

**DEMYSTIFYING THE ESTATE PLANNING PROCESS:
WHAT YOU NEED TO KNOW TO BE AN EDUCATED CONSUMER**

The Chicago Estate Planning Council

Presentation

at

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I. Basic Overview

- A. Creating an estate plan can be an emotional topic. It is difficult to address your own mortality and talk about what will happen to your loved ones when you are no longer here. No matter how uncomfortable the issues are surrounding the estate plan, it is important to get past that hesitation and provide a roadmap to your survivors.
- B. One of the most common questions estate planners hear is “When do I need a will?” There are three general guidelines: (1) when you have a child; (2) when you have assets in excess of \$100,000; or (3) when you have assets that you want to give to someone who will not receive them under the law.
- C. There are two groups of assets generally discussed as part of an estate plan, probate assets and non-probate assets. The easiest way to describe the difference between the two asset classes is to say that non-probate assets have a beneficiary designation (e.g. life insurance, IRA, 401(k), jointly owned house or bank account if rights of survivorship are included). Of course, if your beneficiary does not survive you, your non-probate asset may fall back into your probate estate. Probate assets are those that require a court procedure or court order to be validly transferred to the beneficiary under the applicable law.
- D. Unmarried individuals often need an estate plan more than married individuals, particularly if they are in a committed relationship. Without a legal marriage or civil union, the relationship will be ignored for purposes of both the care of an individual during disability and the distribution of property at death. A good estate plan can ensure that both issues are dealt with in the manner the individual intends.
- E. A basic estate plan should include a will, powers of attorney for property and health care, and possibly a revocable trust (living trust) and/or an insurance trust. Whether trusts are employed in the planning depends on several factors.
- F. For younger individuals, a revocable trust usually is warranted only where the assets (or combined assets of spouses) are approaching \$1,000,000. If the individual owns quickly appreciating assets or anticipates a large outright inheritance, a revocable trust may also be recommended. For older individuals or ill individuals, a revocable trust often is recommended because it allows you to avoid probate and also serves to provide smooth transition of asset management if the individual becomes unable to manage his or her own affairs.

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- G. Insurance trusts are used to remove life insurance proceeds from the taxable estate pool. Although life insurance proceeds generally are not subject to income taxes, they are subject to estate taxes. This type of planning is used to maximize the amount of assets passing to descendants.
- H. In addition to the personal goals that drive the planning, there are two tax schemes that influence estate planning. The first is the estate tax. Under current law, every individual will have a \$5,340,000 federal estate tax exemption, a \$4,000,000 Illinois estate tax exemption equivalent and can give unlimited assets to a citizen spouse without those assets being subject to estate tax. There is also portability between spouses that allows a surviving spouse to take advantage of the unused portion of the federal estate tax exemption of the predeceased spouse.
- I. The other tax scheme is the generation skipping transfer (“GST”) tax, which applies to transfers to grandchildren or younger generations. The GST exemption is also \$5,340,000.
- J. Estate planning can also meet short term goals, such as appointing a short term guardian for minor children while the parent(s) are unavailable due to travel or other constraints. Illinois law provides a form (found at 755 ILCS 5/11-5.4) that allows parents to appoint someone to act as short term guardian for minors for a period of up to 365 days.

II. Definitions Used In Estate Planning

- A. **Will**: a legal expression of a person's wishes regarding disposition of his or her property after death. The law requires specific language and process to make the documents valid.
 - **Testator**: the person who makes a Will.
- B. **Trust**: a form of ownership in which one party (the Trustee) holds and administers the property for the benefit of another (the Beneficiary).
 - **Grantor/Settlor**: the person who establishes a trust.
- C. **Probate**: a proceeding by which title to property of a decedent is transferred to the decedent's heirs (if decedent died intestate, i.e., without a Will).
 - **Executor**: the personal representative nominated under a decedent's Will to administer the estate.
 - **Administrator**: the personal representative appointed by the court to administer the estate when there is no Will or no Executor nominated by the Will qualifies to act.

- D. **Intestate Succession**: the manner in which the law provides for disposition of a person's property among his heirs in an intestate (no Will) situation.
- E. **Land Trust**: a method of holding title to real estate in Illinois, in which the legal owner is a Land Trustee, and the beneficial interest is owned by named individuals. A land trust provides some confidentiality regarding the names of the owners of the beneficial interest of the property and is a method sometimes used to designate the successor owner of real estate without setting up a living trust or putting the property in joint tenancy.
- F. **Surety**: court ordered insurance policy, paid for by the estate, on an amount equal to one and one-half times the value of the personal property (i.e. everything other than real estate), to protect the heirs/beneficiaries from any wrongdoing by the personal representative.

III. Why Do You Need a Will?

- A. Requirements for a Valid Will in Illinois
 - Must be 18 years of age
 - Testamentary capacity
 - In writing
 - At least two witnesses
 - Notary required to make Will “self proving” (i.e. avoid questions about whether it was signed properly)

B. What Happens if You Die Without a Will (Intestate)?

- Your property is distributed according to statute as follows:

<u>If a decedent leaves surviving:</u>	<u>Distribution:</u>
A surviving spouse and descendants	50% to surviving spouse and 50% to descendants, <u>per stirpes</u>
Descendants but no surviving spouse	All to descendants, <u>per stirpes</u>
A surviving spouse but no descendants	All to surviving spouse
No spouse or descendants	Parents, brothers and sisters, in equal shares. A surviving parent receives a double portion. The descendants of a deceased brother or sister take their parent's share.
No spouse, descendants, parents, brothers or sisters, or descendants of brothers and sisters	50% to decedent's maternal grandparents or their descendants, <u>per stirpes</u> , and 50% to decedent's paternal grandparents or their descendants, <u>per stirpes</u> .

*If children born outside of wedlock, see Illinois Probate Act, 755 ILCS 5/2-2 (h).

** Partners in a civil union are treated as spouses for all purposes under Illinois law in accordance with the Illinois Civil Union law. The Religious Freedom and Marriage Fairness Act legalized same-sex marriage in Illinois and redefined “marriage” in terms of “parties to a marriage.”

- If you die with a spouse and children, 1/2 of your estate will not be available to your spouse.
- Probate court chooses the guardian for your minor children (children under age 18). The guardian of the person will have custody of the child. The guardian of the estate will handle the child's finances.
 - Limits investment options;
 - Requires court permission for all distributions;
 - Expensive annual court filings and associated attorney fees;
 - Children get all the assets at age 18;
 - Annual surety bond required.

C. With a Will, You Can:

- Distribute property in the manner and to whom you want;
- You choose your Executor to manage the cash and assets;
- You choose the guardian of the person for your minor children;
- You can establish trusts after your death for your children's share of the property, avoiding the need for guardian of the estate. You can also provide at what age(s) the children receive money;
- You can waive surety and avoid that expense.

IV. What is a Trust, and Why Do You Need One?

A. Many Illinois clients use a Living Trust. A trust is a form of property ownership.

- Grantor/Settlor – person who establishes the trust.
- Trustee holds title - any individual or authorized institution can serve as Trustee.
- Beneficiary is the person(s) for whose benefit the trust is established.

B. Different types of Trusts

- A Living Trust (also called a Revocable Trust) is created by you during your lifetime -- called a Declaration of Trust. You name yourself as Trustee, with successors named if you die or become incapacitated.
- Irrevocable Trust Agreement -- you name one or more other persons or a bank as Trustee during life.
- Testamentary Trust is established under Will -- takes effect at your death.

C. Purposes and Advantages of a “Living Trust”

1. Avoids probate at death -- No court proceeding needed.
 - Trust assets are non-probate property;
 - Trust instrument governs disposition of trust assets at death;
 - Probate costs avoided;
 - Privacy -- no public disclosure of your assets or your distribution plan;
 - Avoids will contests.
2. Avoids need for a Guardian in the event of your incapacity
 - Trustee, or successor Trustee, continues management of your assets for your benefit.
 - Avoids court determination of incapacity.
 - Privacy and ease of burden on family.
3. No estate or gift tax consequences to transfer of assets to trust name. Funding the trust is an important part of process.
4. If the grantor acts as Trustee, there are no separate income tax reporting requirements because trust is a “grantor” trust. All items of income, deductions and credits are reported on grantor's own income tax return (Form 1040).
5. A Living Trust may not make sense:
 - Where assets are relatively minimal;

- Where concerns about disability are resolved with use of Powers of Attorney;
- Where family situation makes disagreements during disability or at death unlikely.

V. Why Use Trusts?

- While you get a marital deduction for what is left outright to your spouse, remember that the spouse has complete control and can leave everything to a new spouse, who can spend it as he or she wishes.
- If it is a second marriage situation, your spouse may leave everything to his or her children, not yours.
- Consider using a QTIP (Qualified Terminable Interest Property) marital trust - spouse receives income or a percentage distribution (unitrust) for life, and limited principal for purposes you define, but at death, assets pass to your intended beneficiaries (your children).
- Using a trust can guarantee that children will receive their inheritance gradually, rather than at age 18 (A typical structure: in thirds at ages 25, 30, and 35).

VI. Planning for disability - Powers of Attorney and “Living Will”

- The U.S. Supreme Court has ruled that a State has the right to keep a person alive by artificial means if the individual has not evidenced his or her intent to the contrary by some method that the State has approved, even though there is evidence that the person did not want to be kept alive by artificial means.
- A Power of Attorney for Health Care and Living Will allow an individual to control his or her own medical care.

A. Power of Attorney for Health Care

1. An Agent named to make health care decisions for the principal in the event of illness, incapacity or incompetence.
2. Avoids guardianship of the person and court determination of incapacity.
3. Protection of health care providers adhering to agent's direction
 - If doctor or other health care provider is unwilling to comply with agent's direction, then patient's care must be transferred to another doctor or provider who will comply.

- Doctor or health care provider will not be subject to any type of civil or criminal liability or discipline for unprofessional conduct for complying with agent's decision, even if death or injury ensues.
4. Agent can be given authority to withhold or to maintain life-sustaining measures.

B. Power of Attorney for Property

1. An Agent is named to manage property of the principal in the event of illness, unavailability, incapacity or incompetence.
 - The Principal is free to limit the powers granted.
 - The Power of Attorney can be structured to come into effect at some future point, such as a doctor's determination of incapacity, rather than immediately.
2. Avoids guardianship of the estate and court determination of incapacity.
3. Agents may be given authority to transfer assets to a Living Trust and make gifts, but such gifts are closely examined by the IRS.
4. Power of attorney may survive adjudication of incapacity.
5. Authority terminates at death.

C. Living Will (also known as “Declaration of Intent”)

1. Direction to Physician:

“If at any time I should have an incurable and irreversible injury, disease, or illness judged to be a terminal condition by my attending physician who has personally examined me and has determined that my death is imminent except for death delaying procedures, I direct that such procedures which would only prolong the dying process be withheld or withdrawn, and that I be permitted to die naturally with only the administration of medication, sustenance, or the performance of any medical procedure deemed necessary by my attending physician to provide me with comfort care.”

2. Physicians or other health care providers are under a duty to either comply with the provisions of the “living will” or to inform the patient or family of unwillingness so that transfer to a willing physician is possible.

VII. What You Need to Know About Transfer Taxes: How You Can Reduce Their Impact on You and Your Family

A. Tax on Gratuitous Transfer of Wealth

1. Unified System of Taxation

- Gift Tax - Taxes gratuitous transfer of wealth during lifetime (inter vivos).
- Estate Tax - taxes transfer of wealth at death (testamentary).
- Generation skipping tax (“GST Tax”) - an additional tax on transfers during life or at death to grandchildren or more remote descendants.

2. Rates

- The Gift Tax and Estate Tax is a single 40% rate for amounts in excess of \$5,340,000.
- The GST Tax will be the highest Estate Tax rate - 40%.

3. Assets subject to Estate Tax.

- Virtually all assets owned by you at your death are counted, including real estate, stock, bonds, mutual funds, mortgages, notes, cash, business interests, collectibles, automobiles, jewelry, and personal effects.
- Life insurance proceeds on your life if you possess any incidents of ownership (e.g. you are the policy owner) with respect to the policy.
- Any annuity or other payment receivable at the time of your death. Property includable here includes commercial annuities, payments under retirement plans maintained by your employer and individual retirement account (IRA) benefits.
- One-half of the value of property that you owned in joint tenancy with your spouse.
- The full value of property owned in joint tenancy by you and other individuals except:
 - Property acquired by you and other joint owner or owners by inheritance, gift or bequest; or

- To the extent the surviving joint tenants can prove an independent contribution to the value of the jointly owned property.
4. **Income Tax Cost** — Other than for deaths in 2010, the basis of property received from a decedent is generally adjusted or “stepped-up” (or “stepped-down”) to its fair market value at the time of death. This rule allows the beneficiaries to avoid the income tax on the appreciation of assets from the time the decedent purchased them until the date of death; however, there is no adjustment for assets passing a part of an IRA, 401(k) or other deferred compensation plan. Special rules apply for individuals who died during 2010.
 5. Illinois has enacted an Estate Tax for estates of decedents dying after December 31, 2010. There is an exemption equivalent per individual of \$4,000,000 for 2014 and beyond and an unlimited marital deduction. Therefore, an estate may owe Illinois Estate Tax, but no Federal Estate Tax.

B. Credits, Deductions and Exclusions

1. **Unified Credit (also called Applicable Exclusion)**
 - Applies to both Estate Tax and Gift Tax.
 - Permits aggregate tax-free transfers (during life and at death) of \$5,340,000.
 - Properly structured estate plans allow spouses to transfer up to \$10,680,000 without any transfer taxes.
2. **Unlimited Marital Deduction**
 - Applies to Estate Tax and Gift Tax, as well as Illinois Estate Tax.
 - Unlimited gifts or entire estate may be given to a citizen spouse free of Federal and Illinois Estate and Gift Taxes.
 - Most tax efficient estate plan uses the unified credit in coordination with the unlimited marital deduction.
 - There are special rules for non-citizen spouses, and transfers generally are not tax-free. For example, the annual exclusion for gifts to a non-U.S. citizen spouse is limited to \$145,000 in 2014.

- New portability provision allows surviving spouse to utilize unused portion of the deceased's spouse's exemption amount if an election is made on a timely filed Estate Tax return.
3. Transfers qualifying for marital deduction
- Outright transfers to spouses
 - Transfers in trust for benefit of spouse
 - full power of withdrawal
 - general power of appointment
 - “QTIP” - all income for life to spouse
 - estate trust
4. Annual Exclusion
- Applies only to Gift Tax.
 - Permits transfer to anyone (a “donee”) of up to \$14,000 annually free of Gift Tax.
 - Annual exclusion applies per donee.
 - “Gift splitting” - with consent of spouse, annual exclusion may be combined for a total of \$28,000.
 - Inflation adjustment (if any) is determined annually.
 - Gift must be of a “present” as opposed to a “future” interest
 - Outright gifts qualify.
 - Certain gifts in trust qualify.
5. Tuition and Medical Care
- Applies only to Gift Tax
 - Unlimited amounts
 - Not applied against unified credit or annual exclusions
 - Payments must be made
 - for tuition
 - for medical care
 - directly to the institution

- reimbursements do NOT qualify and will be considered taxable gifts subject to the annual exclusion limits
 - Can also utilize Section 529 Plans
6. Charity
- Qualified Transfers to charity during life or at death are entirely tax free.
 - outright gifts qualify
 - cash
 - appreciated securities
 - retirement assets
 - certain gifts in trust qualify
 - life income gifts
 - charitable gift annuities
 - charitable remainder trusts charitable lead trusts
7. Generation-Skipping Transfer Tax Exemption (“GST Exemption”)
- Taxes transfers to persons two or more generations younger than the transferor (e.g. grandchildren).
 - Rate - highest Estate Tax rate (40%).
 - This tax is in addition to Estate and Gift Taxes.
 - A \$5,340,000 exemption is available
8. Using “By-Pass” Trusts for Tax Benefits

VIII. So I need an Estate Plan - Now What?

- You should view selection of an estate planning attorney as you would shopping for any other product you purchase. Would you buy a 50-inch plasma television without doing your homework and testing out the products at the store?
- A good estate planning attorney can be a trusted advisor not just in the financial arena. Ask the questions that will provide you with the information you need to determine whether the attorney is someone you feel comfortable with. Your estate planner will be able to serve you best if you are able to share honestly your thoughts and secrets. As such, you need to find someone who inspires trust and confidence.

- It is important to inquire about the attorney's credentials. Ideally, you want an attorney who spends a substantial amount of his or her time advising for and drafting estate plans.

A. Outline your goals and concerns

1. Always ask for a fee estimate, but understand that your efficiency drives the price. Before you meet with the attorney to begin the drafting process, think about who you want to receive your assets, restrictions you may want to place on access to the assets, and who will be named to serve as executor, guardian and trustee. Consider the following questions and have your own list of answers or questions when you meet with your attorney.
 - a. Who is to receive your personal effects (such as clothing and jewelry), household effects (such as furniture and artwork), and vehicles (cars, boats, etc.)?
 - b. Whom do you wish to name as guardian of your minor children?
 - i. If you are considering naming a married couple, what would you want to have happen if they get divorced or one of them dies?
 - ii. Who will serve as successor guardian if your first choice cannot or will not act as guardian?
 - c. Whom do you wish to name as executor of your will? Also provide the names of successor executors in case the original executor is unable or unwilling to act as executor.
 - d. Do you wish to make any specific (cash or property) gifts to any individuals or charities?
 - e. Who should receive the balance of your assets (after any specific gifts described in response to question d) upon your death?
 - f. If you are leaving assets to your spouse, do you want those assets held in trust for the benefit of your spouse? Retaining assets in trust may provide protection from creditors.
 - i. Who should act as trustee of assets held for your spouse? Successor trustee?
 - ii. Typically, tax benefits are achieved by providing that your spouse will receive all income from the trust. Should principal of the trust be made available as well? If so, under a broad "best interests" standard, or limited only to support?

- iii. Should your spouse have a right to redistribute assets among your descendants after your death (i.e. change your estate plan with respect to your descendants)?
 - g. If you are leaving assets to children or grandchildren, should they be retained in trust?
 - i. Who should act as trustee? Successor trustee?
 - ii. At what age(s) should the child or grandchild have independent access to the funds? (e.g. 1/3 at each of ages 25, 30 and 35)? Should a child or a grandchild have full access to the funds at any age?
 - h. Who should ultimately receive assets if none of you, your spouse or a child of yours is living (i.e., the immediate family is eliminated in a common disaster)?
 - i. Would you like to name an individual who would be able to make health care decisions for you if you are incapable of doing so for yourself?
 - i. Who should act as your health care agent? Please provide the city and state of residence. Successors?
 - ii. Do you have special requests regarding burial, such as cremation?
 - iii. Do you want to be an organ donor? If yes, any restrictions?
 - j. Would you like to name an individual who would be able to make financial decisions for you if you are incapable of doing so for yourself?
 - i. Who should act as your property agent? Please provide the city and state of residence. Successors?
 - ii. Should any special restrictions be imposed upon this person's ability to act? The law generally imposes a duty to handle assets only for your benefit.

HELPFUL WEBSITES

Chicago Estate Planning Council — www.cepcweb.org
 National Association of Estate Planning Councils — www.naepc.org
 American Bar Association — www.abanet.org/public.html

