PLANNING YOUR ESTATE – AN OVERVIEW

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By

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"Planning your Estate" is a short-hand way to refer to the task of asking and answering several questions, including:

1) **What are my material possessions?**
2) **Who do I want to benefit from my material possessions?**
3) **Do I want those persons to benefit during my life-time or after my death?**
4) **How do I prepare for infirmity or incapacity?**

There are as many different answers to these questions as there are people who ask them. The purpose of these questions and this outline is to help you to identify your goals and to determine how they may be best achieved. We'll suggest some ways you might think about answering these questions and introduce some of the tools and techniques that can be used to accomplish the result that you want to achieve.

Estate Plans run the gamut from very simple to very complex depending on the size of the donor's estate and specificity of the donor's intentions. One size definitely does not fit all. Sometimes the donor's intentions can be documented by a simple will and the powers of attorney and directive. Sometimes the donor's intentions require a more complicated plan combining gifts made while living with gifts made at death using one or more of the tools and techniques we discuss here.

This discussion is not exhaustive and is not intended to provide specific legal advice. You should establish your estate plan in consultation with your lawyer.

1) Taking stock: what are my material possessions?

a. **<u>Community Property</u>**. Married couples domiciled in Louisiana are presumed to live under a community property regime. Very generally, each spouse is presumed to have an undivided one-half interest in the property the couple acquires during marriage. Wages earned by either spouse during marriage are community property as is interest or dividends received by either spouse. Property owned by a spouse before marriage or acquired by gift or inheritance during marriage is presumed to be that spouse's separate property. Upon the death of the first spouse to die, that spouse's Will determines who will receive one half of the community property and that spouse's separate property. The surviving spouse becomes the owner of the other half of the community property by operation of law. So, as you consider what it is that you own, be aware that

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Louisiana's community property regime may limit how you can devise (give away) your property.

For example, Mr. and Mrs. A's estate consists of a $100 savings account that they built up from wages earned during their marriage. At his death, Mr. A has only $50 to devise; Mrs. A receives $50 by operation of law. Mr. A could not leave $90 to his children and $10 to Mrs. A.

b. **<u>Special Assets</u>**. Some assets need special consideration when planning your estate.

(1) <u>Real Estate in Another State</u>. If you own real estate in another state, your executor may need to open an ancillary probate proceeding in that other state in addition to the succession proceeding in Louisiana.

A. This result may be avoided by having the property titled in both spouses' names as joint tenants with full rights of survivorship. Title to the land will pass to the surviving spouse by operation of law.

B. Another option is to form a limited liability company to own the real estate.

i. Your ownership interest in the LLC would be treated as personal or movable property rather than real or immovable property and be probated in the Louisiana succession proceeding.

ii. This option would facilitate donating the property to the next generation by giving it a bit at a time to take advantage of the annual gift tax exclusion which will be mentioned later

(2) <u>Hard to Value Assets</u>. Special Assets also include assets that may be difficult to value or liquidate, for example, a coin collection, a watch collection, antique cars, art or furniture..

c. **<u>Financial Assets</u>**. These include bank accounts, brokerage accounts, IRAs, 401K's, life insurance policies and the like.

(1) <u>Bank Accounts</u>. Bank accounts and certificates of deposit may be set up as "Payable on Death' accounts, or "POD Accounts." The account owner directs the bank to transfer the account to another person upon the account owner's death.

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(2) Brokerage Accounts. Brokerage accounts may be registered as "Transfer on Death" accounts or "TOD Accounts." This registration allows the account owner to pass the securities in the account directly to another person or entity (the "TOD beneficiary") upon the death of the account owner without having to go through probate. Louisiana has not enacted the necessary legislation to permit this type of registration however, there are certain rules allowing such registration for Louisiana residents, so it is worthwhile to discuss this option with your Broker.

(3) IRAs, and 401Ks. Upon the death of the owner, these accounts pass directly to the named beneficiaries rather than through your Succession. It is important to check and update the beneficiary designation as life circumstances change.

(4) Insurance Policies. The death benefits of insurance policies insuring the life of the decedent are paid directly to beneficiary designated in the insurance policy. However, for Estate Tax purposes, the amount of the death benefit is included in the decedent's taxable estate if the decedent owned the policy at his or her death. Consideration should be given to acquiring a new policy in a trust or transferring an existing policy to a trust or a third person. .

d. **Closely Held Businesses**. Ownership of an interest in closely held businesses require special planning both for the Company and the owners.

(1) For many closely held businesses there is no ready buyer for the decedent's shares, especially if the decedent held only a minority interest in the business.

(2) A Buy – Sell Agreement among the owners can provide for the purchase and sale of the decedent's shares by the Company or the co-owners at a predetermined price (often by application of a formula to the business' financial results).

(3) Valuation of a closely held business can be difficult and can give rise to disputes where the method of valuation is not clearly set forth and agreed to by all parties.

(4) We will forego discussion of succession planning for the business and transfer of ownership interests of retiring members which is fascinating but beyond the scope of this exercise.

e. **Real Estate**. Your home, investment properties, raw land, etc. Time and expense may be avoided later by locating Acts of Sale, title insurance policies or other documents that set forth the legal description of the property.

2. Donative Intent: who do I want to benefit from my material possessions?

a. **Key Considerations.** You should consider the needs of your spouse, partner and other loved ones, the age and financial acumen of potential beneficiaries, and your desire to benefit charitable institutions that are important to you.

b. **Estate Planning Tools**. Many options are available to implement your plans for giving. The following is not an exhaustive list of all of the estate planning tools or techniques and is intended only to highlight some of the more common ones in use.

(1) Trusts.

(1) A trust is created by a written document (including a Will) that identifies the donor (the "Settlor"), the Trustee, and the Beneficiaries.

(2) It is a separate taxable entity with its own Taxpayer Identification Number and is required to file its own tax returns.

(3) The Trustee of the trust, either a bank or trust company or a trusted individual, will manage the assets held by the trust.

(4) A Trust can provide for payment of income or principal or both to beneficiaries who may not want to or be able to manage an outright gift or bequest.

(5) A trust is flexible and may provide for payment of the income or principal or corpus of the trust to those beneficiaries as they become more able to manage their affairs.

i. For example, a trust could be created to provide the surviving spouse with the income from the assets put into the trust (the "corpus" or "principal") together with a right to use the corpus for health or other needs, and, upon the death of the surviving spouse, the remaining corpus would go to children.

ii. Similarly, a trust can be used to make a gift to younger children and provide that the income from the trust corpus be accumulated until the beneficiary attains a certain age and/or is enrolled in an institution of higher education and then paid over to the beneficiary. The trust could specify that the corpus and accumulated income would be distributed to the beneficiary in "ages

and stages." For example, one third would be distributed when the beneficiary attains age 30, one half of the remaining trust assets when the beneficiary attains age 35, and the remaining assets when the beneficiary attains age 40.

iii. Trusts almost always have "spendthrift provisions" which prevent a beneficiary's creditor from seizing the trust assets to satisfy the debt.

F. A trust can either be revocable or irrevocable. Revocable Trusts can be terminated or modified and are sometimes used to centralize management of assets and to providing for management of the assets by a named trustee. Revocable Trusts provide for the disposition of their assets upon the occurrence of specified events, including the death of the donor and are often touted as a tool to avoid probate. Irrevocable Trusts once created cannot be revoked and may be modified only under limited circumstances.

G. Gifts made to a trust may not qualify for the $15,000 Annual Exclusion discussed below, unless the trust has certain provisions referred to as "Crummey Powers" named for the taxpayer who established the legitimacy of the technique through litigation with the IRS.

(2) <u>Charitable or Split Interest Trusts</u>. This type of trust provides for an interest to be given to a family member or other individual and an interest to be given to one or more charities. These trusts are more fully described below in the discussion of gifts made while the donor is alive.

(3) <u>Family Limited Partnerships or Family Limited Liability Companies</u>. A Family Limited Partnership or Family Limited Liability Company can provide for centralized management of assets and allow for the gifting of interests in that partnership or LLC to family members over the years to maximize the use of the annual gift exclusion. A family limited partnership or a family LLC will usually create valuation discounts. The limited partnership or LLC may be managed by the donor, by a professional manager or by a trusted family member or friend.

(4) <u>Last Will and Testament</u>. A well drafted Will accurately setting forth your intentions and executed in compliance with the necessary legal formalities is the keystone of an estate plan. Your Will may utilize some or all of the tools or techniques mentioned above.

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(5) Powers of Attorney and End of Life Directives. These documents are discussed in section 4 below.

3. In Life or After Death: When do I want to make my gifts?

a. **Tax Considerations**.

(1) Exclusion Amount. The amount excluded from federal tax on Estates, Gifts and Generation Skipping Transfers is now $11,400,000 for each person or $22,800,000 for a couple. Thus, a couple can transfer $22,800,000, while they are alive or upon their deaths without incurring taxes. These amounts will be reduced to $5,490,000 per person and $10,980,000 for a couple in 2026 unless Congress extends the current amounts.

(2) Annual Gift and Generation Skipping Transfer Tax Exclusion Amount. In addition to the exclusion noted above, the federal law provides that certain gifts are not subject to tax.

A. A donor may give up to $15,000 each year to any beneficiary without incurring any gift tax or generation skipping transfer tax liability. Thus, a parent can give his or her child $15,000 per year; two parents can combine their annual exclusions and give their child $30,000 without incurring gift tax liability.

B. Payments made directly to a school for tuition for a third party such as a grandchild are not taxable.

C. Payments made directly to a provider of medical services for a third party are not taxable.

(3) Carryover Basis and Stepped Up Basis.

A. Carryover Basis. When a gift of property other than cash is made to a beneficiary during the donor's life, the tax basis of the property in the hands of the beneficiary is the same as the donor's basis. Thus, whatever increase in value that property may have had while owned by the donor, if realized on the sale of the property by the beneficiary, is fully taxable.

B. Stepped up Basis. When a gift of property other than cash is made to a beneficiary upon the donor's death, the tax basis of the property in the hands of the beneficiary is the fair market value of the property as of the date of death of the donor. Thus, whatever increase in value that the property may have had while owned by the donor is not taxed.

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(4) Deductible Gifts to Charity.

A. Gifts to charities whose exempt status is recognized by the IRS under Internal Revenue Code section 501(c)(3) are deductible from the donor's income subject to some limitations based on the donor's income, the type of organization receiving the property, and the type of property donated.

B. The amount of the Income Tax Standard Deduction has been raised significantly and fewer taxpayers are itemizing their deductions. For those taxpayers, charitable donations do not reduce their income tax liability.

C. Charitable gifts must be properly documented in order to obtain the Income Tax deduction for charitable gifts. The donor must receive a statement from the charity setting forth the amount of the gift and whether any goods or services were provided by the charity to the donor in connection with the gifts. Independent appraisals may be required to establish the value of certain gifts in order to claim the deduction.

D. Charitable gifts made at death are deductible from the donor's estate and reduce the amount of Estate Tax payable by the estate, if any.

b. **Gifts Upon the Death of the Donor**. Although the law makes provisions for the disposition of assets upon the death of an individual without a Will, a well drafted Will is essential to any estate plan. The typical Will generally contains some or all of the following types of bequests (gifts):

(1) Special Bequests.

A. Gifts of cash or specific property to friends, family members, household workers, caretakers, etc.;

B. Gifts of special possessions – your interest in your home and/or titled vehicles to your spouse;

C. Gifts of particular pieces of jewelry or other valuables to particular individuals – an heirloom ring to a niece, for example.

(2) Charitable Bequests – gifts to charities that are important to you.

A. Gifts to charity may be of a specific dollar amount, a particular item of property, or a percentage of your estate.

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B. It is also possible to give to a "pooled income fund" that a charity has created. Your gift is placed in a pooled income fund which will pay a specified income stream to a non-charitable beneficiary, a surviving spouse for example, for a set term of years or for his or her life. A gift to a pooled income fund may also be made during the donor's life.

C. It is also possible to create a "split interest" or charitable trust in your will. This type of trust is more fully discussed below when we discuss lifetime giving techniques.

(3) Marital Bequests – gifts to a spouse either outright or subject to a trust or a usufruct.

A. Gifts between spouses are exempt from Gift or Estate Tax.

B. If an outright bequest is made in favor of a spouse of all or most of the testator's (the person making the Will) property, the tax on the estate of the first to die is effectively deferred until the death of the second to die. At the death of the second to die, the combined amount of the two estates is subject to tax. An outright bequest of a large portion of the testator's estate to a spouse is more common now that the amount exempt from estate tax is relatively large and there is "portability" which allows the surviving spouse to use the unused estate tax exemption of the first to die spouse to reduce the estate tax upon his or her death.

C. A trust or a usufruct may be used to make a marital bequest. A usufruct gives the surviving spouse the use of the income from the assets of the first spouse to die for his or her life (if the Will so provides). The remainder is given to named beneficiaries at the death of the second spouse to die. A trust allows the donor to be more precise as to the rights of the surviving spouse and the beneficiaries.

(4) Bequests to children or grandchildren – these gifts can be made outright or be burdened by a trust depending on the beneficiaries' ages or ability to manage their money. Some of the typical provisions of a trust in favor of a child or grandchild have been described above and some alternative giving techniques are discussed below. A bequest to a grandchild made while the grandchild's parent is still alive may be subject to a separate tax, the Generation Skipping Transfer Tax. This tax is intended to eliminate generation skipping as a way to avoid estate taxation. For example, a grandparent whose child is well off might consider skipping over the child and give directly to the grandchild to avoid having the gift taxed in the child's estate. The GSTT discourages this by imposing a tax on the skip transfer. There are exclusions from this tax so a generations skipping gift may be made without incurring the GSTT.

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(5) Bequest to the Universal Legatees -- a typical Will provides for a "universal legatee," someone or a charity that would receive whatever is left over in your estate after the foregoing bequests are fulfilled. The amount to be received by the universal legatee depends on how much of the donor's estate has been allocated to the beneficiaries named above. Depending on the donor's intention, the amount to be received may be relatively small or very large.

(5) Naming an Executor and providing for Independent Administration --

A. The duty of the executor is to identify and evaluate all of the decedent's assets, open a Succession or probate proceeding in court, pay the decedent's debts, file required tax returns and pay any applicable taxes, maintain the assets while the Succession is in process, and distribute the assets according to the Will. The executor will obtain a judgment of possession from the court ordering that the distribution of assets be made. The executor typically engages professional advisors, including lawyers, accountants and investment managers to help discharge these duties.

B. Often the surviving spouse is named as executor and an adult child is named as a successor executor if the spouse does not want to serve. It is also common for the donor to name a trusted friend or another relative to serve as executor. It is advisable to name a successor executor in case the named executor cannot or does not want to serve.

C. The executor can execute his or her duties under Independent Administration if the Will provides for it. This is advisable because it allows the executor to proceed without court orders which can be time consuming and costly to obtain.

c. **Inter Vivos Gifts – Gifts while the donor is alive**.

(1) Gifts to individuals. -- Gifts to individuals are subject to gift tax or the generation skipping transfer tax with the exclusions noted above. Gifts to individuals can be outright or through a trust also as described above.

(2) Gifts to minors. Options include:

A. Establishing a Uniform Gift to Minors account with a brokerage or a bank and making gifts into that account. Its advantage is simplicity. Its disadvantage is that when the minor attains the age of majority at 18 her or she may assert control over the account.

B. Establishing a 529 education savings account for the minor. The law establishing these accounts restrict the use of the funds and permit the donor to combine the $15,000 annual gift tax exclusion amount for five years to allow for accelerated funding of the account.

C. Establishing a trust in favor of the minor. The trust could stipulate that the gifts could only be used for certain specified purposes and only be distributed when the minor attains specified ages.

(3) Gifts to Individuals and Charities through a Charitable Remainder Trust or a Charitable Lead Trust -- A Charitable Remainder Trust provides income to one or more individuals for a set term of years or his, her or their lives with the remainder to go to the charity. A Charitable Lead Trust would pay a specified amount or percentage of the gifted amount to the charity for a term of years and the remainder to a named individual, a grandchild perhaps, at the end of the specified term. The amount of the gift that is deductible depends on the value of the charitable interest which is computed using life expectancy tables and interest rates specified by the IRS.

(4) Gifts to Individuals and Charities through a Pooled Income Fund. Many charities, including the Episcopal Church, have established "Pooled Income Funds." The charity will accept a donation and agree to pay a named beneficiary a specified amount determined by the size of the donation and the applicable interest rate for a term of years or for the life of the non-charitable beneficiary.

(5) Gifts to Charity – Appreciated Publicly Traded Stock. Gifts of publicly traded stock which has increased in value while held by the donor is advantageous because the gain in the appreciated stock is not taxed. The amount of the gift is determined by the price of the stock on the date of donation. Usually, the charity sells the stock upon receipt and because the charity is exempt from taxes, the appreciation in the stock is not taxed.

(6) Gifts to Charity – Gifts of other Property. Charities typically have established policies as to the types of property they will accept as a donation. The scope of permissible gifts may go beyond cash and publicly traded stock. The IRS has established rules regarding the valuation of various types of property for purposes of establishing a charitable deduction, so a donor intending to make a donation of such property should consult with an accountant or tax lawyer before making the donation to assure that he or she may claim the full amount of the charitable deduction.

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(7) Gifts to Charity – Transfers from IRAs. The IRS requires owners of IRAs to make required minimum distributions from the IRA starting at age 70 and ½. The amount of the required minimum distribution is based on the amount held in the IRA and the life expectancy of the owner of the IRA. The owner of the IRA can divert some or all of the minimum required distribution to a charity (a "Qualified Charitable Distribution") and exclude that amount from his or her income where it would be taxed at ordinary rates.

4. Infirmity or Incapacity – what do I need to do to prepare?

a. The goal is to provide for the continuation of business or investment activities, to provide access to funds for specified loved ones, to name a person to make medical decisions, and to state your instructions regarding the termination of medical treatment if you are unable to do so yourself.

b. A well planned estate includes the following documents in addition to a Will::

(1) A Medical Power of Attorney naming the person or persons who you want to make decisions regarding your medical care if you are unable to do so yourself because of incapacity.

(2) A HIPAA release authorizing the medical provider to fully inform that person of your medical condition and the treatment options.

(3) A Business Power of Attorney naming the person or persons who you want to make business or investment decisions for you and have access to your bank accounts if you are incapacitated..

(4) A "Living Will" or "End of Life Directive" expressing your instructions regarding the continuation of medical care and the provision of nutrition and hydration to you if you are in a comatose state and continued treatment would only artificially prolong the dying process.

Disclaimer: The foregoing discussion is not exhaustive and is not intended to provide specific legal advice. You should establish your estate plan in consultation with your lawyer.

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