Objectives of Estate Planning

- Assuring that property passes to the people or institutions you choose after death.
- Establishing the timing for the distribution of property after death.
- Appointing the right people to handle your estate, liquidate your trust, take care of minor children.
- Naming people to make your financial and/or medical decisions if you become incapacitated.
- Eliminating, minimizing, or deferring estate taxes.
- Minimizing the cost of estate administration.
Estate Planning Documents

- Last Will and Testament (Requires Probate)
- Revocable or “Living” Trust (No Probate)
- Durable Financial Power of Attorney
- Advance Medical Directives
  - Durable Health Care Power of Attorney
  - Living Will
  - Guardianship Avoidance
  - Medical Records Release
The Probate Process

The court process by which a Will is proven valid; assets are inventoried; debts are paid; creditors are notified; and ultimately assets are distributed to legatees, heirs or other beneficiaries.

**Probate Assets**
- Sole Name Property
- Tenants in Common Property
- Beneficiary Designations: Estate, Executor, Personal Representative

**Non-Probate Assets**
- Trusts
- Joint Assets
- Transfer-on-Death (TOD)
- Beneficiary Designations: Persons, trusts, entities
Should Probate Be Avoided?

- Expensive: court costs; publication costs, insurance costs, executor commissions, attorneys fees.
- Time consuming:
  Often > 1 year delayed distribution to beneficiaries (6 months asset freeze).
- Inflexibility: publication, accountings, inventories, court supervision (can be waived).
- Public process (watch out for marketers).
Revocable or “Living” Trust

**Step One: Creation**

Grantor (G) makes agreement/declaration and transfers property in trust to be managed by one or more trustees (T) for his/her benefit during his/her lifetime and incapacity and for the benefit of his/her heirs upon death, i.e. beneficiaries (B)

**Step Two: Funding**

Personal property (art, furniture, jewelry, car), real property (home, condo), bank accounts; investment accounts, life insurance, retirement assets (for non spouses).
1. Single Trust

\[ G \rightarrow T \rightarrow B \]

- G = grantor
- T = trustee
- B = beneficiary

2. Joint Trust

\[ T_1 \rightarrow T_2 \rightarrow G_1 \rightarrow G_2 \rightarrow B_1 \rightarrow B_2 \]

- G_1 = grantor
- T_1 = trustee
- B_1 = beneficiary
- G_2 = grantor
- T_2 = trustee
- B_2 = beneficiary

Assets
3. Separate Trusts

T = H

G = H, B = H

T = W

G = W, B = W

Assets

H = Husband
W = Wife
Uses for Trusts

During the life of the grantor:
Grantor = Trustee = Beneficiary
- Mere change of title of assets

In case of Incapacity:
Successor trustee (ST) manages assets for the benefit of the incapacitated grantor
- Works like Power of Attorney
Uses for Trusts (continued)

*In case of Death:* Successor trustee distributes trust assets to the beneficiaries named in the trust without court probate.

- Works like a Will

Diagram:
- **ST** = Santiago
- **G** = Maria
- **B** = Santiago/others
- **$** = Trust assets
Benefits of Trusts

- Avoids Probate and Ancillary Probate
- Privacy and confidentiality
- Avoids Court guardianship
- No Court Supervision
- Asset Management for Young Beneficiaries
- Minimizes Estate Administration expenses
- Can include tax saving/deferral mechanisms
Myths about Trusts

- Requires annual tax returns
- Avoids all estate taxes
- Annual maintenance fees
- Fees for future assets
- Administrative inconvenience
- Cost
Recommendations and Questions

- Execute Estate Planning
- Avoid Probate
- Avoid individually titled assets
- Review beneficiary designations
**Estate Taxes & Gift Taxes**

*Income Taxes, Capital Gains Taxes, Taxes on Dividends, Real Property Taxes and......*

*Estate Tax:* IRS and some States impose a tax on transfers at death of non-exempt assets exceeding the applicable exemption, regardless of how transfer takes place.

*Gift Tax:* IRS imposes a tax on lifetime gifts exceeding annual exemption.
The 2010 Act

“Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010” signed 12/17/10 by President Obama.

<table>
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<th>Year</th>
<th>Exclusion US/Residents</th>
<th>Non-Residents</th>
<th>Max Tax</th>
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<tr>
<td>2010</td>
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</tr>
<tr>
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<tr>
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<td>55%</td>
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2013?

2010 Act sunsets.....

If Congress does not act by 12/31/12 the estate tax exemption goes back to 2001 levels of $1,000,000 with maximum tax rate of 55%.

Options for Congress:

1) Keep current exemptions and make them permanent. Wishful thinking!

2) Extend current exemptions for 2 more years.. Déjà vu!

3) Have permanent exemption of $3,5 million with 45% top rate (2009 regime favored by Democrats).
<table>
<thead>
<tr>
<th>State</th>
<th>Exemption</th>
<th>Tax Rate</th>
</tr>
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<tr>
<td>DC</td>
<td>$1,000,000</td>
<td>16%</td>
</tr>
<tr>
<td>Maryland</td>
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<tr>
<td>Virginia</td>
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</tbody>
</table>
Gift Tax Exemptions

- $5,120,000 Lifetime Exemption (for US Citizens and residents only) for 2011, 2012 (back to $1,000,000 in 2013)
- $13,000 Annual Exclusion Gifts (indexed)
- Unlimited Payments of Medical and Educational Expenses if paid to providers
- Unlimited Transfers to Charities
- Unlimited Marital deduction for transfers to U.S. Citizen Spouse
- $139,000 Annual Exclusion for Gifts to Non-U.S. Citizen Spouse (indexed)
Estate Taxes for U.S. Citizens and Residents

Taxed on Worldwide Assets, including probate and non-probate assets (i.e., personal property, joint property, real estate, stocks, bonds, mutual funds, life insurance, present value of surviving spouse’s pension, bank accounts, business interests, etc.)
Estate Taxes for Non-Residents

Taxed only on U.S.-Situs Assets

- Stocks in US companies
- US bonds
- Real estate located in the US
- Tangible personal property located in the US

*except:*
- U.S. Bank accounts
- Life insurance proceeds
- Pension from International Organizations
Estate Tax Residency Test

**Income Tax Test:**

- Substantial Presence Test

**Estate and Gift Tax Test:**

- Domicile Test = physical presence with intent to remain in the U.S.

Many G-4s who are non-residents for income taxes **ARE** considered residents for estate tax purposes.
Domicile Facts and Circumstances Test

- Time allocation between U.S. and other countries
- Length of stay in the US
- Location of residence, assets, family
- Immigration status, including that of other family members
- Integration in U.S. society, memberships & other affiliations
- Business interests
- Estate Plan
- Cemetery Plots
Taxation of Joint Property

*Fifty Percent Rule:*

- If the *surviving spouse* is a U. S. citizen, 50% of the value of the joint assets is included in the decedent’s estate.

*One Hundred Percent Rule:*

- If the *surviving spouse* is a non-U. S. citizen, 100% of the value of the joint assets is included in the decedent’s estate, unless surviving spouse challenges the IRS by proving history of contributions.
Marital Deduction for U.S. Citizen Spouse

If a decedent is survived by a U.S. Citizen spouse, the unlimited marital deduction delays estate tax until the death of the surviving spouse.

Careful: Permanent Resident surviving spouses do not qualify for the marital deduction.
No Marital Deduction for Non-U.S. Citizen Spouse

- No marital deduction allowed for assets exceeding the estate tax exemption.
- Estate taxes are due within 9 months of death, unless assets are transferred into a Qualified Domestic Trust (a.k.a. “QDOT”) for the benefit of the non-citizen surviving spouse (G-4 or permanent resident).
Under the 2010 Act, any unused estate tax exemption of the previous spouse to die is “portable” and can be added to the exemption of the surviving spouse.

$5M exemption at W’s death is increased by $2M so NO estate tax is due.
Portability Traps

- Not automatic: must make election which requires preparation of Federal Estate Tax Return
- Risk of Audit
- Not available for non-residents
- Not indexed for inflation
- Will disappear after 2012
- Applies to “last” spouse only
- Not available for State estate tax
- No control over assets at second death
- Appreciation of assets in 2\textsuperscript{nd} estate could trigger additional estate taxes at 2\textsuperscript{nd} death
- Loss of credit shelter estate tax free growth
- Loss of asset management
Bypass/Credit Shelter Trust

- Exemption amount of 1st spouse can be “sheltered” in Family Trust/Credit Shelter/Bypass Trust.

Heirs get:
- $3M + growth
- $3M
- $6 Million (no tax)

- Bypass Trust benefits surviving spouse and can be used for other family members
- Upon the death of 2nd spouse, exemption amount (plus growth!) goes to heirs free of estate tax
Bypass Trust Advantages

- No Federal Estate Returns for estates under 5M.
- No Risk of Audit.
- Available to Citizens, residents, and non-residents.
- Qualifies for full step up in basis at 1\textsuperscript{st} death.
- Permanent (will not disappear after 2012).
- Control of assets after remarriage.
- Can use for State exemption.
- Avoids estate taxes on appreciation.
Excess Marital Share for U.S Surviving Spouse

Assets exceeding estate tax exemption can be transferred (1) outright, (2) to the revocable trust (RLT) or (3) to a marital trust (MT) using the unlimited marital deduction (zero tax)

- **(1) $2M**: H → W
- **(2) $2M**: W → RLT
- **(3) $2M**: H → MT

H: RLT $7M
W: RLT
MT
BP $5M
Excess Marital Share for Non-U.S Surviving Spouse

Assets exceeding estate tax exemption can be transferred to a QDOT using the unlimited marital deduction.

- **US co-trustee required**
- **No Estate Tax on “income”**
- **35% Estate Tax on “principal”**

**Diagram**:
- H RLT $7M → QDOT $2M → BP $5M
- $2M → QDOT $2M
- $5M → BP $5M
- NO TAX
Recommendations and Questions

- Consider using bypass, qualified domestic and marital trusts.
- Consider making lifetime gifts.
- Consider making charitable gifts.
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