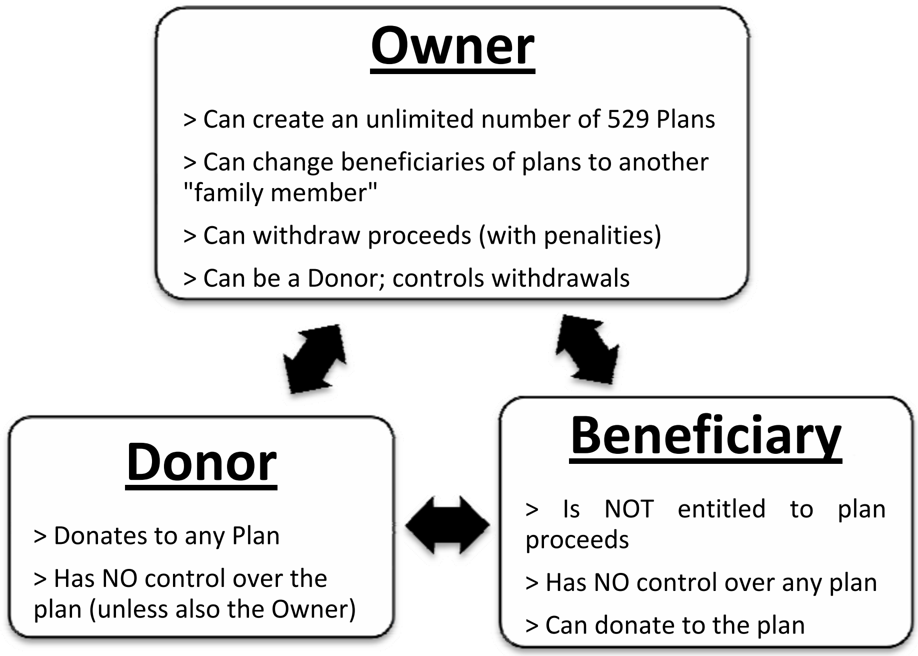
[5] Payments to student loan providers are not considered qualified education expenses, and therefore are considered gifts to the donee; the donor may make an annual exclusion gift of the first $13,000 that year, and all additional transferred funds are deducted from the donor's lifetime exemption.

[6] In addition, an state income tax credit may be permitted for contributions to the sponsoring state's plan.

529 Plans have a unique exception to the standard gifting rules: Transfers are considered completed gifts for gift tax purposes, but a plan **Owner** may change the **Beneficiary** of the plan to another family member or revoke the gift and bring plan assets back into his possession no matter who donated the funds (with a 10% penalty assessed on gains). Though tax benefits of 529 Plans make them attractive, there are caveats that should be understood prior to making substantial investments in 529 Plans.



529 Plan Features	
Positive	**Negative**
• Tax deferred growth on investments in Plans • Tax free distributions for "qualified" expenses • New York state income tax deduction for contributions to "New York Plans" • Owners can change the plan Beneficiaries to a wide range of family members • Contributions to the plan qualify as annual exclusion transfers • Can be "Front-loaded" with 5 years of annual exclusion gifts • Definition of "qualified education expenses" is very broad • Plan assets do not affect student loan eligibility	• 10% penalty on withdrawals of gains not spent on qualified education expenses • Donor's have no control over distributions or changes of beneficiaries • Owner (even Successors) have the power to withdraw funds & rename beneficiaries (even to themselves) • Frontloading "Proration Recapture Rules" • Some limitations on investment options • Lifetime limit of $235,000 on contributions (not account value) to any one Beneficiary • Upon death, a Plan may unintentionally be transferred by Will instead of to the named / desired beneficiary

Contribution maximums are based on annual exclusion gifts. A Donor can "*front load*" a Beneficiary's 529 Plan with five (5) years worth of annual exclusion gifts. This means a Donor (not just the plan's Owner) in 2009 can fund a 529 Plan with up to $65,000 ($13,000 exclusion X 5 years) the first year; a couple can fund up to $130,000 the first year of the Plan.

A major pitfall with front-loading are the **Prorated Recapture Rules** that apply if a Donor dies in the middle of a front-loading period. Recapture rules are based on percentages of the contribution, known as "proration rules," not on an annual exclusion basis. People with a short life expectancies and taxable estates should probably avoid front-loading 529 Plans, as doing so may add to estate administration expenses, and alternatively holding additional assets in a Trust with instructions to fund education expenses.

Example: In 2009 Mickey, a widower, front-loads a 529 Plan for his granddaughter, Cindy, with $40,000. Mickey passes away in 2010. Because Mickey was alive for two years of the transfer period, one would think that, at worst, $26,000 would pass to the beneficiary's Plan estate tax free (due to two years-worth of annual exclusion gifts). However, the amount that passes is based on a 5-year prorated amount: Only $16,000 ($40,000 / 5 years x 2 year proration) passes without estate tax consequences - $24,000 is recaptures in Mickey's estate for estate tax purposes. This result would have been avoided if Mickey had transferred $13,000 per year during his life to the plan, but since he surpassed the annual exclusion amount prorated recapture rules apply.

The other major disadvantage is that front-loading a 529 Plan utilizes a donor's annual exclusion to the donee for the requisite time period. Therefore, a grandparent who front-loads a grandchild's 529 Plan cannot make additional annual exclusion gifts to the grandchild until the period expires unless the donor chooses to draw from his or her gift tax exemption reserve.

Example: In 2009 Stacy decides to frontload her granddaughter Elsie's 529 Plan with $50,000. Because the annual exclusion is currently $13,000, Stacy cannot gift any more funds to Elsie in 2009, 2010 or 2011, and in 2012 she can only gift $2,000. Any additional funds gifted to Elsie during this period will decrease Stacy's lifetime exemption for gift and estate tax purposes.

A single Beneficiary can have multiple 529 Plans set up by different Owners. However, once total contributions to that Beneficiary's 529 Plans have reached $235,000 no further contributions may be made to any of that Beneficiary's 529 Plans regardless of investment performance.

Lastly, if no **Successor Owner** is named at the time of the Owner's death the 529 Plan will have to go through Probate (or Administration), in which case it will pass to the Beneficiary of the Owner's estate. This is particularly undesirable if a grandparent wants to fund a grandchild's education expenses, but his or her children are the Beneficiaries of the Will. To avoid this problem a Successor Owner should be named both in the 529 Plan and some provision should be made in a Will to allow the Executor to name a Successor Owner to all 529 Plans owned by the Decedent if none are currently named. Take care when choosing a Successor Owner: the Successor can hypothetically change the Beneficiary of the 529 Plan to themself and use the funds for his or her own purposes.

B. Medical and Education Expenses

A person may pay for any and every US citizen's medical and education expenses without any gift tax consequences.[7] There is no annual or lifetime limitation on these payments. For example, a grandparent may pay for all of the medical and higher education expenses for her children, grandchildren, friends, and three people she met this afternoon while playing Cribbage. However, these transfers are only affective if the Donor pays the funds directly to the institution.

[7] [7] IRC §§170(b)(1)(A)(ii); also see IRC §2053(e)(2)(A)

Also, paying student loans, even if directly to the lending company, does not transfer tax-free, since the payment is being made to a lending institution and not to an educational institution.

Example: Cynthia wants to pay for her two grandchildren's health and education costs which totaled $100,000 this year ($50,000 each). However, instead of making checks directly payable to Valhalla Medical Associates and Iona College, Cynthia sends the checks directly to her grandchildren in their names. The grandchildren pay Valhalla Medical Associates and Iona College the full amounts they owe. Because Cynthia did not make the checks out to the medical and education institution she has made gifts to the grandchildren. Cynthia's lifetime exclusion for federal gift and estate tax purposes will be decreased by $74,000 (the $13,000 annual exclusion will be credited for both grandchildren).

Instead of using a 529 Plan, some people prefer to pay for higher education expenses by establishing a Trust which explicitly states that funds are to be used for the beneficiaries' health, education, maintenance or support, especially if the beneficiary may become the trustee of his or her own trust (see below). This avoids the complex "proration" recapture rules of 529 Plans, and if the Trust is irrevocable the funds are no longer in the Donor's gross estate.

C. Uniform Transfers to Minor's Act ["UTMA"]

A parent or guardian has a support obligation owed to a minor. During this time a minor has restrictions on the type of property he or she can own. The Surrogate's Court may not withhold a minor's right to own a doll or a few baseball cards, but will not allow the minor to have access to the proceeds of a $500,000 life insurance policy, and will hold a Guardianship Proceeding to determine how to best administer these funds.

UTMAs allow a fiduciary, such as an Executor or Trustee, to transfer property to a **Custodian** for the benefit of a minor where there is no Will or when a valid Will leaves funds to a minor. Any type of property can be owned by an UTMA, and the Custodian can use UTMA funds for the benefit of the minor despite the Custodian's own support obligation to the Beneficiary.

Example: Grandmother passes away. Her Will leaves Mother with $100,000 and Son, her 12 year old grandson, with $100,000. By law Son cannot have access to these funds, but an UTMA was created 2 years ago by Grandmother for Son's benefit naming Mother as Custodian. Mother can use UTMA funds to pay for Son's food and clothing even though she has a legal obligation to pay for these expenses out of her own assets.

UTMAs can only have one custodian at one time (no "co-custodians"), and can only have one beneficiary at one time. The other important limitation with an UTMA is that the funds in the UTMA are added to the gross estate of the custodian if the custodian dies before the minor reaches age 21 (though the funds are still kept in the UTMA for the Beneficiary). Despite these shortcomings, creating UTMAs simplifies estate distributions and the distribution of life insurance proceeds that inadvertently end up in the hands of minors. Naming distributions to a minor's UTMA allows the custodian to receive the funds, thereby avoiding a Guardianship Proceeding in the Surrogate's Court. Whereas a trust may be a preferable option, if no Trust exists at the time of the donor's death an UTMA should be utilized.

IV. POST-MORTEM TRANSFERS

Gifting takes place during life. Transfers after life are known as **Devises** (of real property) or **Bequests** (of anything other than real property). Though the legal distinction of these terms may mean little to a client, it is important that an attorney use such terms appropriately when drafting legal documents, particularly trusts.

There are three types of post-mortem transfer techniques: **Operation of Law Transfers**, **Testamentary Transfers** and **Statutory Transfers**. All three have different distribution requirements timeframes upon which distribution actually occurs. As a general rule, when expediency is the primary objective, Operation of Law Transfers are favored. Where Surrogate's Court oversight is required (such as Testamentary Transfers) or demanded (Statutory Transfers) the timeframe of actual distribution may increase drastically.

Certain transfers, such as by operation of law, do not require direct court oversight, while others, such as Testamentary transfers (I.e. property transferred by the Probate of Wills) require direct oversight. However, where there is a dispute over any property of a decedent, no matter what type of transfer is involved, the Surrogate's Court has original jurisdiction over the matter. This includes claims of wrongful death and creditor disputes, as well as disputes among family members.

A. Operation of Law

All property that passes via operation of law takes place outside of a Will. The primary documents to enable the transfer are (1) an original **Death Certificate**, and (2) the **Beneficiary Designation Form**. Though some estate planning practitioners prefer to merely advise clients on how to name their beneficiaries on these forms, it is a better practice for the practitioner to both prepare life insurance and retirement plan beneficiary designation forms for the client, then follow up with the respective institutions a few months later to ensure the proper beneficiaries are actually recorded.

For many married clients assets being transferred by operation of law may represent the bulk of the couple's estate: A couple with a jointly owned house and bank account serving as the main source of paying expenses, some assets in retirement accounts and a modest life insurance policy may have only a fraction of his or her estate pass under their Will. Due to this reality, an attorney who merely prepares a Will for his clients should be very clear that he is not preparing a comprehensive estate plan.

1. Joint Property

Unlike Tenants in Common Property[8] (which passes as a Testamentary transfer unless owned by a Trust), joint property does pass by operation of law. Joint property may include real property, investment accounts, and the like. All that is required to claim the property is a death certificate

[8] EPTL §6-2.2

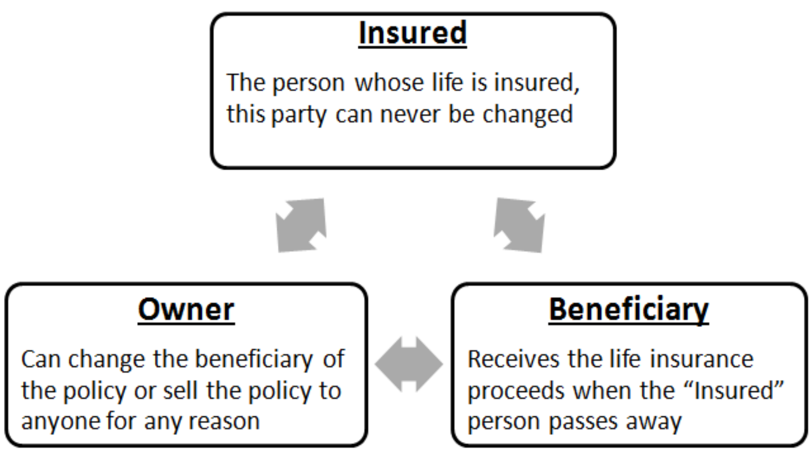
and that the other named party to the property outlives the decedent.[9] Ownership of joint property vests in the survivor even if title is not formally changed to the survivor as sole owner, such as when a spouse who own real estate as Tenants by the Entirety[10] with another spouse who predeceases but does not change the Deed to reflect her new individual ownership.

Due to the ease of the transfer and access to joint property, it has a valuable place in estate planning. However, when taking estate tax considerations into account, a practitioner should attempt to minimize the amount of joint property owned between spouses and / or parents and children in favor of holding more funds in a Credit Shelter Trust.

2. Retirement Plans

Retirement plans, such as IRC §401(k)s and §403(b)s Plans or Individual Retirement Accounts ["IRAs"] also pass by operation of law. As will be discussed later, it almost always makes sense to name a spouse as primary beneficiary for a retirement plan due to favorable Required Minimum Distribution[11] ["RMD"] rates. Otherwise, consideration should be made to determine whether to fund the participant's Credit Shelter Trust with the principal from the plans. When neither of these scenarios apply it may make sense to have the beneficiary of the plan be a See-Through Trust for the benefit of the plan participant's children in order to provide creditor protection associated with Trusts while simultaneously ensuring favorable RMD rates.

3. Life Insurance



There are three parties to any life insurance policy. The **Insured** is the measuring life that determines when the policy pays out (upon his or her death). The **Owner** is the party who may assign or trade the policy and may choose the beneficiary. The **Beneficiary** receives the proceeds of the policy upon the death of the Insured.

Naming the correct beneficiary on a life insurance policy is very important, particularly after a divorce or where minor children are involved. Unlike transfers to ex-spouses by a Will (which are invalidated by divorce), life insurance passes to the named individual in the beneficiary

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[9] However, in the case of bank and investment accounts, see New York Banking Law §675, which allows a party to rebut the transfer to the survivor if the account merely state "Joint Tenant," in which case the account is considered an "account of convenience," in which case the property becomes a Testamentary asset. In order to ensure the property passes to the joint owner the term "Joint Tenant with Right of Survivorship" should be used.

[10] EPTL §6-2.2(b); "Tenants by the Entirety only applies to Real Property owned by spouses, and allows a spouse's homestead to be sheltered from his or her spouse co-owner's financial depravities.

[11] IRC §72(t)

designation form (because it is transferred by operation of law); the divorced spouse would have a rebuttable right to these life insurance proceeds of his or her former spouse. On the other hand, a minor is not permitted to receive life insurance proceeds (or any other substantial financial assets for that matter), so parents considering naming their children as life insurance beneficiaries should instead name a trust created for the benefit of the children.

4. Trusts

Transfers in trust pass by operation of law. The caveat is that the mere existence of a trust is not sufficient to transfer assets – an unfunded trust is akin to a bank account with no money in it. Merely naming the property to be owned by the trust in the trust document is also insufficient.[12] A trust must be funded in order to transfer any assets. The owner of the property must be the trust, such as a bank account being owned by ***"The Doris Day Revocable Trust,"*** or the Deed to a house naming ***"John Rockefeller, Trustee of the John Rockefeller Revocable Trust."***

B. Testamentary Transfers ("Wills")

Testamentary Transfers are any transfers that are not determined through peration of law or by statute, and take place under the terms of a valid **Last Will and Testament**. The **Testator's** property that is passed by a Will is administered by the estate's fiduciary, known as the **Executor.**[13] This property is known as the **Testamentary Estate,** and the process by which it is distributed is called **Probate.** Probate is specifically overseen by the Surrogate's Court.

The size of a Testator's testamentary estate may be very large or may be nonexistent. Some people, such as an unmarried individual, may not have any jointly owned property. Conversely, a married couple may own their house jointly, have the bulk of their financial assets in retirement accounts, and own some life insurance policies (all operation of law transfers); in addition, the surviving spouse may claim the next $50,000 of the testator's estate under his or her Right of Election, then claim additional estate assets that are considered Exempt Property (both Statutory Transfers, see below), thereby leaving even less property to be distributed through Testamentary transfers. However, a Will should always be drafted for a client in case an unforeseen sum becomes available to the Testator, such as an unexpected inheritance prior to the testator's death or a wrongful death claim.

The attorney assisting the Executor has a legal duty to the fiduciary, NOT to the Testator. An ethical dilemma arises if the attorney becomes aware of the Executor serving his own self interest and breaching his fiduciary duty to the estate. Under these circumstances the New York Rules of Professional Conduct should be applied: The attorney may not knowingly assist in the continuing crime, must do his best to dissuade the client from continued deviant behavior, then (barring cessaction of the breach) should disengage from the attorney/client relationship.[14]

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[12] This concept, known as "Incorporation by Reference," used to be permitted under New York state law. However, currently New York does not recognize Incorporation by Reference, either for property or for one estate planning document (such as a Pour-Over Will) instructing a party to respect the terms of another document (such as a Trust).

[13] Both Executors of Wills and Administrators of Administration Proceedings are court appointed. Typically the court will permit the Executor to be the choice of the Testator's, but in Administration Proceedings the choice of fiduciary often requires more family cooperation.

[14] See NYRPC Rule 1.16(b)

Although these materials do not cover the execution requirements or technical aspects of Wills, it is worth noting the importance of planning for ademption and abatement of property.

Ademption occurs when a specific bequest, such as the transfer of a mother's engagement ring to her daughter, fails because the item cannot be found or is no longer owned by the decedent's estate.[15] One common example is a parent who owns two parcels of real estate and makes a specific bequest of each property, one to each of her two children. If the testator has at some point sold one of the properties but never updated her Will the bequest of the sold house "adeems," and there is no substitute compensation for the devisee. Under these circumstances one child receives an unintended financial benefit over the other. It is advisable for the practitioner to inform the client of potential iniquities, and suggest limiting specific bequests to items of personalty of lesser value.

Abatement occurs when there is not enough property to pay for the testator's debts, funeral expenses, expenses of administration, and all dispositions. The issue at stake is: Who has the greater right to the testator's property? The order of distribution is (1) administration expenses, (2) funeral expenses, (3) debts of the testamentary estate, (4) specific dispositions, (5) general dispositions, (6) demonstrative dispositions, (7) residuary dispositions, and (8) any property that has to pass through partial intestacy. To best ensure minimizing the abatement of testamentary assets, a practitioner should stay apprised of the client's financial situation both during the initial engagement and on an on-going basis.

C. Statutory Transfers

In New York there are three statutes that give certain family members rights to the decedent's estate. This applies to Exempt Property and the Spousal Right of Election even if there is a valid Will or properly executed beneficiary designation forms for operation of law assets. These assets are not property of the estate, but instead "come off the top" of the decedent's estate if a permissible recipient invokes his or her right to receive the property. A disowned spouse would want to first claim Exempt Property, then exercise her Right of Election. Intestacy, on the other hand, only applies to non-operation of law assets.

1. Exempt Property

Exempt Property[16] includes certain items that are considered to not be a part of the Testator's testamentary estate, but instead vest in another party's name. Specifically, exempt property applies only to a surviving spouse or, in his or her absence, to the decedent's children under the age of 21 years of age; the statute does not make mention of the much more broad range of "issue," which might include grandchildren. In some cases the recipient may receive as much property as $56,000, but it must comply with the following limits:

- Computers & electronic devices, fuel, clothing of decedent: Not to exceed $10,000
- Family bible & pictures, software and books: Not to exceed $1,000
- Domestic animals & 60 days of animal food, one tractor: Not to exceed $15,000

[15] The primary exceptions to ademption of specific bequests can be found in EPTL §§ 3-4.2, 3-4.4 and 3-4.5
[16] EPTL §5-3.1

- One motor vehicle not to exceed $15,000, or the recipient may pay the estate the excess of the vehicle's value over this amount and claim the vehicle.

If the property in any of these categories does not exist the recipient is not permitted to receive a greater amount from a different category. In addition, creditors canot claim the property because it "shall...be deemed reasonably required for the support of the surviving spouse or children under 21"...[17] The sole exception for creditors is if the items have their value reduced by these obligations or liens (I.e. "secure loans"), such as a car loan on the applicable automobile.

2. Law of Intestacy

Where no valid Will exists, assets of the **Decedent** pass through **Intestacy**; the process is known as **Estate Administration**, which is conducted by a fiduciary known as the **Administrator**. Whenever the decedent did not have a Will, or where his or her Will is silent as to a relevant issue, the Court will look to EPTL Section 4 to determine how to deal with the matter.[18] Specifically, the order of recipient is as follows: (1) If there is a surviving spouse and issue: $50,000 and ½ of the residue to the spouse, the balance to the issue by representation; (2) A surviving spouse and no issue: the whole to the spouse; (3) Issue and no spouse: the whole to the issue, by representation; (4) One or both parents are still alive, and there is no spouse or issue: the whole to the surviving parent/s; (5) Issue of parents (I.e. a Brother & Sisters), and no surviving spouse, issue, or parent, in which case the entire administrative estate goes to the issue of the parents by right of representation.[19]

Intestacy distributions are simple: the class of heirs either receives all or none. Relatives by half blood are treated as if they are whole blood. Distributees of the decedent conceived before death but born after death take as if born during the decedent's lifetime. Lastly, adoptive children take as provided under domestic law.

3. Spousal Right of Election

To better ensure that a surviving spouse cannot be disowned by a deceased spouse New York (and several other states) allows a surviving to exercise a personal **Right of Election** against the decedent's estate. The available **Elective Share**[20] is the greater of (1) $50,000, or (2) one third of the decedent's estate minus debts, administrative expenses and reasonable funeral costs. In addition. the elective share is a very powerful tool for a disowned spouse: it includes the value of certain property the decedent transferred during his lifetime. It also does not include the spouse's right to claim exempt property, thereby allowing a surviving spouse to claim even more property even if completely disowned by the decedent's estate. The right, however, must be exercised by the spouse or her agent if she is incapacitated; if the surviving spouse passes away soon after the first spouse's death her Executor may not exercise the right.

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[17] EPTL §5-3.1(c)

[18] In the absence of a specific instruction as to whom shall receive estate assets and in what order, EPTL §4-1.1 dictates the parties who receive distributions.

[19] EPTL §4-1.1(a)(1-5)

[20] EPTL §5-1.1

V. GIFT, ESTATE AND OTHER TAX ISSUES

In 2009 the landscape of estate taxation is complex and its future is uncertain. It is imperative that all estate planning attorneys stay up to date on changes in taxation laws, and draft legal documents with sufficient flexibility to protect the client's interests.

A. Spouses and Charities

Spouses who are both considered "US Persons" for gift and estate tax purposes are permitted to transfer an unlimited amount of property to one another. This is known as the **Unlimited Marital Deduction,** and applies to both lifetime transfers[21] and post mortem transfers[22] of property to spouses. A transfer to any person other than a spouse will invoke limitations based on the **Annual Exclusion**[23] and the **Lifetime Gift Tax Exemption**.[24] Any gift given by a married person is also eligible for **Gift Splitting**[25] between the two spouses, thereby allowing a married individual to give twice the annual exclusion without diminishing his or her gift tax exemption. Some exceptions to these rules apply for individuals who are married to people who are not American citizens (see below). A transfer may be made to a **Qualified Charity**, allowing the transferor to take a deduction on his or her transfer taxes (I.e. no gift taxes will be assessed)[26]; a similar deduction on estate taxes is permitted for post-mortem transfers to charities.[27]

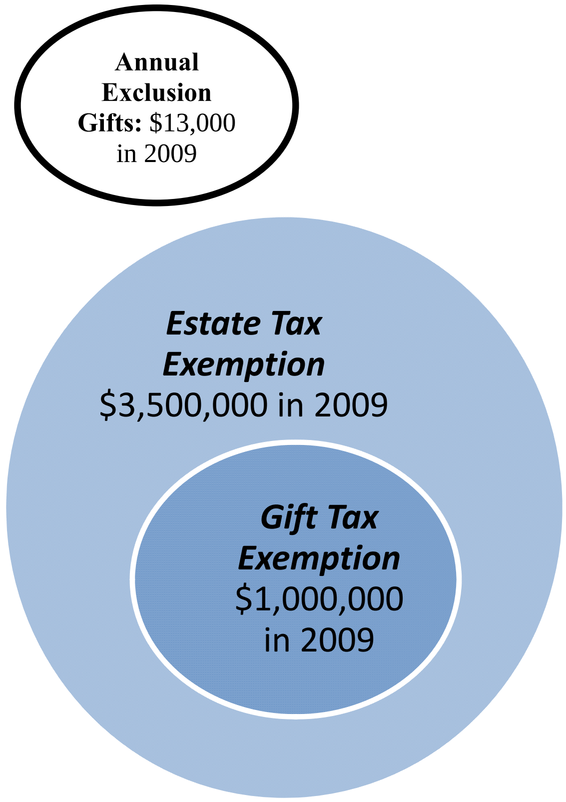
B. The Unified Credit and The Economic Growth and Tax Relief Reconciliation Act of 2001

The **Federal Gift and Estate Tax** used to be "unified," meaning that (1) the amount a person could transfer gift tax free during life (his **Gift Tax Credit**) was the same amount he could transfer free of estate tax (his **Estate Tax Credit**), (2) a transfer during life that decreased his Gift Tax Exemption equally depleted his Estate Tax Exemption**,** and (3) the tax rates for gift taxes and estate taxes were the same. For this reason the Federal Gift and Estate Taxes were known as the **Unified Credit**. [28]

By 2001 this credit allowed a person to transfer $675,000 during his or her lifetime (in excess of annual exclusion gifts) without assessing a transfer tax. At that time transfers of Annual Exclusion gifts were permitted up to $10,000 per year to any and every US Citizen, and were free of estate and gift tax consequences.

[21] IRC §2523; see IRC §2053 for estate tax deduction
[22] IRC § 2056
[23] IRC § 2503(a) and (c)
[24] IRC § 2512(b)
[25] IRC § 2513
[26] IRC § 2522
[27] IRC § 2055
[28] IRC §2010

The Economic Growth and Tax Relief Reconciliation Act of 2001 ["EGTRRA"] drastically changed the federal gift and estate tax landscape by modifying the relationship between these taxes. Transfer tax rates were decreased, and the **Gift Tax Exclusion** and **Estate Tax Exclusion** were increased, but the credit amounts no longer mirrored one-another (see below). EGTRRA also terminated the unlimited Step-Up in Basis[29] of the decedent's capital gains taxes (starting in 2010), replacing it with a limited step-up of $4,300,000 to spouses and $1,300,000 to non-spouses.[30] Lastly, guidelines were established to increase the amount of annual exclusion gifts.



However, EGTRRA was drafted to "sunset" in 2011, which will lead to a return to the Unified Credit system, increased gift and estate tax rates, and 2002 estate and gift tax exemption levels. New legislation has not yet passed through Congress, leading to a great deal of uncertainty surrounding the future parameters of federal gift and estate taxes.

Gift and Estate Tax Exclusions Under EGTRRA

	For Gift Tax Purposes:		For Estate Tax Purposes:		Highest Marginal Gift and Estate Tax Rate
Year	Unified Credit	Applicable Exclusion Amount	Unified Credit	Applicable Exclusion Amount	
2001	220,550	675,000	220,550	675,000	60%
2002	345,800	1,000,000	345,800	1,000,000	50%
2003	345,800	1,000,000	345,800	1,000,000	49%
2004*	345,800	1,000,000	555,800	1,500,000	48%
2005	345,800	1,000,000	555,800	1,500,000	47%
2006	345,800	1,000,000	780,800	2,000,000	46%
2007	345,800	1,000,000	780,800	2,000,000	45%
2008	345,800	1,000,000	780,800	2,000,000	45%
2009	345,800	1,000,000	1,455,800	3,500,000	45%
2010	345,800	1,000,000	**N/A: No Tax**	**N/A: No Tax**	**Gift Tax Only: 35%**
2011**	**345,800**	**1,000,000**	**345,800**	**1,000,000**	**55%**

* Denotes first year showing the effects of non-unified credit amounts.
** Denotes "Sunset Provision" which returns exclusion and credit amounts to what they were in 2002.

[29] IRC §1014
[30] IRC §1022

C. Federal Gift Taxes

A tax is imposed upon gifts (lifetime transfers) from one individual to another for which there is no consideration[31] or insufficient consideration.[32] The federal **Gift Tax Exclusion,** $1,000,000 in 2009, is the amount of property which may be transferred free of gift taxes during life. However, some notable exclusions and deductions are permitted. The most frequently utilized exclusion is known as the **Annual Exclusion**,[33] which represents the dollar amount that a donor can gift to any and every US citizen every year without decreasing the donor's gift and estate tax exemptions. In 2009 this amount is $13,000 per year, increasing thereafter in increments of $1,000 based on inflation, The donor can gift $13,000 to an unlimited number of donees during one year using cash, checks, transfers of real or person property, through a 529 Plan,[34] UTMA, an Irrevocable Trusts, or several other methods. A married couple can give $26,000 to a donee (or any number of donees) through gift splitting every year.[35]

The gift tax exclusion (and credit) applies to one Donor, but the annual exclusion is based on amounts received by each individual donee. If a donor transfers less than the annual exclusion amount to all donees there is no reduction of the donor's gift (or estate tax) exemption. However, if even only one done receives more than the annual exclusion in any one given year, the <u>donor's</u> gift and estate tax exemptions are decreased by the amount greater than the annual exclusion. Therefore, it is best to use the annual exclusion often and early: A client on his or her deathbed can only take advantage of one year's worth of annual exclusion gifts, and the transfers must be completed prior to the donor's death.

D. Federal Estate Taxes and Calculating the Gross Estate: IRC §§ 2033 - 2044

The **Taxable Estate** for an individual is his **Gross Estate** minus deductions,[36] such as transfers to spouses and qualified charities. The Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States,[37] (also known as a "US Person" for taxation purposes; see below). The gross estate means the value of all property, real or personal, tangible or intangible, wherever situated; the relevant IRC sections are IRC§§ 2033 – 2044. Deductions from the gross estate are codified in IRC §§ 2053 – 2058.[38]

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[31] IRC § 2501; § 2052 declares that the tax imposed "shall be the tentative tax rate (under § 2001(c)) on the excess of (1) a tentative tax imposed on the sum of the taxable gifts (as defined in §2503(a)) for this year and all preceding years over (2) the tentative tax on the sum of taxable gifts for all preceding years."

[32] IRC § 2512: a "gift" is the amount by which the value of the property transferred exceed the value of the consideration received.

[33] IRC § 2503(b)

[34] A donor can "front load" a 529 Plan with 4 years of Annual Exclusion gifts in one year (and then must wait 5 years to contribute to the plan again). However, even though this is considered a completed gift, (1) if the donor dies during this period some of these funds will be recaptured in the donor's estate, and (2) if the donor is also the Plan's owner he or she may repossess the funds (which leads to a 10% penalty on any gains distributed from the Plan)..

[35] Though IRS Form 709 must be filed any time a person (even a married person) gifts property worth more than $13,000, gift splitting is assumed for married couples.

[36] IRC § 2051

[37] IRC § 2001

[38] § 2053 – expenses, indebtedness, taxes; § 2054 – investment losses; § 2055 – contributions for public, charitable and religious uses; § 2056 – transfers to the surviving spouse; § 2057 – value of QFOBI; § 2058 – state death taxes.

An estate does not pay estate taxes unless the decedent's gross estate on the date of death is larger than the estate tax exclusion listed above, and taxes may still not be due if the net estate is less than the federal **Estate Tax Exclusion**, which is $3,500,000. Additionally, a second valuation may be made six months after the date of death, often referred to as the **Alternate Valuation Date**.[39] The lower of the date of death valuation and alternate valuation date may be used in calculating whether and how much estate taxes are due.

Estate taxes are due nine months after the date of death, whether or not an extension is filed, Any underpayment is penalized. It is essential to (1) establish the initial valuation of the gross estate once all assets have been collected, (2) choose which assets are suitable to pay foreseeable estate taxes, (3) determine the six month alternate valuation and complete IRS Form 706 as quickly as possible, and (4) pay any taxes owed prior to nine months after the decedent's death. [40]

- ➔ Property that is successfully transferred to another individual does not necessarily mean it has been transferred out of the donor's taxable estate. A person who names her son the beneficiary of a life insurance policy has successfully transferred the proceeds to her son…but because she owned the policy upon her death the proceeds are included in her gross estate for estate taxation purposes.

The gross estate for federal estate tax purposes is calculated using Internal Revenue Code sections 2033 – 2044 (listed below). Section 2033 is the broadest and most obvious category of assets included in the gross estate, while Sections 2034 and 2039 rarely come up at this point in time. However, special attention must be given to all of these IRC sections, particularly where a person or married couple's estate is near (or over) the estate tax exemption amount. The IRC specifies that the "gross estate" includes the following property interests:

§2033 - Property owned by the decedent or in which the decedent had an ownership interest at death: This section includes all real and personal property (tangible and intangible) wherever it is located, as well as property owned as tenancy in common interests and income in respect of a decedent ["IRD"][41]

> Example: Decedent owns a house, car, boat, a Picasso painting and bank accounts all in his own name equal to $2,000,000. His Gross Estate is worth $2,000,000.

§2034 - Dower or curtesy interests: This section includes property in which a widow or widower has a right to a life estate in the decedent's real estate.

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39 IRC §2032(a)

40 If no federal estate tax is owed then the estate does not have to file a Form 706. However, if an estate close to the exemption amount and is planning on using the six month alternate valuation date to avoid estate tax liability the form should be filed.

41 IRC §691

§2035 - Gifts of life insurance on decedent's life and gift taxes paid made within three years of the decedent's death: The general rule of gifting life insurance policies to an irrevocable trust or paying gift taxes is that they should attempted at least three years prior to the owner / donor's death. This section is meant to capture deathbed transfers, and includes any (1) transfer of a retained life estate, (2) transfer of a retained power to alter, amend or revoke under §2038, (3) transfer of the ownership of existing life insurance policies on the decedent's own life, (4) transfer of a retained reversionary interest with a 5% or greater probability of reversion or a transfer that the transferee can enjoy or possess only at the decedent's death under § 2037.

> <u>Example</u>: Mother transferred an existing $3,000,000 life insurance policy to an irrevocable trust and paid gift taxes of $1,000,000 on gifts she made to her children. She dies two years later. At death her Gross Estate includes this $4,000,000.

§2036: Retained interests and gifts of property over which the decedent retained control of the income for his or her own <u>use</u>, <u>possession</u> or <u>enjoyment</u>[42]<u>:</u> This is a very powerful section that the IRS uses with great regularity. If the decedent retained ANY rights over lifetime transfers the full value of the property is included in the gross estate. This includes any life estate interests owned by the decedent (<u>use</u>) or a lifetime right to which he could <u>enjoy</u>, <u>possess</u>, or receive income from the property. If the decedent gave up or transferred these retained rights within 3 years of death the property is still included in the decedent's gross estate under § 2035.

> <u>Example</u>: Father gifts his $1,000,000 house to his children and continues living there for 20 years without paying them fair market value rent. At his death the house is worth $4,000,000. Father's Gross Estate includes this $4,000,000.

§2037: Reversionary interests or gifts where enjoyment of the property is conditioned on the donee surviving the decedent: This section applies if the decedent's reversionary interest at the date of death is computed to exceed 5% of the value of the property (an actuarially computation determined by IRS standardized tables). It is meant to include completed transfers that the donor has a modest chance of recapturing upon the donee's death.

§2038 - Gifts over which the decedent retained the power to <u>alter</u>, <u>amend</u> or <u>revoke</u> a gift already delivered or held in trust. A gift is meant to be final without "strings attached." A gift in trust is permitted to have some prerequisites before the beneficiary can claim them, but the Settlor / Trustee is limited as to which restrictions are acceptable to avoid inclusion in his or her gross estate. *This often happens when a grantor is also a trustee of the gift in trust and the trust allows him unfettered discretion to distribute trust property to the beneficiaries.*

> <u>Example</u>: A Trust allows the Grantor to <u>Alter</u> the Trust beneficiaries' percentages, (or <u>Amend</u> the terms of the Trust or <u>Revoke</u> the Trust). At the Grantor's death the Trust assets are worth $1,000,000. His Gross Estate includes this $1,000,000.

[42] §2036 is a very powerful tool for the IRS, who won many Family Limited Partnership fractional discount valuation cases and "life estate" tax contests due to this code section

§2039: The survivorship interest of joint and survivor annuities. If at death the decedent owned an annuity that will pay a survivorship benefit to a named beneficiary the present value of the future payments that will be made to the beneficiary is included in decedent's estate

§2040: Property held in joint tenancy with rights of survivorship: Unless the decedent's fiduciary or joint party can convincingly prove the first decedent contributed a different amount of the consideration of joint property, the IRS assumes the amounts both parties contributed:

- **Between Spouses**: 50% of the property's value is attributed to the deceased spouse, regardless of who contributed what amount
- **Anyone Else**: the entire value is included in the first decedent's estate

  Example: Mother and Daughter have a joint bank account where Mother supplied all of the funds in the account. If Daughter predeceases Mother the IRS will assume Daughter provided all of the funds in the account unless Mother can prove otherwise.

§2041: Property subject to the decedent's "general power of appointment" at death[43]: A General Power of Appointment allows the "power holder" of another person's assets to exercise the use of those assets in favor of (1) the power holder, (2) the holder's estate, (3) the holder's creditors, or (4) the creditors of the holder's estate. One way to minimize estate inclusion is to give the holder a **"5-and-5 Power":** if the decedent held a power to appoint annually the greater of $5,000 or 5% of trust principal, the holder's gross estate will include the greater of $5,000 or 5% of the trust assets

§2042: Proceeds of life insurance policies on the life of the decedent, payable to the decedent's estate, or in which the decedent had any "incidents of ownership"[44]: This section applies where the decedent was the owner of a life insurance policy at death. It also applies when the decedent had "incidents of ownership" in the policy, meaning that he or she retained the right to: (1) change the policy beneficiary, (2) surrender the policy for its cash value, (3) receive any policy dividends, (4) borrow against the policy's cash value, (5) pledge the policy as collateral for a loan, (6) assign the policy or to assign any of these named rights, or (7) revoke any assignment of the policy

§2043: Transfers for insufficient consideration: The amount that will be included in the decedent's gross estate is the difference between the transfer amount and its fair market value.

§2044: Property for which the marital deduction was previously allowed: Property that was transferred to the surviving spouse by the decedent free of tax may not be transferred again without the property being included in the spouse's gross estate.

[43] Durable Powers of Attorney which leave unfettered discretion over the principal's property may result in a power of appointment for the agent – if the agent pre-deceases the principal the entire value of the principal's property could be included in the agent's estate

[44] The IRS typically invokes the incidence of ownership argument when a irrevocable trust is the owner of a policy but the trust language allows the Grantor these powers

D. New York State Transfer Taxes

Though a great deal of attention is placed on the federal estate tax, it currently affects only about one percent of estates due to its high exemption amount. However, for New York domiciliaries, the New York state estate tax is assessed far more frequently due to both its more modest exemption amount and the fact that New York has several affluent individuals. In addition, whereas the future structure of the federal estate tax is in question, New York's estate tax in all likelihood will remain in its current form for the foreseeable future. Therefore, though the state tax will affect many estates, its current stable status allows for longer-term planning.

New York repealed both the standing New York estate tax and gift tax in 1997.[45] The New York gift tax was permanently repealed starting on January 1, 2000 and continues to be repealed to this day. Therefore, an unlimited amount of property may be transferred to any individual by a New York domiciliary without incurring any New York gift taxes (though Federal gift tax will still apply). Annual Exclusion gifts are also exempt from New York taxation.

On February 1, 2000 the New York estate tax was repealed and replaced. The new state estate tax would be limited to the amount allowed as a credit against the federal estate tax. However, two years later EGTRRA increased the Federal estate tax credit, thereby limited New York's ability to collect estate taxes except against larger estates. This ultimately led to New York **Decoupling** its estate tax from the federal estate tax system. Any person domiciled in New York at the time of his or her death with a <u>net estate of $1,000,000</u> or more will now be subject to New York estate tax.[46] The lowest tax rate in 2008 was 9.77%, and hits a maximum of 16% once an estate exceeded $10,040,000. Due to the general affluence of clients in Southern New York it is highly likely that many estates that escape Federal estate taxes will still be required to pay New York estate taxes.

Several strategies may be employed to avoid the New York estate tax, particularly for the first spouse who passes away. The spouses may use a **QTIP** or **Credit Shelter Trust** upon the death of the first spouse for all property in excess of $1,000,000. Keep in mind that several clients with older estate planning documents prior to federal and state estate tax system being decoupled may reference the federal estate tax as the trigger for their Credit Shelter Trusts. The client may also choose to gift up to $1,000,000 plus annual exclusion transfers during his or her lifetime, as this will not cause any gift tax liability for Federal purposes ($1,000,000 lifetime exemption) or New York gift taxes (because there are none), and still allow the decedent to transfer $1,000,000 estate tax free for New York purposes. For clients who have a second residence in a state that has no estate or gift tax, such as Florida, and live there for much of the year a change of domicile may also be suggested as a last resort.

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[45] 1997 N.Y. Laws ch. 389, pt. A, §7

[46] The fiduciary of the estate must file New York Tax Form ET-706, which is almost identical to IRS Form 706 for Federal estate tax. However, due to the fact that more New York domiciliaries will have to pay New York estate taxes and not Federal estate taxes, it is more common that the state form will be required than the Federal form.

E. Income Tax Issues

Estate Planning attorneys must have more than a basic knowledge of income taxes and how they effect a client's estate plan both during life and after death: Several estate planning clients may not have any estate tax issues, but all clients who earn even a de minimus amount of income will be responsible for income taxes both during life and afterward.

1. Grantor Trust Rules: IRC §§ 671 - 679

Grantor Trust rules are different than Estate Tax rules, though many of them appear the same. The Grantor makes transfers to a trust, but part or all of the income, deductions and credits are passed through to the owner for income tax purposes. Why do this? Because income tax rates for trusts are accelerated much faster than personal income tax rates: For example, in 2007 trusts reached the top income tax rate of 35% at $10,450 of income, while married filers reached this same bracket at $349,700 of AGI. This discrepancy exists because the tax rates were reversed in the 1980s (trust income tax rates were lower), but while the actual tax rates were switched, the IRC has not been changed to correct this discrepancy. Think of it this way:

- Grantor Trust IRC Sections affect Income Taxes (you DO want them to apply)
- Estate Tax IRC Sections affect Estate Taxes (you DO NOT want them to apply)

2007 Federal Estate and Trust Income Tax Rates

If taxable income is not over:	The tax is:
$2,150	15% tax rate
$5,000	$322.50 plus 25% of the excess over $2,150
$7,650	$1,035.00 plus 28% of the excess over $5,000
$10,450	$1,777.00 plus 33% of the excess over $7,650
Over $10,450	$2,701.00 plus 35% of the excess over $10,450

2007 Married Filing Jointly Income Tax Rates

If taxable income is not over--	The tax is:
$15,650	10% of the amount over $0
$63,700	$1,565.00 plus 15% of the amount over 15,650
$128,500	$8,772.50 plus 25% of the amount over 63,700
$195,850	$24,972.50 plus 28% of the amount over 128,500
$349,700	$43,830.50 plus 33% of the amount over 195,850
Over $349,700	$94,601.00 plus 35% of the amount over

<u>Example</u>**:** A trust with $15,000 of income pays income tax of **$4,293.50**. However, if the trust is a Grantor Trust and the Grantor and his wife earned $100,000 of personal income, we add the $15,000 of trust income to their personal income taxes, meaning that the trust income tax is only **$3,750**. If by some unlikely chance the Grantor had no personal income that year the Grantor Trust would only owe **$1,500** of income tax.

Under IRC §671, if the grantor of a trust is treated as the owner of any portion of a trust, those items of income, deductions and credits against tax of the trust that are attributable to that portion of the trust must be included in computing the taxable income of the grantor. Simply stated, drafting certain powers into a trust will cause the income from the trust to be taxed at the grantor's personal income tax rate. A grantor is considered the "owner" of a trust for income tax purposes if he has <u>any</u> of the following IRC powers under the terms of the trust document:

- §673 – Reversionary Interest of 5% of the trust or greater
- §674 – Power to control beneficial enjoyment
- §675 – <u>Certain administrative powers</u> *(this is the primary anomaly to Estate Tax rules)*
- §676 – Power to revoke a gift in trust
- §677 – Power to distribute trust income

A quick glance will show that many of these "Grantor Trust" IRC sections have a corresponding "Estate Tax" IRC section. The main exception is found in IRC § 675: If the Trust document allows the Grantor to retain certain administrative powers the trust is considered the alter-ego of the Grantor for income tax purposes, but not for estate tax purposes. These powers are:

(1) The **Grantor's Power to Substitute Assets of Equal or Equivalent Value:** This must be in a "non-fiduciary" capacity.[47] This does not cause inclusion in Grantor's estate under §2038(a)(2) because the Grantor does not have the power to "alter, amend or revoke" the trust. This is akin to Grantor having investment decision-making powers, a power which is not included under §2038.[48] *This power is the most commonly used power to invoke Grantor Trust taxation rules*

(2) Power to Borrow Without Adequate Interest or Security: This may happen when the Grantor or a "non-adverse party" have a power allowing the Grantor to borrow from the trust without having to pay adequate interest or security on a loan from the trust.

(3) Related or Subordinate Trustee Authorized to Make Discretionary Distributions: The problem with this method to ensure favorable Grantor income tax treatment is that a trust with this term is defective for estate tax purposes, thus estate taxes are included in the decedent / grantor's estate.

Intentionally Defective Grantor Trusts ("IDGT"): Here the retained powers of the Grantor remain the same for income tax purposes (thus Grantor Trust rules apply with their favorable income tax rates) but the gift is irrevocable (and therefore escapes estate taxes as well). Because the transfer is irrevocable it avoids §§ 2033, 2034, 2037, 2039, 2040 & 2041. The Grantor also retains a minor power that does not exceed the scope of §§ 2036, 2038 or 2042, but especially § 2038's "Alter, Amend or Revoke" language.[49] Also, since the Grantor is paying taxes directly for the trust they are depleting their own estate - these taxes are not included in the Grantor's gift tax calculations, and are not themselves subject to additional gift taxes

<u>Example</u>: A Grantor creates an irrevocable trust 10 years ago; the trust explicitly gives him the power to transfer property of equal value between himself and the trust. This IS a Grantor Trust under §675 administrative powers, and there is NO corresponding code section regarding Estate Tax: The Grantor received both tax advantages: Lower income tax rates on the trust income during his life, and no estate taxes on the trust corpus upon his death.

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[47] IRC §675(4)(C)
[48] *<u>Jordahl v. Commissioner</u>*, 65 T.C. 92 (1975)
[49] The down side is that §2035's "three year transfer" rule still applies

2. Income in Respect to a Decedent: IRC § 691

Under the Internal Revenue Code, any property owned by a decedent that would be income if payable to decedent during life is taxable as income at death.[50] For income and estate tax purposes these assets are considered **Income in Respect to a Decedent ["IRD"].** The most notable IRD items are retirement plans, such as 401(k), 403(b) and deferred compensation plans, and IRAs (excluding Roth IRAs and Roth 401(k)s, which <u>have</u> already been taxed).

Since IRD items are considered items of income that have never been taxed, there is no step-up in basis for any IRD assets upon the death of the owner of the assets. Additionally, because income taxes are due on these items the IRS permits a correlating estate tax deduction for income taxes paid. This avoids double taxation of the same funds. Therefore, IRD treatment of assets only applies where an estate is taxable for estate tax purposes: If an estate is not taxable there is no IRD deduction. Though this deduction is welcome relief for estates holding large amounts of funds in IRD assets, the estate tax "deduction" is still far less favorable than a tax "credit." Due to this quandary, in the event that a client is charitably motivated, several estate planners will consider having IRD items paid to the client's charities, thereby (1) decreasing the gross estate for estate tax purposes, (2) maximizing estate tax deductions, and (3) transferring assets that would not receive a step-up in basis if left to a non-charitable recipient.

One consequence of IRD and the associated deduction is that they are assessed in the year when received. This may be problematic in the case of "stretch IRA" payments on inherited IRAs, since only partial distributions and income taxes are taking place on these funds every year; in this case the IRD deduction must be calculated every year, which can lead to additional repetitive accounting fees.

3. International Gift, Estate and Income Tax Planning

Congress has the power to tax based on (1) US citizenship, (2) US residency, (3) US sources of income, and (4) US situs of assets. Persons who are not US citizens or residents have special rules governing gift and estate taxation. With the number of "international couples" increasing, it is essential that an estate planning practitioner have at least a basic understanding of these differences. Though the practice of international estate planning can be quite complex, it is made somewhat easier if planning commences prior to the client officially immigrating to the US.

a. US Persons

A **US Person** is either a **US Citizen** (situs of residency and dual citizenship are irrelevant) or **US Resident**. Remember that all US citizens are US Persons, but not all US Persons are US citizens. A person can be a US Resident (and therefore a US Person) for either federal income tax ["FIT"] or federal transfer tax ["FTT"] purposes, or both. To be a US Person for FIT purposes there are two objective tests. The "**Green Card Test**" asks whether a person have a green card and is present in US at least 1 day in calendar year. The "**Substantial Presence Test**" asks whether the person is actually present in the US for at least 183 days per year or has averaged over 121 days per year in the US over past 3 years.

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[50] IRC § 691

To be a US Person for FTT purposes there is a subjective **Domicile Analysis.** This analysis is based on whether the person is *"…living there* (the US) *for even a brief period of time, with no definite present intent of later removing therefrom…"* Factors may include whether the person has a visa, the number and location of businesses and property, travel habits, family immigration history, statements by the individual (or in the case of a family, individuals), motivations, durations and number of US visits, community affairs and affiliations.

Once a person is considered a US Person, the next issue is: What is taxable? For FIT, all income from all sources worldwide is subject to US income tax, and, for FTT, all assets in the estate is subject to US transfer tax (regardless of situs).

b. Non-US Persons

Non-US Persons are people who are not considered citizens or residents. The only FIT that is taxable (for federal income tax purposes) is US sources of income, which is taxed at a hefty flat rate of thirty (30%) percent. Sources include dividends, rents and gains on real property, but exclude gains from the sale of securities and interest from debt instruments. A progressive tax rate structure may apply if a non-US Person for FIT is "engaged in trade or business in the US" ["ETBUS"]. For FTT purposes, the only transfer taxes that are assessed are on US-situs property, meaning that US gift and estate taxes only apply to US situs realty & US personalty, such as a house in Aspen and the paintings & furniture inside it

Gift Taxation of Non-US Persons: Non-Us Persons are assessed the same gift tax rate as US Persons and the annual exclusion applies. However, there is NO (I.e. $0) lifetime gift tax exclusion; the $60,000 exemption for estate taxation inapplicable for gift tax purposes. Also, married non-resident (FTT) non-citizens cannot "gift split." Additionally, the marital deduction of gifts to a non-citizen spouse is limited to $100,000 per year. Lastly, reporting is required for (1) total foreign gifts total more than $100,000 per year, or (2) transfers from foreign entities exceeding $10,000. Failure to report leads to a 25% penalty, and if fraud is involved criminal charges will be filed.

Estate Taxation of Non-US Persons: Estate tax treatment for non-residents are somewhat severe: even though the estate tax rates are the same as US Persons, there is no umlimited marital deduction,[51] and only a $60,000 exemption (as opposed to $3,500,000 for US FTT Persons). Estate debts, administration expenses and charitable contributions are deductible, but a full disclosure of world-wide assets is required. The $60,000 deduction is then limited to the ratio of US property as a percentage of the gross estate.

A **Qualified Domestic Trusts ["QDOT"]**[52] does allow for an unlimited marital deduction for a surviving non-US spouse. The trustee for this trust must be a US corporation or citizen. If assets in the trust exceed $2,000,000 the trustee must be a United States bank. Income can then be distributed to the surviving spouse without any estate taxes being assessed, though any distributions of principal are subject to estate taxes. Upon the death of the surviving spouse and/or termination of the trust, the distributed principal of the trust is subject to federal estate tax.

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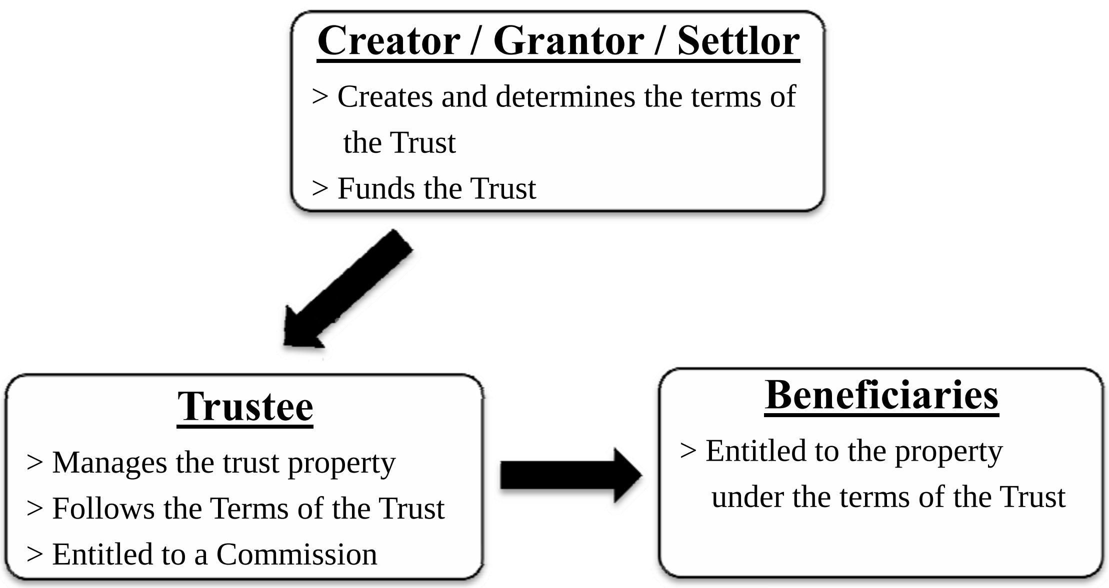
[51] IRC §2056(d)(1)
[52] IRC §2056(d)(2)(A)

VI. TRUSTS

There is no one "cornerstone" of the estate planning world, but the most integral part of estate planning as it concerns the transfer of wealth is the use of trusts. In fact, the field of estate planning law is often referred to as "Trusts and Estates" for good reason: There are numerous, powerful benefits to utilizing trusts. Some of these benefits may be available using either **Inter Vivos Trusts** (those created during life using a separate instrument, sometimes referred to as "Stand Alone Trusts") or **Testamentary Trusts** (trusts created after death, typically by a section in a Will).[53] However, certain powers and benefits only apply to inter vivos trusts.

A. Parties to a Trust

There are three primary parties to any Trust: The Settlor (also known as the Grantor or Creator), the Trustee and the Beneficiary. Each party may include more than one individual, such as two grandparents who create and fund a trust (the Settlors) who name their three children to administer to the property in the trust (the Co-Trustees) for the benefit of the Settlor's grandchildren (the Beneficiaries).



Settlor (or **Grantor,** or **Creator)**[54]**:** The Settlor creates the trust, typically with the assistance of an attorney, executes the trust, and funds the trust. The Settlor of a trust can never change – once a trust is created by a party no other party can create it, though other people may be permitted to contribute to the trust.

[53] A Will containing a testamentary trust should name both an Executor and a Trustee within the Will; these individuals do not have to be the same person or entity.

[54] These three terms are used interchangeably, though it is preferable to use the term "Settlor" in the trust document; the term "Grantor" is most frequently used to describe trust income tax treatment (see below); the term "Creator" is rarely used in legal documents, but is the best term to describe the position to the client. Therefore, it is best to show the client all three terms together at once.

Trustee: The Trustee is the fiduciary of the trust: He manages and invests the trust property, follows the terms of the trust, represents the interests of the trust (such as protecting the beneficiaries assets in the trust from creditors), and distributes trust funds to the beneficiaries. Trustees are entitled to a commission of approximately one percent (1%) of principal, income and distributions,[55] but are not required to accept them. Upon the resignation, death or incapacity of a Trustee a Successor Trustee takes the initial Trustee's position and responsibilities. This allows for continuity of administration of trust assets. Because the creator of a testamentary trust is deceased at the moment the trust is created, it should be obvious that the testator should not name himself the trustee of his own testamentary trust.

Beneficiary: There are frequently several levels of Beneficiaries. There is typically an initial beneficiary(s), followed by one or more remainder beneficiaries once the initial beneficiary no longer receives trust funds. A beneficiary may compel the Trustee to account for trust funds and expenses, but there is still a question as to whether a Trustee has an obligation to inform a beneficiary of her right to receive trust funds prior to the time they are entitled to distributions. Again, the creator of the testamentary trust is deceased, and should not name himself the beneficiary of the trust.[56]

B. Benefits of Using Inter Vivos Trusts

The general rule for estate planning practitioners is that use of inter vivos trusts is almost always the preferred way to distribute estate property. The only rational reason not to have an inter vivos trust implemented is when the client does not want to pay the added legal fees for the additional document(s). Probate is not required if all of the Settlor's potential testamentary assets are held in an inter vivos trust, but a Will should always be created in addition to a trust for any assets that are not titled correctly. Therefore, it is best to view an inter vivos trust as the complement to a Will, and not as a supplement.

Much like Wills, the **Rule Against Perpetuities** does apply to both inter vivos and testamentary trusts, but some states, such as Delaware and Alaska, allow for much longer ROP periods than 21 years, or abolish the rule entirely. [57] Only inter vivos trusts may have their "situs" changed in order to take advantage of these and other valuable benefits.

1. Avoidance of Probate / Continuity of Asset Management

Trust assets pass by operation of law, not Testamentary transfers, and thus do not pass through Probate. This is desirable for several reasons. Probate has filing fees that are not required for transfers in trust. These court fees are reasonable, but the paperwork required to Probate Testamentary assets is lengthy and may add substantial attorney fees to administration expenses. Probate also takes more time to accomplish than trust administration, due to the fact that multiple

[55] SCPA § 2307 serves as the default rate available to Trustees, however the Settlor may permit higher or lower commission levels in the trust instrument.
[56] Though the testator / settlor may allow their trustee to reimburse or supply the executor of his estate the expenses needed to pay for estate expenses used for the benefit of the testator, such as burial costs.
[57] Delaware has abolished ROP entirely, excluding real estate, thereby enticing billions of out of state dollars to be held in trust and managed within the state. In addition, this allows wealthy individuals to create "Dynasty Trusts" that have the potential to provide trusts distributions and protections for several generation of their family.

court requirements must be fulfilled. When a person passes away her assets are required to be frozen until Letters Testamentary have been issued. However, if a successor trustee is named in the instrument and agrees to serve, inter vivos trusts allow these assets to be administered, traded or transferred.[58]

Probate is a *public* *affair* – even lineal descendants who are being disowned by the Testator are entitled to notice of Probate, whereas the *administration of Trusts is a* *private* *affair*.[59] Administration and distribution of trust assets is much faster than going through Probate. Lastly, Inter Vivos Trusts (those created during the Settlor's life) require no court supervision, whereas Testamentary Trusts (those created by a Will at the death of the Testator) may require years of court oversight and supervision, thereby drastically increasing expenses.

Negatives aspects of trusts are (1) trusts are typically more expensive to create than Wills, and (2) a great deal of time may be required to fund the trust by renaming the Settlor's assets. In addition, the mere existence of a trust does not obviate the need to have a Will in place as well, since it is inevitable that some assets will not be owned by the trust.[60]

If the Settlor / Testator does not perceive a conflict between family members he or she may choose to have a **Pour-Over Will.** This Will has standard Will provisions (naming an Executor, preferred Guardian of minor children, etc.), but also includes the entire content of his or her trust, which states how the estate is to be distributed. The property not owned by the Trust does go through Probate, but the beneficial testamentary pattern is maintained. This can be done by simply "copying and pasting" the trust into the Will.[61] Therefore, even though the Pour-Over Will shall be a longer document than the trust itself, it may have less significance for transferring estate property.[62]

2. Avoidance of Ancillary Probate

Certain property, such as cash in a bank account or securities in a brokerage account, are considered fungible for estate administration purposes – the fact that the financial institution is in a state other than the decedent's domicile has no relevance in determining the proper venue to Probate the assets. However, real property and the personal property located in that real property is different. Real property is unique: It cannot be transferred, so a decedent's estate owning real property in two or more states shall need a Will in each of those states and shall face Probate (or Intestacy) in each of those states.

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[58] Active management of trust assets may not be desirable if the estate wishes to take advantage of six month alternate valuation rules.

[59] Despite this secrecy, an interested party may still petition the Surrogate's Court for information regarding the Trust if he knows to ask, and would probably do so if he or she was disowned by the Decedent.

[60] For example, few clients will change the title to their automobiles to being owned by their trust.

[61] Merely stating "My estate is to be distributed as stated in my Trust dated January 22, 2004" is not sufficient; this is known as "Incorporation by Reference," a practice which is no longer recognized in New York.

[62] If the Settlor / Testator does perceive a dispute amongst descendants receiving differing amounts of estate assets he or she will NOT want a Pour-Over (because the terms of the trust are public); and may choose to have the unequal portion transferred by a Trust (thereby maintaining enhanced privacy) with the remaining amount transferred by a non Pour-Over Will (which is transferred publicly).

The process of having to hold a Probate proceeding in a non-domiciliary state is known as **Ancillary Probate**. From a financial perspective this process has no benefit, as attorneys in two different states will need to do nearly identical work in order to settle the decedent's estate. Ancillary Probate can be avoided by having the out-of-state real property owned by a trust. Because property owned by a trust does not need to be Probated the real property in the second state avoids Probate entirely.

3. Types of Inter Vivos Trusts

The number of trusts that can be created during the Settlor's life and the terms that can be applied to them are only as limited as human imagination and certain laws will allow. One important rule does remain constant: <u>Any and all trusts become irrevocable upon the death of the Settlor, even Revocable Trusts.</u> What follows is a brief explanation of frequently utilized inter vivos trusts.

a. Revocable Trusts: Settlor's Alter Ego / Seamless Transition

Frequently the Settlor will serve as the initial Trustee and Beneficiary of his or her Trust: Trust property is administered by the Settlor for the benefit of the Settlor. Upon the Settlor's incapacity his or her choice of Successor Trustee can continue to use trust assets for the Settlor's benefit. Upon the Settlor's death the next Beneficiary begins receiving trust assets (typically a spouse, child, more distant family member, friend, or a charity). *<u>This is currently the most frequently utilized Trust</u>*: The trust acts as the Settlor's alter-ego by creating wealth, administering these assets and taking distributions, while also permitting near-seamless transition of administrative power and funds to other parties. In this vein, because the trust property is included under several Grantor Trust IRC sections any income generated by the trust is taxable at the Grantor's favorable income tax rate. However, a revocable trust is included as property included under IRC §2038, so property held in revocable trusts are always included in the Settlor's gross estate for estate tax purposes.

b. Irrevocable Trusts

All trusts, including revocable inter vivos trusts, become irrevocable upon the death of the Settlor.[63] Apart from **Decanting** (described below), irrevocable trusts cannot be changed without court oversight and beneficiary appoval.[64] Unless Grantor Trust Rules apply, the trust will need its own tax identification number and will need to pay taxes on any investment gains, even if this income is not distributed to the beneficiaries. Most irrevocable trusts are created to transfer wealth to family members in order to avoid estate taxes. Some may have simple terms that merely require the Settlor to transfer funds into the trust.

➔ *Keep in mind that <u>successfully transferring property</u> does not automatically mean the transfer <u>avoids estate taxation</u> – the terms of the trust must comport with IRC sections 2033 – 2044 in order to include inclusion in the gross estate for estate tax purposes.*

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[63] However, as shall be discussed later, a trust may be altered if it meets the requirements of New York's "Decanting" statute, EPTL §10-6.6(b).
[64] Unanimous beneficiary approval may be nearly impossible to attain, especially where minors are involved.

Other trusts, such as **GRATs** (grantor retained annuity trusts)**, GRUTs** (grantor retained unitrusts)**, QPRTs** (qualified personal residence trusts)[65] and **QDOTs** (qualified domestic trusts) attempt to avoid estate tax by transferring property several years in advance and using IRS mandated formulas and percentage rate[66] in order to escape estate taxation. **CLATs** (charitable lead annuity trusts) and **CLUTs** (charitable lead unitrusts) use these same formulas and rates to leave an income interest to charities with a remainder interest to family members (giving the Settlor both an income and estate tax deduction): **CRATs** (charitable remainder annuity trusts) and **CRUTs** (charitable remainder unitrusts), give the family member(s) a lifetime income interest, and leave the charity a remainder interest (thereby providing the Settlor with an estate tax deduction).

4. Funding Inter Vivos Trusts

Unlike testamentary trusts, which are funded through the Probate process, inter vivos trusts must be funded prior to the Settlor's death. An unfunded inter vivos trust is ineffective in transferring assets by the terms of the trust, which leads to the assets having to pass by the Settlor's Will (Probate), Intestacy or a form of operation of law transfer. It is absolutely essential that the attorney oversees the process of naming assets correctly to fund the Settlor's trust.

<u>Example</u>: An investment or bank account should be named ***The Margaret Smith Revocable Trust.*** In order to avoid Ancillary Probate, the Deed to an out of state residence should be titled to ***The Jeremy Roberts Revocable Trust, Jeremy Roberts as Trustee***

Most financial institutions and insurance companies will require two aspects of the trust before they will allow the account to be owned by the trust: (1) The page with the Article naming the trust, and (2) the signature page of the trust.[67] A less experienced estate planning practitioner should initially ask for the assistance of a financial planner and bank manager in correctly setting up a client's trust accounts; setting up these accounts typically does not cost the client any administrative funds. When retitling real estate to a trust as the owner a practitioner should work with a Title Insurance company to file the Deed; this will often lead to costs associated with changing the Deed with the municipality and fees owed to the Title Company for preparation, but these costs are often well worth the expense.

5. Using Inter Vivos Trusts to Transfer Operation of Law Assets

Certain operation of law assets, life insurance and retirement accounts in particular (as described further below), can name a trust as the beneficiary of the asset. This provides two important safeguards for the beneficiary. First, a trust beneficiary who may not have financial discipline can have life insurance or retirement plan proceeds distributed at intervals instead of all at one time. Second, as explained below, a beneficiary with creditor issues will not receive the asset, but rather have them held in trust until a settlement can be made with the creditor.

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[65] IRC §2702
[66] IRC §7520; these interest rates are revised monthly.
[67] For this reason it is a good practice to include an Article explicitly naming the trust, and having the following trust requirements on the same page: (1) the Settlor and Trustee's signatures, (2) the signature of two witnesses, and (3) notarization of the Settlor and Trustee's signatures.

C. Creditor Protection / Naming the Correct Trustee

One substantial benefit of using trusts is the power to protect trust assets from creditors. A Settlor cannot protect his own property from creditors by placing it in a trust for his own benefit. In addition, state law permits a person's creditors to attach certain transfers made three years prior to filing a valid cause of action.[68] However, a trust, whether it is an Inter Vivos or Testamentary Trust, does allow for creditor protection for almost anyone other than a Settlor and his spouse. The rationale for allowing this protection is that the property held in trust is owned by the Settlor or his estate, so he and his successor fiduciaries may dispense with the funds as they see fit. In New York it is assumed that the Settlor desires this protection for his beneficiaries, even if the trust is silent as to this protection.

For example, a family member who has defaulted on his debts is the beneficiary of a trust. Under the trust instrument the trustee is permitted to withhold trust distributions if he believes it would be prudent to do so. When the beneficiary's creditors demand payment the trustee can continue to withhold distributing trust funds to the beneficiary until the creditors negotiate for a lower settlement amount (perhaps forty percent of what is owed, though the actual amount will vary depending on the circumstances). This strategy will typically not succeed if the beneficiary also happens to be the trust's sole trustee or if the trustee is "beholden" to the beneficiary, such as a spouse, employee or child of the beneficiary. Some exceptions may be made if the distributions are based on an **Ascertainable Standard** for the trustee/beneficiary's **health, education, maintenance or support** [sometimes referred to by the acronym **"HEMS**"],[69] but there are several intricacies that should be understood before naming a beneficiary as the sole trustee of his or her own trust. To avoid these problems it is advisable to include trust language permitting a trustee or trust protector to appoint a disinterested co-trustee.

D. Estate Tax Credit Shelter Trusts (for Married Couples)

Another advantage of both testamentary and inter vivos trusts is their ability to shelter estate assets from estate taxes. A **Credit Shelter Trust**, also known as an "A/B Trust," is typically not its own document, but a provision in a trust or Will that holds aside the estate tax credit amount upon the death of a married decedent. This credit shelter amount may be referenced as either the federal exemption amount, the New York state exemption amount, or specify neither, allowing the then-serving trustee to make the determination. This last example may be helpful during times when the future of one exemption amount is in question (such as now in 2009). The practitioner should never refer to the exemption as a **Pecuniary Formula** (a specific dollar amount) which would make it rigid and inefficient due to changes in future legislation, but should instead use a **Fractional Formula** (defines the parameters of the numerator and denominator of the bequest) to determine the credit shelter amount.

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[68] For example, if a parent involved in a driving accident believes he will have to compensate the victim, then tries to transfer the bulk of his property in an irrevocable trust for the benefit of his children, the victim

[69] See Jennings v. Smith, 161 F.2d 74 (2d Cir. 1947) and Leopold v. US, 510 F.2d 617 (9th Cir. 1975) regarding guidelines for determining guidelines for an "ascertainable standard"; however, also see Estate of Flood, 262 A.D. 2d 643 (1999) regarding permitting a creditor the right to attach all property subject to a trustee/beneficiary's power to withdraw.

Qualified Terminal Interest Property ["QTIP"] Trusts[70] may be suitable when only one spouse has substantial assets and does not want the other spouse to have unfettered access to the principal of his or her credit shelter amount. At a minimum a QTIP must leave an income interest to the less wealthy spouse while permitting the wealthy spouse to name the residuary beneficiary and utilize the less wealthy spouse's estate tax exemption. A QTIP is typically used when the wealthy spouse is remarried but has children from a prior marriage, or when the wealthy spouse does not feel the surviving spouse will be responsible for managing a CST's principal. In order for a QTIP Trust to be effective in utilizing the non-wealthy (surviving) spouse's estate tax exemption amount the trust must meet the following requirements: (1) the property must pass from the decedent, (2) the surviving spouse must have a "qualified income interest for life" in the property, and (3) the decedent's Executor or Trustee must make a valid election to treat the property as a QTIP, at which time the election becomes irrevocable.

E. Supplemental Needs Trusts

Of the many irrevocable trusts that are available in addition to those already mentioned, perhaps the most frequently utilized one is the **Supplemental Needs Trust ["SNT"]**[71]. It is crucial that an estate planning attorney understand how to use SNTs, even if they are not drafting the documents themselves, and may want to partner with an elder or disability law attorney to ensure the SNT is effective.

SNTs are irrevocable discretionary spendthrift trusts that terminate at the death of a named beneficiary who has a severe and chronic or persistent disability (even if the recipient is over the age of 65). SNTs are meant to supplement (not supplant) government benefits which the individual is eligible, such as Medicaid, Supplemental Security Income and Social Security Disability Income.[72] Funds transferred to these trusts are meant to be used for a disabled beneficiary for any purpose that is not being paid for by a government program. Vacations, wide screen televisions and clothing are all permissible expenses. However, the beneficiary cannot be the trustee, and can never receive trust funds in the form of cash or a check.

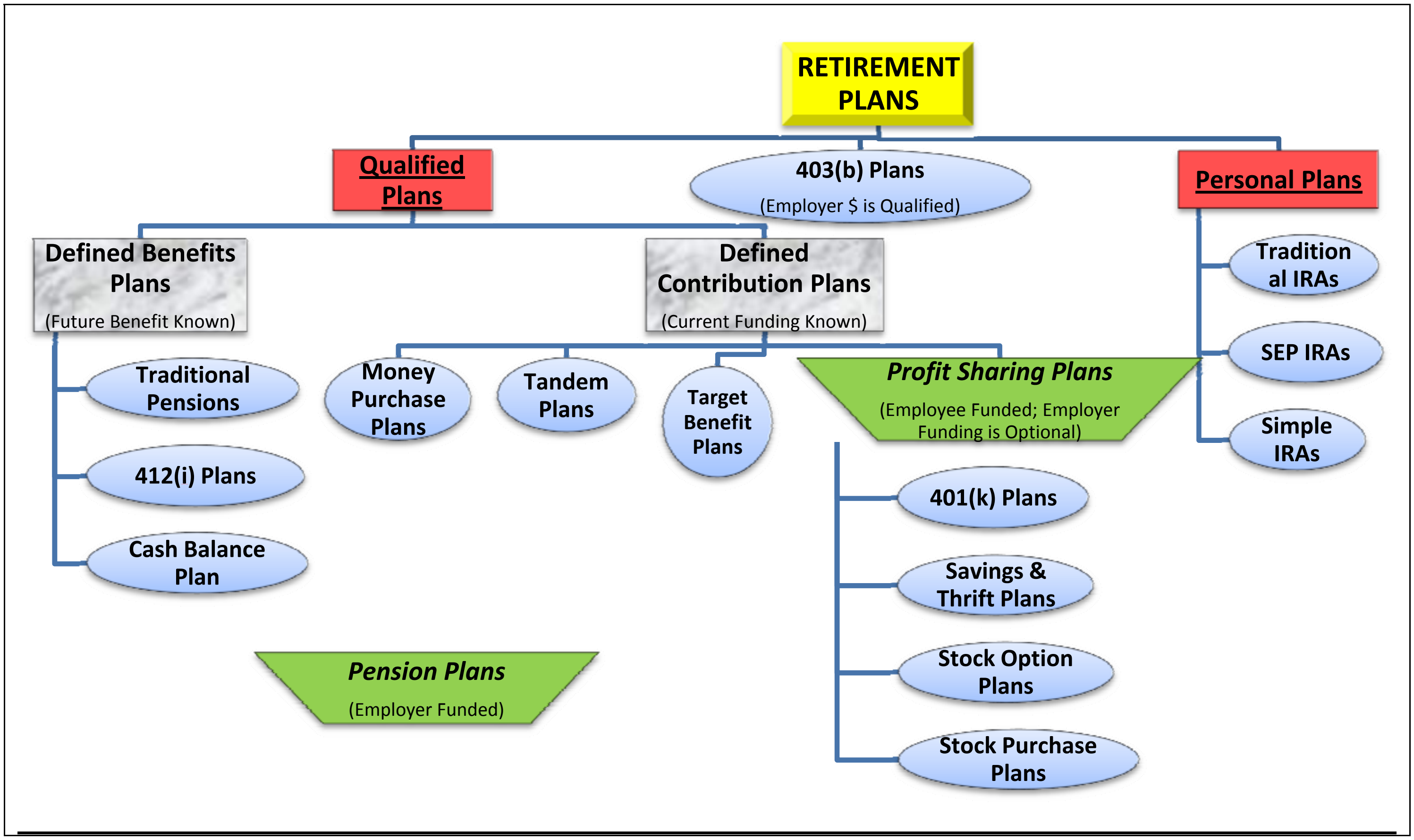
SNTs can be created inter vivos or testamentary, but it is often best to avoid testamentary SNTs to minimize future Surrogate's Court supervision and associated legal fees. The trust document must clearly state that the beneficiary cannot have power to assign, encumber, direct, distribute or authorize distribution from trust. The be submitted to the Department of Social Services to assure the trust conforms with state requirements, and must name a remainder beneficiary.

"Third Party SNTs," meaning those created and funded by a settlor other than the beneficiary, and must be established by a parent, grandparent, legal guardian, or court, even if the funds being used are for an individual who also has full mental capacity. Because the trust courpus is from a third party the remainder trust principal is directed to a named remainder beneficiary at the death of the disabled individual. "First Party SNTs" are created with the beneficiary's money (typically from an unforeseen inheritance or lawsuit), and must contain a payback provision for Medicaid.

[70] IRC §2056(b)(7)
[71] EPTL §7-1.12
[72] For an SNT to be valid the beneficiary must typically be receiving either SSI or SSDI.

VII. RETIREMENT PLAN ISSUES

Due to both the massive amount of wealth currently held in retirement plans and the impending retirement of a large percent of the US population, and considering both the level of wealth in New York and a state estate tax exemption of only $1,000,000, an estate planning attorney must quickly attain a level of comfort and understanding of the issues surrounding retirement plan. Retirement plans pass by operation of law, so a beneficiary designation form (not a Will) provides the means to successfully transfer the property.



A. Required Minimum Distributions ["RMDs"]: During Life

IRC §72(t) mandates that owners of certain retirement accounts begin taking distributions the year they turn 70½.[73] These distributions are known as **Required Minimum Distributions ["RMDs"].** Missing an RMD or underpaying what is owed leads to the IRS assessing a 50% penalty on the shortfall.[74] The amount of RMD due is determined using (1) the total IRA and Qualified Plan balance on December 31st of the prior year divided by (2) the percentage noted in the standard IRS "**Uniform Tables.**"

[73] Exceptions include qualified funds when the employee is still working at the business sponsoring the plan and Roth IRAs. However, non-spousal beneficiaries of a Roth must begin taking RMDs from the inherited Roth account.
[74] Use IRS **FORM 5329**, which asks the IRS for an exception for missed RMDs (due to bad health, bad advising, etc)

Age	Distribution Period	Age	Distribution Period
70	27.4*	93	9.6**
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115+	1.9

RMDs are based on a person's life expectancy: The tables require a higher percentage of plan assets to be distributed to older recipients and lower amounts to younger recipients. A 70 year old has to withdraw 3.77% of her retirement funds (100 / 27.4*), and pay income taxes on this amount, whereas a 93 year old will have to withdraw 10.4% (100 / 9.6**) of her combined retirement account values. Some commonly used abbreviations to describe how the RMD process works include:

- **Applicable Distribution Period ["ADP"]**: the period during which benefits can be distributed
- **Required Begin Date ["RBD"]:** April 1st of the year following the year in which participant reaches age 70½
- **First Distributions Year ["FDY"]:** Typically the year owner reaches 70½ at which time the distribution can be made by December 31st of that year. However, this can be postponed to April 1st of the following year. The RBD is the following year (because a distribution is "required" by then). Waiting for the RBD will lead to two years worth of distributions and income taxes (one for FDY and one for the RBD year)

B. RMDs After Life

Estates and charities receive the worse RMD treatment, because an estate or charity does not have a life expectancy. Of course, since a charity is not required to pay federal income taxes this is not a terrible outcome. However, for the estate this will lead to the **5 Year Rule** for RMD purposes: The retirement account must be distributed in full by the fifth year after the death of the participant, leading to large income tax rates in the short term.

Spouses receive the most favorable RMD treatment: A surviving spouse may either (1) keep the funds in the deceased spouse's retirement account (and distribute RMDs based on the deceased spouse's life expectancy), or (2) transfer the account to his or her own retirement plan. All other individuals must transfer the retirement account of a decedent to an "Inherited IRA." A non-spousal beneficiary must begin taking RMDs no matter what his age, but because he is typically younger than the participant RMD rates are relatively low. This allows for gradual distributions, thereby assessing lower income taxes in any given year, and longer tax deferral periods. This is known as a **Stretch IRA**, since the beneficiary is stretching distributions based on his or her longer life expectancy.

Inherited IRAs: Aside from instances of fraud or the use of a QUADRO in divorce disputes, retirement plans generally cannot be transferred to another person or creditor during the account owner's life.[75] However, when a plan participant (the owner of the retirement plan) passes away the funds may either be transferred to his or her spouse's IRA, or be transferred to another person using an "Inherited IRA." These must be titled as ***"IRA f/b/o Tom Smith, John Smith, Dec'd"*** or ***"John Smith, IRA (deceased on May 21, 2007) f/b/o Tom Smith, Beneficiary."*** <u>Be very cautious to work with the financial institution holding the account:</u> Failure to fulfill Inherited IRA requirements (for example, rolling over the funds directly into a non-spousal beneficiary's IRA) causes immediate taxation of ALL the funds, an obvious income tax nightmare.

Eligible Designated Beneficiaries ["DB"]: A **Designated Beneficiary** is different than a "Beneficiary." Many entities (charities, corporations, estates, non-qualified trust) can be the latter, but only an individual or a qualifying trust can be a DB. Remember: If even ONE beneficiary is not a DB then NONE of the beneficiaries are DBs. Whether or not a beneficiary is "applicable" to be a DB is determined on <u>Sept. 30</u> of year following the participant's date of death.

<table>
<tr><th></th><th></th><th><u>Death BEFORE RBD</u></th><th><u>Death AFTER RBD</u></th></tr>
<tr><td rowspan="2"><u>If NO Designated Beneficiary</u> (on the Beneficiary Designation form)</td><td>First Year</td><td rowspan="2">• All Qualified Pland & IRA funds must be distributed by 12/31 of year of 5th anniversary of owner's death</td><td>• RMDs over the owner's remaining life expectancy without recalculation</td></tr>
<tr><td>Subsequent Years</td><td>▪ RMD is calculated by reducing the <u>owner's</u> life expectancy by "1"</td></tr>
<tr><td rowspan="2"><u>If a Legitimate "Individual" Designated Beneficiary</u></td><td>First Year</td><td>• RMDs made over the bene's life expectancy from the Single Life Expectancy Table IF the bene commences distributions by 12/31 of the year after the year of owner's death

• RMD for designated bene uses bene's life expectancy for his age on his birthday in the year following the year of the owner's death</td><td>• RMDs may be made over the longer of:

(1) the owner's remaining life expectancy, or

(2) the bene's remaining life expectancy</td></tr>
<tr><td>Subsequent Years</td><td>• RMD calculated by reducing <u>bene's</u> life expectancy by "1"</td><td>RMD calculated over <u>bene's</u> life expectancy from the Single Life Expectancy Table</td></tr>
</table>

Naming one or several DBs on the beneficiary designation form allows for the most favorable post-mortem Stretch RMD treatment using the beneficiary's longer life expectancy. Failing to name DBs, or naming multiple beneficiaries where even one is not a DB, will invoke the 5 year rule, forcing the beneficiaries to withdraw all funds from the retirement plan within five years,

[75] Funds in a Qualified Plan are generally fully protected against creditors absent fraud. Funds in a contributory IRA are protected up to $1,000,000 or more. It is a suggested practice that funds initially contributed to qualified plans be transferred to separate IRAs, thereby segregating them from contributory IRAs.

negating the opportunity to stretch distributions. The DB's actual name need not be stated as long as the DB(s) can be identified using a class or distinction, such as *"my children"* or *"my living lineal issue at the time of my death."*

If there are multiple DBs or only one qualifying trust, even if all of the beneficiaries are eligible DBs (I.e. identifiable individuals) RMD treatment is based on the DB with the shortest life expectancy – the oldest beneficiary. In this case the client may want to separate & retitle assets into separate IRAs; this can also be done post mortem by September 30th of year following the date of death to ensure all DB's get their own life expectancy for stretch RMDs. For all beneficiaries to use their own life expectancy, IRAs must be divided into separate Inherited IRAs by December 31st of the year following the participant's date of death.

Common Mistakes: Post-mortem problems frequently occur when retirement plans have multiple DBs, or a non-DB such as a charity being a partial beneficiary with other DBs. This can be corrected in several ways, but all require that the fiduciary change the decedent's retirement account structure post-mortem. This is permissible until the "Beneficiary Finalization Date." Then, the fiduciary of the estate can "unlump" the beneficiaries by creating separate Inherited IRAs, one for each beneficiary, thereby (1) avoiding all beneficiaries receiving RMDs at the oldest beneficiary's RMD rate, and (2) giving the charitable beneficiary its own account so the DBs can avoid the 5 year rule.

Avoid paying estate taxes with IRA assets: An estate is a non-DB, which accelerates RMDs under the 5 year rule. To avoid this, customize the beneficiary designation forms to say (1) all estate taxes and expenses and (2) all charitable bequests that may apply to a Trust beneficiary of an IRA, must be made by September 30th of the year following the participant's death.

If a minor is named as a direct beneficiary there must be a Guardianship Proceeding[76] since a minor cannot disclaim the assets. It is better to name a Trust as the IRA beneficiary: The IRA will pay RMDs based on the minor's life expectancy to the trust, which then holds the funds until the beneficiary becomes an adult and is entitled to distributions under the trust's terms.

When a DB takes over an Inherited IRA name a beneficiary for when the DB passes away; here the RMD is fixed at the life expectancy of the DB because he is the initial beneficiary. If an Inherited IRA is in the participant's spouse's name (which should almost never be your strategy) and she dies, the successor beneficiaries get the worst RMD treatment because the spouse's life expectancy becomes the measuring life for RMDs, even for the successor beneficiaries. Instead, if the estate tax exemption is fully utilized at the participant's death you should always roll the IRA over to a Spousal IRA. The result upon the death of the spouse is that her beneficiaries receive RMDs based on their life expectancies since the funds are technically in the spouse's IRA as if the participant had never lived.

C. RMDs when Naming Trusts as Beneficiaries

Qualified / "See Through" Trusts: With these trusts the beneficiary is treated as the beneficiary of the retirement account for purposes of determining whether there is a DB. *This is the most*

[76] SCPA Article 17

desirable outcome for a parent to child transfer, especially if the child is still a minor, since RMDs will take place at the rate of the child beneficiary. In order for a See Through Trust to accomplish this end the following requirements must be met:

(1) The trust must be valid under state law,
(2) The trust must have identifiable beneficiaries; “classes,” such as “my children,” are okay, but the beneficiaries with the longest and shortest life expectancies must be identifiable at the time of the transfer,
(3) The trust must be irrevocable before or as of the participant’s death,
(4) A copy of the Trust must be sent to the plan administrator or trustee by 10/31 of the year following participant’s death, or the plan admininistrator or trustee must receive a list of all trust beneficiaries (including contingent and remainder beneficiaries) by September 30 of year following participant’s death, and
(5) All primary trust beneficiaries must be individuals

Conduit Trusts: With a Conduit Trust all distributions paid to the trust are immediately distributed to the beneficiary and not accumulated for future distributions to the successor beneficiaries. This language must be written into the trust in order for it to be effective. In addition, make sure there are separate trusts for each beneficiary in order to take advantage of favorable stretch RMD distributions for the younger beneficiaries.

Accumulation Trusts: These trusts are good if the Settlor / plan participant wants to withhold principal and income from the initial trust beneficiaries, thus it is the opposite of a Conduit Trust. However, these trusts receive the worst RMD treatment as they must use the life expectancy of the oldest beneficiary, even if he or she is only a contingent beneficiary, and even if there is an extremely low probability that beneficiary will collect the funds.

Suggestions for Naming Children as Primary or Contingent Beneficiaries to a Retirement Plan
1. Split up IRA accounts so each child is a contingent beneficiary of his or her own account for RMD purposes (this can be done instead of using See-Through Trusts, and can be done after life)
2. Younger beneficiaries are able to “stretch” RMDs for longer periods of time due to their increased life expectancy, allowing for a longer period of tax deferral.
3. If children need funds now and the retirement plan does not have a Trust as the beneficiary RMD rules won’t matter – they need the money now, so they will take it (and a hefty income tax).
4. If the account Owner’s estate will be subject to **IRD** consider (1) converting the plan to a Roth IRA, and/or (2) having desired charitable legacies paid for out of the retirement plan to minimize short term and future income taxes.
5. Name a “See-Through Trust” as the beneficiary of the plan.

VIII. LIFE INSURANCE ISSUES

Life insurance plays an important part in several people's estate plans: It provides a replacement source of income for a surviving spouse and children, it allows income tax free growth of investments, it allows businesses to cover costs for deceased partners or key employees, and it can be an effective investment for decreasing estate taxes.

A. Parties to a Life Insurance Policy

There are three parties to a life insurance policy: The **Insured** is the measuring life for the policy paying out upon death, the **Owner** can trade the policy and name or change the beneficiary of the policy, and the **Beneficiary** receives policy proceeds upon the insured's death. Each has a different power and purpose relating to tax matters.

B. Benefits of Using Trusts as Beneficiaries

Life insurance policies rarely pay out to minor beneficiaries - the beneficiary is typically a spouse or adult family member. However, two problems arise if a minor beneficiary does become the owner of policy proceeds: (1) The minor cannot claim any of the funds until the age of majority, thereby forcing an SCPA Article 17 Guardianship and continued monitoring (with all of the associated legal fees), and (2) when the beneficiary does reach the age of majority the policy pays out in full, leaving the young adult a financial windfall that he or she may not be old enough to appreciate. Alternatively, a child (or spouse) with spendthrift issues, or substance or creditor issues may not be well served by receiving the entire proceeds outright.

By having the insured policy owner create a revocable trust as beneficiary, with the trust itself naming the child or troubled spouse as beneficiary and naming the distributive terms, the Settlor can both determine how these life insurance proceeds may be used by the child during minority, and future payout options for any remaining proceeds upon the age of majority. In some circumstances the practitioner should strongly urge the client to name a trust as the life insurance beneficiary, such as when there are minor children but no surviving spouse or trustworthy alternate adult caretakers (this avoids a Guardianship Proceeding), where the life insurance proceeds are substantial (allowing for the beneficiary to receive proceeds gradually until they are responsible or adequately protected), or where the beneficiary has displayed self-destructive behavior (thereby protecting the beneficiary from himself).

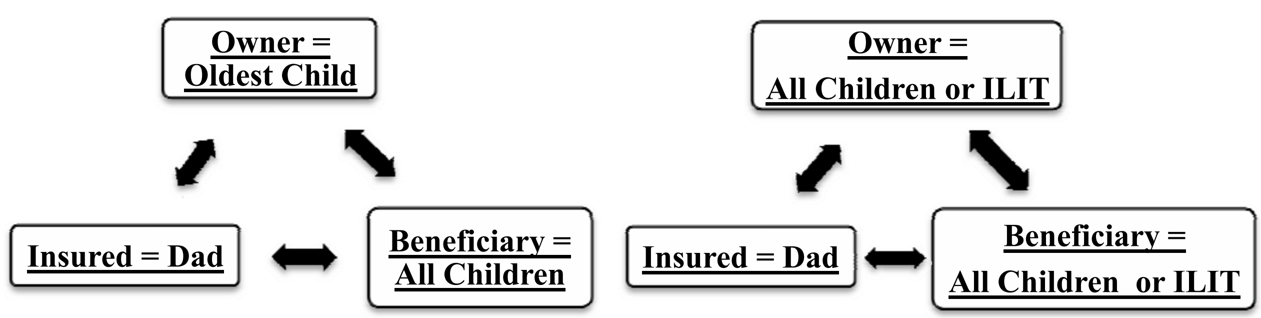
C. Using "ILITS" to Avoid Estate Taxes

Several clients have the misconception that life insurance proceeds always escape estate taxes; this is far from the truth. Life insurance proceeds almost always avoid <u>income</u> taxation to the beneficiary (there are some notable nuanced exceptions, such as when an owner / insured withdraws funds in a heavily front-loaded policy, for beneficiaries who are organizations, policies owned by certain qualified retirement plans, etc.), but life insurance is more often than not included in the insured's gross estate for estate tax purposes if that insured is the owner of the policy. Remember that IRC §2033 includes any property in which the decedent had an ownership interest, IRC §2035 includes the proceeds of existing policies in the former insured/owner's gross estate if it was transferred to a new owner less than three years prior to death,[77] and IRC §2042 includes the death benefit in the estate of the insured/owner if he maintained any incidents of ownership.

The issue typically revolves around "Who owns the policy?" The most frequent way to avoid estate taxation on life insurance proceeds is to not have the insured own the policy either personally or through a revocable trust. An **Irrevocable Life Insurance Trust ["ILIT"]** names an irrevocable trust as both the owner and the beneficiary of a life insurance policy and almost always does not name the insured as the trustee. ILITs are one of the preferred methods of transferring wealth free of estate taxes, since they (1) avoid income taxes for the beneficiary, (2) are not included in the gross estate of the insured, thereby avoiding estate taxes, and (3) the Settlor of the trust can dictate the terms of the trust, provided those terms comport with IRC §§ 2033 – 2042.

D. The "Goodman Rule"

Estate planning is fraught with nuances and traps for the unwary practitioner. Naming the owner and beneficiary of a life insurance policy seems to be an innocent proposition, but like so many aspects of estate planning can lead to unintended outcomes. The **Goodman Rule** states that if the Insurance, Owner and Beneficiary are thre different people, the Owner (upon the death of the Insured) is treated as though he has made a gift of the proceeds.[78]



TAXABLE GIFT (from Oldest Child) **NO GIFT**

As a general rule, to avoid this (and several other) unpleasant outcome in respect to life insurance and taxation, it is advisable to name the Owner and Beneficiary as the same person, persons or trust.

[77] The caveat to this code section relates to newly issued policies: If a life insurance policy is issued within the three year period

[78] Estate of Goodman vs. Commissioner, 156 F 2d 218 (Second Circuit, 1946)

IX. POST- MORTEM PLANNING

During the preparation of a client's estate plan some future variables may not be foreseeable. What if the surviving spouse unexpectedly comes into more wealth than had been anticipated, and will face certain estate taxes upon her death? What if one beneficiary becomes disabled and his Medicaid and SSDI benefits will be jeopardized if he receives funds from his parent's trust?

Post mortem planning may preserve estate assets that would otherwise be spent on administrative expenses or estate and income taxes. Some post-mortem planning, such as reforming a Will, dissolving a trust or having a binding stipulation entered require direct court supervision. Other actions may be done with minimal or no court oversight. It is the latter which is addressed below.

A. Qualified Disclaimers

A **Qualified Disclaimer** allows the recipient of a post-mortem transfer to act as though he or she predeceased the decedent's date of death, allowing the property to pass to the next designated beneficiary of the transfer.[79] A disclaimer may also be a **Partial Disclaimer**, meaning that the initial Beneficiary may receive some of the property (perhaps $200,000 of a $1,000,000 bequest), and disclaim the rest. Disclaimers are widely used in post-mortem planning, but for one to be effective all of the following requirements must be met:

- (I) The disclaimer must be (1) irrevocable, (2) unconditional and (3) in writing
- (II) Person disclaiming must not have accepted any of the disclaimed property's interest
- (III) The disclaimer must be determined within 9 months of the participant's death
- (IV) The written disclaimer must be received by (1) the receiving party, (2) the Surrogate's Court, and (3) the Executor or Trustee
- (V) Disclaimed property must pass to some party other than the disclaiming party and
- (VI) The disclaiming party cannot direct who receives the property

The IRS also allows a disclaimer of joint property with some limitations. With respect to real property between spouses, the surviving joint owner may disclaim any of the joint interest includible in the decedent's gross estate under IRC § 2040.[80] This is different than joint bank, brokerage and investment accounts: The surviving joint owner may not disclaim any portion of the accounts attributable to the consideration he or she furnished. Therefore, if the deceased joint owner provided none of the consideration of the joint property the survivor cannot disclaim any of the property; conversely, if the deceased joint owner provided all of the consideration the survivor may disclaim all, some or none of the account.[81]

[79] IRC §2518
[80] Treas. Reg. §25.2518-2(c)(4)(ii)
[81] Treas. Reg. §25.2518-2(c)(5), Example (13); Example (14)

B. Retirement Plan Modifications

As was discussed earlier, leaving one Inherited IRA to multiple individuals will mean that all RMDs will be based on the oldest beneficiary's life expectancy. However, by separating Inherited IRAs to each individual beneficiary the youngest recipient will be permitted to receive RMDs based on his or her own life expectancy.

Another strategy is to use the deceased participant's non-retirement account estate funds to pay the income taxes on a conversion to a Roth IRA. The benefits in doing this are that (1) the beneficiary's adjusted gross income is not increased by the Inherited IRA's RMDs, and (2) the estate is further depleted, thereby minimizing both estate taxes and taxes assessed on IRD or, at a minimum, decreasing some of the administrative costs associated with tracking long-term RMD deductions. This strategy may be most appropriate for non-spousal beneficiaries with high AGIs, since the Roth distributions will not be added to their income and the associated taxes.

C. Decanting of Trusts

Decanting is the transfer of assets of one trust into another trust with different Trustee(s) and/or provisions.[82] Specifically, these statutory prerequisites are that (1) the Trustee must have absolute power to invade trust principal (cannot only by HEMS / ascertainable standard), (2) the exercise cannot reduce fixed income rights of any party, (3) the new recipients must be in favor of one or more "proper objects" of the old trust (i.e. the same beneficiaries), and (4) the updated trust must not violate public policies that absolve Trustees of their fiduciary duties under EPTL §11-1.7.

Possible reasons for decanting a trust include the desire to eliminate one or more of the trust beneficiaries, extend the term of the trust (for example, beyond a stated age for a beneficiary)., change a power of appointment (limit or broaden the power), or hold a remainderman's interest in further trust.

Decanting can be done with or without Court Approval.[83] A decanted trust must be accomplished by written and acknowledged instrument, filed in Court and delivered to the beneficiaries. In addition, notice must be made to any party who would be cited in a judicial accounting.

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[82] This power was created by EPTL §10-6.6(b) in 1991, though due to the strict requirements needed to decant trust, this option is not frequently utilized.
[83] EPTL §10-6.6(b)(2)

X. SAMPLE ESTATE PLANNING ENGAGEMENT LETTER

PRIVILEGED and CONFIDENTIAL
ATTORNEY-CLIENT WORK PRODUCT

(Date)

(Client Names)
(Address 1)
(Address 2)

Re: Engagement Letter for Estate Planning

Dear (name),

Thank you for choosing to work with our firm for your Estate Planning goals. We know that this is a very important activity in clients' lives, and we look forward to working with you to help you achieve your needs and desires.

This Engagement Letter is furnished to you in accordance with Part 1215 of the Joint Rules of the Appellate Division of New York. Having delivered you the "Statement of Client's Rights" as mandated by New York law, we have decided to undertake your legal representation in connection with the matters described below:

SCOPE OF REPRESENTATION

Legal representation commences once our bank account receives the funds you have paid our firm for this legal matter. The fees you have been charged entitle you to the estate planning consultations outlined below as well as preparation, explanation and execution of the following documents for your Estate Planning needs:

- An in-person **Strategy Session**, during which time we will review your current legal position and plan your Estate Planning documents. We will also briefly review your investment accounts and beneficiary designations.
- You will receive via mail or email **drafts of the following legal documents:**
    - ☐ **Power of Attorney(s)**
    - ☐ **Health Care Proxy(ies)**
    - ☐ **Living Will(s)**
    - ☐ **Advanced Guardianship Directive(s)**
    - ☐ **Disposition of Remains Directive(s)**
    - ☐ **Last Will & Testament(s)**
    - ☐ **Revocable Trust(s)**

- Once our Firm receives corrections of your documents we will schedule an in-person **Execution Session**, during which time you will execute your legal documents. Occasionally we may require two Execution Sessions in order to effectively execute all of your documents. If so, you will not be charged additional fees for the second session. We will also assist you in implementing any recommended changes to your Beneficiary Designation Forms for your retirement accounts and life insurance policies, and changes to any Deeds to real estate.

Legal representation in this matter ceases upon the earliest of the following events: (1) upon Execution of the documents listed above, (2) client withdrawal from representation, or (2) rightful withdrawal of counsel. If representation ceases prior to execution for any reason, Counsel will be entitled to reasonable compensation for work completed at a rate of **$250 per hour,** not to exceed any flat-fee agreed-upon below. Though representation in this matter typically ceases upon execution of your legal documents, Counsel may hold onto your original Wills and / or Trusts for safekeeping to avoid potential legal disputes in the event you unexpectedly pass away or are incapacitated. You may request and receive your original executed documents at any time.

Lastly, you have the right to consult with outside counsel regarding this legal matter either preceding, during or after your representation.

SCOPE OF REPRESENTATION FOR MARRIED COUPLES

It is important for you, as a married couple, to know that what you share with us is confidential: If you have a secret you wish to keep from your spouse you may confide in your attorney. However, you should also know that under certain circumstances your attorneys may have to withdraw from representing you if your estate planning objectives are so inconsistent with that of your spouse that it is extremely difficult for your attorneys to effectively represent both of your interests simultaneously. If this does occur your attorneys may have to withdraw from representing both of you simultaneously after you have both received full and fair notice, and Counsel will be entitled to reasonable compensation for work completed at a rate of **$250 per hour,** not to exceed any flat-fee agreed-upon below. Additionally, any information that is shared with both your attorney and your spouse present is NOT protected by attorney-client privilege if your spouse later decides to disclose the information to another party.

COUNSEL'S RESPONSIBILITIES

Counsel (**Timins & Durante, LLP)** will be responsible for reviewing the Client's legal and financial situation, making recommendations regarding naming Agents and suggesting estate tax strategies, drafting your documents, and supervising document execution ceremonies.

By law, Council is required to maintain privacy of all of your legal matters. Any sharing of information will require your prior approval, or will be presented as a "hypothetical" circumstance to those not involved with the matter.

Counsel agrees to notify the Client promptly of all significant developments, and to consult with the Client in advance as to any significant decisions attendant to those developments.

CLIENT'S RESPONSIBILITIES

The Client (you) are expected to provide all information known by or available to you that may aid Counsel in representing you in these matters and to pay the Counsel for the performance of such legal services.

The Client is also responsible for the following tasks:

- Informing any named Agents of his or her potential legal responsibilities.
- Informing any past Agents whose status has been revoked of the revocation.
- Procuring and switching any financial firm's independent Power of Attorney forms.
- Destroying any originals or drafts of legal documents received by you either from our Firm or from a former attorney.
- Ordering Beneficiary Designation forms for retirement accounts and life insurance policies (if applicable).

You may discontinue your representation at any time. If such cessation is not due to Counsel's wrongful conduct the Client shall pay Counsel for all earned legal fees at a price of **$250 per hour** up to, but not exceeding, the agreed upon flat fee listed below.

OUTSIDE COUNSEL

Occasionally some matters you want addressed are more complicated than the Firm handles on a regular basis. In these rare circumstances and with your informed consent the Firm may use outside legal consultants to ensure that these complex issues are handled correctly by specialists in the field. Any additional billing will be disclosed to you by the Firm and billed directly from **Timins & Durante, LLP** for your convenience.

FEES, EXPENSES AND BILLING PRACTICE

All fees due to this engagement are due prior to the commencement of the drafting of any legal documents and consultative review of legal strategies.

The flat fee for services to be provided is:	**$________**
Fees for any services not explicitly named above at an hourly rate of:	**$ 250 / hr.**
As of the day of this Retainer Agreement you have paid:	**$________**

The fees listed above do NOT include the costs of filing any Deeds or other legal paperwork with any courts, city, town, village, county or state government agencies, overnight mailings, or other fees not traditionally associated with legal estate planning services.

Because we will be talking about tax strategies in the course of legal representation some or all of your legal fees may be income tax deductible. Please keep this retainer and inform your accountant of the legal fees you paid for this legal matter.

SHARED OFFICE SPACE

As of the date of this Retainer Agreement **Timins & Durante, LLP** shares office space with [redacted] **LLC**, and [redacted] **and Associates**, the latter being a law firm which is unaffiliated with **Timins & Durante, LLP.** For purposes of maintaining the confidentiality of your information, if you are unsure whether you are speaking with an attorney from **Timins & Durante, LLP** please ask prior to sharing your personal information.

ARBITRATION

In the event that a dispute arises between us relating to our fees, you may have the right to arbitration of the dispute pursuant to Part 137 of the Rules of the Chief Administrator of the Courts, a copy of which will be provided to you upon request.

Please feel free to contact us with any questions or comments you have.

We look forward to working with you!

____________________________ ____________________

Daniel A. Timins Date
Partner, Attorney of Law

XI. SAMPLE CLIENT PROFILE

Timins & Durante, LLP

45 Knollwood Road
3rd Floor
Elmsford, New York 10523

Phone: (914) 819-0663
Fax: (914) 517-5942
www.tdlawoffices.com

Estate Planning Client Profile

CLIENT PROFITE

Important Message Regarding Information in This Pamphlet

In order to achieve a comprehensive estate plan it is essential that you prepare for all legal uncertainties. This includes making a commitment to spending time collecting your legal and financial documents and implementing the steps recommended by your estate planning attorney. **Addressing your estate planning needs while you are healthy and mentally alert saves you and your heirs much more money and time than attempting to take action when you are incapacitated or, worse, deceased.** Consider this:

If you are incapacitated before your estate plan is in order: Loved ones may act on your behalf in ways you did not desire. They may attempt to keep you alive in a seriously incapacitated state, deny certain types of medication, or deal with your finances in a way that you would not approve. Taking time now to deal with these problems will ensure your living wishes are adhered to in a way that protects your dignity and desires.

If you die before your estate plan is in order: Your beneficiaries will almost certainly have to pay tens of thousands of additional dollars of legal fees. Your estate may have to pay hundreds of thousands of additional dollars in extra taxes. Even worse, your heirs may contest legal guardianship of your minor children, or contest who receives the property and family heirlooms you leave behind; in these circumstances some of your estate's assets will often be used for additional legal fees. Worst of all, some third parties involved in your final years may become predators if they perceive you to be in a weakened physical or mental state. Preparing your estate for transition after death ensures that your minor children are taken care of, you receive the type of funeral you desire, you save money on estate and income taxes, your property goes to whom you want it to go to, and ensures you leave the legacy you desire to those you think deserve it most.

In order to make the most of your consultation time, please take time to fill in this pamphlet as completely as possible. If you are uncertain of an answer please contact us or leave the space blank so we can answer it together during our consultation. Make sure to bring as many of the documents you can find listed on Page 14 to our consultation.

We look forward to working with you.

Client #1	Client #2
Full Legal Name (as you wish it to appear on your documents)	**Full Legal Name** (as you wish it to appear on your documents)
Date of Birth	**Date of Birth**
Social Security Number or Tax ID Number (necessary for establishing trusts and transferring property)	**Social Security Number or Tax ID Number** (necessary for establishing trusts and transferring property)
YES NO	YES NO
Are you a United States Citizen? (Circle One)	**Are you a United States Citizen?** (Circle One)
If not a citizen, what is your country of citizenship? (Circle One)	**If not a citizen, what is your country of citizenship?** (Circle One)
Cell Phone Number	**Cell Phone Number**
Preferred Email address	**Preferred Email address**

Home Street Address: Street	**Mailing Address (if different): Street**
Home City, State, Zip	**Mailing City, State, Zip**
Home Phone Number	**Home Fax Number** (if applicable)

Occupation	**Occupation**
Business Name	**Business Name**
Business Address (for our records)	**Business Address** (for our records)
City, State, Zip	**City, State, Zip**

Primary Care Physician's Name	**Primary Care Physician's Name**
Primary Care Physician's Phone Number	**Primary Care Physician's Phone Number**
Primary Care Physician's Street Address	**Primary Care Physician's Street Address**
Primary Care Physician's City, State, Zip	**Primary Care Physician's City, State, Zip**

CHILDREN & GRANCHILDREN INFORMATION

Children & Grandchildren (including adopted and step-children)		
CHILD #1 **M F**		
Male/Female (Circle one)	**Full Legal Name** & whether child is **Adopted** or a **Step-Child**	**Date of Birth**
Social Security Number	**Address** (if different from your address)	**Name of child's Current Spouse**

Grandchildren from Child 1

M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**

CHILD #2 **M F**		
Male/Female (Circle one)	**Full Legal Name** & whether child is **Adopted** or a **Step-Child**	**Date of Birth**
Social Security Number	**Address** (if different from your address)	**Name of child's Current Spouse**

Grandchildren from Child 2

M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**

CHILD #3 **M F**		
Male/Female (Circle one)	**Full Legal Name** & whether child is **Adopted** or a **Step-Child**	**Date of Birth**
Social Security Number	**Address** (if different from your address)	**Name of child's Current Spouse**

Grandchildren from Child 3

M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**

CHILD #4 M F		
Male/Female (Circle one)	**Full Legal Name** & whether child is **Adopted** or a **Step-Child**	**Date of Birth**
Social Security Number	**Address** (if different from your address)	**Name of child's Current Spouse**

Grandchildren from Child 4

M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**

CHILD #5 M F		
Male/Female (Circle one)	**Full Legal Name** & whether child is **Adopted** or a **Step-Child**	**Date of Birth**
Social Security Number	**Address** (if different from your address)	**Name of child's Current Spouse**

Grandchildren from Child 5

M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**
M F		
Male / Female	**Legal Name**	**Date of Birth**

*If necessary, please list additional children and/or grandchildren on the back of this page.

Are there any other children? From a prior marriage, estranged or non-marital.

YES NO			
	Full Name	**Date of Birth**	**Social Security Number**
	Full Name	**Date of Birth**	**Social Security Number**

Do you have any deceased children?

YES NO			
	Full Name	**Date of Birth**	**Date of Death**
	Full Name	**Date of Birth**	**Date of Death**

<u>If you have NO living children OR grandchildren</u>, please list your living and deceased family members up to and including your brothers, sisters, nieces and nephews in the space below.

Full Name	**Relationship to you** (Sister, Nephew, etc.)	**Date of Birth**
Address (Number, Street, City, State, ZIP Code)	**Phone Number**	

Full Name	**Relationship to you** (Sister, Nephew, etc.)	**Date of Birth**
Address (Number, Street, City, State, ZIP Code)	**Phone Number**	

Full Name	**Relationship to you** (Sister, Nephew, etc.)	**Date of Birth**
Address (Number, Street, City, State, ZIP Code)	**Phone Number**	

PARENT INFORMATION

Client #1	Client #2
Mother's Name (including Maiden name)	**Mother's Name** (including Maiden name)
YES NO	YES NO
Is your Mother living? (Circle One)	**Is your Mother living?** (Circle One)
Father's Name	**Father's Name**
YES NO	YES NO
Is your Father living? (Circle One)	**Is your Father living?** (Circle One)
If living, Address: Street	**If living, Address: Street**
City, State, Zip	**City, State, Zip**
Mother's Date of Birth	**Mother's Date of Birth**
Father's Date of Birth	**Father's Date of Birth**

YOUR FINANCIAL and INSURANCE INFORMATION

REAL ESTATE

Please list all real property (Residential, Investment, Rental)

					Ownership **Client 1, 2 or Joint**
1.		$	$	$	
	Legal Address	Estimated Value	Cost Basis	Mortgage Balance	
2.		$	$	$	
	Legal Address	Estimated Value	Cost Basis	Mortgage Balance	
3.		$	$	$	
	Legal Address	Estimated Value	Cost Basis	Mortgage Balance	

BANK ACCOUNTS

Savings and/or checking (not brokerage accounts)

				Ownership **Client 1, 2 or Joint**
1.			$	
	Bank Name	**Account Number**	**Account Value**	
2.			$	
	Bank Name	**Account Number**	**Account Value**	
3.			$	
	Bank Name	**Account Number**	**Account Value**	
4.			$	
	Bank Name	**Account Number**	**Account Value**	
5.			$	
	Bank Name	**Account Number**	**Account Value**	

BANK SAFETY DEPOSIT BOX

Please list locations of any bank safety deposit boxes, and indicate who is a signatory to each box.

1.			
	Bank Branch where box is located. Include Address, City, State	**Box Number**	**Name(s) of person(s) who can open the box.**

2.			
	Bank Branch where box is located. Include Address, City, State	**Box Number**	**Name(s) of person(s) who can open the box.**

NON-RETIREMENT BROKERAGE/STOCK ACCOUNTS

Include any non-retirement stock or mutual fund accounts, UGMA/UTMAs, 529 Plans or custodial accounts you are a signatory on (i.e. accounts for your children).

Ownership **Client 1, 2 or Joint**

1.			$	
	Brokerage Institution Name	Account Number	Account Value	
2.			$	
	Brokerage Institution Name	Account Number	Account Value	
3.			$	
	Brokerage Institution Name	Account Number	Account Value	
4.			$	
	Brokerage Institution Name	Account Number	Account Value	
5.			$	
	Brokerage Institution Name	Account Number	Account Value	
6.			$	
	Brokerage Institution Name	Account Number	Account Value	
7.			$	
	Brokerage Institution Name	Account Number	Account Value	

RETIREMENT ACCOUNTS

Pension / IRA / 401(k) / 403(b) /Annuities / Roth IRA / SEP / KEOGH accounts.

Ownership **Client 1, 2 or Joint**

1.			
	Company Name	**Account Number**	
	Type of Plan (IRA, 401(k), etc.)	**Value of Account**	
	Beneficiary(ies)		

2.			
	Company Name	**Account Number**	
	Type of Plan (IRA, 401(k), etc.)	**Value of Account**	
	Beneficiary(ies)		

3.			
	Company Name	**Account Number**	
	Type of Plan (IRA, 401(k), etc.)	**Value of Account**	
	Beneficiary(ies)		

4.			
	Company Name	**Account Number**	
	Type of Plan (IRA, 401(k), etc.)	**Value of Account**	
	Beneficiary(ies)		

5.			
	Company Name	**Account Number**	
	Type of Plan (IRA, 401(k), etc.)	**Value of Account**	
	Beneficiary(ies)		

6.			
	Company Name	**Account Number**	
	Type of Plan (IRA, 401(k), etc.)	**Value of Account**	
	Beneficiary(ies)		

LIFE INSURANCE Do you own any Term, Whole Life, Universal Life or Employer Insurance?			Ownership **Client 1, 2 or Joint**
1.			
	Insurance Company Name	**Policy Number**	
	Type of Policy (Term, Whole, Universal, Business, etc.)	**Face Amount of Policy**	
	Beneficiary(ies)		

2.			
	Insurance Company Name	**Policy Number**	
	Type of Policy (Term, Whole, Universal, Business, etc.)	**Face Amount of Policy**	
	Beneficiary(ies)		

3.			
	Insurance Company Name	**Policy Number**	
	Type of Policy (Term, Whole, Universal, Business, etc.)	**Face Amount of Policy**	
	Beneficiary(ies)		

4.			
	Insurance Company Name	**Policy Number**	
	Type of Policy (Term, Whole, Universal, Business, etc.)	**Face Amount of Policy**	
	Beneficiary(ies)		

5.			
	Insurance Company Name	**Policy Number**	
	Type of Policy (Term, Whole, Universal, Business, etc.)	**Face Amount of Policy**	
	Beneficiary(ies)		

BUSINESS INTERESTS Do you own a business? Are you a member of a Limited Partnership, an LLP, FLP, LLC or an S-Corp?				Ownership **Client 1, 2 or Joint**
1.				
	Business Name		**Description of Business**	
	$			
	Estimated Value of Business.	**% owned**	**Sole Proprietorship/Partnership/LLC/S-Corp?**	
2.				
	Business Name		**Description of Business**	
	$			
	Estimated Value of Business.	**% owned**	**Sole Proprietorship/Partnership/LLC/S-Corp?**	
3.				
	Business Name		**Description of Business**	
	$			
	Estimated Value of Business.	**% owned**	**Sole Proprietorship/Partnership/LLC/S-Corp?**	
4.				
	Business Name		**Description of Business**	
	$			
	Estimated Value of Business.	**% owned**	**Sole Proprietorship/Partnership/LLC/S-Corp?**	

IMPORTANT MISCELLANEOUS ASSETS Please list any other significant assets not already listed (cars, jewelry, artwork, antiques collection, boats, aircraft, patents, copyrights, etc.)			Ownership **Client 1, 2 or Joint**
1.		**$**	
	Asset	**Estimated Value**	
2.		**$**	
	Asset	**Estimated Value**	
3.		**$**	
	Asset	**Estimated Value**	
4.		**$**	
	Asset	**Estimated Value**	
5.		**$**	
	Asset	**Estimated Value**	
6.		**$**	
	Asset	**Estimated Value**	

SPECIAL INSURANCE NEEDS		
Have you been a victim of Identity Theft? YES NO	If "YES", when:	
Do you frequently travel outside of the United States often? YES NO	If "YES", where:	
Do you hire any domestic employees (housekeeping, child sitters)? YES NO	If "YES", are any of them illegal or undocumented immigrants? YES NO	(Name #1) (Name #2)
Are you a Board Member of a Co-op Board or Publicly Traded Company? YES NO	If "YES", name board:	
Do you consider yourself to be a "Well Known Person" to the public (celebrity, politician, public figure)? YES NO		
Are you a "Collector" of valuable collectables (stamps, jewelry, artwork, etc.) YES NO	If "YES", list specific information on prior page under "Miscellaneous Assets"	(Insurance Company) (Policy Number)
Do you own substantial luxury goods (yachts, airplanes, luxury auto, etc.) YES NO	If "YES", what type of goods?	(Insurance Company) (Policy Number)
Do you have an Umbrella Insurance Policy? YES NO	(Insurance Company) (Policy Number)	

POTENTIAL LEGAL RESPONSIBILITIES		
Have you been divorced? YES NO	(Former Spouse #1 Name) (Former Spouse #2 Name)	
Do you have children whom you are not the primary custodian for? YES NO	(Name of non-custodial Child #1) (Name of non-custodial Child #2)	(Name of non-custodial Child #3) (Name of non-custodial Child #3)
Are you named Trustee of any Trust? YES NO Don't Know	(Name of Trust #1)	(Name of Trust #2)
Are you named Executor of any Will? YES NO Don't Know	(Name of Will #1)	(Name of Will #2)
Are you named Agent of any Power of Attorney? YES NO Don't Know	(Represented Person #1)	Represented Person #2)

CURRENT ADVISORS		
ATTORNEY	**Name**	**Law Firm Name**
May we contact them? YES NO	**Address**	**Telephone number**
ACCOUNTANT	**Name**	**Accounting Firm Name**
May we contact them? YES NO	**Address**	**Telephone number**
FINANCIAL PLANNER	**Name**	**Financial Company Name**
May we contact them? YES NO	**Address**	**Telephone number**
INSURANCE AGENT	**Name**	**Insurance Company Name**
May we contact them? YES NO	**Address**	**Telephone number**

DOCUMENTS NEEDED FOR CURRENT PLANNING

Please bring with you the following documents to assist in the preparation of your estate plan. Remember, many of these documents may not apply to you currently.

	Does this apply to you?	**Did you bring it?**
Last Will and Testament (copies or originals)		
Revocable Trust (also called a "Living Trust")		
Health Care Proxies, Living Wills, Powers of Attorney		
Federal and State Income Tax Returns for the last three years filed.		
Deeds to all real property (copies or originals)		
If you own a Co-op: a copy of the share certificate		
Deed to any burial plot (copies or originals)		
Insurance Policies (copies or originals)		
Latest bank statements (copies or originals)		
Latest brokerage statements (copies or originals)		
Latest retirement account statements (401(k), IRAs, Pensions, etc)		
All Gift Tax Returns (IRS Form 709)		
Estate Tax Return IF former spouse is deceased (IRS Form 706)		
Pension and profit sharing agreement (copies or originals)		
Buy-Sell Agreement for a closely-held or family corporation		
Partnership Agreements, past or present (copies or originals)		
Divorce decree or separation agreement (copies or originals)		
Pre-Nuptial or Ante-Nuptial agreement (copies or originals)		