

THE IMPORTANCE OF A PROPERLY PREPARED ESTATE PLAN

Approximately one-half of all people in Louisiana either have no will or their will is outdated due to changes in their family dynamics or the law. Most people spend countless hours when they buy a television but few people spend even a few hours preparing for how they want their property to pass upon their death. This occurs because many do not want to face the issue or they simply procrastinate and the consequences of not addressing this can be severe.

We have all heard the horror stories involving contested inheritances and the sad part is that many disputes can be avoided through proper planning. Spending a few hours of time planning for an event that will happen to all of us can save your loved ones a substantial amount of time and money.

Each estate plan is different depending on the objectives of the persons involved. It is imperative that you consult with a specialist in this area to make sure that consideration is given to every area of your plan. You would not contact a podiatrist if you were having a heart attack and, considering the importance of this issue, you should make sure that your attorney is an expert in all aspects of estate planning. Below is a summary of some of the basic federal and Louisiana estate planning issues and other items that should be considered in a properly prepared estate plan.

I. WILL PREPARATION

If you do not have a will, one should be prepared. If you have a will in place, make sure that it complies with your objectives and with the current law. Important items that you need to consider include:

- a) “Forced Heirship” - The 1995 changes to forced heirship law did not abolish forced heirship. Rather, it restricted the classification of forced heirs to persons 23 years of age or younger and persons of any age if mentally or physically incapacitated. Without a will, your children will be entitled to your community property subject to your surviving spouse’s legal usufruct. This creates numerous problems for clients with blended families and for those with outdated wills.

- b) Independent Administration - In 2001, Louisiana adopted the very useful concept of “Independent Administration.” This can be used if stipulated in your will or if agreed to by all your heirs or legatees. If obtained, the Executor or Administrator does not have to seek prior court approval to dispose of assets. This is a particularly efficient and helpful development in the probate law and should be employed in most circumstances.

- c) Specific Bequests - Absent a will, all community property devolves to your direct descendants subject to your spouse's usufruct. If you have a family heirloom that you want a particular person to receive, it can be specified in your will. This is also applicable to a family business that you want to pass to a particular child who has worked for the company rather than having all of your children inherit it equally.
- d) Guardianship or Tutor Provisions - If you have a minor child, you may stipulate in your will the person or persons that will have legal authority to raise your minor children.
- e) Trust Provisions – A testamentary trust will allow your property to devolve over time to your heirs as well as protect the assets from seizure by creditors in many circumstances. This is important if your heirs are spendthrifts or if you simply want to ensure that they will have sufficient assets later in life rather than having your assets wasted in their youth.
- f) Estate Administration - Your will can provide for the persons you name to execute the administration of your estate and succession. Absent a will, the courts would decide who your representative will be and this can be very contentious.
- g) Multiple Marriages - Many problems can result when one or both spouses have children from prior unions. With a properly prepared estate plan, you can address these problems.
- h) Transfer Out-of-State Real Estate – If a client dies owning real estate located in another state, a separate ancillary probate procedure will be required to transfer title of such real estate. If, instead, the real estate is transferred into an L.L.C., an ancillary proceeding can be avoided. The L.L.C. will also provide additional asset protection for your family.
- i) Tax Planning - If your estate is valued at over \$3,500,000, it is critical that you implement estate tax planning strategies. Many people do not think they have this much in assets, but the death benefit of life insurance alone can exceed this amount and will be included in your estate absent proper tax planning.

At this point, it makes sense to give you a brief overview of some of the tax issues involved in this planning.

II. Federal and Estate Taxes

1. Federal and State Gift Tax.

- a. IRC §2501 imposes a tax for each calendar year on the transfer of property by gift.

- b. The value of the assets as of the date of the gift is the value used for the gift, rather than the value as of your date of death, subject to special valuation rules under Sections 2701 et seq. IRC§2512(a).
- c. Donative intent is irrelevant.
- d. A transfer is complete for gift tax purposes when the donor has parted with dominion and control so as to leave them with no power over its disposition. Treas. Reg. §25.2511-2.
- e. There is an annual exclusion for all gifts of a present interest in property, up to \$13,000 in value per donor, per donee, per year. For years after 1988, this amount is indexed for inflation in increments of \$1,000. Further, each person is allowed to gift \$1,000,000 of their \$3,500,000 exemption amount while they are alive without paying gift taxes.
- f. Gift tax returns are due on April 15 for any gifts exceeding the annual exclusion, made during the prior year.
- g. Even if gift tax returns are not required to be filed, it is often advisable to file the return in order to fix the value being reported for donated property.
- h. Louisiana no longer imposes a gift or inheritance tax.

2. Federal Estate Tax.

- a. IRC §2001 imposes a tax on the transfer of the taxable estate of every decedent who is a U.S. citizen or resident.
- b. IRC §2002 imposes liability for the tax upon the executor of the estate.
- c. The property included in the gross estate is the value of all property, real or personal, tangible or intangible, wherever situated to the extent of the decedent's interest therein as of his or her date of death.
- d. The State of Louisiana has eliminated its inheritance tax for deaths occurring after July 1, 2004.

- f. The Internal Revenue Code has provided rules for the possible deferral of the federal estate tax in the circumstance of married persons. This deferral is termed the “federal estate tax marital deduction.” The federal estate tax marital deduction can be used in the following circumstances:
 - 1) An outright bequest of full ownership to a surviving spouse or receipt of assets in full ownership by way of a beneficiary designation form;
 - 2) A stipulation in the will granting a lifetime usufruct over your assets;
or
 - 3) Designating the spouse to receive annually all of the income of property to be held in a specially designed marital trust.
- g. **Without a will, you will not be eligible for the unlimited marital deduction because the surviving spouse’s legal usufructuary interest will not qualify.**

III. OTHER IMPORTANT INITIAL ESTATE PLANNING DOCUMENTS

- a) Living Will - A living will is required if you do not want to have your life unnecessarily prolonged by artificial means. If you have a living will already, make sure that none of your heirs are witnesses as this will invalidate the document and could lead to costly medical bills and needless delays.
- b) Powers Of Attorney - You can designate persons to act in your place to make health care and financial decisions in the event of your disability
- c) Living Trust - This type of trust involves the transfer of your assets during your life into a revocable trust and is, in effect, a will substitute. For Louisiana residents, these often do not provide any real benefits other than privacy.

IV. ADVANCED ESTATE PLANNING VEHICLES – THE NEXT STEP

Once you have laid the proper foundation of an estate plan by reviewing and executing your wills, living wills and powers of attorney, some families still face a federal estate tax that will be applied when both spouses have passed away. Many clients will, once again, delay the implementation of advanced strategies due to lack of time or the belief that they do not have to worry about it until one spouse dies. This can be a dangerous plan in that if both spouses die in a common accident, within a short period of each other, or if the surviving spouse is not able to plan due to incapacity, a severe estate tax can be imposed at the surviving spouse’s death.

For those who wish to currently plan for the estate tax, several vehicles are often used,

depending on the client's objectives. Below is a summary of some options available to you if your estate is, or may be, subject to the federal tax.

- a) Do Nothing. While this is certainly the easiest approach, it is also the least thoughtful. You have worked your entire life trying to build your net worth so that your family could enjoy the freedom that financial security brings. Despite this, many people will act like an ostrich and stick their heads in the sand hoping the problem will go away. You have the ability to plan so that your heirs receive more of your assets and reduce the amount taken by the IRS. It is incumbent upon you to take the time to plan so that one-half of what you have worked so hard for does not get taken from your family.
- b) Annual Gifting. Each person is allowed to give \$13,000.00 per calendar year to as many people as they wish. For example, if a husband and wife have three children, they can give up to \$78,000.00 per year free of Federal and State gift tax and thereby save their children \$35,000.00 in estate tax immediately as well as the 45% estate tax on the growth of that \$78,000.00 that has been removed from their estate.
- c) Irrevocable Life Insurance Trusts The most important tax factor in estate planning with life insurance is whether or not policy proceeds are subject to estate taxation. Internal Revenue Code Section 2042 provides that the death benefit of life insurance proceeds will be included in an insured's estate if they die while holding "incidents of ownership" in a policy on their life.

"Incidents of ownership" include the power to change beneficiaries, surrender or revoke the policy, assign the policy, revoke an assignment, pledge the policy for a loan, or obtain from the insurer a loan against the surrender value of the policy. Possession of a single incident of ownership will cause inclusion in the estate.

Further, if the decedent gifts a policy within three years of death, or if the proceeds are payable to the benefit of their estate, the policy proceeds will be included in their estate as well.

Sometimes insurance is unavailable due to age limitations or the client's health.

Solutions to problems posed:

1. To avoid inclusion of life insurance proceeds, care should be taken so that the insured does not own the policy and the beneficiary is not the policy owner's estate.
2. To avoid the three year look back rule, the trust can apply for a new policy, it can purchase an existing policy (subject to the transfer for value rules) or the insured may purchase a term policy that would cover

the estate tax attributable to inclusion of the policy in the owner's estate for the three year period.

Annual gifting

1. Each person can donate \$13,000.00 per calendar year per donee. If gifts are being made to fund a life insurance trust, care must be taken to insure that the requirements under the *Crummey* case are met.
2. Without *Crummey* provisions, gifts in trust will not qualify for the annual exclusion since they are gifts of a future interest.

Benefits of Irrevocable Life insurance Trusts (ILIT's)

1. If properly structured, an ILIT removes insurance proceeds from the insured owner's gross estate and from their spouse's estate as well even though the spouse of the insured can serve as Trustee, receive all income from the trust and can be given limited rights to the principal of the trust.
2. Trusts offer tremendous flexibility in distributing property at times the insured deems proper and in an asset protected manner.
3. Trusts can also be a safeguard against unexpected catastrophic illnesses in the grantor's family.
4. Professional management and investment of the proceeds can be achieved through appointing a corporate trustee. Trusts must be irrevocable to avoid estate tax.
5. Typically transfers to an insurance trust do not qualify for the annual exclusion since they are considered to be future interests. To qualify a transfer as a present interest, *Crummey* withdrawal rights must be given. This right is generally given to the beneficiary of a trust and allows the beneficiary to withdraw contributions made to the trust in an amount up to the annual exclusion. If this is properly done, the grantor will get the benefit of the annual exclusion for the transfers they make to the trust annually.

Valuation

A transfer by gift of a life insurance policy is subject to gift tax. The value of the gift is the replacement cost of the policy at the time the gift is made, *not* the cash surrender value of the policy. If the insurance contract has been in effect for some time, valuation may not be ascertainable. In such cases, the value may be approximated through the use of the interpolated terminal reserve value.

- d) Family Limited Partnership or L.L.C. This is a vehicle used for transferring assets while still maintaining some degree of control. Additionally, a family can leverage its gifts by as much as 50%. This vehicle allows the parent's to retain voting power over the company while gifting limited ownership interests in the company to the children. However, great care must be exercised in both the creation and ongoing operations of such entities. For a more detailed discussion, see Family Limited Partnerships.
- e) Charitable Remainder Trust. This vehicle can reduce your estate taxes, eliminate capital gains taxes, provide a guaranteed income stream for life, yield a substantial income tax deduction and provide your favorite charities with a substantial donation at your death. With this plan, you transfer assets into the CRT and receive an income stream of between 5% and 50%, the assets can be sold without incurring capital gains taxes, you will get a charitable income tax deduction that can offset your income for up to five years, and at death your favorite charities will receive the assets from the trust. For a more detailed discussion, see Charitable Planning Strategies.
- f) Other Vehicles. Other common vehicles include:
- Qualified Personal Residence Trusts which are designed to pass your home to your heirs in a tax advantaged manner.
 - Self Cancelling Installment Notes and Private Annuities which involve a sale of assets to your heirs in exchange for an annuity or note that cancels at death.
 - GRATS which are used to transfer assets to the children over a period of time so that appreciation of those assets in excess of the IRS 7520 rate can pass to your children transfer tax free.
 - Charitable Lead Trusts which allow your charities to use your assets for a set amount of time and thereafter the assets devolve to your heirs after having yielded a charitable estate tax deduction.