

ESTATE PLANNING:
LIVING TRUSTS, WILLS & PROBATE

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National Probate and Administrative Costs

Gross Estate	Percentage
\$ 50,000	8.6
\$100,000	8.2
\$500,000	7.0
\$1,000,000	6.4
\$5,000,000	5.8

Table I
Compiled by the Estate Research Institute

ESTATE TAX

The government is gradually increasing the amount that can be sheltered from estate taxes through the year 2010.

Generally, all assets greater than \$1,500,000 (for years 2004-2005) that are passed directly to an individual, including retirement accounts, are subject to federal gift and estate taxes (see chart below). The \$1,500,000 exemption from estate taxes is known as the unified credit equivalent, which can be used to offset assets you leave to your beneficiaries upon your death. Assets that pass to a surviving spouse, however, are generally not subject to estate tax regardless of the amount (unlimited marital deduction).

Credit and rate changes for estate and gift tax over the next ten years.

YEAR	ESTATE TAX CREDIT	MAXIMUM ESTATE TAX RATE	GIFT TAX CREDIT	MAXIMUM GIFT TAX RATE
2001	\$675,000	55%*	\$675,000	55%*
2002	\$1,000,000	50%**	\$1,000,000	50%**
2003	\$1,000,000	49%	\$1,000,000	49%
2004	\$1,500,000	48%	\$1,000,000	48%
2005	\$1,500,000	47%	\$1,000,000	47%
2006	\$2,000,000	46%	\$1,000,000	46%
2007	\$2,000,000	45%	\$1,000,000	45%
2008	\$2,000,000	45%	\$1,000,000	45%
2009	\$3,500,000	45%	\$1,000,000	45%
2010	N/A	0	\$1,000,000	35%***
2011	\$1,000,000****	55%	\$1,000,000	55%

* There is a 5% surcharge - 60% rate - on estates and cumulative gift values between approximately \$10 and \$20 million.

** The 5% surtax is repealed as of 1/1/02.

*** Maximum gift tax rate in 2010 is equal to the highest marginal income tax rate.

**** Pursuant to the Economic Growth and Tax Relief Reconciliation Act of 2001, the federal estate tax exemption is scheduled to increase and be repealed in 2010. The repeal of the estate tax will expire on December 31, 2010, unless new legislation is enacted. Upon expiration, the federal estate tax will revert back to the law applicable prior to the 2001 Tax Act.

TABLE II

A Living Trust Can Be Better Than A Will

BY RAYMOND HERSCHTHAL, ATTORNEY-AT-LAW

The most popular tool today to set up a comprehensive estate plan is the revocable trust, also known as a living (inter-vivos) trust. The reason for this choice of plan is quite simple. The basic function of the trust is to completely avoid probate court upon the death of the grantor (individual) and to effectuate a transfer of title and distribution of assets without the need for court intervention. By contrast, a will takes effect only upon death and must be probated by the court in order to transfer legal title to designated heirs.

Probate court has gotten a bad reputation for several reasons. The most common difficulties associated with this process are an extended period of time, substantial expense and the loss of privacy. The average length of a probate proceeding is anywhere from twelve (12) to eighteen (18) months. The legal steps involved to complete this task include the filing of many documents, beginning from the petition, letters testamentary, notices, inventories, accounts, bond, publication, appraisal and ending with the final distribution order. Attorney fees, court costs and executor commissions, which are primarily controlled by the gross value of the estate can reach anywhere from five (5%) to ten (10%) percent of the value of the property. Probate proceedings are a requirement in each state where the decedent owned property.

By contrast, a living trust is extremely flexible and thereby, once executed and properly funded, it can offer the most benefits for the vast majority of situations. The trust is basically an entity created during the lifetime of the person(s) setting up the trust (trustor/grantor) and usually that person(s) is also the trustee (manager). A trust should be organized to establish the form of ownership (declaration of trust) and maintain various "schedules" to ensure control during lifetime, transferring and titling property to the trust, successor trustee nomination, power, duties and obligations of the trustee and finally, distribution upon death to designated recipients either outright or in a continuing trust or income stream arrangement. Trusts can also be utilized to manage one's property and affairs during periods of disability and incapacity as well. This wide range of options is all done without the need or necessity of court supervision and interference.

In addition to avoiding probate court, trusts have been customized to reduce and often eliminate federal estate taxes, the rates of which range from 37% to 55% on estates in excess of the individual credit of \$2,000,000. The most common example of this type of trust, which is used as a planning tool for husbands and wives, is called a Credit Shelter Trust, also known as an A/B Trust or By-pass Trust. The basic concept here is to double up on the individual exemption of \$2,000,000 and result in being able to give up to 4 million dollars estate tax free to children or other family members.

Married couples set up two trusts, one for each of them, and fund the trust by dividing their assets (severing joint ownership) into the respective trusts. Instead of making a gift directly to the surviving spouse upon death, the gift is made to another trust (Credit Shelter) for the benefit of the spouse which can be used to draw income and principal. Upon such spouse's death however, the value of this trust "by-passes" their estate for tax purposes and is passed tax free to the remaining beneficiaries.

Other estate tax reducing techniques, which can be incorporated into a trust format to avoid the probate complications and pitfalls of a will are charitable remainder trusts, irrevocable life insurance trusts and grantor retained interest trusts. All these programs are more complicated and sophisticated but they share in common the basic principle of estate tax reduction whereby an individual "divests" or gives up control over an asset, irrevocably, which results in exclusion from the estate for tax purposes as well as provide substantial benefits (net) to ultimate recipients of such assets including immediate tax breaks to the grantor. Incidentally, the most simple gift technique during lifetime, without using up any portion of the unified credit is to give away up to a maximum of \$11,000 per person (donee) per year. However, good record keeping is still essential.

The use of trusts also illustrates taking advantage of the income tax laws for the benefit of ultimate recipients of property (real estate, stocks, bonds mutual funds etc.). The law is very clear when it comes to capital gains tax. The objective when someone inherits property is to be able to sell that property at a full "stepped up" basis, at fair market value at the time of the donor's death. Such type of a transaction would yield a zero capital gains tax. The question today is how to get a "full step up" and avoid probate court at the same time? The response is definitely not maintaining ownership as joint tenants, which carries the negative baggage of "carry over" (actual cost) basis and "indivisible halves" for tax computation purposes. The answer is to set up a trust and transfer appreciating property to the trust which, upon death will receive the full "step up" and not be encumbered by the probate process.

When you compare favorable tax treatment of property placed in a trust with the downside of jointly held assets, especially when it comes to control, flexibility and exposure to the other joint holders legal problems (creditors, taxes, divorce, etc.) living trusts, under the complete control of the grantor, are the optimum choice.

ESTATE PLANNING CHECKLIST

In order to achieve your desire goals, you should start your estate planning by completing these simple steps.

- 1. Write down your objectives:
 - Who will receive your property, (spouse, children, grandchildren, etc.)
 - How will they receive it, (cash, real estate, etc.)
 - When do they receive it, (upon death, at a specific age, over a term, etc.)
- 2. List all your assets and determine the value of your gross estate.
 - Subtract liabilities.
- 3. Determine your tax liability.
- 4. Consider the options available to avoid taxes.
 - Lifetime transfers of property:*
 - Annual gifts of \$11,000.00 per donor, (\$22,000.00 with spouse)
 - Taxable lifetime gifts
 - Living Trusts
 - Charitable gifts
 - Transfers at death:*
 - Testamentary Trusts
 - Marital Deduction Trusts
 - Qualified Terminal Interest Property Trusts
 - Generation-skipping Trusts
 - Charitable gifts
 - Foundations
- 5. Recalculate your tax liability.
- 6. Options for remaining tax (if any).
 - Life insurance (if you are insurable)
 - Sinking Fund
 - Advise heirs of potential tax liability
- 7. Provide for access to important documents.
 - Make a list or inventory of:*
 - All assets
 - Location of important documents
 - Names of attorney, accountant, financial advisor

COMPARISON AT A GLANCE

The following comparisons briefly describe the advantages and flexibility
a Living Trust offers:

	<i>With No Will</i>	<i>With A Will</i>	<i>With a Living Trust</i>
<i>Privacy</i>	<i>None:</i> Probate proceedings are public record. Exposes family to unscrupulous solicitors and greedy heirs.	<i>None:</i> Same as with no Will.	<i>Total:</i> Privacy preserved. No probate. Living Trusts are not public record.
<i>Flexibility & Control</i>	<i>None:</i> Your property is controlled and distributed by probate court according to state law. Very easy for anyone to contest.	<i>Limited:</i> You can change your Will any time, but it can easily be contested. Family has no control over probate costs or delays.	<i>Total:</i> You can change your Trust at any time, even revoke it. Your property remains under total control of your trust, even if you are disabled.
<i>At Disability</i>	<i>Probate:</i> Court appoints conservator/guardian who oversees your care. Must keep detailed records and reports to the Court. Court controls all your finances and assets, approves all expenses.	<i>Probate:</i> Same as with no Will.	<i>No Probate:</i> Your Successor Trustee manages your financial affairs according to your instructions for as long as necessary. (In some states, conservator/guardian may be required for health care decisions in the absence of a Power of Attorney)
<i>At Death</i>	<i>Probate:</i> Court orders your debts paid and possessions distributed according to state law, which may not be what you would have wanted.	<i>Probate:</i> After verifying your Will, the court orders your debts paid and possessions distributed according to your Will.	<i>No Probate:</i> Debts are paid and possessions immediately distributed to beneficiaries by successor trustee according to your written instructions.
<i>Court Costs</i>	Your estate pays all court costs and legal fees (often estimated at 5-10% of the gross value of your estate, higher if your will is contested).	Same as with no Will.	<i>None:</i>
<i>Time</i>	The current average is 18 months before heirs can inherit.	Same as with no Will.	<i>No Probate:</i> Usually days or weeks depending upon the size of the estate and the speed of the Successor Trustee.
<i>Minor Children</i>	Probate Court controls inheritance appoints a guardian. All decisions and financial transactions require Court approval. Child receives full inheritance (or balance remaining after fees are paid) at legal age.	Same as with no Will. A Will must be probated first and it offers limited protection for a child's Trust. If you become physically or mentally incapacitated a Will cannot go into effect.	<i>No Probate:</i> Your appointed Trustee manages inheritance and provides funds for expenses until child reaches age(s) you specify. Court approves guardian, but cannot overrule your choice of Trustee and has no control over inheritance.
<i>Cost</i>	All Court costs and attorney fees are paid from child's inheritance.	Same as with no will.	None.