MAINE CENTER *for* ELDER LAW

A PRACTICE OF PERKINS | THOMPSON

FREQUENTLY ASKED QUESTIONS

ESTATE PLANNING

Q: What is estate planning?

When someone passes away, his or her property must somehow pass to another person. In the United States, any competent adult has the right to choose the manner in which his or her assets are distributed after his or her passing. (The main exception to this general rule involves what is called a spousal right of election which disallows the complete disinheritance of a spouse in most states.) A proper estate plan also involves strategies to minimize potential estate taxes and settlement costs as well as to coordinate what would happen with your home, your investments, your business, your life insurance, your employee benefits (such as a 401K plan), and other property in the event of death or disability. On the personal side, a good estate plan should include directions to carry out your wishes regarding health care matters, so that if you ever are unable to give the directions yourself, someone you know and trust can do that for you.

Q: Why is it important to establish an estate plan?

Sadly, many individuals don't engage in formal estate planning because they don't think that they have "a lot of assets" or mistakenly believe that their assets will be automatically shared among their children upon their passing. If you don't make proper legal arrangements for the management of your assets and affairs after your passing, the state's intestacy laws will take over upon your death or incapacity. This often results in the wrong people getting your assets as well as higher estate taxes.

If you pass away without establishing an estate plan, your estate would undergo probate, a public, court-supervised proceeding. Probate can be expensive and tie up the assets of the deceased for a prolonged period before beneficiaries can receive them. Even worse, your failure to outline your intentions through proper estate planning can tear apart your family as each person maneuvers to be appointed with the authority to manage your affairs. Further, it is not unusual for bitter family feuds to ensue over modest sums of money or a family heirloom.

Q: What does my estate include?

Your estate is simply everything that you own, anywhere in the world, including:

- Your home or any other real estate that you own
- Your business
- Your share of any joint accounts
- The full value of your retirement accounts
- Any life insurance policies that you own
- Any property owned by a trust, over which you have a significant control

Q: How do I name a guardian for my children?

If you have children under the age of eighteen, you should designate a person or persons to be appointed guardian(s) over their person and property. Of course, if a surviving parent lives with the minor children (and has custody over them) he or she automatically continues to remain their sole guardian. This is true despite the fact that others may be named as the guardian in your estate planning documents. You should name at least one alternate guardian in case the primary guardian cannot serve or is not appointed by the court.

Q: What estate planning documents should I have?

A comprehensive estate plan should include the following documents, prepared by an attorney based on in-depth counseling which takes into account your particular family and financial situation:

A Living Trust can be used to hold legal title to and provide a mechanism to manage your property. You (and your spouse) are the Trustee(s) and beneficiaries of your trust during your lifetime. You also designate successor Trustees to carry out your instructions in case of death or incapacity. Unlike a will, a trust usually becomes effective immediately after incapacity or death. Your Living Trust is "revocable" which allows you to make changes and even to terminate it. One of the great benefits of a properly funded Living Trust is the fact that it will avoid or minimize the expense, delays and publicity associated with probate.

If you have a Living Trust-based estate plan, you also need a pour-over will. For those with minor children, the nomination of a guardian must be set forth in a will. The other major function of a pour-over will is that it allows the executor to transfer any assets owned by the decedent into the decedent's trust so that they are distributed according to its terms.

A Will, also referred to as a Last Will and Testament, is primarily designed to transfer your assets according to your wishes. A Will also typically names someone to be your Executor, who is the person you designate to carry out your instructions. If you have minor children, you should also name a Guardian as well as alternate Guardians in case your first choice is unable or unwilling to serve. A Will only becomes effective upon your death, and after it is admitted by a probate court.

A Durable Power of Attorney for Property allows you to carry on your financial affairs in the event that you become disabled. Unless you have a properly drafted power of attorney, it may be necessary to apply to a court to have a guardian or conservator appointed to make decisions for you during a period of incapacitation. This guardianship process is time-consuming, expensive, emotionally draining and often costs thousands of dollars.

There are generally two types of durable powers of attorney: a present durable power of attorney in which the power is immediately transferred to your agent (also known as your attorney in fact); and a springing or future durable power of attorney that only comes into effect upon your subsequent disability as determined by your doctor. Anyone can be designated, most commonly your spouse or domestic partner, a trusted family member, or friend. Appointing a power of attorney assures that your wishes are carried out exactly as you want them, allows you to decide who will make decisions for you, and is effective immediately upon subsequent disability.

The law allows you to appoint someone you trust to decide about medical treatment options if you lose the ability to decide for yourself. You can do this by using a Durable Power of Attorney for Health Care or Health Care Proxy where you designate the person or persons to make such decisions on your behalf. You can allow your health care agent to decide about all health care or only about certain treatments. You may also give your agent instructions that he or she has to follow. Your agent can then ensure that health care professionals follow your wishes. Hospitals, doctors and other health care providers must follow your agent's decisions as if they were your own.

A Living Will informs others of your preferred medical treatment should you become permanently unconscious, terminally ill, or otherwise unable to make or communicate decisions regarding treatment. In conjunction with other estate planning tools, it can bring peace of mind and security while avoiding unnecessary expense and delay in the event of future incapacity.

Some medical providers have refused to release information, even to spouses and adult children authorized by durable medical powers of attorney, on the grounds that the 1996 Health Insurance Portability and Accountability Act, or HIPAA, prohibits such releases. In addition to the above documents, you should also sign a HIPAA authorization form that allows the release of medical information to your agents, your successor trustees, your family and other people whom you designate.

LIVING TRUSTS

Q: What is Probate and why does everyone want to avoid it?

When a loved one passes away, his or her estate often goes through a court-managed process called probate or estate administration where the assets of the deceased are managed and distributed. If your loved one owned his or her assets through a properly drafted and funded Living Trust, it is likely that no court-managed administration is necessary, though the successor trustee needs to administer the distribution of the deceased. The length of time needed to complete probate of an estate depends on the size and complexity of the estate as well as the rules and schedule of the local probate court.

Every probate estate is unique, but most involve the following steps:

- Filing of a petition with the proper probate court
- Notice to heirs under the will or to statutory heirs (if no will exists)
- Petition to appoint Executor (in the case of a will) or Administrator for the estate
- Inventory and appraisal of estate assets by Executor/Administrator
- Payment of estate debt to rightful creditors
- Sale of estate assets
- Payment of estate taxes, if applicable
- Final distribution of assets to heirs

Q: What is a Revocable Living Trust?

A properly drafted Revocable living trust (RLT) is a powerful estate planning tool that allows you to remain in control of your assets during your lifetime, have them managed during incapacity, and efficiently and privately transfer them to your loved ones at death according to your wishes.

Sometimes referred to simply as a Living Trust, an RLT holds legal title to your assets and provides a mechanism to manage them. You would serve as the trustee and beneficiary of your trust during your lifetime. You also designate successor trustee(s) to carry out your instructions for how you want your assets managed and distributed in case of death or incapacity.

In order for the Living Trust to function properly, you need to transfer many of your assets to your Living Trust during your lifetime. The fact that it is "revocable" means that you can make changes to it or even terminate it at any time.

Q: What are the advantages of having a Living Trust?

Like a will, a Living Trust is a legal document that provides for the management and distribution of your assets after you pass away. However, a Living Trust has certain advantages when compared to a will. A Living Trust allows for the immediate transfer of assets after death without court interference. It also allows for the management of your affairs in case of incapacity, without the need for a guardianship or conservatorship process. With a properly funded Living Trust, there is no need to undergo a potentially expensive and time consuming public probate process. In short, a well thought out estate plan using a Living Trust can provide your loved ones with the ability to administer your estate privately, with more flexibility and in an efficient and low-cost manner.

Q: Will I lose any control over my property if I create a Revocable Living Trust?

Creating a Revocable Living Trust and transferring your assets to the name of that trust will generally not affect your ability to control such assets. During your lifetime when you are mentally competent, you have complete control over all of your assets. As the trustee of your trust, you may engage in any transaction that you could before you had a Living Trust. There are no changes in your income taxes. If you filed a 1040 before you had a trust, you can continue to file a 1040 when you have a Living Trust. There are no new Tax Identification Numbers to obtain. Because a Living Trust is revocable, it can be modified at any time or it can be completely revoked if you so desire. Upon your incapacity, the individuals you designate will be able to transact on your behalf according to the instructions you have laid out in the Living Trust. Upon your passing, the Living Trust can no longer be modified and the successor trustee(s) you have designated will then proceed to implement your wishes as directed.

Q: Do I have to transfer all my assets to my Living Trust?

Assets with beneficiary designations such as a life insurance policy or annuity payable directly to a named beneficiary need not be transferred to your Living Trust. Furthermore, money from IRAs, Keoghs, 401(k) accounts and most other retirement accounts transfer automatically, outside probate, to the persons named as beneficiaries. Bank accounts that are set up as payable-on-death account (POD for short) or an "in trust for" account (a "Totten Trust") with a named beneficiary also pass to that beneficiary without having to be titled into your trust. It is important, however, to seek the counsel of an experienced estate planning attorney who can advise on and assist with transferring necessary assets to your trust.

Q: If I transfer title to real property to my Living Trust can the bank accelerate my mortgage?

Federal law prohibits financial institutions from calling or accelerating your loan when you transfer property to your living trust as long as you continue to live in that home. The only exception to the federal law, enacted as part of the 1982 Garn-St. Germain Act is that it does not provide for such protection for residential real estate with more than five dwelling units.

ESTATE TAXES

Q: Will my estate be subject to death taxes?

There are two types of death taxes that you should be concerned about: the federal estate tax and state estate tax. The federal estate tax is computed as a percentage of your net estate. Your net taxable estate is comprised of all assets you own or control minus certain deductions. Such deductions can be for administrative expenses such as funeral and burial costs as well as charitable donations. The federal estate tax currently taxes estates with net assets of $5,250,000 or greater.

Even if you believe that that you may not be affected by the federal estate tax, you still need to determine whether you may be subject to state estate and inheritance taxes. Further, you may have a taxable estate in the future as your assets appreciate in value. You should regularly review your estate plan with an estate planning attorney to ensure your estate plan takes into account changes in the tax laws as well as shifts in your individual circumstances.

Q: What is my taxable estate?

Your taxable estate comprises of the total value of your assets including your home, other real estate, business interests, your share of joint accounts, retirement accounts, and life insurance policies minus liabilities and deductions such as funeral expenses paid out of the estate, debts owed by you at the time of death, bequests to charities and value of the assets passed on to your U.S. citizen spouse. The taxes imposed on the taxable portion of the estate are then paid out of the estate itself before distribution to your beneficiaries.

Q: What is the unlimited marital deduction?

The federal government allows every married individual to give an unlimited amount of assets either by gift or bequest, to his or her spouse without the imposition of any federal gift or estate taxes. In effect, the unlimited marital deduction allows married couples to delay the payment of estate taxes at the passing of the first spouse because at the death of the surviving spouse, all assets in the estate over the applicable exclusion amount ($5,120,000) will be included in the survivor's taxable estate. It is important to keep in mind that the unlimited marital deduction is only available to surviving spouses who are United States citizens.

Q: What is a Credit Shelter or A/B Trust and how does it work?

A Credit Shelter Trust, also known as a Bypass or A/B Trust is used to eliminate or reduce federal estate taxes and is typically used by a married couple whose estate exceeds the amount exempt from federal estate tax.

Because of the Unlimited Marital Deduction, a married person may leave an unlimited amount of assets to his or her spouse, free of federal estate taxes and without using up any of his or her estate tax exemption. However, for individuals with substantial assets, the Unlimited Marital Deduction does not eliminate estate taxes, but simply works to delay them. This is because when the second spouse dies with an estate worth more than the exemption amount, his or her estate may be subject to estate tax on the amount exceeding the exemption. Meanwhile, the first spouse's estate tax credit was unused and, in effect, wasted. This could be avoided by ensuring that after the passing of the first spouse, an estate tax return is filed even if no taxes are due. The purpose of a Credit Shelter Trust is to ensure preservation of both spouses' exemptions. Upon the death of the first spouse, the Credit Shelter Trust establishes a separate, irrevocable trust with the deceased spouse's share of the trust's assets. The surviving spouse is the beneficiary of this trust, with the children as beneficiaries of the remaining interest. This irrevocable trust is funded to the extent of the first spouse's exemption. Thus, the amount in the irrevocable trust is not subject to estate taxes on the death of the first spouse, and the trust takes full advantage of the first spouse's estate tax credit. Special language in the trust provides limited control of the trust assets to the surviving spouse which prevents the assets in that trust from becoming subject to federal estate taxation, even if the value of the trust goes on to exceed the exemption amount by the time the surviving spouse dies.

Q: What is a Qualified Personal Residence Trust (QPRT) and how does it work?

Our homes are often our most valuable assets and hence one of the largest components of our taxable estate. A Qualified Personal Residence Trust, or a QPRT (pronounced "cue-pert") allows you to give away your house or vacation home at a great discount, freeze its value for estate tax purposes, and still continue to live in it. Here is how it works: You transfer the title to your house to the QPRT (usually for the benefit of your family members), reserving the right to live in the house for a specified number of years. If you live to the end of the specified period, the house (as well as any appreciation in its value since the transfer) passes to your children or other beneficiaries free of any additional estate or gift taxes. After the end of the specified period, you may continue to live in the home, but you must pay rent to your family or designated beneficiary in order to avoid inclusion of the residence in your estate. This may be an added benefit as it serves to further reduce the value of your taxable estate, though the rent income does have income tax consequences for your family. If you die before the end of the period, the full value of the house will be included in your estate for estate tax purposes, though in most cases you are no worse off than you would have been had you not established a QPRT. An added benefit of the QPRT is that it also serves as an excellent asset/creditor protection vehicle since you no longer technically own the property once the trust is established.

Q: What is an Irrevocable Life Insurance Trust and how does it work?

There is a common misconception that life insurance proceeds are not subject to estate tax. While the proceeds are received by your loved ones free of any income taxes, they are countable as part of your taxable estate and therefore your loved ones can lose over forty percent of its value to federal estate taxes. An Irrevocable Life Insurance Trust keeps the death benefits of your life insurance policy outside your estate so that they are not subject to estate taxes. There are many options available when setting up an ILIT. For example, ILITs can be structured to provide income to a surviving spouse with the remainder going to your children from a previous marriage. You can also provide for distribution of a limited amount of the insurance proceeds over a period of time to a financially irresponsible child.

Q: What is a Family Limited Partnership and how does it work?

A Family Limited Partnership (FLP) is simply a form of limited partnership among members of a family. A limited partnership is one which has both general partners (who control management) and limited partners (who are passive investors). General partners bear unlimited personal liability for partnership obligations, while limited partners have no liability beyond their capital contributions. Typically, the partnership is formed by the older generation family members who contribute assets to the partnership in return for a small general partnership interest and a large limited partnership interest. Then the limited partnership interests are transferred to their children and/or grandchildren, while retaining the general partnership interests that control the partnership.

The FLP has a number of benefits: transferring limited partnership interests to family members reduces the taxable estate of the older family members while they retain control over the decisions and distributions of the investment. Since the limited partners cannot control investments or distributions, they can be eligible for valuation discounts at the time of transfer which reduces the value of their holdings for gift and estate tax purposes. Lastly, a properly structured FLP can have creditor protection characteristics since the general partners are not obligated to distribute earnings of the partnership.