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THE FARRELL LAW GROUP

IS READY TO ASSIST YOU IN CREATING AND IMPLEMENTING YOUR ESTATE PLAN

Almost everyone thinks about putting together an estate plan to properly protect themselves, and their family, or at least getting a will. Unfortunately, too many people (you?) fail to contact their financial advisor and/or attorney in order to actually move the process forward and, finally, to sign the necessary documents to implement the estate plan agreed upon. Putting this process off generally leads to significant, if not huge, and unnecessary problems being encountered by family members later.

Although each person's case is unique, and a one-on-one consultation with your financial advisor and/or attorney, is necessary, the following information, provided to you in an easy to read Q & A format, is intended to provide you with answers to what we have found to be the most frequently asked questions concerning estate planning. I promise you that, by taking just a few minutes now to read this material, and then beginning the planning process by making an appointment with your financial advisor and/or your attorney, you will save time, aggravation and money (possibly a lot) in the future.

1. What is estate planning?

The entire concept of "estate planning" includes the accumulation, preservation, and distribution of your assets. Its primary purpose is to accomplish your personal family goals, to provide for the best management of your estate, and to minimize, or at least to reduce, taxes.

2. What "tools" can be used to implement my estate plan?

There are many "tools" that can be used by your advisor/attorney to implement an appropriate estate plan. The most important is usually your will. Other "tools" include powers of attorney, trusts, gifts, life insurance, and family limited partnerships. Each of these is discussed at greater length below.

3. How is my property transferred if I die without a will?

Dying without a will is called "dying intestate." If you die intestate North Carolina law (or the law of the state in which you reside if other than North Carolina) prescribes who will get the assets of your estate. You therefore give up your right to decide how you want your property distributed. This type of "intestate distribution" required by the law can become very complex and, almost always, results in assets passing in a way that you would not want to have occur. The problems of intestate distribution also increase substantially for estates with higher values. Do not let this happen to you.

4. What is property held in a joint tenancy with right of survivorship?

If property is held in joint tenancy with right of survivorship, by two or more people, when one of the owners dies all of his or her interest in the property is transferred immediately to the surviving owners. Unfortunately, many people believe that joint tenancy with right of survivorship can act as a substitute for a will, or estate plan. That is not true. Although joint tenancy with right of survivorship may be a "short term" way to avoid the need for a will for some assets, it can end up costing you, and your loved ones, many times the expense and headaches you thought you were avoiding.

5. What is a trust?

A trust is really a "receptacle" where assets are placed to be cared for by a named trustee,

which may be either a person, or a company. The management of the assets while held by the trust, and the distribution of the assets while the trust exists, are described in the trust document. *Example:* Compare a trust to an empty soup can without a label having instructions. You pour the contents (the assets) into the can, and you write the instructions and place them on the can. The trustee you name then holds the assets in the can, and pours them out, per your instructions. As discussed further below, trusts represent one of the most significant “tools” for estate planning.

6. How can gift-giving be used as part of an estate plan?

Gift-giving provides you with the opportunity to reduce the value of your estate, and to get your assets, during your lifetime, into the hands of your loved ones. These are two of the major purposes of all estate planning. In each year up to \$11,000 may be given by you to any recipient without incurring any gift tax. You can also join with a spouse to give up to \$22,000 to any recipient in a year without incurring a gift tax. You can also give gifts to as many different recipients as you wish in any year so long as each gift does not exceed the gift tax exemption. Gifts can be used in many different and flexible ways, and can be a very valuable estate planning tool.

7. How large can an estate be without paying federal estate taxes?

The federal government allows every individual a “credit” against estate (and gift) taxes. This is sort of a “bank account” you can use during your life (to apply against gift taxes you may incur), or your estate can use against federal estate taxes after you die. In the year 2004-2005 this “credit” is \$555,800, allowing an estate with a value of up to \$1.5 million to pass free of federal estate taxes. In 2006-2008 the “credit” will increase to \$780,800, allowing an estate of up to \$2 million to pass free of federal estate taxes, and in 2009 the “credit” is increased to \$1,455,800, allowing an estate of up to \$3.5 million to pass free of federal estate taxes. At the present time, in 2010 estate taxes are to be repealed, however, if further legislation is not passed by the Congress, in 2011 federal estate taxes will revert to their prior levels. Therefore, the situation in 2010 and beyond is *extremely uncertain*.

8. What is the “marital deduction,” and how does it work as part of an estate plan?

The Internal Revenue Service (IRS) allows an individual to leave any amount of assets to his or her spouse without federal estate taxes being imposed. *However*, when the surviving spouse dies, all assets in the estate above the amount that may pass tax free (see the answer above) will be included in the *survivor’s taxable estate*. In other words, the assets of both the first and the second to die become “bulked-up” in the estate of the second to die. At the present time (2005), estate taxes on all assets above \$1 million *begin* at a rate of 41%, and increase to 47%.

9. Why can’t I just leave my entire estate to my surviving spouse tax-free?

As discussed above, the amount of your estate that you leave to your surviving spouse passes entirely free of federal estate taxes. However, by doing this the first spouse to die can lose the entire value of the “credit” against the federal estate taxes discussed above. The end result is that, although the surviving spouse takes the entire estate of the first to die tax-free, the estate of both the first spouse to die, as well as the second to die, become “bulked-up” (*i.e.*, added one on top of the other) when the second spouse is deceased, resulting in the overall tax impact potentially being greatly, and unnecessarily, increased.

10. How can the “credit” of both a husband and wife be best used to reduce estate taxes?

If a married couple's estate is more than \$1.5 million (in 2005, and increasing in later years as described above) creating what is known as a "bypass trust" in the will of the first spouse to die may be best, rather than having the deceased spouse simply leave everything to the surviving spouse. By creating the "bypass trust," the "bulking-up" of the estate in the second spouse to die is either avoided or greatly reduced. By properly using the "bypass trust," in 2005 an estate valued at \$3 million at the time of the death of the second spouse to die could pass without the payment of any estate taxes on either spouse's estate, which could result in a net estate tax *savings* of \$555,800. This is done because the "bypass trust" uses the first deceased spouse's \$1.5 million exclusion amount (in 2005), which would not be used if his or her share of the estate were simply left to the surviving spouse. The "bypass trust" is created by taking the amount that is equivalent to the sum that could be passed by the estate of the first spouse to die estate tax-free (\$1.5 million in 2005, and increasing in later years) and placing it into a trust, rather than simply passing it to the surviving spouse. The trust amount therefore "bypasses" the estate of the second to die. The surviving spouse is not simply deprived of the use of this amount placed in trust, however. To the contrary, the surviving spouse may receive all of the income from the trust, as well as amounts that the trustee (who was named by the first spouse to die) believes necessary to provide for the "health, maintenance and support" of the surviving spouse for the remainder of his/her lifetime. When the second spouse dies, the assets remaining in the "bypass trust" are cared for, or distributed, in accordance with what the trust says. By using this "tool" a couple can take full advantage of both of their estate tax "credits," rather than wasting them.

11. How can a power of attorney be used as part of an estate plan?

A power of attorney is a legal document authorizing someone else to act on your behalf when you cannot act for yourself. There are specific forms made up for various types of powers of attorney. One type known as a "durable power of attorney" can provide to another person (generally known as the "agent") wide ranging powers that essentially allow the agent to act in any way that you (known as the "principal") could act. This type of power of attorney is especially valuable if you become incapacitated, or otherwise unable to control your own affairs.

There is also a document generally known as "healthcare power of attorney," sometimes referred to as a "living will." By this document you authorize the designated individual to make healthcare decisions, generally including the right to authorize "pull the plug" procedures on the part of doctors.

Both types of powers of attorney are integral parts of any estate plan.

12. What is a "living trust?"

The "bypass trust" discussed above is a trust created under someone's will, and is also known as a "testamentary trust." In comparison, "living trusts" are trusts that are set up *during your lifetime*. "Living trusts" can fill many purposes, and are often an invaluable estate planning tool. Some of the most important types of "living trusts" are discussed below.

13. What is a "revocable living trust," and how can it be part of an estate plan?

A "revocable" trust is one that you can change, or dissolve, during your lifetime if you wish. In the appropriate circumstances a revocable living trust can be a primary estate planning tool. It includes provisions saying how your property is to be managed while you are alive, and often how it is to be distributed when you die. Despite some "hype" of such trusts, however, they are not necessary or appropriate for everyone. Individual circumstances should be reviewed by a competent professional to determine whether or not a revocable living trust is appropriate for you.

You will still have control over the property you place into the living trust while you are alive, and you will generally act as the trustee, naming a "successor" trustee only if you become

incompetent, or to act after you die. Neither income nor estate taxes are generally changed by implementing a living trust. The trust is “funded” when you transfer your (and possibly your spouses) assets into the trust, to be owned and administered by it. This includes virtually any type of asset, although many people choose to leave their individual checking accounts in their names alone rather than have them held by the trust. In the appropriate circumstances, revocable living trusts can provide significant benefits. These include: passing the assets held by the trust outside of probate proceedings; ensuring the proper management of the assets in the case of the incapacity of those establishing the trust; allowing flexibility to take full advantage of estate tax credits (see above); ensuring the privacy of your financial and personal affairs; and other benefits depending upon the nature of the assets placed into the trust. Finally, not only can the terms of the trust be altered as you wish, and as circumstances may require, but the entire trust itself can be revoked if you wish in the future.

14. How can an “irrevocable life insurance trust” be part of an estate plan?

An “irrevocable trust” is one that cannot be changed or revoked after you set it up. It is often used for life insurance. The proceeds payable under an insurance policy owned by you on the date of your death may be includable in your estate, and can considerably increase your federal estate tax burden. Even if the proceeds are paid to a surviving spouse, and are therefore free from tax under the “marital deduction” discussed above (which allows any assets passing from your estate to a surviving spouse to pass tax free), the proceeds from the life insurance still “bulk-up” in the surviving spouse’s estate, possibly resulting in substantially increased taxes later. By creating an “irrevocable life insurance trust” this problem can be eliminated.

As with any other trust, an irrevocable life insurance trust is a written document. The trust owns the life insurance policy on your life, and receives the necessary funds to allow it pay the premiums as they come due. Upon your death, the life insurance proceeds are collected by the trust, and those proceeds are then managed and distributed in accordance with what the provisions of the trust document require. There are various legal requirements that must be followed when implementing an irrevocable life insurance trust. Your personal financial advisor and/or attorney can ensure that you follow those requirements. By creating an irrevocable life insurance trust substantial estate tax savings can be realized.

15. How can a “charitable remainder trust” be an effective part of a lifetime financial plan, and estate plan?

A charitable remainder trust is a trust that allows a person to make a gift to a charitable organization by transferring property to the trust established by a written document. Often, the asset(s) transferred to the trust have increased considerably in value during the time that the person creating the trust has owned them. However, by transferring the property to the charitable trust, the person creating the trust is able to reduce or avoid the income/capital gain consequences, while taking advantage of the increased value of the gift being made. The person creating the trust then keeps the right to receive an ongoing stream of annual payments for a term chosen by him/her. At the death of the person creating the trust, the remaining assets in the trust go outright to the charity. The creation of a charitable remainder trust can therefore be an extremely valuable tool not only for estate planning, but for lifetime financial planning as well, while fulfilling the charitable desires of the person creating the trust.

16. What is a “family limited partnership,” and how can it be part of an estate plan?

A family limited partnership is a partnership made up of family members. It is generally used to provide effective asset management, tax planning and gifting opportunities. Usually, the parents are the general partners, controlling the partnership and making most or all of the decisions. The limited partners are often the children or grandchildren who receive gifts of

partnership interests. The family limited partnership can be used for many purposes, including to provide protection for limited partners from creditors, and also to reduce the transfer tax value of property.

17. Considering all of these “tools” that are available, what should a “basic” estate plan consist of?

Every person’s estate plan is unique. The plan that is eventually created depends not only on the value of the assets, but the character of the assets, and, most of all, the desires of the people making the plan. Developing a proper plan is not merely a mathematical exercise. While reducing the tax impact on an estate is almost always an important consideration, it is ultimately the desires of those creating the plan that must control. The plan will also depend upon the age(s) of those involved in or impacted by the plan. The first step to take is to provide a completed estate planning questionnaire to the professional(s) assisting you in the creation of your plan. Next, you should fully disclose your desires regarding a conceptual estate plan to those assisting you.

In the case of a married couple, if the value of the total estate is substantially under \$1.5 million (which amount can be passed free of federal estate taxes in 2005, which amount increases to 2009) it is likely that an appropriate estate plan can be implemented using wills for both the husband and wife, naming an initial and alternate guardian if there are minor children, creating a trust into which the estate assets will be placed to be administered for the benefit of any minor children until they reach a specified age if both parents die, and naming an initial and alternate executor. The plan should also consist of a durable power of attorney, and a health care power of attorney. Finally, if there are substantial amounts of life insurance that could impact upon the taxability of the estate, an irrevocable life insurance trust should be considered.

In the case of estates that are greater than the amount that can pass each year without incurring a federal estate tax, the estate plan should consider the use of a revocable living trust in conjunction with a “pour-over will” (a will that “pours-over” assets to a trust set up earlier), as well as the same powers of attorney, and an irrevocable life insurance trust, if appropriate. In substantial estates, the use of gift-giving, charitable remainder trusts, and family limited partnerships may also be appropriate.

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We hope this information helps you. It is important to understand that you need the assistance of professionals who are knowledgeable in the field of estate planning in order to make the decisions that are necessary to create an estate plan that is appropriate to your needs, and to your desires, and to implement the plan agreed upon by the use of the proper documents. If we can be of further assistance to you, please contact us by phone or e-mail at your convenience to schedule a conference.

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