

**Estate Planning. Who gets what, and when do they get it. Proper estate planning attempts to maximize the value of your estate that passes to your heirs by minimizing costs and expenses.**

- I. Adding up the Assets of Your Estate. The first step in the estate planning process is to make a list of all your assets and liabilities. The list should specify how each asset is held (individually, jointly, etc.). A personal financial statement or net worth statement will ordinarily serve this purpose. Legally, assets are categorized as follows:
  - A. Personal Property
    1. Tangible Personal Property - jewelry, china, clothing, furniture, collectibles, automobiles, etc.
    2. Intangible Personal Property - investments, such as bank accounts, stocks, bonds, annuities, certificates of deposit, mutual funds, retirement plans, face amount of life insurance policies.
  - B. Real Property - all real estate including principal residence, commercial or rental properties, raw land, vacation homes, etc. Provide your planner with copies of all deeds.
- II. How Property Passes at Death. Depending on how an asset is titled, it will pass at your death in one of four (4) ways.
  - A. By Operation of Law - property owned with another individual as joint tenants with rights of survivorship.
  - B. Contract Assets. Assets which pass to your designated beneficiary when you die, such as:
    1. Life insurance policy death benefits;
    2. Annuities;
    3. Retirement plans and IRAs.
  - C. Probate. Assets that are titled solely in your own name will pass through probate. Probate is a court supervised process by which your assets are distributed to your heirs.
    1. Intestacy. If you die without a will, your estate will be distributed according to the laws of intestacy regardless of your intentions:

- (a) If you are married without children and one or both of your parents are living, surviving spouse gets first \$100,000 plus  $\frac{3}{4}$  of the remainder, and parents get  $\frac{1}{4}$  of remainder.
- (b) If you are married with children, surviving spouse gets first \$100,000 plus  $\frac{1}{2}$  of remainder, and children get  $\frac{1}{2}$  of remainder.
  - (i) outright if over 18 years of age.
  - (ii) If over \$10,000 must be held by a court-appointed

guardian.

Note: If you are married and have children who are not also children of your spouse, surviving spouse gets  $\frac{1}{2}$  and children get  $\frac{1}{2}$ .

## 2. Testate Succession.

- (a) Your will determines who gets what and when. The when is important when minor children are involved.
- (b) You select the executor of your estate.
- (c) You authorize your executor to sell assets.
- (d) You excuse the filing of a bond.

## 3. The Probate Process

- (a) Will is admitted to the court and is accepted or contested.
- (b) Executor is appointed by the court.
- (c) Assets are inventoried, and an inventory of probate assets is filed with the probate court.
- (d) Notice to creditors of estate is published. Claims against the estate are paid or disallowed, and Executor files a return and list of claims with the probate court.
- (e) Connecticut succession tax return must be filed within six months of the date of death, and United States estate tax return is filed within nine months of the date of death.
- (f) Executor prepares a final accounting of all activity of the estate.

- (g) After the probate court approves the final account, all assets are distributed to the beneficiaries and the estate is closed.

4. Small Estates Procedure

A shortened probate procedure is available if the total value of all personal property is less than \$20,000.00. You cannot use the small estate procedure if you own any interest in real property (other than joint property with rights of survivorship) regardless of the value.

D. Revocable Living Trust. A trust created during your lifetime by transferring assets you own to a trustee who holds the assets according to the terms of the trust. You can serve as trustee of your revocable trust during your lifetime. The trust is completely revocable; that is, whatever you put in you can take out at any time. For tax purposes all assets are treated as if you own them (no separate income tax return is filed by the trust and all assets are still included in your taxable estate). Revocable Trusts have several advantages:

- 1. Assets that you put into your trust avoid probate resulting in a cost savings. **Note, however, that you will not eliminate all costs of probate.**
- 2. Ancillary probate can be avoided when you own real estate in other states.
- 3. Trust assets are not a matter of public record as are the assets in your estate.
- 4. Provides for the management of your estate if you become disabled or incapacitated without the need to appoint a conservator of your estate.

III. Taxation of Gifts and Estates.

A. Federal Estate, Gift, and Generation-Skipping Transfer Taxes

1. Pre-2001 Law.

- (a) Most transfers to a spouse qualify for the unlimited marital deduction, regardless of value.
- (b) The unified credit allows a taxpayer to transfer assets, either during life (by gift) or at death, with a fair market value of \$675,000 to beneficiaries, other than a spouse, free of federal estate or gift tax.

- (c) Unified credit scheduled to increase, in phases, to \$1,000,000 by the year 2006.
- (d) An additional tax, called the generation-skipping transfer tax (the “GST tax”), imposed on certain transfers to persons who are more than one generation younger than the donor, to the extent the transfers exceed the GST tax exemption which is currently \$1,060,000. The GST tax rate is a flat 55% rate.
- (e) Gift Tax. Gift tax unified with federal estate tax.
  - (i) \$11,000 annual gift exclusion per donee (\$10,000 for gifts made prior to January 1, 2002). Since 1999, this amount has been indexed for inflation (rounded to nearest \$1,000.00).
  - (ii) Gift splitting with spouse allows you to gift \$22,000 per year to each donee.

2. The Economic Growth and Tax Relief Reconciliation Act (“EGTRRA”) of 2001

- (a) Under this new law, Federal estate and generation-skipping transfer taxes to be repealed over a ten-year period.
- (b) Due to its “Sunset Provision,” the Act will expire as of December 31, 2010, and the pre-2001 tax laws will be reinstated.
- (c) The Act’s Sunset Provision ensures further Congressional action in this area. It is likely the Act will be modified significantly in the near future, with proposals amending the Act having already been offered for debate. Most experts agree that the Act, as it is currently written, will not survive intact.
- (d) As the table below illustrates, the top estate and gift tax rates will be reduced and the unified credit effective exemption amount will continue to increase in steps.

Calendar Year	Estate Tax Exemption	Gift Tax Exemption	GST Tax Exemption	Highest Estate and Gift Tax Rate (and GST Tax Rate)
1997	\$600,000	\$600,000	\$1,000,000	55%*
1998	\$625,000	\$625,000	\$1,000,000	55%*
1999	\$650,000	\$650,000	\$1,010,000	55%*
2000	\$675,000	\$675,000	\$1,030,000	55%*
2001	\$675,000	\$675,000	\$1,060,000	55%*
2002	\$1 million	\$1 million	Indexed for inflation	50%
2003	\$1 million	\$1 million	Indexed for inflation	49%
2004	\$1.5 million	\$1 million	\$1.5 million	48%
2005	\$1.5 million	\$1 million	\$1.5 million	47%
2006	\$2 million	\$1 million	\$2 million	46%
2007	\$2 million	\$1 million	\$2 million	45%
2008	\$2 million	\$1 million	\$2 million	45%
2009	\$3.5 million	\$1 million	\$3.5 million	45%
2010	Tax repealed	\$1 million	Tax Repealed	35%**
2011	\$1 million	\$1 million	\$1,060,000 plus inflation adjustment	55%
<p>* Additional 5% surcharge applies to estates between \$10 million and \$17.184 million.  **After 2010, the gift-tax rate will be equal to the highest income-tax rate for individuals.</p>				

B. The New Basis Rules

Pre-2001 Law.

1. Carryover Basis for Gifted Assets. Assets that are gifted during life retain the donor's basis ("carryover basis"), not to exceed the asset's fair market value as of the date of the gift.
2. Step-up in Basis at Death. Assets passing from a decedent's estate receive a "stepped-up" basis equal to the fair market value as of date of death (or as of the alternate valuation date). This stepped-up basis eliminates capital gain on any appreciation in the value of the property that occurred after the acquisition of the asset and prior to the decedent's death.

Law Under EGTRRA. Starting in 2010, the stepped-up basis rule for transfers at death is repealed and replaced with a modified carryover basis rule. In general, the basis of property received from a decedent will be the *lesser* of: (1) the decedent's adjusted basis in the property or (2) the property's fair market value as of date of death. However, subject to a number of limitations, a stepped-up basis in assets of the decedent is still permitted.

1. Recipients of property "owned by the decedent" at death will generally be entitled to an aggregate basis increase (to date of death value) of \$1.3 million (as adjusted for inflation after 2010).
  - (a) The surviving spouse of the decedent will be entitled to an additional aggregate basis increase of \$3 million (as adjusted for inflation after 2010) for "qualified spousal property" owned by the decedent at death. Qualified spousal property is property that would currently be entitled to the unlimited marital deduction under IRC §2056 and is either outright transfer property, or qualified terminable interest property (property which passes from the decedent and in which the surviving spouse has a qualified income interest for life).
  - (b) In the case of a decedent who was neither a U.S. resident nor a U.S. citizen, the aggregate basis increase is limited to only \$60,000 (as indexed for inflation beginning in year 2010).
2. The following rules are applicable in determining whether property was "owned by the decedent" at death:
  - (a) The decedent will be treated as having owned 50% of any property jointly owned by the decedent and his or her surviving spouse.

- (b) For property held as joint tenants with rights of survivorship with a non-spouse and which was acquired for consideration, the decedent will be considered to have owned only that portion of the property which reflects his or her pro rata portion of the consideration furnished to acquire the property.
- (c) If the decedent acquired property by gift (or any transfer without consideration) during a 3 year period ending on the date of his or her death, the decedent will not be treated as having owned the property unless it was acquired from his or her spouse and the decedent's spouse did not acquire the property for no consideration within said 3 year period.
- (d) The decedent will be considered to have owned all property transferred by him or her to a qualified revocable trust (i.e. grantor trust) during life.
- (e) The income tax exclusion of up to \$250,000 of gain on the sale of a principal residence is available to the decedent's estate or beneficiary where the decedent's pre-death use and ownership qualifies for the exclusion pursuant to IRC §121.
- (f) All items of income in respect of a decedent (IRD) are not eligible for basis step-up.

3. Information Reporting

- (a) If the fair market value of property acquired from a decedent exceeds the \$1.3 million basis increase amount, or the decedent received gifts of appreciated property within three years of the decedent's death that are not eligible for the basis increases, the executor must provide the following information to the IRS:
  - (i) The name and social security number of the recipient of such property;
  - (ii) An accurate description of such property;
  - (iii) The adjusted basis of such property in the hands of the decedent and its fair market value at the time of death;
  - (iv) The decedent's holding period for such property;

Revisions to the Connecticut Succession Tax. The Connecticut Succession Tax was initially scheduled to be repealed incrementally over a nine year period that began in 1997 by increasing the exemption amount applicable to each class of beneficiaries. The repeal period has since been extended. As the law currently stands, the Connecticut Succession Tax will be fully repealed as of January 1, 2008.

- A. Transfers to Spouse. Unlimited marital deduction is available at all times on transfers to spouses.
- B. Exemption Amount Applicable to Transfers to Children and Other Lineal Descendants.

<u>Calendar Year of Death</u>	<u>Exemption Amount</u>
1996	\$ 50,000
1997	\$250,000
1998	\$500,000
1999	\$800,000
2000	\$2 million
2001	unlimited

- C. Exemption Amount Applicable to Transfers to Brothers, Sisters and Their Descendants. Phase-out began by increasing exemption amount to \$200,000 in 1999. Phase-out is complete in 2006.

<u>Calendar Year of Death</u>	<u>Exemption Amount</u>
1998	\$ 6,000
1999	\$ 200,000
2000	\$ 400,000
2001-2004*	\$ 600,000*
2005	\$1,500,000
2006	unlimited

\*Note, for taxpayers dying in January and February 2003, the exemption amount is \$1,500,000.

- D. Exemption Amount Applicable to Transfers to Unrelated Noncharitable Beneficiaries. Exemption increases to \$200,000 in 2001. All transfers are exempt beginning in 2008.

<u>Calendar Year of Death</u>	<u>Exemption Amount</u>
2000	\$ 1,000
2001 – 2005*	\$ 200,000*
2005	\$ 400,000
2006	\$ 600,000
2007	\$1,500,000
2008	unlimited

\*Note, for taxpayers dying in January and February 2003, the exemption amount is \$400,000.

- VI. The Connecticut Estate Tax. With the repeal of the Succession Tax, the Connecticut Estate Tax applies more frequently to estates in Connecticut. The amount of the tax is the credit given by the Federal Government for state death taxes paid.

- A. Phase out of the Credit at the Federal Level. Beginning on January 1, 2002. The Federal Government is phasing out the state death tax credit allowable to estates for purposes of calculating the amount of federal estate tax due will be phased out:

1. For estates of decedents dying in 2002, the state death tax credit will be 75% of its current amount.
2. For estates of decedents dying in 2003, the state death tax credit will be 50% of its current amount.

3. For estates of decedents dying in 2004, the state death tax credit will be 25% of its current amount.
  4. The state death tax credit will be repealed for estates of decedents dying after December 31, 2004.
- B. Because the repeal of the state death tax credit will result in a significant loss of revenue for the states, many states have revised or are considering revising their estate tax laws so they are “decoupled” from the federal state death tax credit. The estate tax laws in the handful of states that have decoupled vary. However, in general, these states now calculate their estate tax by ignoring, in some measure, the increases to the Federal unified credit and the decreases to the Federal state death tax credit that have taken place since January 1, 2002.
- C. Decoupling in Connecticut. The Connecticut Estate Tax is scheduled to be temporarily decoupled from the Federal state death tax credit for six months. Effective for decedent’s dying July 1, 2004 through December 31, 2004, the Connecticut Estate Tax is computed by:
1. Limiting the unified credit equivalent to \$1,000,000;
  2. Ignoring the state death tax credit reductions for federal estate tax purposes: and
  3. Increasing the amount arrived at by 30%.

In addition, for decedents dying from July 1, 2004 through December 31, 2004, the Connecticut Estate Tax will be due six months (rather than nine months) from date of death.

Note: This temporary decoupling of the Connecticut Estate Tax is only scheduled to take place if Connecticut does not receive \$110 million in Federal Medicaid funds for the 2004-2005 fiscal year. However, given the ongoing budget crises faced by the State, it is likely that, at some point in time, the Connecticut Estate Tax will be permanently decoupled from Federal law.

- D. In all cases, an estate may deduct the amount of Connecticut Succession Taxes paid from the amount of Connecticut Estate Taxes otherwise due.

VII. Freeze in Connecticut Gift Tax Exemption. The Connecticut Gift Tax exemption was initially scheduled to be increased to \$1,000,000 over a six year period beginning with the 2001 calendar year. As with the phase-out of the Connecticut Succession Tax, the scheduled increases in the Connecticut Gift Tax exemption have been temporarily “frozen,” with the increases in now scheduled to be complete in 2010.

A.	<u>Calendar</u> <u>Year of Gift</u>	<u>Exemption</u> <u>Amount</u>
	2001-2005	\$ 25,000
	2006	\$ 50,000
	2007	\$ 75,000
	2008	\$ 100,000
	2009	\$ 950,000
	2010	\$1,000,000

- B. In addition to the exemption amounts listed above, the Federal annual gift tax exclusion of \$11,000 per person continues to apply to present interest gifts. For example, no Connecticut gift tax will be due on a present interest gift of \$36,000 from a single donor to one person in year 2003. Remember, however, the \_\_\_\_\_ results if the \_\_\_\_\_ gift in the preceding example was \$36,000 (\_\_\_\_\_ gift totals of \$250.20 \_\_\_\_\_ be due).
- C. Rate of tax ranging from 1% to 6% applies to gifts that exceed the exemption amount. Remembering, Connecticut gift tax will continue to apply beyond 2010 for gifts of more than \$1.0 million!

A. The Mechanics

1. When one spouse dies, first \$1,000,000 of assets (under current law) passes into the credit shelter trust, and the excess passes directly or indirectly to the surviving spouse.
2. Income and principal can be distributed from the credit shelter trust to the surviving spouse for health, support, education and maintenance during the surviving spouse's entire lifetime.
3. When surviving spouse dies, all assets in the credit shelter trust pass to your children or other designated beneficiaries free of estate tax.

B. Tax Consequences

1. When first spouse dies, the deceased spouse uses his or her unified credit to shelter the amount passing into the credit shelter trust from tax. Generally, assets that pass directly or indirectly to the surviving spouse qualify for the unlimited marital deduction and escape estate tax. The excess (above the unified credit equivalent) that passes to the surviving spouse is usually structured in one of three ways:
  - (a) Outright marital bequest to surviving spouse;
  - (b) A marital trust which qualifies as a QTIP Trust; or
  - (c) A general power of appointment trust.
2. When second spouse dies, the assets in the credit shelter trust are not subject to estate tax regardless of the value of the assets at that time. Estate taxes are paid, only to the extent that the value of the surviving spouse's taxable estate (which includes the value of assets in any QTIP or general power of appointment trust created by the first spouse) exceeds \$1,000,000.

C. Conclusion. Many married couples with estates of \$2 million or less can avoid paying estate taxes entirely if the proper planning is done. By properly using credit shelter trusts the federal estate tax savings is in excess of \$210,000.

V. The Irrevocable Life Insurance Trust ("ILIT").

A. Ownership of the Policy. Life Insurance policy is obtained through an irrevocable trust; that is, the trust is the owner and beneficiary of the insurance policy.

1. When the insured dies, the Trustee of the Trust collects the death benefit and distributes the death benefit to the insured's beneficiaries who take the proceeds free from income and estate taxes.

**NOTE:** Regardless of how a life insurance policy is owned, the beneficiary of the policy generally receives the death benefit income tax free. However, the full amount of the death benefit is included in the estate of the owner/insured of the policy upon his or her death. The main benefit of the ILIT is that the Trust is the owner of the policy, and therefore, the death benefit is not included in the estate of the insured upon death. In other words, the death benefit can pass to the insured's intended beneficiaries entirely free of income and estate taxes.

2. Traditionally a life insurance policy insuring one life has been used with an ILIT. An ILIT can also be the owner of an insurance policy on two lives; a joint-and-survivor policy that pays a death benefit only when the surviving insured dies. For estate planning purposes, a joint and survivor policy insuring the lives of a husband and wife offers several benefits:
  - (a) It pays a death benefit upon the death of the surviving spouse (when estate taxes generally must be paid) thereby providing a vehicle for funding a married couple's estate tax liability.
  - (b) Since the policy only pays a death benefit on the death of the surviving spouse, the premiums are generally less.
  - (c) In some cases, a joint and survivor policy can be obtained when one of the spouses is not insurable.
3. If an existing policy of life insurance on the life of a person is transferred by that person into an ILIT, the person must live for three (3) years from the date of transfer to successfully exclude the policy proceeds from his or her estate.

B. Payment of Premiums

1. Each year the insured transfers cash into the ILIT, and the Trustee uses the cash to pay the policy premiums.
2. The transfer of cash into the ILIT is treated as a gift to the beneficiaries of the trust. The insured can transfer up to \$11,000 per beneficiary per year into the trust (\$22,000 if the insured is married). If each beneficiary is given a withdrawal or crummy power over the funds placed into the trust

for his or her benefit, the annual gift exclusion applies so that the gift is not taxable.

3. The ILIT can build a substantial cash value entirely income tax free.
4. The ILIT allows parents to make non-taxable gifts to their children by using their annual gift exclusions, and, at the same time, postpone the actual transfer of funds (by retaining assets in trust) until some preselected point of time in the future.
5. Contributions to the ILIT decrease the portion of an individual's estate which is subject to estate tax.
6. Assets in the ILIT are not subject to the claims of creditors of the beneficiaries of the ILIT.

C. Distributions During Lifetime of Insured

1. THE ILIT IS IRREVOCABLE; THAT IS, THE PERSON WHO SETS UP THE TRUST CANNOT REVOKE THE TRUST OR EVER TAKE BACK PROPERTY CONVEYED INTO THE TRUST.
2. The ILIT is typically structured so that distributions can be made to the beneficiaries of the Trust during the insured's lifetime.
3. Beneficiaries of the ILIT have no legal obligation to return trust property which has been distributed to them to the persons who set up the trust and made the gifts. ILITs are often structured, however, on the premise that the persons who set up the trust have trust that the beneficiaries would return the trust property to them following a distribution if and when the need arises.

D. Distributions After Death of Insured

1. In situations where an estate is illiquid or does not have enough cash to pay estate taxes, an ILIT can purchase illiquid assets from the estate, thereby providing the cash needed to pay the estate taxes.
2. The possibilities are endless with respect to how the ILIT can be structured to make distributions to beneficiaries after the death of the insured:
  - (a) The Trustee may simply be required to distribute the death benefit outright to each beneficiary in equal shares.

- (b) The Trustee may be required to hold the trust property until each beneficiary attains a certain age, goes to college or retires.
- (c) The ILIT can be structured as a generation skipping trust which avoids ever being taxed in the beneficiaries' estates. This is typically done by limiting distributions to income distributions and discretionary principal distributions. Beneficiaries can even be given a special power of appointment without the property in the trust being included in their estates. When the beneficiary dies, his or her share of the trust property would then pass according to the special power of appointment if exercised, or if not, to the beneficiary's heirs.