Why Do Estate Planning?

By Jerome P. Friedlander, II, Esq.

Q. With Virginia having no death tax and with the "federal exemption" for the death tax beginning in 2018 being $11.2 million per person with portability between spouses, why does a real estate agent or anyone else for that matter, with less than this size of an estate need to consider estate planning? This exemption will return to $5,000,000 per person in the year 2025 unless Congress changes the law.

A: The subject of estate planning includes three main topics: (1) The passage of ownership to one's property at their death through the use of joint ownership techniques, a will, a trust, a deed or some other entity; including business succession planning; (2) asset protection issues that may arise and (3) where applicable the avoidance (not evasion) of death or inheritance taxes that may be applicable.

Q. I heard that a transfer to my spouse is tax free during my lifetime and at death?

A: This is called the "marital deduction." It is entire free if the donee spouse is a US citizen. If not, then only $152,000 (as indexed in 2018 for inflation) of the transfers will be tax free using the "marital deduction." Otherwise, you must use the lifetime exemption that applies at the federal and state level.

Q. Is gifting to non-spouses during your lifetime free of taxation?

A: There are four areas where there is no gift tax: (1) the annual exclusion which remains at $15,000 per donee per year (as indexed in 2018 for inflation) for which no gift tax is due and no gift tax return need be filed. A spouse can also use the spouse's annual exclusion with the spouses' consent and with the filing of a gift tax return; (2) the lifetime gift exemption of $11.2 million (in 2018); (3) paying medical bills directly to the provider for someone else's care; and (4) paying someone else's education bills directly to the institution.

Q. What are the key differences between a will and trust, and how is title passed into a trust?

A: A will is a formal and witnessed document that is effective only upon your death. It must be probated through the court, which process is the court supervised transfer of title. Probate is public and a listing of your assets and how they are accounted for and to whom they pass will be available to the public to see.

A trust takes title by the transfer from you into the trust. This can occur while you are alive, (referred to as a living trust), or the transfer can take place through your will into a trust at your death (referred to as a testamentary trust). A trust created within a will must go through the probate process, while one made during your lifetime passes title outside of the will and avoids probate.

If you set up a trust, such as a revocable living trust, you can transfer title to real estate by using a deed from you into the trust or put your bank accounts in the name of the trustee or by an assignment of your personal property into the trust. At the death of the trustmaker the trust still owns the assets and title is directed in accordance with the terms of the trust document. There is no probated need to transfer title of assets held in trust. This privacy means that ex-spouses, creditors, neighbors and relatives cannot go to the courthouse to see what your assets were and where they are going.

Q. Will joint ownership, with survivorship, or TOD, POD or TODD solve a lot of the transfer of title at death problems?

A: Joint ownership with survivorship will solve some problems and create others. It will transfer ownership of the first to die to the survivor and hence avoid probate at that level. The survivor's ownership will not pass by survivorship unless a new joint owner is named. Bank and financial accounts can use "TOD" or "POD" on them to "transfer on death" or "pay on death" and for real estate one may use its equivalent; the "transfer on death deed." Only about half of the states have this deed form available.

The problem created by joint ownership is that the survivor may add a new spouse to the deed, or sell the property and put the money into a property owned with a new spouse and with survivorship, so that the ultimate ownership will not pass to the original owner's children as planned, but to strangers. This is what we call the "unintended heir."

What is this TODD I just mentioned? There is a deed now available in Virginia and a number of other states by which title may transfer not by survivorship, not by will, not by trust but by the deed which says that on your death, title passes automatically to the designated beneficiary without probate. Until you die, the named beneficiary will have no rights to the real estate, or any right to interfere with your use or enjoyment of the property until your death or to have a say in the financing of the real estate during your lifetime. Moreover, the beneficiary's creditors cannot attach the property until title has passed at your death. If, on the other hand, you simply added your child as a co-owner with survivorship, that child and his/her creditors could force a sale of the property and could prevent your sale or leasing of the property, or refinancing.

Q. With no death tax in Virginia, why are you still talking about death tax planning at the federal and state levels?

A: There is no death tax in Virginia, a number of states still have a death or inheritance tax that should be considered in your planning should you own property in those jurisdictions at your death: <u>DC</u>, <u>MD</u>, DE, NJ, CT, RI, MA, PA, NY, VT, NH, ME, TN, KY, IL, IA, MN, NE, OR, & WA.

Q. If there is a death tax, is there something that we can do to avoid death tax?

A: Yes, there are basis and sophisticated tax planning tools available depending on the situation. The planning techniques for federal taxation planning may be the same as is needed at the state death tax level. Good planning should include an analysis of your assets and situation.

Q. You say that asset protection techniques should also be considered. What are you talking about?

A: If you have assets from which personal liability may arise, then that liability will attach to all of the assets that you own in your own name. If the liability only will attach to a corporation or limited liability company, then only the assets inside those entities will be subject to the liability.

Q. An example?

A: Let's say your primary residence is Virginia, but you have a residential rental house that you own in your own name in DC. In your individual name, title passes in DC and ancillary probate will be required in DC to pass title. Depending on its value it may be subject to DC's death tax and because it is in your individual name you are exposed to personal liability for problems related to the conduct of that rental business. If the ownership is in an entity, such as a corporation then your liability will be limited, which is the asset protection aspect. Because the ownership of a corporation is a stock certificate, that certificate is not real property but personal property and the passage of its ownership will be probated in Virginia where you live and not in DC. If you reside in Virginia where there is no death tax, you will also avoid death tax. If you have moved the ownership of the corporation into your revocable living trust, then you will avoid probate.

Q. If I put my assets in a revocable living trust, will they be protected from my individual creditors?

A: No. Many people mistakenly think that by forming a living trust, revocable or irrevocable, that those assets are protected from their creditors. This is a complex topic, but let me say this. A revocable living trust offers no asset protection; same is true for most, but not all, irrevocable trusts. For asset protection you need a statutory entity that gives you that protection, such as a corporation, limited liability company, statutory business trust, or other limited liability entities. Asset protection planning is complex.

A: It is a recognized practice for a real estate broker to form his own LLC or corporation to protect the assets that are held within that entity but what about protection from the agent's personal creditors? Will this ownership of the LLC or a corporation protect the agent from his personal creditors in addition to the company's creditors?

A: No. Whether it is a share in Microsoft or a share in your wholly owned corporation, the ownership interest of the LLC or the corporation may be subject to attachment by the personal creditors of the owner. This is different than liability for the creditors of the company. Understand that the stock of a corporation can be sold to pay off the shareholder's personal creditors. The creditor can become the new owner of the corporation, while that cannot be the case with a LLC. LLC membership will be subject to what is called a "charging order" in Virginia and offers some protection which is better than that for corporate stock and prevents the loss of ownership.