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THAT STARTS AND  
ENDS WITH FAMILY  
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**RUGGIERO LAW OFFICES LLC**

*Helping families safeguard the treasures  
they value most – their loved ones*



## RUGGIERO LAW OFFICES LLC

Paoli Corporate Center  
16 Industrial Boulevard., Ste. 211  
Paoli, PA 19301  
Phone: 610.889.0288  
3477 Corporate Parkway, Ste. 100  
Center Valley, PA 18034  
Phone: 484.224.3487

[www.PaoliLaw.com](http://www.PaoliLaw.com)

Congratulations on taking an important step to protect your family and your assets.

Nobody wants to think about death or disability – or the tax implications that would result at your death. However, establishing an estate plan is one of the most important steps you can take to protect yourself, your assets, and your loved ones.

At Ruggiero Law Offices LLC, we take pride in our one-stop, team-oriented approach to estate planning. Our mission is to be creative problem solvers and indispensable advisors for our clients throughout their lifetimes. We offer caring, comprehensive advice for the long-term protection of your most valuable assets – your family, your health, and your family's financial security.

This guide provides you with an overview of estate planning concepts, issues, and strategies. It is designed to help you begin discussions with your family, make the optimum decisions about your estate, and consider strategies you may not be currently employing. The Estate Planning Worksheet on the last page will help you prepare for an in-depth estate planning consultation.

I established my law practice in 1990. Since then, I have devoted my career to estate planning, business planning, and elder law, with an emphasis on asset protection, business succession planning, and Medicaid strategies. I have focused my professional development and earned peer recognition in estate planning, so I am uniquely qualified to assist you in establishing the right plan for you, your assets and your family.

I have earned the following recognitions:

- Designated as an Accredited Estate Planner® (AEP®) by the National Association of Estate Planners and Councils. This is a graduate-level specialization in estate planning awarded to professionals with a minimum of 5 years of experience in estate planning who meet stringent requirements of experience, knowledge, education, professional reputation and character.
- Certified as an Estate Planning Law Specialist (EPLS) by the Estate Law Specialist Board, Inc.
- Named a Top Attorney in Trusts and Estates and Elder Law in Main Line Today Magazine 2009, 2011, 2012.
- Winner of the prestigious Five Star Wealth Manager, Best in Client Satisfaction Award 5 years in a row by Philadelphia Magazine 2009-2013

Why not take a few minutes to read through this guide and consider some of the strategies outlined within? It will help focus your thinking about who should inherit your assets, which assets they should inherit, and when and how they should inherit them. It discusses, wills, trusts, executors and trustees, guardians for minor children, estate evaluation, and much more.

Then, fill out the worksheet on the last page and mail, fax or email it to me along with your estate planning questionnaire so we can set up an in-depth consultation to get your affairs in order and put your mind at ease.

Very truly yours,

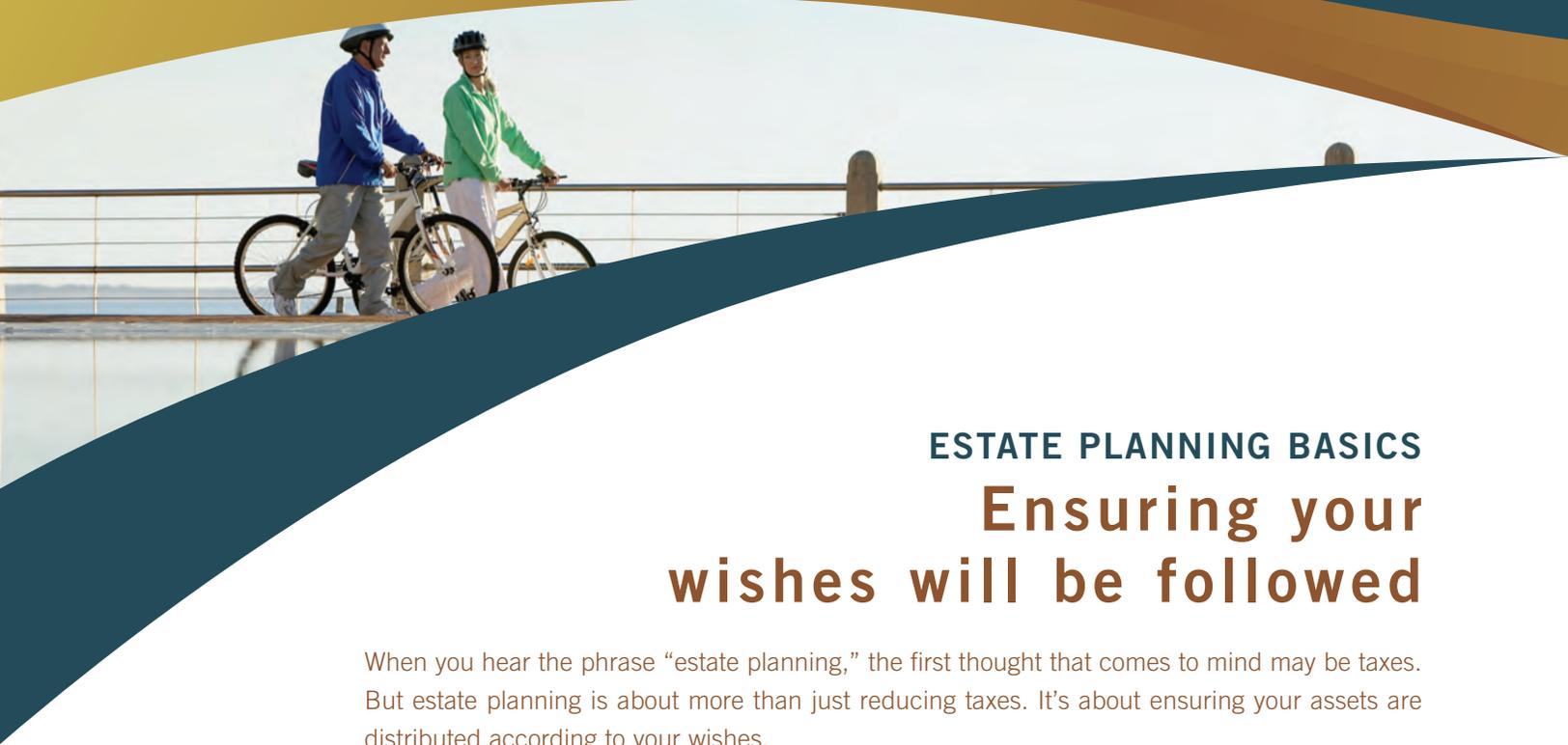
*James J. Ruggiero*

James J. Ruggiero, Jr., Esq. AEP®, EPLS

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## ESTATE PLANNING BASICS

# Ensuring your wishes will be followed

When you hear the phrase “estate planning,” the first thought that comes to mind may be taxes. But estate planning is about more than just reducing taxes. It’s about ensuring your assets are distributed according to your wishes.

If you haven’t prepared an estate plan, this guide will help you get started. And if you already have a plan in place, the guide may offer strategies that you currently may not be employing — including strategies that will help you lock in the benefits of higher exemptions and lower rates while they’re available.

Certainly this guide is no replacement for professional financial, tax and legal advice. So work with a qualified estate planning advisor before implementing any estate planning strategies or making any changes to your current plan.

### FUNDAMENTAL QUESTIONS

Estate planning should begin with considering three fundamental questions — or *reconsidering* them if you’re reviewing your estate plan.

#### 1. Who should inherit your assets?

If you’re married, before you can decide who should inherit your assets, you must consider marital rights. States have different laws designed to protect surviving spouses. If you die without a will or living trust, state law will dictate how much passes to your spouse.

Even with a will or living trust, if you provide less for your spouse than state law deems appropriate, the law may allow the survivor to elect to receive the greater amount.

If you live in a community property state or your estate includes community property, you’ll need to consider the impact on your estate planning. (See page 22.)

Once you’ve considered your spouse’s rights, ask yourself these questions:

- Should your children share equally in your estate?
- Do you wish to include grandchildren or others as beneficiaries?
- Would you like to leave any assets to charity?

#### 2. Which assets should they inherit?

You may want to consider special questions when transferring certain types of assets. For example:

- If you own a business, should the stock pass only to your children who are active in the business? Should you compensate the others with assets of comparable value?

- If you own rental properties, should all beneficiaries inherit them? Do they all have the ability to manage property? What are the cash needs of each beneficiary?

### 3. When and how should they inherit the assets?

You need to focus on factors such as:

- The potential age and maturity of the beneficiaries,
- The financial needs of you and your spouse during your lifetimes, and
- The tax implications.

Outright bequests offer simplicity, flexibility and some tax advantages, but you have no control over what the recipient does with the assets. Trusts are more complex, but they can be useful when heirs are young or immature or lack asset management capabilities. They also can help save taxes and protect assets from creditors.

## TRANSFERRING PROPERTY AT DEATH

There are three basic ways for your assets to be transferred on your death: a will, which is the standard method; a living trust, which offers some advantages over a will; and beneficiary designations, for assets such as life insurance and IRAs. If you die without either a will or a living trust, state intestate succession law controls the disposition of your property that doesn't otherwise pass

via "operation of law," such as by beneficiary designation. And settling your estate likely will be more troublesome — and more costly.

The primary difference between a will and a living trust is that assets placed in your living trust, except in rare circumstances, avoid probate at your death. Neither the will nor the living trust document, in and of itself, reduces estate taxes — though both can be drafted to do this. Let's take a closer look at each vehicle.

### Wills

If you choose just a will, your estate will most likely have to go through probate. Probate is a court-supervised process to protect the rights of creditors and beneficiaries and to ensure the orderly and timely transfer of assets. The probate process generally has six steps:

#### 1. Notification of interested parties.

Most states require disclosure of the estate's approximate value as well as the names and addresses of interested parties. These include all beneficiaries named in the will, natural heirs and creditors.

**2. Appointment of an executor or personal representative.** If you haven't named an executor

or personal representative, the court will appoint one to oversee your estate's administration and distribution.

**3. Inventory of assets.** Essentially, all assets you owned or controlled at the time of your death need to be accounted for.

**4. Payment of claims.** The type and length of notice required to establish a deadline for creditors to file their claims vary by state. If a creditor doesn't file its claim on time, the claim generally is barred.

**5. Filing of tax returns.** This includes the individual's final income taxes and the estate's income taxes.

**6. Distribution of residuary estate.** After the estate has paid debts and taxes, the executor or



personal representative can distribute the remaining assets to the beneficiaries and close the estate.

Probate can be advantageous because it provides standardized procedures and court supervision. Also, the creditor claims limitation period is often shorter than for a living trust.

### Living trusts

Because probate is time consuming, potentially expensive and public, avoiding probate is a common estate planning goal. A living trust (also referred to as a “revocable trust,” “declaration of trust” or “inter vivos trust”) acts as a will substitute, although you’ll still also need to have a short will, often referred to as a “pour over” will.

How does a living trust work? You transfer assets into a trust for your own benefit during your lifetime. (See Planning Tip 1.) You can serve as trustee, select some other individual to serve or select a professional trustee. If you choose to be the trustee, the successor trustee you name will take over as trustee upon your death, serving in a role similar to that of an executor.

In nearly every state, you’ll avoid probate if all of your assets are in the living trust when you die, or if any assets not in the trust are held in a manner that allows them to pass automatically by operation of law (for example, a joint bank account). The pour over will can specify how assets you didn’t transfer to your living trust during your life will be transferred at death.

Essentially, you retain the same control you had before you established the trust. Whether or not you serve as trustee, you retain the right to revoke the trust and appoint and remove trustees. If you name a professional trustee to manage trust assets, you can require the trustee to consult with you before buying or selling assets.

The trust doesn’t need to file an income tax return until after you



die. Instead, you pay the tax on any income the trust earns as if you had never created the trust.

A living trust offers additional benefits. First, your assets aren’t exposed to public record. Besides keeping your affairs private, this makes it more difficult for anyone to challenge the disposition of your estate. Second, a living trust can serve as a vehicle for managing your financial assets if you become incapacitated and unable to manage them yourself. (See page 6 for more information.)

### Selecting an executor, personal representative or trustee

Whether you choose a will or a living trust, you also need to select someone to administer the disposition of your estate — an executor or personal representative and, if you have a living trust, a trustee.

#### PLANNING TIP 1

##### TITLE ASSETS CORRECTLY

When you create a trust, make sure you direct your attorney to change the title of all assets you want managed by your trust’s provisions. Otherwise, those assets may unexpectedly be included in your probate estate.

What does the executor or personal representative do? He or she serves after your death and has several major responsibilities, including:

- Administering your estate and distributing the assets to your beneficiaries,
- Making certain tax decisions,
- Paying any estate debts or expenses,
- Ensuring all life insurance and retirement plan benefits are received, and
- Filing the necessary tax returns and paying the appropriate federal and state taxes.

A trustee's duties are similar, but related only to assets held in the trust — plus he or she would also serve should you become incapacitated. (See page 6 for more information on planning for incapacity.)

An individual (such as a family member, a friend or a professional advisor) or an institution (such as a bank or trust company) can serve as executor, personal representative or trustee. (See Planning Tip 2.) Many people name both an individual and an institution to leverage their collective expertise. Nevertheless, naming only a spouse, child or other relative to act as executor or personal representative is common, and he or she certainly can hire any professional assistance needed.

But make sure the person doesn't have a conflict of interest. For example, think twice about choosing a second spouse, children from a prior marriage or an individual who owns part of your business. The desires of a stepparent and stepchildren may conflict, and a co-owner's personal goals regarding your business may differ from those of your family.

Also make sure the executor, personal representative or trustee is willing to serve. The job isn't easy, and not everyone will want or accept the responsibility. Even if you choose an individual rather than a professional, consider paying a reasonable fee for the services. Finally, provide for an alternate in case your first choice is unable or unwilling to perform when the time comes.

### Selecting a guardian for your children

If you have minor children, perhaps the most important element of your estate plan doesn't involve your assets. Rather, it involves who will be your children's guardian. Of course, the well-being of your children is your top priority, but there are some financial issues to consider:

- Will the guardian be capable of managing your children's assets?
- Will the guardian be financially strong?
- Will the guardian's home accommodate your children?

If you prefer, you can name separate guardians for your child and his or her assets. Taking the time to name a guardian or guardians *now*

#### PLANNING TIP 2

##### PROFESSIONAL VS. INDIVIDUAL EXECUTOR, PERSONAL REPRESENTATIVE OR TRUSTEE

Advantages of a professional executor, personal representative or trustee:

- Specialist in handling estates or trusts
- Impartiality and independence — usually free of personal conflicts of interest with the beneficiaries and sensitive to but not hindered by emotional considerations
- Financial expertise

Advantages of an individual executor, personal representative or trustee:

- More familiarity with the family
- Potentially lower administrative fees



ensures your children will be cared for as you wish if you die while they're still minors.

## PLANNING FOR INCAPACITY

Estate planning typically is associated with how your wishes will be carried out after your death. But it's also important that your plan address incapacity due to illness, injury, advanced age or other circumstances.

As with other aspects of your estate plan, the time to act is now, while you're healthy. If an illness or injury renders you unconscious or otherwise incapacitated, it will be too late. Unless you specify how financial and health care decisions will be made in the event you become incapacitated, there's no guarantee your wishes will be carried out. And your family may have to go through

expensive and time-consuming guardianship proceedings.

Regarding financial decisions, planning techniques to consider include:

### **A durable power of attorney.**

This document authorizes the representative you name — subject to limitations you establish — to control your assets and manage your financial affairs.

**A living trust.** The same trust that can help you achieve your estate planning goals (see page 4) can also be invaluable should you become unable to manage your financial affairs. If you become incapacitated, your chosen representative takes over as trustee. A properly drawn living trust avoids guardianship proceedings and related costs, and it offers greater protection and control than a

durable power of attorney because the trustee can manage trust assets for your benefit.

Regarding health care decisions, planning techniques to consider include:

### **A health care power of attorney.**

This document (also referred to as a “durable medical power of attorney” or “health care proxy”) authorizes a surrogate — your spouse, child or another trusted representative — to make medical decisions or consent to medical treatment on your behalf when you're unable to do so.

**A living will.** This document (also referred to as an “advance health care directive”) expresses your preferences for the use of life-sustaining medical procedures, such as artificial feeding and breathing, surgery, and invasive diagnostic tests. It also specifies the situations in which these procedures should be used or withheld.

## DETERMINING POTENTIAL ESTATE TAXES

The next step is to get an idea of what your estate is worth and whether you need to worry about estate taxes.

### **How much is your estate worth?**

Begin by listing all of your assets and their value, including cash, stocks and bonds, notes and mortgages, annuities, retirement benefits, your personal residence, other real

estate, partnership interests, life insurance, automobiles, artwork, jewelry, and collectibles. If you're married, prepare a similar list for your spouse's assets. And be careful to review how you title the assets, to include them correctly in each spouse's list.

If you own a life insurance policy at the time of your death, the proceeds on that policy usually will be includible in your estate. Remember: That's *proceeds*. Your \$1 million term insurance policy that isn't worth much while you're alive is suddenly worth \$1 million on your death. If your estate is large enough, a significant share of those proceeds may go to the government as taxes, not to your chosen beneficiaries.

### How the estate tax system works

Here's a simplified way to project your estate tax exposure. Take the value of your estate, net of any debts. Also subtract any assets

that will pass to charity on your death — such transfers are deductions for your estate.

Then, if you're married and your spouse is a U.S. citizen, subtract any assets you'll pass to him or her. Those assets qualify for the marital deduction and avoid estate taxes until the surviving spouse dies. (If you're single or your spouse isn't a U.S. citizen, turn to pages 19 and 20 for more information.) The net number represents your taxable estate.

You can transfer up to your available exemption amount at death free of estate taxes. So if your taxable estate is equal to or less than the estate tax exemption in the year of your death (reduced by any gift tax exemption you used during your life), no federal estate tax will be due when you die. But if your



taxable estate exceeds this amount, it will be subject to estate tax.

### The impact of state taxes

Many states, prompted by changes to the federal estate tax (such as increases in the federal exemption amount and elimination of the credit for state death tax), now impose estate tax at a lower threshold than the federal government does. In addition, although same-sex married couples now are generally treated as married for federal tax purposes, they might not, depending on the state, be treated as married for state tax purposes, which could also have significant state tax implications. (See page 19 for more information.)

Because of differences between federal and state law, it's vital to consider the rules in your state in order to avoid unexpected tax liability or other unintended consequences. The nuances are many; be sure to consult an estate planning professional with expertise on your particular state.

CHART 1

#### GIFT AND ESTATE TAX EXEMPTIONS AND RATES

	2013	2014	Future years
<b>Gift tax exemption</b>	\$5.25 million	\$5.34 million	Indexed for inflation
<b>Estate tax exemption<sup>1</sup></b>	\$5.25 million	\$5.34 million	Indexed for inflation
<b>Highest tax rates</b>	40%	40%	40%

<sup>1</sup> Less any gift tax exemption already used during life.



## ESTATE TAX SAVING STRATEGIES

# Minimizing taxes and maximizing what goes to your heirs

Here's a look at the most important estate planning tools and how you can use them to minimize taxes and maximize what goes to your heirs. You'll learn how the marital deduction, lifetime gift and estate tax exemptions, various trusts, life insurance, charitable contributions, and other estate planning tools and techniques can help you achieve your goals.

### THE MARITAL DEDUCTION

The marital deduction is one of the most powerful estate planning tools. For federal tax purposes, any assets passing to a surviving spouse pass tax-free at the time the first spouse dies, as long as the surviving spouse is a U.S. citizen. (If either you or your spouse isn't a U.S. citizen, see page 20.) Therefore, if you and your spouse are willing to pass all of your assets to the survivor, no federal estate tax will be due on the first spouse's death.

But this doesn't solve your estate tax problem. First, if the surviving spouse doesn't remarry, that spouse won't be able to take advantage of the marital deduction when he or she dies. Thus, the assets transferred from the first spouse could be subject to tax in the survivor's estate, depending on the size of the estate and the estate tax laws in effect at the survivor's death. Second, if your spouse does remarry, you probably don't want your spouse to pass all assets to the new spouse even if it would save estate taxes.

### Take advantage of exemption "portability"

Because assets in an estate equal to the available exemption amount aren't subject to estate taxes, a married couple can use their exemptions to avoid tax on up to double the exemption amount. (See Chart 1 on page 7.)

Since 2011, it's been easier for married couples to take advantage of both their exemptions. When one spouse dies and part (or all) of his or her estate tax exemption has been unused, the estate can elect to permit the surviving spouse to use the deceased spouse's remaining estate tax exemption. Thus, the exemption is "portable" between spouses.

Similar results can be achieved by making asset transfers between spouses during life and/or setting up certain trusts at death (both discussed later in this section). But the portability election is simpler and, if proper planning hasn't been done before the first spouse's death, can provide valuable flexibility. Plus, the surviving spouse can use the remaining exemption to make lifetime gifts.

Still, making lifetime asset transfers and setting up certain trusts can provide benefits that the portability election doesn't offer.

### Enjoy additional benefits with a credit shelter trust

One effective way to preserve both spouses' exemptions and enjoy additional benefits is to use a credit shelter trust. Before exemption portability, credit shelter trusts were necessary to protect the exemptions of both spouses if 1) their combined estates exceeded the estate tax exemption, and 2) the couple didn't want, at the first spouse's death, to use that spouse's exemption to transfer assets to the next generation (or to other beneficiaries besides the surviving spouse) — in other words, in situations where the couple wanted the surviving spouse to continue to benefit from those assets.

Now portability eliminates the need for a credit shelter trust for that purpose. However, such trusts continue to offer significant benefits, including:

- Professional asset management,
- Protection of assets against creditors' claims,
- Generation-skipping transfer (GST) tax planning (portability doesn't apply to the GST tax; see "Grandparents" on page 21 for more on the GST tax),
- Preservation of state exclusion amounts in states that don't recognize portability, and
- Preservation of the exemption if a surviving spouse remarries. (Portability is available only for the most recent spouse's exemption.)

But perhaps the biggest benefit of a credit shelter trust is the ability



to avoid transfer taxes on future appreciation of assets in the trust.

**Let's look at an example:** The Joneses each hold \$5.34 million of assets in their own names, and they haven't used up any of their lifetime gift tax exemptions. At Mr. Jones' death, all of his assets pass to Mrs. Jones — tax-free because of the marital deduction. Mr. Jones' taxable estate is zero. His estate makes the portability election, so Mrs. Jones can use his exemption.

Mrs. Jones dies several years later without having used any of her or Mr. Jones' exemptions on lifetime gifts, and without remarrying. So her estate has \$10.68 million of exemption available. (For simplicity we're ignoring inflation adjustments and we're rounding the amounts.) But her estate has grown by 30% to \$13.88 million. As a result, \$3.20 million is subject to estate tax, which means \$1.28 million goes to estate taxes (assuming the current 40% rate applies), leaving her heirs with \$12.60 million.

#### PLANNING TIP 3

#### MAKE SURE YOUR CREDIT SHELTER TRUST WILL ACHIEVE YOUR GOALS

If you already have a credit shelter trust in your estate plan, it's important to review your plan documents to ensure that they'll allow your estate to take full advantage of the 2014 exemption amount and future indexing of exemptions. Yet, be prepared for the possibility that, even though the exemption amount isn't scheduled to expire, Congress could still pass changes to it.

The document language should be flexible enough to allow you to gain all available estate tax benefits. For example, check that the language doesn't specify a fixed dollar amount to go to the credit shelter trust. Such language could cause you to lose out on the ability to shelter the full amount you might be entitled to.

**Let's look at an alternative:**

Mr. Jones' will calls for assets equal to the estate tax exemption to go into a credit shelter trust on his death. This trust provides income to Mrs. Jones during her lifetime. She also can receive principal payments if she needs them to maintain her lifestyle. Because of the trust language, Mr. Jones may allocate \$5.34 million (his exemption amount) to the trust to protect it from estate taxes; the trust assets won't be included in Mrs. Jones' taxable estate at her death.

Let's assume that the \$5.34 million in the trust and the \$5.34 million outside the trust both grew at the same rate as in our first scenario. So at Mrs. Jones' death, the trust is worth \$6.94 million and her estate is also worth \$6.94 million. But because the credit shelter trust assets aren't included in her taxable estate, only \$1.6 million is subject to estate tax. So only \$640,000 goes to estate taxes, leaving her heirs \$13.24 million — \$640,000 more than without the credit shelter trust.

The estate tax savings could be even greater if the Joneses structure their estates so that the credit shelter trust will hold the assets that are most likely to produce the greatest amount of growth. Let's say that their combined estates still grow to \$13.88 million, but all of the growth occurs within the credit shelter trust.

At Mrs. Jones' death, the credit shelter trust is worth \$8.54 million and Mrs. Jones' estate remains at \$5.34 million. Because her taxable estate doesn't exceed her estate tax exemption, there is no estate tax liability at her death and the full \$13.88 million passes to her heirs.

The Joneses do give up something for the credit shelter trust's tax advantages: Mrs. Jones doesn't have unlimited access to the funds in the credit shelter trust because, if she did, the trust would be includible in her estate.

Still, Mr. Jones can give her all of the trust income and any principal she needs to maintain her lifestyle. And the family can save significant estate taxes. But the outcome could be quite different if both spouses didn't hold enough assets in their own names. (See Case Study I.)

### Control assets with a QTIP trust

When assets in an estate will exceed the amount that can fund a credit shelter trust, a common estate planning concern is that, if those excess assets are distributed outright to

## CASE STUDY I

### SPLITTING ASSETS

Does it matter if one spouse holds more assets than the other? Maybe. Let's look at the Joneses from our example starting on page 9. Assume that, instead of each spouse holding \$5.34 million in his or her own name, Mr. Jones has \$9 million of assets and Mrs. Jones has \$1.68 million.

If Mr. Jones dies first, the credit shelter trust can be funded with \$5.34 million from his assets, and the remaining \$3.66 million can go directly to Mrs. Jones tax-free under the marital deduction. So the results are the same as if she'd held \$5.34 million of assets in her name to begin with.

But if Mrs. Jones dies first, only the \$1.68 million in her name is available to fund the trust. Her estate can make the portability election so that Mr. Jones can use her remaining \$3.66 million exemption. But less growth is protected from estate taxes. Assuming again that the assets both inside and outside the trust have grown 30% by the time of the death of the surviving spouse — but in this case Mr. Jones — the trust assets are worth \$2.18 million and Mr. Jones' estate is worth \$11.7 million. Applying his \$5.34 million exemption and Mrs. Jones' remaining \$3.66 million exemption, \$2.7 million is subject to estate tax. So \$1.08 million goes to estate taxes, leaving his heirs \$12.8 million — \$440,000 less than if Mrs. Jones had died first and the credit shelter trust could have been fully funded.

the surviving spouse, they'll eventually be distributed in a manner against the original owner's wishes. For instance, you may want stock in your business to pass only to the child active in the business, but your spouse may feel it should be distributed to all the children. Or you may want to ensure that after your spouse's death the assets will go to your children from a prior marriage.

You can address such concerns by structuring your estate plan so that some or all of your assets pass into a qualified terminable interest property (QTIP) trust. The QTIP trust allows you to provide your surviving spouse with income from the trust for the remainder of his or her lifetime. You also can provide your spouse with as little or as much access to the trust's principal as you choose. On your spouse's death, the remaining QTIP trust assets pass as the trust indicates.

Thus, you can provide support for your spouse during his or her lifetime but dictate who will receive the trust assets after your spouse's death. Because of the marital deduction, no estate taxes are due at your death. But the entire value of the QTIP trust will be included in your spouse's estate.

## LIFE INSURANCE

Life insurance can play an important role in your estate plan. It's often necessary to support the deceased's family or to provide

liquidity. You must determine not only the type and amount of coverage you need, but also who should own insurance on your life to best meet your estate planning goals.

### Replace lost earning power

If you're still working, your first step should be determining how much your family will need to replace your lost earning power. Don't just consider what you earn; also look at your spouse's future earning potential. If your spouse is currently employed, consider whether becoming a single parent will impede career advancement and earning power. If your spouse isn't employed, consider whether he or she will start to work and what his or her earning potential will be.

Next, look at what funds may be available to your family in addition to your spouse's earnings and any savings. Then estimate what your family's living expenses will be. Consider your current expenditures for housing, food, clothing, medical care, and other household and family expenses; any significant debts, such as a mortgage and student loans; and your children's education.

How do you determine the amount of insurance you need? Start by calculating how much annual cash flow your current investments, retirement plans and any other resources will provide. Use conservative earnings, inflation and tax rates. Compare the amount of cash flow generated with the amount

#### PLANNING TIP 4

#### CONSIDER SECOND-TO-DIE LIFE INSURANCE

Second-to-die life insurance can be a useful tool for providing liquidity to pay estate taxes. This type of policy pays off when the surviving spouse dies. Because a properly structured estate plan can defer all estate taxes on the first spouse's death, some families may find they don't need any life insurance proceeds at that time. But significant estate taxes may be due on the second spouse's death, and a second-to-die policy can be the perfect vehicle for providing cash to pay the taxes.

A second-to-die policy has a couple of key advantages over insurance on a single life. First, premiums are lower. Second, generally an uninsurable person can be covered if the other person is insurable.

But a second-to-die policy might not fit in your current irrevocable life insurance trust (ILIT), which is probably designed for a single-life policy. To ensure that the proceeds aren't taxed in either your estate or your spouse's, set up a new ILIT as policy owner and beneficiary. (For more on ILITs, see page 13.)

needed to cover the projected expenses. Life insurance can be used to cover any shortfall.

When you quantify the numbers to determine what cash flow your family will need, the result may be surprisingly high. Depending on your age, you may be trying to replace 25 or more years of earnings.

## CASE STUDY II

### IN AN ILIT WE TRUST

Walter was the sole income provider for his family. While working on his estate plan, he and his advisor determined he needed to purchase life insurance to provide for his family if something happened to him. After calculating the size of policy his family would need, Walter had to determine who should own it.

Because his children were still relatively young, Walter ruled them out as owners. He also ruled out his wife; he was concerned that, if his wife were the owner and something happened to her, his children would lose too much to estate taxes. So Walter decided to establish an irrevocable life insurance trust (ILIT) to hold the policy. Despite the loss of some control over the policy, Walter felt the ILIT offered the best combination of flexibility and protection for his family.

### Avoid liquidity problems

Insurance can be the best solution for liquidity problems. Estates are often cash poor, and your estate may be composed primarily of illiquid assets such as closely held business interests, real estate or collectibles. If your heirs need cash to pay estate taxes or for their own support, these assets can be hard to sell. For that matter, you may not want these assets sold.

Even if your estate is of substantial value, you may want to purchase insurance simply to avoid the unnecessary sale of assets to pay expenses or taxes. Sometimes second-to-die insurance makes the most sense. (See Planning Tip 4 on page 11.) Of course, your situation is unique, so get professional advice before purchasing life insurance.

### Choose the best owner

If you own life insurance policies at your death, the proceeds will be included in your estate. Ownership is usually determined by several factors, including who has the right to name the beneficiaries of the proceeds. The way around this problem? Don't own the policies when you die. But don't automatically rule out your ownership either.

To choose the best owner, consider why you want the insurance, such as to replace income, to provide liquidity or to transfer wealth to your heirs. You must also determine the importance to you of tax



implications, control, flexibility, and ease and cost of administration. Let's take a closer look at each type of owner:

**You or your spouse.** Ownership by you or your spouse generally works best when your combined assets, including insurance, don't place either of your estates into a taxable situation. There are several nontax benefits to your ownership, primarily relating to flexibility and control.

The biggest drawback to ownership by you or your spouse is that, on the death of the surviving spouse (assuming the proceeds were initially paid to the spouse), the insurance proceeds could be subject to federal estate taxes, depending on the size of the estate and the estate tax laws in effect at the survivor's death.

**Your children.** Ownership by your children works best when your primary goal is to pass wealth to them. On the plus side, proceeds aren't subject to estate tax on your or your spouse's death, and your children receive all of the proceeds tax-free.

There also are disadvantages. The policy proceeds are paid to your children outright. This may not be in accordance with your general estate plan objectives and may be especially problematic if a child isn't financially responsible or has creditor problems.

**Your business.** Company ownership or sponsorship of insurance on your life can work well when you have cash flow concerns related to paying premiums. Company sponsorship can allow premiums to be paid in part or in whole by the company under a split-dollar arrangement. But if you're the controlling shareholder of the company and the proceeds are payable to a beneficiary other than the company, the proceeds could be included in your estate for estate tax purposes.

**An ILIT.** A properly structured irrevocable life insurance trust (ILIT) could save you estate taxes on any insurance proceeds. Thus, a \$5 million life insurance policy owned by an ILIT instead of by you, individually, could reduce your estate taxes by as much as \$2 million if the entire amount is subject to estate tax and the rate is still 40%.

How does this work? The trust owns the policy and pays the premiums. When you die, the proceeds pass into the trust and aren't included in your estate. The trust can be structured to provide benefits to your surviving spouse and/or other beneficiaries. (See Case Study II.)

ILITs have some inherent disadvantages as well. One is that you lose some control over the insurance policy after the ILIT has been set up.

### ANNUAL GIFTING

Even with insurance proceeds out of your estate, you still can have considerable estate tax exposure. One effective way to reduce it is to remove assets from your estate before you die. As long as you can make the gifts without incurring gift tax, you'll be no worse off taxwise.

Taking advantage of the annual gift tax exclusion is a great way to reduce your estate taxes while keeping your assets within your family. Each individual is entitled to give as much as \$14,000 per year per recipient without any gift tax consequences or using any of his or her gift, estate or GST tax exemption amount. (For more information on the GST tax, see "Grandparents" on page 21.) The exclusion is indexed for inflation, but only in \$1,000 increments, so it typically increases only every few years. Case Study III shows the dramatic impact of an annual gifting program.

### Make gifts without giving up control

To take advantage of the annual exclusion, the law requires that the donor give a present interest in the property to the recipient. This usually means the recipient must

### CASE STUDY III

#### THE EARLY BIRD CATCHES THE TAX SAVINGS

Mr. and Mrs. Brown began a gift program in 2010, giving their combined annual exclusion amount (\$26,000 in 2010, 2011 and 2012 and \$28,000 in 2013 and 2014) to each of their two sons, two daughters-in-law and four grandchildren annually. These gifts totaled \$1,072,000.

Before the end of 2014, both Mr. and Mrs. Brown died with a combined estate of \$12 million. If they hadn't made the annual exclusion gifts, however, their combined estate would have totaled \$13,072,000. The annual exclusion gifts provided an estate tax savings of \$428,800.

The savings may actually be even greater. If Mr. and Mrs. Brown hadn't made the annual gifts, those assets might have generated income or appreciated in value each year. This additional income and appreciation would have been includible in their estate. By making the gifts to their children and grandchildren, they passed on not only the \$1,072,000 of assets free of tax, but also the future income and appreciation of those assets.

have complete access to the funds. But a parent or grandparent might find the prospect of giving complete control of a large sum to a child, teen or young adult a little unsettling. Here are a couple of ways around that concern:

**Crummey trusts.** Years ago, the Crummey family wanted to create trusts for their family members that would provide restrictions on access to the funds but still qualify for the annual gift tax exclusion. Language was included in the trust that allowed the beneficiaries a limited period of time in which to withdraw the funds that had been gifted into the trust. If they didn't withdraw the funds during this period, the funds would remain in the trust. This became known as a "Crummey" withdrawal power.

The court ruled that, because the beneficiaries had a present ability to withdraw the funds, the gifts qualified for the annual exclusion.

Because the funds weren't actually withdrawn, the family accomplished its goal of restricting access to them.

The obvious risk: The beneficiary can withdraw the funds against your wishes. To protect against this, you may want to explain to the beneficiaries that they're better off not withdrawing the funds, so the proceeds can pass tax-free at your death.

**Trusts for minors.** An excellent way to provide future benefits (such as college education funding) for a minor is to create a trust which requires that:

- The income and principal of the trust be used for the benefit of the minor until age 21, and
- Any income and principal not used pass to the minor at age 21.

A trust of this type qualifies for the annual exclusion even though the child has no current access to the funds. Therefore, a parent or



grandparent can make annual exclusion gifts to the trust while the child is a minor. The funds accumulate for the future benefit of the child, and the child doesn't even have to be told about the trust. But one disadvantage is that the child must have access to the trust assets once he or she reaches age 21.

### Leverage the annual exclusion by giving appreciating assets

Gifts don't have to be in cash. Any asset qualifies. In fact, you'll save the most in estate taxes by giving assets with the highest probability of future appreciation. Take a look at Chart 2. Cathy gave her daughter a municipal bond worth \$14,000. During the next five years, the bond generated \$550 of income annually but didn't appreciate in value. After five years, Cathy had

CHART 2

#### THE POWER OF GIVING AWAY APPRECIATING ASSETS

	Municipal bond	Appreciating stock
<b>Value of gift</b>	\$14,000	\$14,000
<b>Income and appreciation (5 years)</b>	2,750 <sup>1</sup>	7,000 <sup>1</sup>
<b>Total excluded from estate</b>	\$16,750	\$21,000

By giving an appreciating asset, an extra \$4,250 is removed from the donor's estate.

<sup>1</sup> These amounts are hypothetical and are used for example only.

passed \$16,750 of assets that would otherwise have been includible in her estate.

But suppose Cathy gave her daughter \$14,000 in stock instead of the bond. If the stock generated no dividends during the next five years but appreciated in value by \$7,000, Cathy would have given her daughter \$21,000 of assets — and taken an additional \$4,250 out of her estate.

### Think twice before giving highly appreciated assets

A recipient usually takes over the donor's basis in the property gifted. If you give your child an asset worth \$14,000 but that cost you \$8,000, your child will generally take over an \$8,000 basis for income tax purposes. Therefore, if your child then sells the asset for \$14,000, he or she will have a \$6,000 gain for capital gains tax purposes.

This gain could potentially be avoided if you bequeath the asset instead. At your death, your assets generally receive a new federal income tax basis equal to the date-of-death fair market value. Going back to our example, if your child receives the \$14,000 asset as a bequest, he or she could sell it for \$14,000 and have no gain for income tax purposes. His or her income tax basis would be \$14,000 instead of your \$8,000.

So, where possible, it's better to make lifetime gifts of assets that

haven't yet appreciated significantly and save highly appreciated assets for bequests.

### Consider whether you should max out your gift tax exemption

Cumulative lifetime taxable gifts up to the gift tax exemption amount (see Chart 1 on page 7) create no gift tax, just as assets in an estate less than or equal to the available estate tax exemption amount create no estate tax. But note that this is on a combined basis. In other words, if you make \$200,000 of taxable gifts during your life, the amount of assets in your estate that will avoid estate taxes will be reduced by \$200,000.

Because many assets appreciate in value, it may make sense to make taxable gifts up to the lifetime gift tax exemption amount now — if you can afford to do so without compromising your own financial security. If you can't afford to give the full \$5.34 million, even smaller gifts can substantially reduce the size of your taxable estate by removing future appreciation. (See Case Study IV.)

### Leverage your tax-free gifts with an FLP

Family limited partnerships (FLPs) can be excellent tools for long-term estate planning, because they can allow you to increase the amount of gifts you make without

## CASE STUDY IV

### WHEN "TAXABLE" GIFTS SAVE TAXES

Let's say John has an estate of \$7 million. In 2014, he has already made \$14,000 annual exclusion gifts to each of his chosen beneficiaries. He's pleased that the \$5.34 million gift and estate tax exemption will continue to be indexed for inflation. But he believes his estate will grow at a much faster rate and is concerned that he could have substantial estate tax exposure. So he gives away an additional \$2 million of assets.

John uses \$2 million of his gift tax exemption by making the taxable gift. Therefore, his estate can't use that amount as an exemption. But by making the taxable gift, he also removes the future appreciation from his estate. If the assets, say, double in value before John's death, the gift will essentially have removed \$4 million from his estate. This amount escapes the estate tax.

One caveat: Watch for taxable gifts made within three years of the date of death, because they'll have to be brought back into the estate as though they had never been made.

increasing the gift tax cost. But the IRS frequently challenges FLPs, and legislation has been proposed that would reduce their benefits. So caution is needed when implementing them. Fortunately, recent court cases have provided insights into how to structure and administer an FLP that will survive IRS scrutiny.

Here's how an FLP works: First you select the type of assets (such as real estate or an interest in a business) and the amount (based on the gift tax rules discussed earlier) and place them in the FLP. Next you give some or all of the limited partnership interests to your children or other family members you'd like to benefit.

The limited partnership interests give your family members ownership interests in the partnership, but no right to control its activities. Control remains with the small percentage (typically at least 1%) of partnership interests known as general partnership interests, of which you (and possibly others) retain ownership. The result is that you can reduce your taxable estate by giving away assets (the partnership interests), without giving up total control of the underlying assets and the income they produce.

Because the limited partners lack any control, these interests can often be valued at a discount. When making a gift of an FLP interest, obtaining a formal valuation by a professional business

appraiser is essential to establish the value of the underlying assets and of the partnership interests.

## CHARITABLE CONTRIBUTIONS

Sharing your estate with charity will allow you to cut your estate tax bill. Direct bequests to charity are fully deductible for estate tax purposes. Leave your entire estate to charity, and you'll owe no estate taxes at all. In addition to providing tax advantages, contributing to charity is a good way to leave a legacy in your community or to instill in your heirs a sense of social responsibility.

But what if you want to make a partial bequest to charity and a partial gift or bequest to your natural beneficiaries? A trust can be the answer.

### Provide for family today and charity tomorrow with a CRT

Your will can create a trust that will pay income for a period of time to

beneficiaries you name. At the end of the stated period, the remaining trust assets pass to your charitable organization(s) of choice. This is a charitable remainder trust (CRT).

For example, let's say you want to make sure your elderly father is provided for in case you precede him in death. From a CRT created upon your death, your father can receive annual distributions until he dies. At that time, the remainder passes to charity. You get what you wanted — you provide for both your father and charity. And, because you're making a partial charitable donation at the time of your death, your estate receives a deduction for a portion of the trust's value.



#### PLANNING TIP 5

#### LEAVE A LEGACY WITH A PRIVATE FOUNDATION OR DONOR-ADVISED FUND

You can form a private foundation to support your charitable activities or to make charitable grants according to your wishes. If the foundation qualifies for tax-exempt status, your charitable contributions to it will be deductible, subject to certain limitations.

An alternative to consider is a donor-advised fund (DAF). Generally, such funds are sponsored by a large public charity that allows you to make contributions that are used to create a pool of funds you control. Thus, a DAF is essentially a small-scale private foundation that requires much less administration.



The size of the estate tax deduction is determined based on the value of the trust assets, the trust term and the amount to be paid to the beneficiary. The value of the interest given to the noncharitable beneficiary is included in your estate.

### Take the reverse approach with a CLT

Now let's reverse the situation: You wish to provide an income stream to a charity for a set period after your death, with the remainder passing to your beneficiaries. The charitable lead trust (CLT) provides a way to do this — and obtain a partial charitable deduction for your estate.

### Gain an income tax deduction with lifetime charitable gifts

You can use the above techniques during your lifetime as well. And if you create a charitable trust during your life, you may be entitled to an income tax deduction for the portion that government tables calculate to be the charitable gift. This way, you can reduce both your income and estate taxes.

The benefits are even greater if you fund the trust with appreciated assets. Let's say you transfer appreciated securities to a CRT. After receiving the stock, the trustee sells it and reinvests the proceeds.

Because a CRT is tax exempt, no capital gains tax is owed at the time of the sale. The trustee is

able to reinvest the full proceeds, potentially increasing the annual distributions to you or your chosen beneficiaries. (Note that some or all of the amount distributed to the beneficiary may be taxable.) See Planning Tip 5 for more ideas on incorporating charitable giving into your estate plan.

## STRATEGIES FOR FAMILY-OWNED BUSINESSES

Few people have more estate planning issues to deal with than a family business owner. The business may be the most valuable asset in the owner's estate. Yet, many family-owned businesses don't survive beyond the first generation. If you're a business owner, you should address the following concerns as you plan your estate:

**Who will take over the business when you die?** Owners often fail to develop a management succession plan. It's vital to the survival of the business that successor management, in the family or otherwise, be ready to take over the reins.

**Who should inherit your business?** Splitting this asset equally among your children may not be a good idea. For those active in the business, inheriting the stock may be critical to their future motivation. To those not involved in the business, the stock may not seem as valuable. Or perhaps your entire family feels entitled to equal shares in the business. Resolve this issue

now to avoid discord and possible disaster later.

**How will the IRS value your company?** Because family-owned businesses aren't typically publicly traded, knowing the exact value of the business is difficult without a professional valuation. The value placed on the business for estate tax purposes is often determined only after a long battle with the IRS. Plan ahead and ensure your estate has enough liquidity to pay estate taxes and support your heirs.

### CASE STUDY V

#### SOMETIMES PUTTING OFF UNTIL TOMORROW MAKES SENSE

Lee owned a small manufacturing company that accounted for 50% of his estate. When he died in October 2013, his estate's total estate tax liability was \$1 million. Half of the liability would be due at the normal due date of his estate's tax return in July 2014 (nine months after Lee's death). The other \$500,000 of liability could be paid in 10 installments, starting in July 2019 (five years and nine months after Lee's death) and ending in July 2028. Lee's estate would also have to pay interest on the unpaid liability each year, but at special low rates. (See "Estate tax deferral" on page 18 for more information.)

## Take advantage of special estate tax breaks

Current tax law has provided two types of tax relief specifically for business owners:

**Section 303 redemptions.** Your company can buy back stock from your estate without the risk of the distribution being treated as a dividend for income tax purposes. Such a distribution must, in general, not exceed the estate taxes and funeral and administration expenses of the estate. One caveat: The value of your family-owned business must exceed 35% of the value of your adjusted gross estate. If the redemption qualifies under Sec. 303, this is an excellent way to pay estate taxes.

**Estate tax deferral.** Normally, estate taxes are due within nine months of your death. But if closely held business interests exceed 35% of your adjusted gross estate, the estate may qualify for a deferral of tax



payments. No payment other than interest is due until five years after the normal due date for taxes owed on the value of the business. The tax related to the closely held business interest then can be paid over as many as 10 equal annual installments. Thus, a portion of your tax can be deferred for as long as 14 years from the original due date. Interest

will be charged on the deferred payments. (See Case Study V on page 17.)

## Ensure a smooth transition with a buy-sell agreement

A powerful tool to help you control your — and your business's — destiny is the buy-sell agreement. This is a contractual agreement between shareholders and their corporation or between a shareholder and the other shareholders of the corporation. (Partners and limited liability company members also can enter into buy-sell agreements.)

The agreement controls what happens to the company stock after a triggering event, such as the death of a shareholder. For example, the agreement might require that, at the death of a shareholder, the stock be bought back by the corporation or that

### PLANNING TIP 6

#### PROTECT YOUR INTERESTS WITH A BUY-SELL AGREEMENT

A buy-sell agreement offers three key benefits:

1. It provides a ready market for the shares in the event the owner's estate wants to sell the stock after the owner's death.
2. It sets a price for the shares. In the right circumstances, it also fixes the value for estate tax purposes.
3. It provides for stable business continuity by avoiding unnecessary disagreements caused by unwanted new shareholders.

the other shareholders buy the deceased's stock.

A well-drafted buy-sell agreement can solve several estate planning problems for the owner of a closely held business and can help ensure the survival of the business. (See Planning Tip 6.) It's also critical to be sure that funding for the agreement is in place, or you risk making all the planning ineffective.

### Remove future appreciation by giving stock

One way to reduce estate taxes is to limit the amount of appreciation in your estate. We talked earlier about giving away assets today so that the future appreciation on those assets will be outside of your taxable estate. There may be no better gift than your company stock — this could be the most rapidly appreciating asset you own.

For example, assume your business is worth \$5 million today but is likely to be worth \$15 million in several years. By giving away some of the stock today, you'll keep a portion of the future appreciation out of your taxable estate.

Be aware that the IRS may challenge the value you place on the gift and try to increase it substantially. The IRS is required to make any challenges to a gift tax return within the normal three-year statute of limitations, even when no tax is payable with the return. But the statute of limitations applies only if

certain disclosures are made on the gift tax return. So seek professional assistance before transferring portions of your business.

## SPECIAL STRATEGIES FOR SPECIAL SITUATIONS

Standard estate planning strategies don't fit every situation. Single people, unmarried couples, same-sex married couples, noncitizen spouses, individuals planning a subsequent marriage and grandparents are among those who might benefit from less common techniques. In this section, we look at these situations and estate planning ideas that may apply to them.

### Singles

Single people with large estates may be at a disadvantage because they don't have the unlimited marital deduction, which allows a spouse to leave assets to a surviving spouse's estate tax-free. But trusts can help reduce taxes and ensure that your loved ones receive your legacy in the manner you desire.

### Unmarried couples

Because unmarried couples aren't granted rights automatically by law, they need to create a legal relationship with a domestic partnership agreement. Such a contract can solidify the couple's handling of estate planning issues.

In addition, unmarried couples don't have the benefit of the marital deduction. There are solutions,

however. One partner can reduce his or her estate and ultimate tax burden through a traditional annual gifting program or by creating an ILIT (see page 13) or a CRT (see page 16) benefiting the other partner. Again, these strategies are complex and require the advice of financial, tax and legal professionals.

### Same-sex married couples

Last year brought many new estate planning opportunities to same-sex married couples. This was thanks to the U.S. Supreme Court's striking down of the provision of the federal Defense of Marriage Act (DOMA) defining marriage for federal benefits purposes as between a man and a woman and the IRS subsequently issuing guidance that same-sex couples who marry in a state



(or foreign country) that authorizes such unions are considered to be lawfully married for federal tax purposes — even if they reside in a state that doesn't recognize the validity of same-sex marriage.

This means most same-sex married couples will be able to take advantage of the federal gift and estate tax perks of marriage, such as the marital deduction and exemption portability. (See page 8.) However, couples residing in states where same-sex marriage isn't recognized may need to implement some strategies for unmarried couples in order to achieve their estate planning goals.

Regardless of where they reside, same-sex married couples should review their estate plans in light of the changes. And if they were hit with gift or estate taxes in previous years as a result of DOMA, they should consider whether they're eligible to file amended returns and to claim a refund. Filing amended returns isn't mandatory, however.

### Noncitizen spouses

The marital deduction differs for a non-U.S. citizen surviving spouse. The government is concerned that he or she could take the marital bequest tax-free and then leave U.S. jurisdiction without the property ever being taxed.

Thus, the marital deduction is allowed only if the assets are transferred to a qualified domestic trust

(QDOT) that meets special requirements. The impact of the marital deduction is dramatically different because any principal distributions from a QDOT to the noncitizen spouse and assets remaining in the QDOT at his or her death will be taxed as if they were in the citizen spouse's estate. Also note that the gift tax marital deduction for gifts to noncitizen spouses is limited to a set amount annually. For 2014, the deduction is \$145,000.

### Subsequent marriages

Estate planning for subsequent marriages can be complicated, especially when children from a prior marriage are involved. Finding the right planning technique for your situation not only can ease family tensions but also can help you pass more assets to the children at a lower tax cost.



A QTIP marital trust can maximize estate tax deferral while benefiting the surviving spouse for his or her lifetime and the children after the spouse's death. Combining a QTIP trust with life insurance benefiting the children or creatively using joint gifts can further leverage your gifting ability. (Turn back to page 10 for more on QTIP trusts.)

A prenuptial agreement can also help you achieve your estate planning goals. But to hold up in court, certain legal requirements must be met. So consulting an attorney is essential.

CHART 3

### GENERATION-SKIPPING TRANSFER TAX EXEMPTIONS AND RATES

	2013	2014	Future years
<b>Exemption</b>	\$5.25 million	\$5.34 million	Indexed for inflation
<b>Tax rate</b>	40%	40%	40%

## Grandparents

If your children also face the prospect of high taxes on their estates, consider skipping a generation with some of your bequests and gifts.

But beware of the GST tax, which applies to transfers to a “skip person” — generally anyone more than one generation below you, such as a grandchild or an unrelated person more than 37½ years younger than you. (A gift or bequest to a grandchild whose parent has died before the transfer isn’t treated as a GST.) Gifts that qualify for the annual exclusion are generally exempt from the GST tax.

The GST tax rate is the same as the top estate tax rate. (See Chart 3.) Fortunately, there’s a GST tax exemption. As with the gift and estate tax exemptions, the GST tax exemption has increased to

\$5.34 million for 2014. (Also see Chart 3.)

Each spouse has this exemption, so a married couple can use double the exemption. (Note, however, that the GST tax exemption isn’t portable between spouses.) Once you’ve used up your exemption, additional GSTs (whether gifts or bequests) that aren’t otherwise exempt will be subject to the GST tax — in addition to any applicable gift or estate tax.

If you can afford to do so without compromising your own financial security, you may want to use up some or all of your \$5.34 million GST tax exemption on lifetime gifts to your grandchildren or other loved ones more than a generation below you. But keep in mind that, if you want to avoid all taxes on the transfers, you’ll also have to use up an equal amount of your gift tax exemption.

If maximizing tax savings is your goal, you may also want to consider a “dynasty trust.” Rather than the assets being included in the grandchildren’s taxable estates, the dynasty trust allows assets to skip several generations of taxation. This is available only in jurisdictions that have abolished the “rule against perpetuities.”

Simply put, you create the trust either during your lifetime by making gifts or at death in the form of bequests. The trust remains in existence from generation to

generation. Because the heirs have restrictions on their access to the trust funds, the trust is sheltered from estate taxes. If any of the heirs have a need for funds, the trust can make distributions to them. (See Case Study VI.)

### CASE STUDY VI

#### DYNASTY TRUST PROVIDES MANY BENEFITS

Saul and Eleanor have accumulated a sizable estate, as has each of their children. Because their children are financially secure and Saul and Eleanor want to take maximum advantage of their combined \$10.68 million generation-skipping transfer (GST) tax exemption, they’ve decided to make some significant gifts to their grandchildren. But they don’t feel comfortable giving such large sums to minors and young adults outright.

So they decide to set up a dynasty trust for their grandchildren’s benefit. Because future estate tax increases are still possible, Saul and Eleanor also like the idea that the trust will protect the assets from estate taxes for generations to come. Further, they’ll remove the future appreciation on those assets from their estates without an estate tax cost.



## COMMUNITY PROPERTY ISSUES

Ten states have community property systems: Alaska (elective), Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Under a community property system, your total estate consists of your 50% share of community property and 100% of your separate property. What's the difference?

Community property usually includes assets you and your spouse acquire under two conditions:

- 1) during your marriage, and
  - 2) while domiciled in a community property state. (See Planning Tip 7.)
- Each spouse is deemed to own a one-half interest in the community property, regardless of who acquired it. For example, wages and other forms of earned income are treated

as community property, even though earned by only one spouse.

Separate property usually includes property you and your spouse owned separately before marriage and property you each acquire during marriage as a gift or inheritance that you keep separate. In some states, income from separate property may be considered community property.

In most community property states, spouses may enter into agreements between themselves to convert separate property into community property or vice versa. This can be an important part of your estate plan.

Same-sex married couples living in community property states that recognize same-sex marriage generally will be subject to the community property system; those residing in community property states that don't recognize same-sex marriage generally won't be. These couples should discuss with their estate planning advisor how they might be affected by community property laws.

### Expanded marital rights

Community property states start out with greater protection for the surviving spouse because he or she is deemed to own 50% of any community property interest. But some states go much further, and the laws can be complex. For example, rules may vary depending on how many children you have and how much the surviving spouse owns

in relation to the deceased spouse. These expanded rights require special attention in relation to a variety of estate planning strategies. So if you're subject to a community property system:

**Plan carefully when using a living trust.** If a living trust isn't carefully drafted, the property may lose its community property character, resulting in adverse income, gift and estate tax consequences. For example, improper language can create an unintended gift from one spouse to the other. To avoid any problems, the living trust should state that:

- Property in the trust and withdrawn from it retains its character as community property,
- You and your spouse each retain a right to amend, alter or revoke the trust, and
- After the death of one spouse, the surviving spouse retains control of his or her community interest.

(For more on living trusts, turn to page 4.)

### Reap the basis benefit.

Community property owners receive a double step-up in basis benefit. Say you and your spouse hold \$200,000 of stock as community property. Only one-half of the stock (\$100,000) would be included in the estate of the first spouse to die. But, the income tax basis of all

#### PLANNING TIP 7

##### DETERMINE YOUR DOMICILE

There's no one definition or single set of rules establishing domicile. Because you can have a residence in, and thereby be a resident of, more than one state, domicile is more than just where you live. Domicile is a principal, true and permanent home to which you always intend to return, even if you're temporarily located elsewhere.

of the stock would rise. Therefore, the surviving spouse could sell his or her 50% share of the stock at no gain, as well as the deceased spouse's 50% share.

**Watch out for unwanted tax consequences with ILITs.**

Several community property state issues must be taken into account to avoid unwanted tax consequences when an ILIT owns a life insurance policy. For example, if you give an existing policy that was community property to an ILIT and the uninsured spouse is a beneficiary of the trust, the estate of the surviving uninsured spouse could be taxed on 50% or more of the trust. However, proper titling of the policy, effective gift agreements between spouses and proper payment of premiums can avoid this problem. (For more on ILITs, see page 13.)

**Distinguish between separate and community property for FLPs.** For community property state residents, it's important to state in the FLP agreement whether the FLP interest is separate or community property. In addition, you should consult your attorney to determine if a partner's income from an FLP is community or separate property. (For more on FLPs, see page 15.)

**Get spousal consent before making charitable gifts.** Under the community property laws in many states, a valid contribution of

community property can't be made to a charity by one spouse without the consent of the other spouse. Consent should be obtained before the close of the tax year for which the tax deduction will be claimed. (For more on charitable contributions, see page 16.)

**Weigh your property treatment options**

You don't always have to follow the property system of your state of domicile. For example, if you live in a community property state and want to avoid having to obtain your spouse's consent to sell or make gifts of community property, you may elect out of community property treatment. But you also can retain community property treatment if you move from a community property state to a separate property state.

To do this, consider establishing a joint trust to hold the community property when you move to the new state or simply prepare an agreement outlining the status of the assets as community property. Another option is to leave assets in a custody account governed by the laws of the community property state. It may even be possible

to retain the community property nature of the assets by simply segregating them from other assets on arriving in the new state. But make sure the estate planning documents that dispose of the segregated assets call for the disposition of only one-half of the assets at the death of each spouse.

You can execute similar strategies if you have separate property that you wish to remain separate when you move to a community property state. Again, to retain its separate property status, it can't become intermingled with community property.

If you aren't concerned about the limits on community property and are interested in obtaining its tax advantages but don't reside in a community property state, consider taking advantage of the Alaskan system. It allows nonresidents to convert separate property to community property, which involves placing property in trust and requires careful planning.





## IMPLEMENTING AND UPDATING YOUR PLAN

# Where do you go from here?

Estate planning is an ongoing process. You must not only develop and implement a plan that reflects your current financial and family situation, but also regularly review your plan to ensure it fits any changes in your circumstances. You'll also want to update your plan after any of the events in Planning Tip 8.

Remember, estate planning is about much more than reducing your estate taxes; it's about ensuring your family is provided for, your business can continue and your charitable goals are achieved. So make sure you have an up-to-date plan in place.

To this end, jot down a few notes about things you want to look at more closely and discuss with a professional advisor. It may be easy for you to put off developing a detailed estate plan — or updating it in light of changes in

tax law or your situation. But if you do, you may find that Uncle Sam gets more of your estate than if you'd done some planning.

So please call your estate planning advisor with any questions you have about the strategies presented here or how they can help you minimize your estate tax liability. He or she can discuss your situation and help you develop, implement and update an estate plan that will preserve for your heirs what it took you a lifetime to build.

### PLANNING TIP 8

#### 4 MORE REASONS TO UPDATE YOUR ESTATE PLAN

- 1. Family changes.** Marriages, divorces, births, adoptions and deaths can all lead to the need for estate plan modifications.
- 2. Increases in income and net worth.** What may have been an appropriate estate plan when your income and net worth were much lower may no longer be effective today.
- 3. Geographic moves.** Different states have different laws, which can affect your estate plan. Any time you move from one state to another, you should review your estate plan.
- 4. New health-related conditions.** A child may develop special needs due to physical or mental limitations, or a surviving spouse's ability to earn a living may change because of a disability. Such circumstances often require an estate plan update.



# Estate planning worksheet

If you have any questions about the topics covered in this guide, or if you want more information on how they relate to you, please fill out this worksheet and mail or e-mail to [info@paolilaw.com](mailto:info@paolilaw.com) and we will contact you to schedule a consultation.

## ESTATE PLANNING NEEDS EVALUATION

*Please check all boxes that apply to your situation.*

### Do you have an estate plan in place?

- Yes (date last reviewed: \_\_\_\_\_)
- No, but I would like to develop one

### I need help with:

- Writing my will
- Establishing a living trust
- Selecting an executor, personal representative and trustees
- Valuing my estate
- Reducing estate taxes
- Determining the role of life insurance
- Creating a family limited partnership
- Creating a buy-sell agreement
- Planning for a subsequent marriage
- Planning for a noncitizen spouse
- Planning for community property
- Updating my estate plan
- Other \_\_\_\_\_

- Creating a succession plan and transferring ownership of my business
- Giving to charity
- Implementing generation-skipping transfers
- Other \_\_\_\_\_

### My greatest estate planning concern/need is:

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NAME

TITLE

ORGANIZATION

ADDRESS

CITY STATE ZIP

PHONE FAX

E-MAIL

### I would like to learn more about the following estate planning strategies:

- Gifting as a technique for transferring wealth
- Setting up a trust for my heirs



## JAMES J. RUGGIERO, JR., ESQ. AEP®, EPLS

Jim Ruggiero is the managing partner of Ruggiero Law Offices LLC, a practice devoted to estate planning, business planning, and elder law. Our emphasis is on Estate Planning including Business Succession Planning, Estate Preservation Planning and Medicaid Planning.

### Uniquely Qualified to Help You Protect Your Assets

Devoting his practice to estate planning, business planning and elder law has allowed Jim to focus his professional development and earn awards, certifications, and recognition. He is an Accredited Estate Planner®, a designation awarded by the National Association of Estate Planners & Councils. He is an accredited attorney with the Department of Veterans Affairs. He is also certified as an Estate Planning Law Specialist by the Estate Law Specialist Board, Inc., an organization accredited by the American Bar Association. He is one of only a handful of attorneys in the entire country that can claim this distinction.

### Recognized as an Expert by Peers and the Local Philadelphia Community

Jim has been the recipient of many awards and accolades. He has been named **Top Lawyer in Trusts, Estates, and Elder Law** numerous times by Main Line Today. He has also earned the **Five Star Wealth Manager Award** given by Philadelphia Magazine for five straight years.

### Respected Educator and Popular Speaker

Jim is an educator for legal and financial professionals. He speaks for professional associations such as the Pennsylvania Bar Association, Pennsylvania Bar Institute and the PA Trial Lawyers Association. He also addresses the community, and he is heard and seen on radio and television discussing topics like Life Care Planning, Business Succession Planning, Special Needs Planning and Dealing with Medicaid. As PA Chairperson for Elder Care Matters, Jim answers legal questions from families across the country.



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Google Plus - [jim@paolilaw.com](mailto:jim@paolilaw.com)



## RUGGIERO LAW OFFICES LLC

*Helping families safeguard the treasures  
they value most – their loved ones*

Paoli Corporate Center  
16 Industrial Boulevard., Ste. 211  
Paoli, Pennsylvania 19301  
Ph: 610.889.0288 Fax: 610.889.0959

3477 Corporate Parkway, Ste. 100  
Center Valley, Pennsylvania 18034  
Ph: 484.224.3487 Fax: 484.224.3501

[info@PaoliLaw.com](mailto:info@PaoliLaw.com)

[www.PaoliLaw.com](http://www.PaoliLaw.com)

# SECURITY FOR YOUR FUTURE GENERATIONS



**Partner with Ruggiero Law Offices LLC to design a plan that stays current with your life plan.**

An integral part of ensuring that your estate planning accomplishes what you intend it to is your commitment to keeping your plan up-to-date with changes in your family situation, health, and finances. It is equally important to stay current with the ever changing tax laws. The most notable events that impact a plan are the birth, death, marriage, or divorce of any of your beneficiaries. In addition, any changes in health or finances could significantly impact your plan. If you experience a shift in health, or receive an inheritance, you will likely want to revise your plan to ensure continued protection. To assist you with this, we offer clients our Ruggiero Law Offices Client Care Program.

#### Highlights of the program include:

- Secure access to healthcare directives and legal and financial documents with 24/7 access through Legal Vault
- Annual legal review consultation including simple changes
- Review meeting with your Financial Advisor

Learn more at:

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Google Plus - [jim@paolilaw.com](mailto:jim@paolilaw.com)



## RUGGIERO LAW OFFICES LLC

*Helping families safeguard the treasures they value most – their loved ones*

### Our practice areas include:

#### Estate Planning

- Wills & Trusts
- Power of Attorney and Living Wills
- Charitable Bequests
- HIPAA Release
- Special Needs Trusts

#### Elder Law

- Asset Protection Planning
- Caregiver Agreements
- Medicaid Planning
- Guardianship
- Contract Review for Continuing Care

#### Business Law

- Formation of LLCs and Corporations
- Buying and Selling a Business
- Executive Compensation Planning
- Business Succession Planning

#### Real Estate

- Represent Buyers and Sellers
- For Sale by Owner Transactions
- Leases - Residential and Commercial

**Ruggiero Law Offices LLC advises in Pennsylvania and in Florida with offices in the Delaware Valley & the Lehigh Valley.**

**Call us today at 610-889-0288.**

Paoli Corporate Center  
16 Industrial Boulevard., Ste. 211  
Paoli, Pennsylvania 19301  
Ph: 610.889.0288 Fax: 610.889.0959

3477 Corporate Parkway, Ste. 100  
Center Valley, Pennsylvania 18034  
Ph: 484.224.3487 Fax: 484.224.3501  
[info@PaoliLaw.com](mailto:info@PaoliLaw.com)

**[www.PaoliLaw.com](http://www.PaoliLaw.com)**

