Estate Planning Essentials
A seminar presented by the Law Offices of Kathleen Fowler, LLC

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WHAT IS ESTATE PLANNING?

* During your lifetime, the creation of plans and documents that will:

  - protect you in the event that you become disabled, by naming the persons who should make your decisions and control your property;

  - protect your property against loss; and

  - ensure that all decisions are made by people who you have chosen.

In other words, eliminate lifetime probate.

* Upon your death, provide for the orderly transfer of your property to persons or entities as you choose:

  - under circumstances prescribed by you;

  - in the most efficient manner;

  - for the lowest expense;

  - at a tax cost that is acceptable to you; and

  - without unintended results.

In other words, eliminate at death probate and minimize taxes and costs.

Charitable
Planning

Lifetime Gift Exclusion
Federal: $5,430,000 in 2015;
Mass: $1,000,000 in 2015:
Discounting gift techniques

Irrevocable Trust-should own any life insurance if the estate is
taxable, Annual Exclusion gifts-$14,000 per year per beneficiary

Durable Power of Attorney; Health Care Proxy; Living Will; Last Will & Testament;
Revocable Trust; Deed Real Property to Trust and other re-titling of assets to the Revocable
Trust

FOUNDATION PLANNING (LEVEL ONE)

OBJECTIVE: To avoid a lifetime probate and at death probate.

* Living Probate - occurs during your lifetime and includes the appointment of your conservator or guardian
    * Formal guardianship
    * Formal conservatorship
    * Probate court decides who shall act for you

* Death Probate - occurs after death and is the legal process of changing the ownership (the title) of assets from the decedent to the beneficiary. Either the probate process (a public, court process) re-titles your assets or you re-title assets through a funded living trust.

* You can avoid the probate process. How?
    * Durable Power of Attorney
      - names the person who can make financial decisions for you
    * Health Care Proxy
      - names the person who can make health care decisions for you when you are unable to make your own decisions
    * Living Will
      - states your decision re: whether to be kept on life support when there is no hope of recovery (determined by physicians)
    * Trust Planning

Note: Even though you create a Trust during your lifetime and fund it during your lifetime, you must also have a Will. The Will can ensure that all of your assets, those that may have been missed during the re-titling process or inadvertently purchased outside of the Trust, will "pour-over" into the Trust at death through a probate process. Although, a probate process will be required for those assets that were not titled in the Trust, those assets will be the only assets having to go through the probate process.

REVOCABLE TRUST

In general, a trust is a written agreement where the Trustee pledges to hold the trust property for the benefit of the beneficiaries, who are named in the trust document, according to the trust terms, which are a set of instructions.

Requirements:

* written agreement
* Settlor, person who creates the trust (sometimes also called the Donor or Grantor)
* beneficiaries, persons who benefit from the trust
* Trustee, persons or entity, which manages the trust property
* trust property (either current or in future)

A Revocable Trust (also sometimes called a Living Trust):

* is created by the Settlor;
* names the Settlor as the current beneficiary;
* appoints a Trustee (usually the Settlor);
* gives the Settlor the power to revoke/amend the trust at any time; and
* instructs the Trustee as to how to distribute the trust property at the Settlor's death. These distribution instructions can be quite detailed and can take into account varying circumstances. This trust may also incorporate separate tax planning sub-trusts.

How does a Revocable Trust avoid probate?

If the Settlor has re-titled his or her assets into the Trust, then upon the Settlor's death there is no need to re-title assets through the probate process. A trust does not die. The Trustee has immediate access to the trust assets and may begin to follow the Settlor's instructions without the requirement of a court order.

How does Revocable Trust planning reduce estate tax for married persons?

Each spouse creates his/her own Revocable Trust. The Trust provides that at the death of the first spouse, the assets held in deceased spouse's Trust are held in three separate sub-trusts depending upon the value of those assets.

Sub-trust C is funded with the maximum amount that can pass free of State estate tax (the MA amount is $1,000,000 at this time). The surviving spouse is the beneficiary of this Sub-trust C, but when the surviving spouse dies, the value of the assets held in Sub-trust C are not included in the taxable estate of the surviving spouse.

Sub-trust B is funded with an amount that when Sub-trust C and Sub-trust B asset values are added together, the two Sub-trusts have total assets valued at the amount that can pass free of federal estate tax ($5,430,000 in 2015). Sub-trust B names the surviving spouse as the sole beneficiary. When the surviving spouse dies, the value of the assets in this Sub-trust B are not included in his/her federal taxable estate, but are included in his/her State taxable estate.

Sub-trust A is funded with any other assets held in deceased spouse's trust. Sub-trust A names the surviving spouse as the sole beneficiary. All of these assets are included in the taxable estate of the surviving spouse for both federal and State estate tax purposes.

As a result of this planning, assets are sheltered from estate tax at the death of the surviving spouse.

Note: Even though under the new federal estate tax law now in effect a surviving spouse may use the federal estate tax free amount that the first spouse to die did not use, this carry-over is not available under MA law and does not cover the generation skipping tax exemption of the first spouse to die. As a result, planning for married couples continues to require the use of two Revocable Trusts where the value of their assets exceeds $2,000,000.

BEYOND PROBATE AVOIDANCE PLANNING
(LEVEL TWO)

OBJECTIVE: To reduce the value of the taxable estate (for state and/or federal estate tax purposes) and/or to protect assets from long term medical care costs.

Estate tax reduction: Estate tax law allows every person to give assets away during lifetime. These gifts are subject to federal gift tax law with certain exclusions and exemptions. Charitable gifts are not subject to gift tax at all.

Gift tax free summary:

- Annual exclusion gifts (now equal to $14,000 per grantor per beneficiary) – reduces the taxable estate immediately
- Lifetime exemption amount – For Federal calculations in 2015, this amount is equal to $5,430,000 per grantor and is indexed for inflation; in Massachusetts, the exemption is $1,000,000.

Where are gifts going?

We recommend the use of Irrevocable Trusts as the recipient for gifted assets.

Why?

- Trusts provide additional benefits to the beneficiaries that include creditor protection and estate tax protection in the beneficiary's estate. In other words, the assets that are held in trust for a beneficiary cannot be accessed by that beneficiary's creditors (divorcing spouse, tort liability, employment related exposure and/or future long term health care costs). In addition, if the Settlor of the trust allocated his or her generation skipping tax exemption to the trust for that beneficiary, then when that beneficiary dies, none of the assets in that trust are subject to estate tax in the estate of the beneficiary.
- Trusts also keep the gifted assets under the control of the Trustee, an advantage when the Settlor has a particular plan for the assets or the beneficiary needs assistance with asset management or has special needs.

- Trust planning for spouses can allow each spouse access to an Irrevocable Trust created by the other spouse (caution must be used to avoid the reciprocal trust doctrine) resulting in estate tax savings, but with the possibility that the Trustees will exercise their discretion and make distributions of gifted assets back to a spouse if need be.
- Tax law provides that certain types of irrevocable trusts have additional benefits, such as income being taxable to the Settlor, which will further reduce the value of the Settlor's estate.

What assets should be considered for gifts?

- Assets that have the greatest potential for appreciation over time.
- Assets that have the greatest potential for valuation discounts.
- Assets that do not have a tremendous amount of built in capital gain tax.
- Assets that will have a minimal impact on the grantor's lifestyle after those are given away.
- First asset that comes to mind is life insurance – appreciates dramatically at death, lifetime value is discounted compared to at death value and death proceeds will never benefit the insured.

Long term care costs:

Irrevocable trusts can shelter assets from being spent down for nursing home care.

One type of Irrevocable Trust can shelter the principal of the Irrevocable Trust from a nursing home "spend down" by giving the Settlor of the trust the right to receive all income. The income would be used to pay for nursing home costs, but the principal could be protected assuming that the trust doesn't allow distributions of principal to the Settlor (and Settlor's spouse) and a five year look back period has expired. (Current Medicaid law considers any asset given away in the five year period that precedes the Medicaid application as available to the applicant.)

Another type of Irrevocable trust can shelter the income and principal of the Irrevocable Trust from spend down, but the Settlor (and Settlor's spouse) cannot have any interest in the Trust at all. For example, a mother creates an Irrevocable Trust for her children and then makes a gift of an investment account. Five years from the date of the transfer to the Irrevocable Trust, this investment account will not be an asset subject to spend down if mother needs nursing home care and has no other assets.

Medicaid eligibility requirements:

- Applicant can have no more than $2,000 in his or her name
- Applicant's spouse can have no more than $119,220
- The equity in the Applicant's house in excess of $828,000 is not counted towards his or her asset limit as long as the Applicant has a spouse, a child under 21 yrs of age or a blind or disabled child (regardless of age) residing in the property; otherwise, the excess equity will be counted
- There are no transfers/gifts within 5 years of Medicaid application

BEYOND GIFT PLANNING USING ANNUAL EXCLUSION GIFTS ONLY (LEVEL THREE)

OBJECTIVE: To reduce the value of the taxable estate (for state and/or federal estate tax purposes) and/or to protect assets from long term medical care costs; assuming that gifts using the annual exclusion gift strategy ($14,000 per beneficiary per Grantor) are insufficient to meet the estate tax and/or long term care goals.

If an Irrevocable Trust is created and the Settlor has transferred assets to the Irrevocable Trust using his/her annual exclusion gifts, but the value of the assets that the Settlor would like to transfer exceeds that amount, then the Settlor can use his/her lifetime exemption amount (formerly called the unified credit amount) as described above. Any gift that is covered by this lifetime exemption amount requires that a Gift Tax Return (Form 709) be filed to report the gift – its fair market value, capital gain tax basis and recipients (an Irrevocable Trust and/or individuals).

Disadvantages of making gifts:

- The Settlor loses control of the assets that he/she has given away.
- Assets that are given away will not receive a step up in basis for capital gain tax purposes when the Settlor passes away. A comparison of the estate tax exposure and capital gain tax exposure should be made when assets are given away for tax reasons only.

BEYOND PLANNING FOR FAMILY ONLY
CHARITABLE PLANNING
(LEVEL FOUR)

OBJECTIVE: To reduce the value of the taxable estate and/or income tax consequences for capital gain tax purposes and provide for charitable beneficiaries. At times this charitable planning can also provide additional benefits to the family.

Charitable Remainder Trust planning (CRT):

Many people have favorite charities that they make gifts to each year. They receive an income tax deduction for those gifts. Upon death, many people continue their lifetime tradition and leave gifts to those same charities. Although the estate receives an estate tax deduction, there is no income tax deduction. A CRT can provide both income tax and estate tax benefits.

A CRT is an Irrevocable Trust. You act as the Trustee and you (and or other beneficiaries) receive an income stream from the CRT. Because your charities ultimately receive the CRT assets, you receive a current income tax deduction. Because a CRT is considered a charitable entity, there is no income tax payable by the Trustee. Thus, if you own appreciated assets that you wish to sell, the CRT is a great vehicle to accomplish the sale, tax free. You contribute those appreciated assets to the CRT and then the Trustee sells those assets. The Trustee will pay no capital gain tax and all of the proceeds from the sale are available to pay the income stream.

Often, this plan also includes a life insurance component. If you are insurable, a life insurance policy that is held in an Irrevocable Trust that is not part of the taxable estate is purchased using some of the income stream received from the CRT. This life insurance benefit replaces the value of the assets that go to charity.

There are two types of CRT: the Charitable Remainder Annuity Trust (CRAT) and the Charitable Remainder Unitrust (CRUT). The difference between the CRAT and the CRUT is how the income stream is calculated. With the CRAT, you contribute assets with a certain value to the CRAT and choose an interest rate. Every year thereafter, the income you receive is set and never changes. For example, if you put $100,000 into a CRAT and

selected an 8% interest rate, then every year you would receive $8,000 ($100,000 x 8%). Because you receive this set amount every year (regardless of the value of the CRAT assets), the named charities bear the risk of depreciation in value.

In a CRUT, the interest rate chosen is applied to the fair market value of the assets in the CRUT at the beginning of each year. As a result, the income that you receive changes every year. For example, if you put $100,000 into a CRUT and selected an 8% interest rate, then in year one you would receive $8,000. At the beginning of the next year, the assets are re-valued. Assuming no change in value, you would apply the 8% interest rate to the CRUT value of $92,000, and would receive $7,360 ($92,000 x 8%). Because the CRUT distributes a changing amount every year to the non-charitable beneficiary (you and/or your beneficiaries), it is the non-charitable beneficiary who benefits from any appreciation in value of the CRUT assets and who suffers from any depreciation in value.

The steps for creating a CRT are as follows:

1. Determine the type of income stream desired – a set amount or variable amount. (Must be at least 5 %.)
2. Name the charities, execute the trust and contribute the assets to the CRT.
3. Calculate the income tax deduction.
4. Although a CRT is irrevocable, the Donor may change the designated charities at any time.
5. Calculate the first year's income amount if a CRUT, or the income for the entire lifetime of the CRAT. Make payments to the Donor as scheduled.

Benefits of the CRT:

1. Your charitable bequests are settled, but you retain the right to change the charitable beneficiaries.
2. You receive an income tax deduction today that you would otherwise never receive.
3. You have the full value of appreciated assets working to provide you with an income stream (no capital gain tax reduction).
4. You receive the income stream!

Charitable Lead Trust planning (CLT):

The Charitable Lead Trust ("CLT"), which is an alternate form of charitable planning using an Irrevocable Trust, can meet not only your charitable objectives, but also your family objectives.

In the CLT, the Settlor identifies charitable beneficiaries and non-charitable beneficiaries. The Settlor then makes a gift of assets to the CLT Trustees. During the CLT term (a term chosen by the Settlor), the Trustee makes distributions to the named charitable beneficiaries. At the end of the CLT term, the remaining CLT assets are distributed to the named non-charitable beneficiaries (e.g., Settlor's individual beneficiaries).

The benefits of a CLT include: (i) the ability to make a gift to non-charitable beneficiaries at a discounted valuation for gift tax purposes; (ii) the ability to reduce the individual's taxable estate; and, (iii) the ability to satisfy the individual's charitable objectives Using a CLT in an estate plan works especially well when the Settlor currently makes annual contributions to one or more charitable organizations.

The discount in the valuation of the gifted asset depends on the trust term (how long the trust lasts) and the annual percentage distributed to the charities. As an example, assume that a single Massachusetts Donor has an estate of $1,200,000. The first $1,000,000 may pass free of Massachusetts and Federal estate tax. Of the $200,000 over the exemption amount, after payment of approximately $90,000 in Massachusetts estate tax, the Donor's children would receive approximately $104,000.

If, however, the Donor gifted $200,000 to a CLT, with the term of the CLT being ten years and the named charities receiving 5% of the trust value annually, then the discounted value of the gift to the CLT is $120,676.00. If the CLT assets earn 8% annually, then at the end of the trust term the value of the remaining assets distributed to the children equals $264,895.00. The Donor has transferred $264,895.00 to his children at a cost of approximately $88,000, the approximate MA estate tax. If the CLT only earned 6%, then the amount to the children would be $218,475. Although this example shows an 8% and 6% investment return, the actual investment return will vary over the term of the trust, based on investment choices. The children receive respectively, $104,000 with no planning, $176,895 with the planning and an 8% yield, or $130,475 with the planning and a 6% yield.

In the alternative, a CLT may be created for the lifetime of the Settlor rather than a term of years. Using a term that is equal to the life of the Settlor, however, introduces additional variables when planning since we don't know when the individual will pass away. The beneficiaries may need to wait longer for their distribution if the Settlor surpasses his or her life expectancy or the charities may receive less if the Settlor passes away much sooner than expected.

Another way to reduce estate taxes and meet one's charitable objectives with a CLT is to include in one's estate plan the requirement that a CLT be created upon death with an amount that will either reduce or eliminate entirely the estate tax payable. The CLT would then be created to meet these objectives using the IRS formula and interest rates in effect at the date of death.

The benefits of the CLT include, meeting charitable objectives, the beneficiaries pay a lower estate tax and the assets pass to the beneficiaries at the end of the trust term.

KEY MEDICAID RULES FOR MA LONG TERM CARE COVERAGE IN 2015

ASSET LIMITATION FOR MEDICAID APPLICANT = $2,000

The maximum amount of assets a Medicaid applicant can have in his or her name to be eligible for Medicaid

2015 COMMUNITY SPOUSE RESOURCE ALLOWANCE (CSRA) = $119,220

- The maximum amount of assets the spouse of a Medicaid applicant can have in his or her name for the applicant to qualify for Medicaid coverage

HOME EQUITY LIMITATION = $828,000

- The maximum amount of equity an applicant may have in his or her principal residence and still be eligible for Medicaid
- This limitation does not apply if a spouse, a child under 21 years of age or a child who is blind or disabled resides in the principal residence

PERSONAL NEEDS ALLOWANCE (PNA) = $72.80 per month

- The amount that a Medicaid recipient may retain from his or her own income sources on a monthly basis
- Amounts of income over the PNA must be paid towards the cost of the skilled nursing facility: this is called the patient paid amount
  - Exception: see Minimum Monthly Maintenance Needs Allowance, below

2015 MINIMUM MONTHLY MAINTENANCE NEEDS ALLOWANCE (MMMNA): MINIMUM = $1,966.25, MAXIMUM = $2,980.50

- The minimum amount of monthly income that an at-home spouse needs to meet his or her basic living expenses in the community
- If the at-home spouse's income does not meet the minimum MMMNA, then Medicaid will allocate a portion, or all, of the Medicaid recipient's income to him or her in order to satisfy the minimum MMMNA
- Exceptional circumstances may exist that warrant additional amounts of the Medicaid recipient's income being allocated to the at-home spouse that would raise the MMMNA above the maximum amount
- If the income of both the at-home spouse and Medicaid recipient is insufficient to meet the needs of the spouse, then a Medicaid hearing officer may increase the CSRA (see above)

Medicaid Transfer Rules

Look-Back Period = 5 years

- The number of years from the date of application that Medicaid will look back to see if the applicant and/or spouse transferred assets from his or her name to an individual or trust for less than fair market value

Penalty Divisor = $310 per day

- The average daily cost to privately pay for a skilled nursing facility in Massachusetts used by Medicaid to determine the disqualification period (or period of ineligibility)

Disqualification Period

- The number of days an applicant is deemed ineligible for Medicaid coverage based on the value of assets transferred within the "look-back period" for less than fair market value
- The disqualification period begins on the date of application
- Calculation: (value of assets) / (penalty divisor) = number of days of disqualification