WEALTH TRANSFER PLANNING

THE BASICS OF
WILLS - TRUSTS - PROBATE
REVOCABLE LIVING TRUSTS
IRREVOCABLE TRUSTS

2018 and Beyond

By

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1 What happens without a Will?

When someone dies without leaving a written Will, his or her estate passes according to the law of intestate succession. The statute that governs where property goes without a will is called the statute of descent and distribution.

1.1 Virginia.

In Virginia, the law of intestate succession (without a Will) provides for passage of ownership of the deceased's property in the following order:

First level: If decedent is survived by a spouse and no children, all of the estate in the decedent's name passes to the surviving spouse;

If decedent is survived by a spouse and there are children, then :

If all of the children are the children of the surviving spouse, then all goes to the spouse;

If any of the surviving children are not the children of the surviving spouse (i.e., a step-child), then one-third goes to the surviving spouse and two-thirds goes to all of the decedent's children equally.

Second level: If there are children surviving but no surviving spouse, then everything goes to the children or their descendants;

Third level: The next level is the father and mother or the survivor of them;

Fourth level: The next level is the brothers and sisters and their descendants;

Fifth level: The next level divides the estate, one share to the paternal kindred (on father's side) and one share to the maternal kindred (mother's side) in the following manner:

1st grandfather and grandmother, or their survivor;

2nd uncles and aunts <u>and</u> their descendants;

3rd great grandfathers or great grandmothers;

4th brothers and sisters of grandfathers and grandmothers.

1.2 District of Columbia.

In the District of Columbia the course of descent where there is no will is as follows:

First: If there is a surviving spouse with no children, then all goes to the surviving spouse;

If, in addition to the surviving spouse, there is also a surviving child, parent, grandchild, brother or sister or a niece or nephew:

A child or children takes two-thirds of the estate and the spouse one-third;

If there is a parent (father or mother), grandchild, brother or sister or niece or nephew then the spouse takes one-half while the others share one-half among themselves equally;

Second: Children will share the estate equally where there is no surviving spouse;

Third: The father or mother takes next;

Fourth: The brother or sister takes next;

Fifth: All other collateral relations share equally next.

2 What is a Last Will and Testament?

This is the written declaration by a person that controls what happens to his property after death. Until the writer dies, the document has no legal affect whatsoever and can be modified, altered, destroyed or canceled at any time.

A Will, at the time of death, does nothing more than control the passage of ownership of the decedent's property.

3 Legal requirements for a Will.

3.1 The writer must be competent.

No person of unsound mind or under the age of 18 years is legally capable of writing a Will. If someone writes a Will who is not mentally competent or who is under 18 years of age, the Will is void.

3.2 It must be written

An oral Will is not recognized except in combat during wartime. The District of Columbia recognizes an oral Will made in war where there are two witnesses to the dying declaration and the substance of it was reduced to writing within 10 days.

It may be typed or it may be in the handwriting of anyone. Virginia recognizes what is called a "holographic Will." If it has been written entirely in the handwriting of the testator and dated and signed by the testator, then that may qualify as a "holographic" Will and admitted to probate without the two witnesses having signed the Will. A holographic Will may then be proven during the probate procedure by two disinterested witnesses as to the testator's handwriting.

3.3 It must be signed by the person making the Will.

A Will cannot be signed by a power of attorney or an agent for another. It must be signed by the person making the Will.

Each Will that is signed and witnessed is an original Will. Therefore, one should only sign one original.

3.4 The Will must be witnessed by two persons.

3.4.1 Virginia

When a person signs his/her Will, there must be two persons watching them sign it or see and hear them acknowledge their signature to it. The witnesses must also witness each other signing it, too. A famous case dealt with a Will that was signed by a gentleman in his hospital bed behind a curtain. The two witnesses were not allowed behind the screen and did not actually see the gentleman sign the Will. The Will was declared invalid. Special language in the Will deals with this requirement.

In Virginia a witness may be an interested person, such as the executor, or a beneficiary of the Will. Attorneys try to avoid having an interested party witness the Will. This prevents fights later on. In the District of Columbia and elsewhere an interested person cannot be a witness. For this reason we avoid having any interested person as a witness.

3.4.2 District of Columbia.

In the District of Columbia, where a witness to a Will is also a beneficiary or someone with a power of appointment, any bequest or devise to that person is void. This includes the beneficiary's heirs should he die before the testator dies. A creditor of the testator is allowed to be a witness.

3.5 Self-proving Wills.

In Virginia, a Will may contain an additional section with a notary's affidavit. This is the "self-proving" section. With this in the Will, there is no need to locate the witnesses at the death of the will-maker in order to authenticate their signatures. The "self-proving" affidavit of the notary performs that task. Sometimes, when the parties are in a hurry there is no time to locate a notary. A Will with two witnesses is just fine without the "self-proving" language. At death, the witnesses will have to be located and a deposition taken to prove their signatures to the Will. This is called proving the Will.

In the District of Columbia it is not necessary to prove the signatures of the witnesses unless there has been a challenge to the Will made after notice and advertising.

3.6 Words of direction.

Many people want to write a Will that is gentle in its language. They say things like "I hope that Blackacre goes to Charlie..." "I ask that my executor will please..."

These words are referred to as "precatory." These words are not legally enforceable directives, since they express a wish or a desire and not a direction.

A Will must contain clear words of direction, such as "I give my watch to ...." , "I direct my executor to ....", "I hereby give, devise and bequeath to...." The expression of a wish or desire is not a direction. If you want to give your personal representative the right to make a decision for you, that is to have discretion in doing something, then say it "I give my executor discretion to take the following decision about...."

4 What's a codicil & Memorandum?

A codicil is an amendment or supplement to the original Last Will and Testament. It must possess the same formalities that are required of a Will. We discourage too many codicils simply because it creates confusion and the opportunity for a lost document. It is better, to make a lot of changes through a rewritten Will. The cost to do a new Will is not usually materially different than a Codicil.

A memorandum is now permitted within the will that allows the will maker to write a memorandum to change the path of ownership at his death of his tangible personal property. "Tangible personal property" means things and objects that are not real property and does not include “intangible” property such as promissory notes, stocks and bonds.

5 Safekeeping of the Will

We are commonly asked about safekeeping the Will. The usual practice is for the parties to keep their own Wills in some fire-resistant cabinet or in their safe deposit box. The suggestion that we make on this is that on the client's death, there be someone who has the power to gain admittance to the box in order to get the Will. Moreover, some instructions to tell the family where the original Will is located should be left in an easy to find place. Also instructions as to where the assets are located are also very important.

If the original is to be kept in a safe deposit box, we recommend that a copy of it be kept in an easy to find location in the house with directions as to where the original is. In this way, survivors can easily locate the original Will.

Virginia also permits one to simply file the Will with the Clerk of Court in the County where the client lives. This will also provide access on death to the original. All that occurs, in that situation, is that the Clerk is merely holding the Will for you and is not processing it in any way. A note must be made among your papers that you have in fact filed the Will and where it is filed. Otherwise, the heirs will not know where to look for it and it may be overlooked and the estate processed as an intestate estate. A copy of the Will is not sufficient.

6 Naming the personal representative.

We recommend against naming an institution as the personal representative of a Will or of a Trust unless there is no alternative. It has been our experience that they lack the warmth and personal concern about your loved ones that may prevent your wishes being carried out the way you want. In most cases, it is better to have a trusted family member, or friend look after your wife or children's money than it is to have a staff member of a bank. The bank's fees are based on the size of the estate and not on how much they spend. This is something that should be discussed with your attorney.

Attorneys who draft the Will or Trust documents are in a conflict of interest if asked to be a personal representative. This practice is discouraged because of the conflicting interests that surface in that situation. If you have questions about using your attorney as a personal representative or trustee, feel free to discuss it with your attorney.

7 A Will transfers property on death.

Wills are construed as if made the day before the death of the testator.

7.1 Real property.

A deed is the document employed to convey real estate while one is alive. At death, the Will performs that function in Virginia. In Virginia the Wills direction as to ownership occurs as a matter of law at the time of death. This means, that if the Will directs Greenacre to pass to John at the death of Jane, then when Jane dies, Greenacres ownership passes by operation of law to John. Not so in the District of Columbia, where by statute title passes to the Personal

Representative for probate and from the Personal Representative to the heir.

7.2 Personal property.

The Will does not automatically convey ownership of personal property. The personal representative of the estate must gather all of the estate assets, value them, identify creditors, pay all taxes and creditors, and then distribute the remaining assets to the heirs. Sometimes, the estate property, including the real property, has to be sold in order to pay the taxes. The term personal property includes all property, whether tangible or intangible, which is not real estate. Do not confuse the term “personal property” with “personal effects”. The term “personal” property is a legal term and will be interpreted as such by a court. If you leave Johnny all of your personal property thinking he will just be getting your furniture and your jewelry, you are mistaken. He will get all of your furniture, jewelry, bank accounts, investments accounts, cash, stamp collection, and everything else that is not consider by the court to be real property.

8 What is probate and what do you need to know?

Probate is a set of procedures enacted by the state to make sure that the personal representative of each estate has collected and identified all of your assets, determined who all of your creditors are, paid them off, and then distributed the estate to the named heirs in accordance with the law or the will.

Probate only affects assets that are in your estate at the time of your death. For example, if you owned a life insurance policy payable by its terms to your spouse, then the insurance money, at your death, would be sent directly by the insurance company to your spouse and will not be probated. It may be taxed by the IRS as part of your estate taxation, but no probate of that money will be required. The same can be said for jointly owned property with survivorship. While ownership to those jointly owned assets will pass under their document of title to the survivor and hence avoid probate, the IRS will want to include the property or a portion of it in the estate for tax purposes. Thus, if all of a person’s assets are owned jointly with another with survivorship, probate will not be needed at the death of that person, since all ownership passes by operation of law to the survivor.

The avoidance of probate is one of the reasons that living trusts are formed. Such an entity permits one to own and control his assets during his lifetime and to avoid probate at death. While joint ownership may accomplish this with the death of the first of the two owners, it will not avoid probate at the death of the second co-owner. Moreover, there are pitfalls of joint ownership.

Once someone dies, the Will is filed, and a personal representative is appointed by the court. The person named in the Will is referred to as the Executor (male) or Executrix (female). Where there is no Will then the personal representative of the estate is called the Administrator or Administratrix. In those situations where there is a Will but the person appointed in the Will cannot or will not serve, then the Court appoints a local attorney as Administrator to fulfill those duties.

Within four months of beginning the probate, the personal representative must file a written inventory of the assets of the estate that have been identified. Within one year, there must be an accounting filed with the court for review and audit to be sure that the assets are being secured and money is being spent only on appropriate expenses. Tax returns must also be timely filed and paid.

There are situations in which the accounting component of this process can be avoided and probate streamlined. To determine if your situation qualifies you need to review your situation with an attorney. Sometimes the Will is written in such a way that the abbreviated method is not available.

A more streamlined method exists under the Virginia Small Estate Act. This is an abbreviated process where the total estate is $15,000 or less. This process usually only requires the filing on the Will or Petition for Probate and an affidavit. There is no further accounting required.

The following estate administration guides will illustrate basic steps to be taken in a routine probate:

File will, if there is one

Prove Will, if it is not self-proving, with depositions of witnesses

Obtain Probate Order from Clerk & Qualify as Executor

Obtain Federal ID tax number for estate (US Form SS-4)

Notice the Probate (within 30 days of qualification)

Spouses Elective Share Deadline within 6 months from the later date of probate or from qualification

Decedents Final Federal Income Tax Return Due, April 15

Decedents Final Gift Tax Return Due, April 15

Estate Tax Return Due, 9 months from date of death

First Federal Fiduciary Income Tax Return 4th month after the estate year-end

First Virginia Fiduciary Income Tax Return

First Annual Accounting Due, 16 months after qualification

Subsequent Annual Accountings

Debts and Demands Proceedings

Request Proceeding

Notice of Hearing Published

Hearing on Debts and Demands

Commissioner Files Debts and Demands Report with Court

Prepare Show Cause Motion and Order and send to Circuit Court

Date of hearing on Show Cause Motion

Publish Order in newspaper

Prepare and present order of distribution for the Judges to enter

Distribute remaining property in estate

Final Accounting Filed

9 Transfer-on-death Deed.

Like the transfer on death (TOD) or pay on death (POD) provisions for bank accounts and financial accounts, Virginia has adopted a law in 2013 that allows a person to prepare and sign a deed that will transfer ownership on the owner's death to a named beneficiary without the necessity of probate.

This trust is revocable by the owner.

The named beneficiary has no interest in the property until the owner dies.

The owner can sell or mortgage or refinance the property as the owner sees fit.

Title passes directly to the named beneficiary without the necessity of probate.

The creditors of the named beneficiary cannot attach or otherwise interfere with the rights of the owner until after the owner dies.

Let's compare this method to other forms of gifting with an example.

***Example**: Widowed Mom wants to transfer her house to her only son before she dies. If she gifts the house to the son, then the son takes the house with her basis. This means, if Mom paid $100,000 for the house (this is her basis) and its now worth $500,000, then when the son sells it, he will pay capital gains tax on $400,000. At 20% capital gain tax, that's $80,000 in tax.*

If Mom leaves the house to the son in her will or through a trust, then son takes title upon Mom's death and he takes the property at a stepped up basis using Mom's date of death, or in this example, $500,000. So when he goes to sell it, there is no capital gain tax.

If Mom gifts one-half to the son with survivorship, then Mom's gifted 50% interest is goes to the son at her basis, and now the son is a co-owner. His signature and approval will be needed for its sale, transfer, mortgage, or refinancing. Moreover, now the son's creditors can lay claim to his interest in the property. Mom could lose the property because of the son's bad debts

With the Transfer-on-Death Deed, there are no rights available to the son's creditors, and the son takes the property only at Mom's death, without probate and at a stepped up basis. Moreover, until Mom dies, the son has no say in what Mom does with the property. This is a very good technique.

Why not use a trust? A trust works just fine but is more costly to prepare than a single deed. The decision to use a trust or Transfer on Death Deed depends on Mom's assets and her estate planning needs. Where Mom's main asset is her home, then the Deed is the best technique with Mom using TOD or POD on her bank accounts and financial accounts to pass title to her son without probate.

10 Estate planning.

10.1 Federal Estate Taxation & Due Date.

On death, each decedent whose estate exceeds the lifetime exemption equivalent must, within 9 months of the decedent's death, file and pay an estate tax return on Form 706 (U.S. Estate (and Generation-Skipping Transfer) Tax Return. (A listing of the exemption equivalents appears in 9.3 of this booklet). A six-month extension may be available but the tax must be paid within the 9 months unless the time for payment has been extended for one year past the due date under IRC 6161(a)(1). Under a different code section, payment of the estate tax in annual installments is permitted for farms or closely held businesses whose value exceeds 35 percent of the adjusted gross estate.

The estate tax is based on the fair market value of the estate at the time of death. An alternative valuation date six months after the date of death is permitted. This may result in a decrease in the amount of estate tax should the market value decrease. The election to use this alternative valuation is made on the Form 706 estate tax return. If property is sold, exchanged or otherwise disposed of during this six month period, it is the sale price that will usually control.

Leading up to 2018. Most relatively simple estates (cash, publicly traded securities, small amounts of other easily valued assets, and no special deductions or elections, or jointly held property) do not require the filing of an estate tax return. A filing is required for estates with combined gross assets and prior taxable gifts exceeding $1,500,000 in 2004 - 2005; $2,000,000 in 2006 - 2008; $3,500,000 for decedents dying in 2009; and $5,000,000 or more for decedent's dying in 2010 and 2011 (note: there are special rules for decedents dying in 2010); $5,120,000 in 2012, $5,250,000 in 2013, $5,340,000 in 2014, $5,430,000 in 2015, $5,450,000 in 2016, $5,490,000 in 2017.

10.2 The basic principle.

As the famous federal Judge Learned Hand once said, there is nothing sinister or illegal in a person making prudent arrangements of his/her affairs in order to minimize the amount of tax that may be due. Good planning accomplishes one's goals of providing for him, his family, preserving his present and future wealth and paying as little in estate taxes as possible, all while maintaining control.

While your Will controls the passage of ownership of property that is in your estate at the time of your death, the IRS taxes many items of property that are not part of your probate estate.

Probate will not pass ownership to items where title itself controls its direction. Think of a jointly owned home which is usually held by husbands and wives with survivorship. On the death of one, the other automatically owns the property. Nothing needs to be done to make that happen. The IRS, however, will include the value of the deceased owner's interest in the home, or a portion of it, in the estate for tax purposes.

The same is true about life insurance. If a life insurance policy of $100,000 is owned by the husband, and he pays the premiums on it for his life time, and on his death, under the contract of insurance, the insurance company pays the money to the wife as the designated beneficiary, there is nothing for the estate to probate. The IRS, however, will include the $100,000 in the estate of the husband for tax purposes.

Where a married couple owns everything jointly with survivorship, on the death of the first spouse to die, the other spouse will own everything without the need for any probate at all. Even if the deceased spouse’s husband's Will left everything to someone else. This is true since the deceased spouse’s entire assets pass by their title to his/her spouse. There is no need to probate any estate. The IRS, however, will want to tax as much of decedent’s estate, including the jointly owned property, as possible.

Accordingly, the passage of ownership by Will does not control the standards by which the IRS may tax the estate.

10.3 The marital deduction. & Exemption Equivalent

The marital deduction.

The marital deduction allows one spouse to transfer to other spouse any amount of money or value, without limit, during their lifetime or at death provided that the spouse to whom the money or property is transferred is a U.S. citizen. If that spouse is not a U.S. citizen then the amount of the marital deduction is limited to approximately $100,000 (adjusted for CPI). In planning for death transfers to a non-U.S. citizen spouse, there is a way to get the benefit of the full unlimited marital deduction by using what is known as a Qualified Domestic Trust (QDOT). This is a trust that establishes a U.S. trustee to hold the property for the benefit of the spouse and it prevents the non-U.S. citizen spouse from taking the assets out of the U.S. without paying death tax on it.

The Exemption Equivalent

The estate tax credit. Death taxes now use the exemption equivalent depending on the year of death and what Congress has enacted that is effective that year. Under the law in place at the time this booklet was written, the exemption equivalents depended on the size of the estate and the year of death. In 2015, the exemption equivalent is $5,430,000 for each spouse with the right of the surviving spouse to use the remaining portion of the first spouse to die’s exemption (this is “portability”). This is not a pure exemption, but is a tax credit based on the tax that would be computed on an estate of $5,430,000.

If the estate is below the exemption equivalent, then no tax return may be due, unless there are certain tax elections that need to be made thereby necessitating the filing of a return. If the estate is more than the exemption equivalent then there will need to be a federal death tax return filed.

Current Threshold

Under the Tax Cut and Jobs Act, Pub. L. No. 115-97, the filing threshold for 2018 increases to $10,000,000, before taking into account the necessary inflation adjustment. The filing threshold for 2018 that includes the inflation adjustment has not yet been released. This information will be updated on IRS.gov as soon as it becomes available.

Portability

Portability Beginning January 1, 2011, estates of decedents survived by a spouse may elect to pass any of the decedent's unused exemption to the surviving spouse. This election is made on a timely filed estate tax return for the decedent with a surviving spouse. This is a complex issue that needs the consultation with a knowledgeable expert when confronting with the question of whether you need to file an estate tax return in order to get the full benefit of this portability right. Portability of the deceased US citizen spouse may apply. This is technical and should be considered when the situation presents itself.

10.4 Gifting during Lifetime.

10.4.1. The marital deduction.

The IRS does not tax a gift or a decedent's estate, regardless of its size, that passes to one's U.S. citizen spouse. This is known as the marital deduction, a great deal of tax planning centers on this deduction. If the surviving spouse is not a U.S. Citizen then the marital deduction is limited to $60,000 (adjusted for inflation from time to time). There is a technique available to solve this problem using a qualified domestic trust ("QDOT"). In essence, this trust uses a U.S. trustee in order to keep the money in the United States. If removed from the country, then the death tax will have to be paid on it. If the surviving non-U.S. citizen spouse becomes a U.S. citizen, then the trust ends.

10.4.2. Annual Gifting/Gift Splitting-Health & Education

A. Gifting has four components of importance to you.

Annual Gifting

The annual exclusion applies to gifts to each donee. In other words, if you give each of your children $11,000 in 2002-2005, $12,000 in 2006-2008, $13,000 in 2009-2012 and $14,000 on or after January 1, 2013, the annual exclusion applies to each gift. There was no increase of the annual gift exclusion for 2015.

After January 1, 2013, each person is permitted to give $14,000 per year per donee to any non-spouse without having to file a gift tax return (Form 709) and not have to pay a gift tax. If one of a married couple wishes to make a gift and the other spouse agrees, then the gift may be treated as being from both spouses. This is then treated as "gift splitting" which allows the gift to be $28,000 per donee even though written by only one spouse. The IRS regards this as $14,000 from each spouse (IRC 2513). A gift tax return is required to be filed in order to show the other spouse's consent to the use of his/her annual gifting exemption. Use Form 709-A for gift splitting, even though no tax is due on it.

Lifetime gifting exemption

Gifts over and above this annual gifting will be subject to tax unless used to reduce the lifetime exemption which is currently $5,430,000 in 2015.

The lifetime exemption for gifting to a non-US citizen spouse is $148,000 for 2016 which is adjusted annually.

Medical expense of another.

Another permitted form of unlimited tax free gifting is to make a gift for medical bills by paying the health care provider directly; insurance repayment is permitted for this code provision.

Education expense of another.

There is also an unlimited tax free gifting for the payment of education tuition directly to the institution (IRC 2503(e)).

B. Valuation of gifts

Gifting is quite different in terms of the basis that conveys as opposed to a transfer at one's death. At death, under current law, the basis in the property passing to the heirs is at the fair market value date of death.

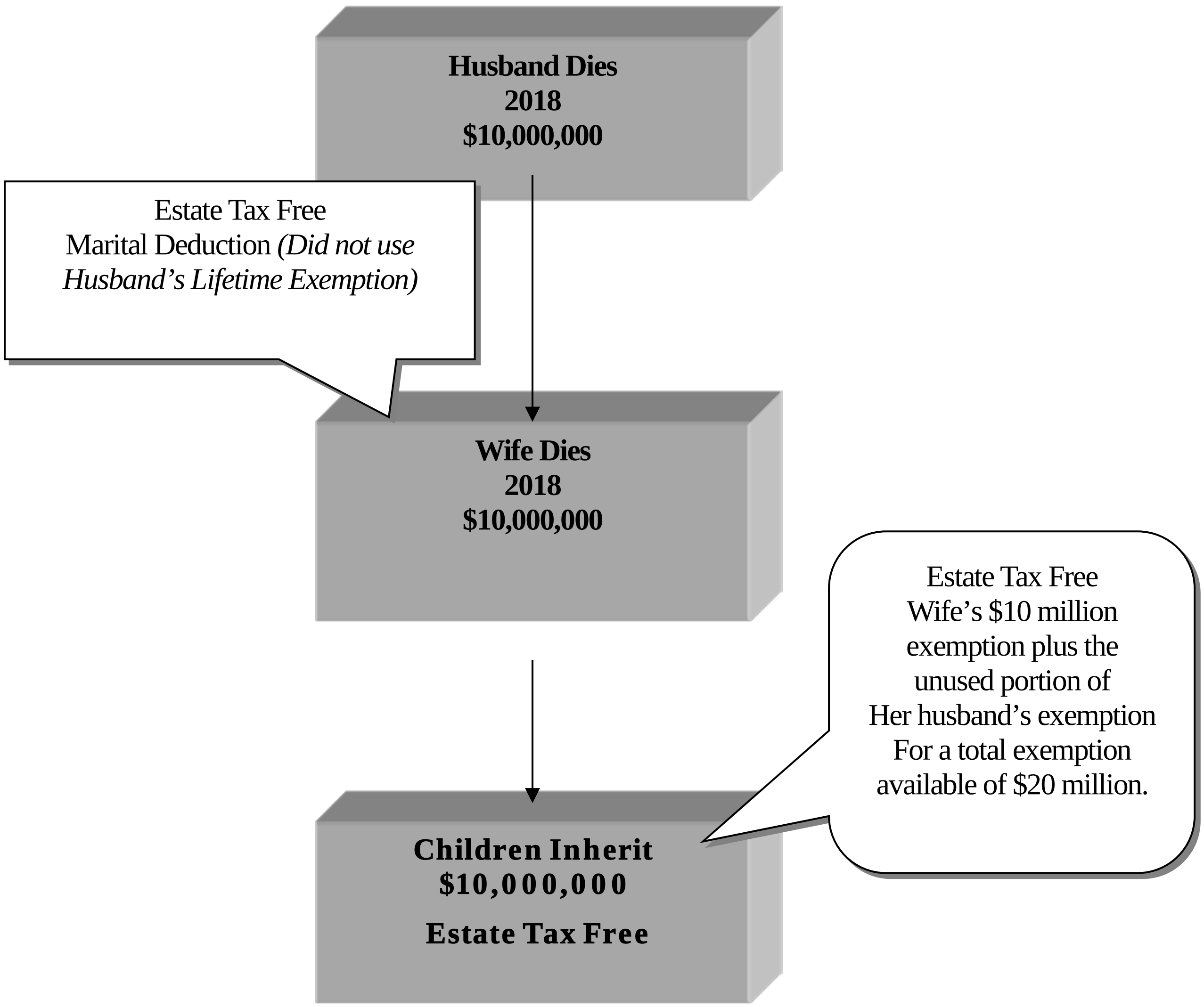
When property is gifted, the value of the gift ("basis") passes to the donee at the same basis as the donor held. What does this mean? If mom paid $100,000 for her home but it is now worth $500,000, her basis is $100,000. If she gifts it to her son then the son takes title with his basis being $100,000. If he sells it for $500,000, he pays capital gains tax on the $400,000 gain on sale --There may be a personal exemption of $250,000 for the son against the gain on sale if he has lived in the home for two of the past five years. If mom passes this home to her son at the death and not as a gift, then the basis in that property passes to the son at $500,000. This can pass through a will, a trust or a "transfer-on-death-deed."

10.5 Illustrations of basic estate structures.

The following examples are designed to take the reader, step by step, into a basic understanding of the how and why of estate planning. In order to understand the illustrations, *please read them in the order they appear.* Also remember that these illustrations only deal with estate tax and do not deal with income taxation at all.

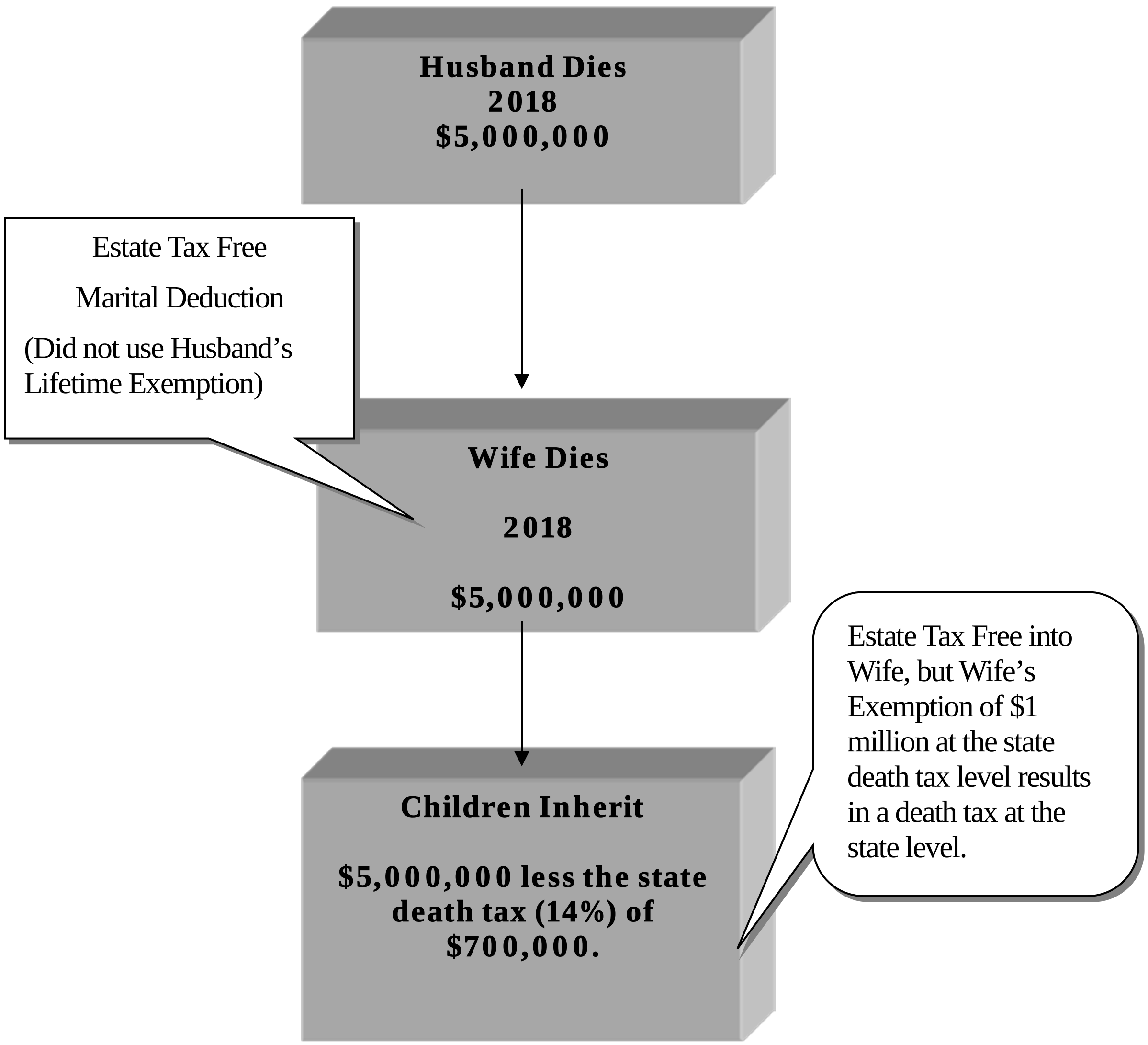
Federal Death Tax Example #1:

In this example, the husband dies in 2018 leaving a taxable estate of $10,000,000 to his US citizen wife. This would pass to her tax free because of the marital deduction. Note should be made that the husband has not used his lifetime exemption equivalent. In this example, assuming the wife dies a little later in 2015 and she uses her lifetime exemption of $10,000,000 in order to shelter the estate that will pass to her beneficiaries estate tax free.


Husband Dies
2018
$10,000,000
Estate Tax Free
Marital Deduction (Did not use Husband's Lifetime Exemption)
Wife Dies
2018
$10,000,000
Estate Tax Free
Wife's $10 million exemption plus the unused portion of Her husband's exemption For a total exemption available of $20 million.
Children Inherit
$10,000,000
Estate Tax Free

State Death Tax Example #2:

Virginia does not presently have a state death tax, but other states do and you must be careful about this. In this example, the husband dies in 2018 leaving a taxable estate of $5,000,000 to his US citizen wife, but they live in a state that has a state death tax with a $1,000,000 exemption. This estate passes to the wife tax free because of the marital deduction. Note should be made that the husband has not used his lifetime exemption equivalent. In this example, assuming the wife dies a little later in 2018 she uses her state lifetime exemption equivalent of $1,000,000 in order to shelter the estate that will pass to her beneficiaries estate tax free.



By Pass Example #3:

The following example uses an estate of $2,000,000. In this example, the husband (the first to die in my examples) has done some estate planning not just for federal taxes but for state death taxes that he may face if he moves to or lives in a state that has a state death tax. He has now planned for the use of his own lifetime exemption equivalent as well as the marital deduction. This permits him to shelter both his own lifetime exemption as well as his wife's lifetime exemption equivalent. Using the example that the husband dies in 2015 leaving a $5.43 million taxable estate and assuming further that the wife also dies in that same year, the combined lifetime exemption equivalents of $10.86 million at the federal level can be sheltered using the portability feature at the federal level or using the by-pass shelter technique that we are using at the state level.

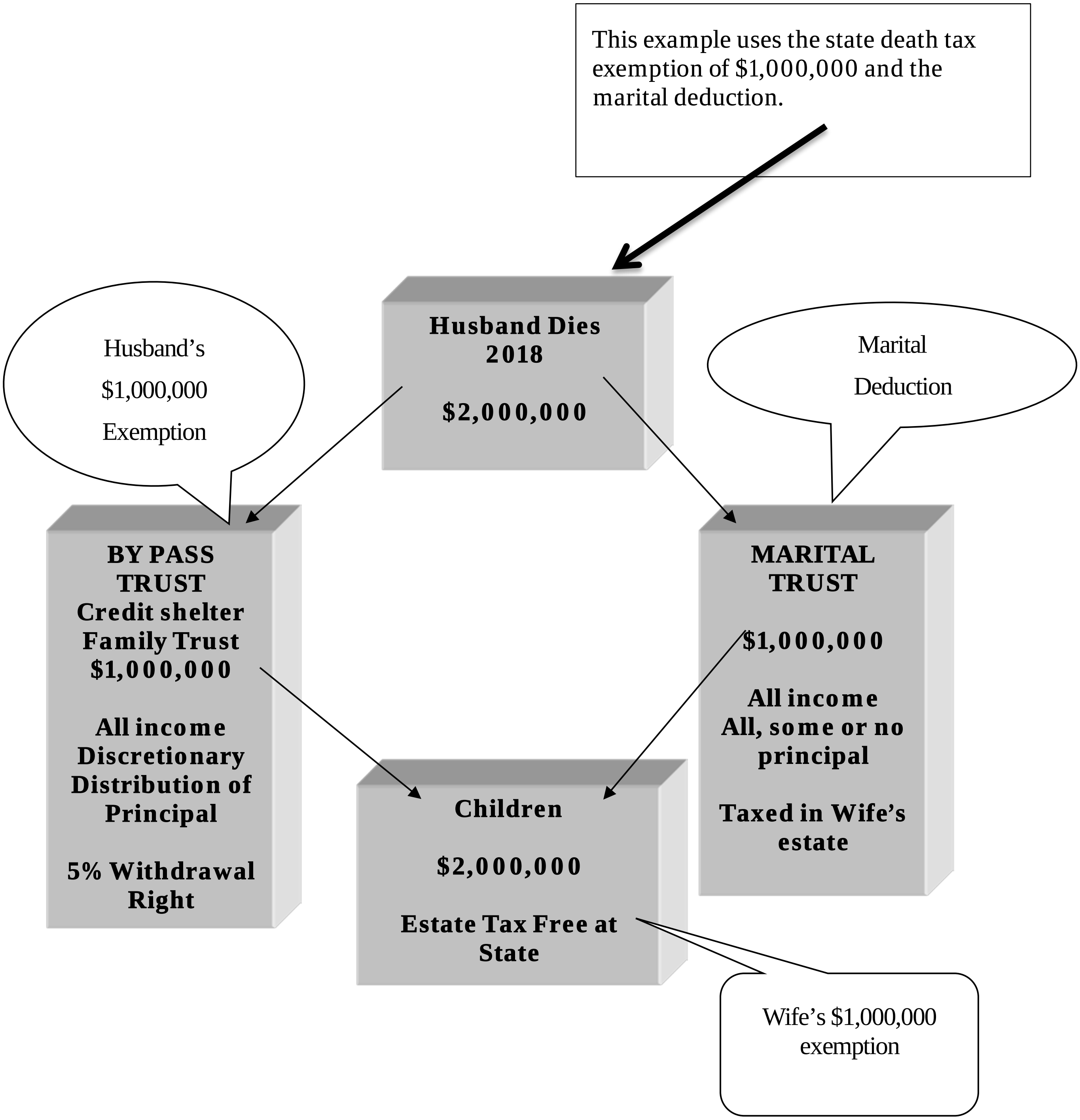
At the state death level, estate planning can shelter $2,000,000 assuming the state tax exemption is $1,000,000 like it is in some states. Without this by-pass planning the wife faces state death taxation in a state where the death tax exemption is $1,000,000 and she has a taxable estate.

The following illustrates how this planning works for a $2 million estate so that one can understand the effect of by-pass trust planning.

At the husband's death, an amount equal to his lifetime exemption is moved into a credit shelter by-pass trust that we call the Family Trust. This avoids estate taxation because of the exemption of the husband and it will not face estate taxation again, even at the wife's death. If the money or property in the by-pass trust grows in value, that growth will also avoid estate taxation at the wife's death.

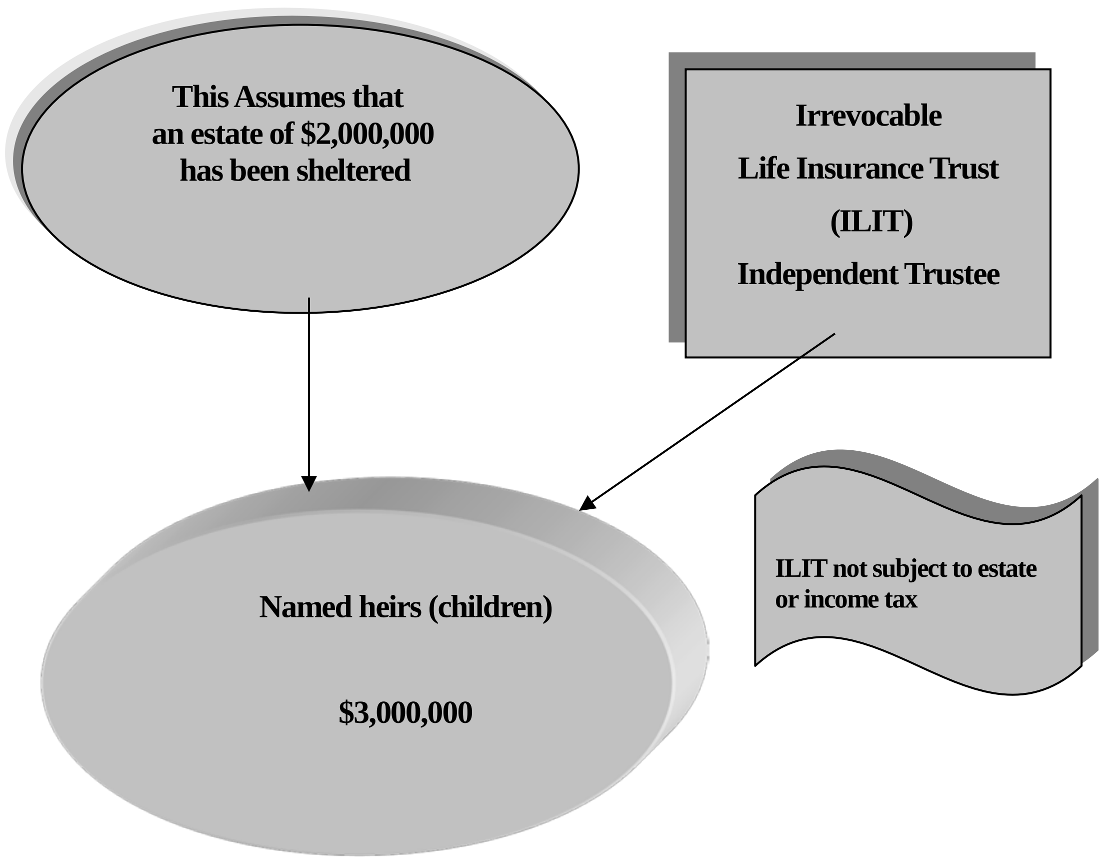
The remaining portion of the husband's estate, which in this example is $1 million, goes into the wife's trust that we call the Marital Trust using the marital deduction. In the Marital Trust, because the wife has control over those funds the amount in the marital trust at her death will be included in her taxable estate. In this example, she dies in 2015 leaving $1 million to her children. Using her lifetime exemption equivalent, there is no estate tax on her estate at the state level. The Family Trust left $1 million to the children also, thereby leaving the entire $2 million to the children and saving approximately $140,000 in state death taxes.

If the federal exemption is lowered, this by-pass planning will have captured the husband's $5 million exemption so that a change in the law will not cause its inclusion in the wife's taxable estate. In other words, using by-pass planning even in this favorable federal estate tax environment will guard against Congress reducing the exemption and also the loss of the portability feature. The by-pass creates a nice safety net against change in the tax laws.


This example uses the state death tax exemption of $1,000,000 and the marital deduction.
Husband Dies 2018
$2,000,000
Husband's $1,000,000 Exemption
Marital Deduction
BY PASS TRUST
Credit shelter Family Trust
$1,000,000
All income
Discretionary Distribution of Principal
5% Withdrawal Right
MARITAL TRUST
$1,000,000
All income
All, some or no principal
Taxed in Wife's estate
Children
$2,000,000
Estate Tax Free at State
Wife's $1,000,000 exemption

Insurance Example #4:

Role of Insurance in estate tax planning. Another basic problem that the estate planner faces arises when the parties carry life insurance in which they have “incidents of ownership”. These are elements of control sufficient for the IRS to deem the insurance payout to be a part of the owner’s taxable estate; even if the insurance is not payable to the estate but goes elsewhere. The solution to this problem is to put ownership of life insurance into an independent irrevocable trust that has an independent Trustee. The policy is owned by the trust and its proceeds are paid to this trust. The trust controls the flow of the money from the policy and can be set up to look a great deal like the Family Trust seen above in Example #3. Using this highly technical trust, the insurance money can by-pass estate taxation; without depriving the family of the benefits of the insurance proceeds. This arrangement is shown in the following chart.



10.6 Assets that increase in value

If property is increasing in value but is held by the wife after the husband dies in such a manner that the IRS will tax it in her estate on her death, then a $400,000 estate, for example, which increases to $700,000 during her lifetime, may result in an estate tax depending on the total size of her estate and the exemption that is applicable at that time.

The benefit of using trust planning that is shown is *Example #3* above is that it allows the wife to make a decision when it really counts. If a piece of real estate is valued at $300,000 when the husband dies but is expected to increase in value, she may elect to put it into the credit shelter by-pass Family Trust. On her death, it comes out of the Trust to the children free of estate tax even though at the time of the wife's death it may be worth a great deal more than the exemption. That is because it went into the Trust below the exemption, tax free. If she had kept it in her marital trust, the children would have paid tax at the appreciated value on her death.

10.7 State death taxes

There are states that have inheritance taxes and those that have death taxes. Some have a combination of both. As of 2015, 31 states do not impose either an estate tax or an inheritance tax – Virginia has no death or inheritance tax.

An "inheritance tax" is one that the heirs pay the tax on what they receive. Spouses and children are usually exempt from inheritance tax and the amount of tax increases dependent on the relationship that the heir has to the decedent.

A "death tax" is one that is imposed on the estate of the decedent based on the value of the estate. The tax rate at the state level may vary from 4.5% (Pennsylvania) to 18% (Nebraska).

Maryland and the District of Columbia each has a death tax with each having an exemption of $ 1,000,000; Maryland has both an inheritance tax and a death tax (is one of two states in the US that has both), and exemptions for spouses.

11 Power of attorney - durable - special – unlimited

A power of attorney is the nomination and appointment of someone to act for you. This can be restricted to particular situations such as signing documents at a real estate closing (often done), or selling a car, or taking care of one's affairs while they are away for a while or are sick and unable to take care of themselves. The person appointed is called an attorney-in-fact. In our trust planning we create a durable power of attorney. This power of attorney may grant unlimited powers to the attorney-in-fact or limit the powers of the attorney-in-fact (agent) to simply moving assets into the trust. Moreover, this power may be effective immediately or only upon a showing of your disability. This helps prevent the attorney-in-fact from abusing his/her powers and gives a level of comfort to the person creating the power of attorney.

Durable simply means that the power of attorney does not expire at the disability of the person who made it but continues in effect even if they become disabled. To avoid the expiration of the power upon the disability of the appointing person, the power should be made durable. State statutes provide for this. If a mother names her son as her power of attorney, when the mother has a stroke or suffers from some other disabling disease or process, then the son can step in and take over her bank account, and all of her affairs to act in her name on her behalf by simply showing the original of the power of attorney.

Unlimited or *general* means that the power of the attorney-in-fact is as complete and total as the person who created it said in the document. An example of this is language which gives the attorney-in-fact the power *"to do any and all things which the grantor could do for himself."*

Special or limited means that the power of the attorney-in-fact is limited to the specific purpose stated in it. A common example of this is a power of attorney given by one who will not be present at a real estate closing, giving his/her spouse or other person to go to the real estate closing and sign the deed and settlement papers on behalf of the person giving the power.

In the District of Columbia a special power of attorney form has been established by DC law to permit an attorney-in-fact to sign a deed for the person appointing him. This power needs special language. Without the special wording, the attorney-in-fact may not, in the District of Columbia, sign a deed for another as their attorney-in-fact.

12 Trusts

In General

A trust is an ancient legal entity created by the Romans and used extensively by the English. Its assets are owned and controlled by a Trustee for the benefit of its beneficiaries. The terms of control, payment of money, etc., are all controlled by the terms of the trust document.

To illustrate: If Mr. Jones creates the Jones Trust naming himself as the Trustee and transfers property into the trust, the property would be handled as the trust document dictates. If Mr. Jones provided that the income from the property would go to him until he died, but on his death, the trust would terminate and its property would go to his children, then on his death that is what would happen. He could provide that the property stays in trust if some or all of the children are under a certain age. The trust could also name the successor trustee or provide a method to name one.

The law is clear that a trust does not fail merely because it does not have a trustee. If that happens, then a judge of the appropriate court would name a trustee for that purpose.

A trust can be written to take effect only at the death of its maker and is created in the maker's will; we call this a testamentary trust. It can also take effect immediately upon its creation and signing, in which case it is a living trust.

A trust can be either revocable or irrevocable.

A revocable trust is one that the person who created it may terminate or change at any time. This is a common form of trust in which people pool their assets while they are alive. The trust becomes irrevocable upon their death. Irrevocable means that it cannot be changed or terminated except by its terms.

Advantages of a living trust:

It is effective right away. The creator does not have to wait until he/she dies until it is operative as with a will. We call this a "living trust".

It avoids probate with its attendant expenses and delays to the extent that the decedent’s assets are titled in the trust. That’s why trust attorneys want the clients to title their assets in their trust so that there is no probate and their Last Will and Testament will not have to be used.

During the lifetime of the trust creator, the assets in the trust can be used and controlled in the same manner and with the same flexibility as if the assets remained in the trustmaker’s own name.

It can provide for the care of the trust maker during his disability without the need for court intervention.

Revocable trusts are easily changed.

It is easy to set up.

It avoids property passing to an unintended heir. Picture a situation in which a home is owned by the husband and wife with survivorship. If the family residence passes on the death of the husband to the wife and she later remarries, the new husband could end up with the house and ultimately it might pass to his children and not the children of the original owners. This was not intended.

It is private, and avoids the public nature of probate.

It avoids having to file for ancillary probate on assets owned in other states. Also, if those assets are owned in a limited liability company or corporation, then the ownership of that entity could be held in trust too.

It shields the beneficiaries such as one’s children from their creditors while the assets are held in trust for the children.

It gives you control over assets after your death which a will or joint tenancy cannot equal.

It can reduce or eliminate death taxes – admittedly, a testamentary trust in a will can also reduce or eliminate death taxes, but such a will must be probated and the trust may be subject to annual accounting with the court for its duration.

A revocable trust created for the benefit of the grantor does not require a separate tax identification number and need not file separate tax returns. Its grantor(s) still use his/her IRS Form 1040 when filing income tax returns. This is known as a "grantor trust."

By putting the ownership of a life insurance policy into an irrevocable living trust with the proper safeguards included, the proceeds can be sheltered from death taxes. This is referred to an Irrevocable Life Insurance Trusts (“ILIT”).

Other forms of irrevocable trusts are used to set up education trusts, private retirement plans, special needs trusts, and many other investment and charitable vehicles for its creators.

13 Living Wills (Advance Medical Directive)

Each jurisdiction has a statute which authorizes a person to prepare a writing in which someone is given the power of attorney to make life and death decisions about you when you are incapacitated through disease or otherwise. This document can also direct the doctors to not keep you alive, but to let you die. This document can also direct them to keep you comfortable so that you will not suffer in pain.

The statutes suggest forms to use. Some hospitals offer these forms to their patients. Someone writing a living Will may include any special instructions or restrictions on types of treatment that he or she wishes.

We include these advance medical directives as part of our trust package of documents.

14. Asset Protection Trusts

Off-Shore Asset Protection Trusts.

Picture the situation in which you create a family trust as mentioned above but instead of designating yourself as the Trustee, you name a bank that is chartered in another country such as Canada, The Cayman Islands, Nassau, The Cook Islands, etc. Add to that off-shore trust, the fact that there is no taxation of the income earned by such trust in that jurisdiction. When you die, there is no estate tax on that money in that jurisdiction, either. This means that while you may face income taxation and estate taxation in the U.S. on these assets, you will not face double taxation.

The law of that jurisdiction imposes significant burdens and delays on your creditors so that your creditors will most likely be unsuccessful in their attempts to have the court of that jurisdiction order the turnover of your assets to them.

Even if a local U.S. state or federal court judge orders the debtor to direct the Trustee of the off shore trust to turn over the assets, the terms of the Trust are such that the Trustee will and must ignore the request and refuse to comply. The Trustee is not subject to the jurisdiction of a U.S. court and therefore the creditor will have to go to that jurisdiction to seek an order directing the release of the funds.

The law of the off shore jurisdiction will have a very short statute of limitations for creditors suits to set aside a fraudulent conveyance. In this manner, the creditor will spend this time in the U.S. courts chasing the debtor before being able to go to the off shore jurisdiction. There the creditor will encounter other obstacles that make it very expensive and difficult to pursue the case through that jurisdiction’s court.

There are no guarantees that this will always work, but it does work often enough to make it an attractive asset protection device. Its planning must be done, however, before there is a real creditor breathing down your neck. In that situation, the debtor would find that even the off shore trust may not protect his assets.

In addition to creditor protection, this type of trust permits the trustee to invest in securities that would otherwise be barred to U.S. licensed securities brokers. This widens the field of investment and may offer desirable investment opportunities for the wise investor.

Another opportunity that this type of trust offers is control over assets that a wealthy parent wants to keep out of the hands of a son-in-law or daughter-in-law who they believe has married their child solely for their money or future expectation. One example of how this trust may work well, a wealthy mother who did not like her new daughter-in-law believing that she was simply chasing her money, created an off shore trust and directed that the trustee provide her son with a monthly allowance which would end at his death, and could end at his separation or divorce so that his wife could not make a claim on the funds. His home would be purchased by the trust and leased to him for a minimal amount. In the event of his death, divorce or separation, the lease would end and the daughter-in-law would not receive any funds and would have no right claim on the home or the right to remain in the house; even if they were living in a community property state.

Two more points to remember. In an off shore trust, your assets do not necessary leave the U.S. shores. They are now owned by a foreign entity but are often managed, through local financial planners, right here in the U.S.

They are not just for the very wealthy but one must be willing to pay the Trustees fees, etc. involved with their set up and operation. Once the trust is set up, you do not lose all control. You may hold the position of trust advisor. You would lose that status in the event that a creditor makes claim to the trust. Then you have no say at all in the trust. This is one of the asset protection devices, among many, that are built into them.

Asset Protection Trusts within the U.S.

A handful of states offer domestic asset protection trusts. These jurisdictions require that this type of trust be formed in that state, have a registered agent there and maintain a trustee who is a resident of that jurisdiction. Moreover, each jurisdiction will have its own requirements as to minimum assets that must be maintained in that jurisdiction. Virginia, Alaska, Delaware, Nevada, and South Dakota are a few of our states with such trusts.

There are advantages and disadvantages that must be considered before using such a trust.

Statutory Business Trust

Virginia has adopted a business trust which offers limited liability protection to its trustee and beneficiaries as it does with a corporation. It is for business use. This entity also allows you to set up a “series” entity. A series entity is one that identifies multiple series within the entity and offers asset protection to each series as if it were a separate entity.

15. Business Succession Planning

Most people who have formed and established a business want to plan for its sale or its succession to the family in a meaningful way.

The process actually began when the business was set up in a corporation or in a limited liability company form. At death, their shares in the company will continue in the family and the family members may continue the business without interruption if they have sufficient voting power to do so.

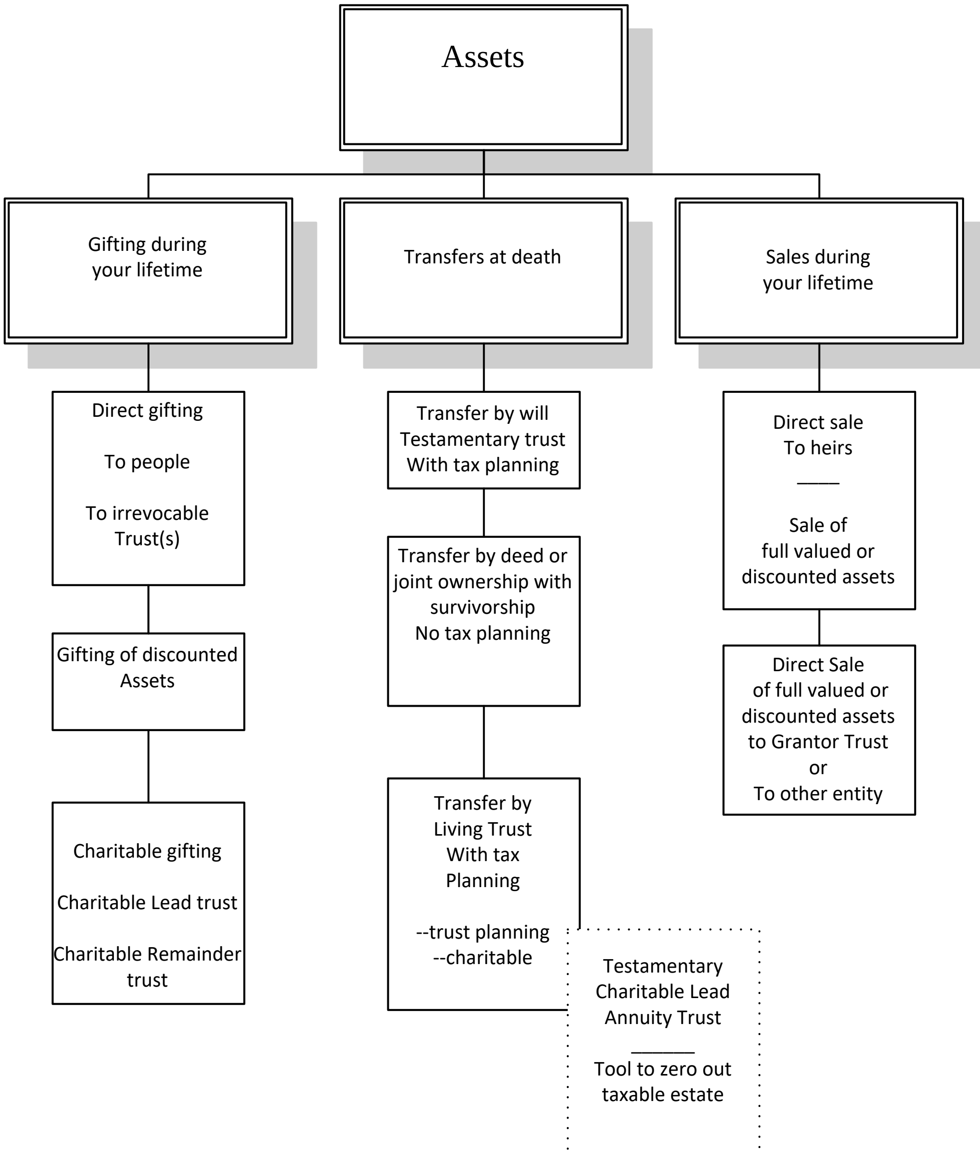
Business succession planning can take many forms.

Simply owning the entity that owns a business in your trust, will avoid probate and create an easy transfer of the ownership at death.

If the property involved with the business is located outside of Virginia, there may be ancillary administration at death unless the business is owned by an entity. Having that entity held by your trust will avoid probate. If it is held in your own name, then you will need to probate the estate to transfer ownership unless you use survivorship in your ownership form.

The following lists some of the available techniques that can be considered to transfer your assets to the next generation as part of an effective estate plan. All of these can be complex and should not be attempted without the aid of a knowledgeable attorney.

"Wait! Am I telling you that a simple sale from Dad to Son is complex and needs an attorney?" The answer is "Yes." "Why?" Because, the IRS will want to know that the sale was at fair market value, otherwise it may be treated as a sham transaction in order to put the income tax rate on the earnings from the transferred property at the child's lower income tax rate, or it is a disguised gift on which gift tax may have to be paid. Proper records are important too in order to avoid IRS scrutiny.



16. Transfers under the Transfers to Minor Act.

Many states, including Virginia have adopted the Uniform Transfers to Minor Act, which is a statutory trust. This is popular and if one goes to a bank or stock brokerage house to open an account for a minor child, they are set up under this statutory trust with simple terms making the parent the guardian. The terms of the trust are dictated by the state statute and cannot be amended.

Unless you specify age 21, the trust will terminate at age 18 for the child and its assets will be distributed to them. If you specify 21 years on it, then the trust will continue until age 21.

A common problem occurs when a parent who has invested wisely, now finds that their child is not sufficiently mature to receive the very large sum of money without any strings attached and they want to know what to do. If they transfer the funds to a newly formed trust, then the child will be able, if they are of a mind to do so, to challenge the transfer and have it set aside.

A popular solution to this problem is for the parent to form a limited partnership naming the parent as the general partner (the person in control) and use the trust funds to purchase limited partnership shares for the minor. When the child reaches majority age and the trust terminates, the asset that the child now owns is a limited partnership share without any control, which remains in the parent as the general partner.

We recommend against using the Transfer to Minor Act for these reasons.

17. About Friedlander, Friedlander & Earman, P.C.

This family firm began in 1925 with Mark P. Friedlander, Sr. and is now in its 3rd generation of lawyers. Mark with over 58 year's experience; Jerry with over 47 years' experience and Susan over 22 years of experience.

The firm covers a broad array of fields in both Virginia and the District of Columbia.

Commercial, business or corporate transactions and litigation. The formation of corporations, partnerships, limited liability companies and the agreements of the parties to them is a normal part of our practice, including the litigation that accompanies disputes with companies and among its members. This also includes buying and selling of businesses, the paperwork and negotiations that are associated with such transactions.

Wills, trusts and estates. The firm provides estate planning, trusts and wills which are both simple and complex. Jerry is a member of the Wealth Counsel, and past member of the National Network of Estate Planning Attorneys. He has taught advanced estate planning techniques to lawyers, accountants and the public.

Real Estate, landlord-tenant, commercial and residential. The firm has vast experience in real estate transactions, zoning issues and litigation. Mark, Jerry and Susan have significant experience in these areas. Jerry has written several books on landlord-tenant law as well as a recent broker's law book on Virginia law and another on DC Real Estate Law.

Construction & builders law. The firm is experienced in preparing contracts, and litigating disputes and mechanics' lien claims for contractors, subcontractors and owners, at both the state and federal level.

Personal Injury and Product Liability Cases. Mark P. Friedlander, Jr. was honored to serve as Liaison Counsel and on the Steering Committee for the national Swine Flu litigation for more than a decade. The firm has broad experience as both plaintiff and defense attorneys in accident and product liability cases of all types. Mark P. Friedlander, Jr. co-authored a book on immunology with the Chairman of Immunology at George Washington University, entitled *Winning the War Within*, Rodale Press.

Franchise litigation and dealership rights. Mark P. Friedlander, Jr. has authored two editions of the *Handbook of Successful Franchising* and has litigated dealership claims around the country for many years.

Zoning and Land Use Law. Mark P. Friedlander, Jr. is the past chairman of the Town of Vienna Board of Zoning Appeals and has broad experience in zoning matters and litigation. Susan Friedlander Earman is the past Chairman of the Falls Church Board of Zoning Appeals. She also served as the Vice-Chairman of the Falls Church Planning Commission before then.

MARK P. FRIEDLANDER, JR. B.A. degree, U.VA (1951); LL.B. – U.VA (1957); former Air Force B-29 pilot; Member of Virginia and District of Columbia bars: in both state and federal courts including the U.S. Court of Claims and the U.S. Supreme Court. He was appointed Commissioner in Chancery for Arlington County Circuit Court. He served as Liaison Counsel for the Swine Flu Plaintiffs Steering Committee prosecuting the national multi-district litigation against the United States arising from personal injury claims from the Swine Flu Immunization Program of 1976. He has extensive trial experience in real estate litigation, zoning, product liability, construction, contracts, business, and many other areas of civil law. Co-authored *Hand-book of Successful Franchising*, Van Nostrand Reinhold Company 1st Ed 1981, 2nd Ed 1985, and *Winning the War Within*, Rodale, 1986, *The Immune System*, Lerner Publishing Co. 1998, a layman's guide to immunology, *Outbreak*, a beginners look at epidemiology, 2000, *When Objects Talk*, Beginner's Forensic Science, 2001, and several books on aviation history and Shakespearean lore. Past chairman, Town of Vienna Board of Zoning Appeals, Chairman Krasnow Institute for Advanced Studies at George Mason University, focusing on the neurosciences and is a past member of the Paralegal Curriculum Advisory Committee, No. VA Community College. He is a member of the American Trial Lawyers Assn & VA Trial Lawyers Assn.

JEROME P. FRIEDLANDER, II. B.S. degree, G. U., Accounting/Business Adm. (1965); LL.B. – U.VA (1968); Former Captain with the 82nd Airborne Division with service in Vietnam; Member of VA and DC Bars, at both state and federal levels including the U.S. Tax Court and the U.S. Supreme Court. Ask Jerry about another high honor that is not mentioned in this biography. Currently he is a member of the Wealth Counsel, a national organization of estate planning attorneys, past member of the National Network of Estate Planning Attorneys having completed their Advanced Studies Program. He is past President of the McLean Bar Association (2009-10) and also past President of the Northern Virginia Chapter of the Federal Bar Association (1991-95). He is an Honorary Member in the Assn of Fellows & Legal Scholars of the Center for International Legal Studies. He is the author of Virginia Practice Series, *Landlord-Tenant Law*, updated each year, Thomson Reutter also known as the West Group, (originally published by Michie and then Lexis Law Publishing going back to 1992); *The Broker's Guide to Virginia Real Estate Law*, Lexstone Publishing 2003, 2nd ed 2010; *The Agent's Guide to DC Real Estate Law*, Peppercorn Paperworks LLC, 2014; *The Limited Liability Company - With a State by State Review*, 1994 The Michie Company; *The Basics of Residential Landlord & Tenant Law*, Peppercorn Paperworks LLC, 1989 with annual supplements; Chapter on <u>*Virginia Law*</u> in *Legal Aspects of Doing Business in North American and Canada*, Kluwer/West also updated each year. Jerry teaches Broker's Law at the No. VA Assn of Realtors, as well as Property

Management, Fair Housing & Landlord-Tenant Law to the NVAR, NVAA, VAR, and Bar Associations. He taught advanced estate planning for the National Business Institute and also NEPA.

SUSAN FRIEDLANDER EARMAN B.A. Degree, Mathematics, U. Va. (1988); JD, George Mason University (1993) past President, McLean Bar Association, (2004 -2006); Member Virginia, Fairfax, McLean and Arlington Bar Association; Officer in the Arlington County Bar Association. Past Chairman of the Board of Zoning Appeals for the City of Falls Church and also Past Vice-Chairman of the Falls Church Planning Commission. Ask Susan about her other high honors not mentioned in this booklet.