HERMENZE & MARCANTONIO LLC
ESTATE PLANNING PRIMER FOR UNMARRIED COUPLES - 2016

(Connecticut)

I. Purposes of Estate Planning.

A. Providing for the distribution and management of your assets after your death.

B. Maximizing your beneficiaries' inheritance by minimizing taxes and administration expenses.

C. Protecting assets left to family members and other beneficiaries from certain claims by third parties (such as spouses and creditors).

D. Minimizing, to the extent advisable, probate court supervision over the settlement of your estate and the administration of trusts you create after death.

E. Providing for the management of your financial and personal affairs should you become incapacitated.

II. How Property is Titled and How it Passes at Death.

A. Property held jointly with right of survivorship.

1. At death of first owner, deceased owner's interest in the property passes automatically by operation of law to the surviving owner.
2. Deceased owner's interest passes to surviving owner outside of probate.
3. Deceased owner's interest is subject to estate taxes at his or her death. For estate tax purposes, the value of the entire property is included in the deceased owner's taxable estate, unless the surviving owner can prove he or she furnished consideration for the property.

B. Property held jointly as tenants in common.

1. At death of first owner, deceased owner's interest in the property passes according to the terms of his or her Will, or if there is no Will, pursuant to the state law of intestacy. Thus, without proper planning, the deceased

Hermenze & Marcantonio LLC • Attorneys at Law • 19 Ludlow Road • Suite 101 • Westport, Connecticut 06880
David R. Hermenze • Edward Marcantonio • James D. Funnell, Jr.
Tel: (203) 226-6552 • Fax: (203) 226-6035 • www.hmtrust.com

owner's interest can potentially pass to someone other than the surviving owner.

2. Deceased owner's interest is subject to probate.

3. Deceased owner's interest is subject to estate taxes at the deceased owner's death.

C. Property passing by beneficiary designation.

1. Examples: Life insurance, IRAs, retirement plans, annuities, "in trust for" (ITF) accounts, and "transfer on death" (TOD) accounts.

2. Property passes outside of probate to person(s) named as beneficiary. If no beneficiary is named, property usually passes as part of the deceased owner's estate. This subjects the property to probate. Some types of property (i.e. IRAs, qualified retirement plans, life insurance) would thereby lose its protection from creditors.

3. Property is subject to estate taxes. (Life insurance proceeds pass free of income tax, but are subject to estate tax unless planning is done.)

D. Property titled in your own name.

1. Includes most types of property not covered by A, B, and C above.

2. Subject to estate taxes.

3. Property titled in your own name passes at death according to the terms of your Will.

4. If you have no Will, property titled in your own name passes pursuant to state law of intestacy.

5. Disadvantages of intestacy:

a. Inability to choose the beneficiaries of your estate and the share of your estate they will receive. Instead, this would be determined by Connecticut law. Example: In Connecticut, if you die without a Will leaving a domestic partner, but you are not legally married, your probate assets will be distributed outright to your children, equally, with the share of any deceased child passing equally to that child's children, if any. If you have no living children, your probate assets would pass to your parents, or if they are deceased, to your siblings. Your domestic partner would receive nothing!

b. Complicates and delays estate administration process and increases settlement costs.

c. Prevents you from selecting your own Executors, Trustees, and Guardians. Instead, state law and the probate court would select these important fiduciaries. If you die without a Will leaving a domestic partner, your blood relatives would have priority over your domestic partner with respect to being appointed as Administrator (Executor) of your estate.

d. Prevents you from making special provisions to address unique family circumstances, e.g. you would not be able to establish trusts for disabled or minor beneficiaries.

MORAL: KNOW HOW YOUR ASSETS ARE TITLED, SO YOU KNOW HOW THEY PASS AT YOUR DEATH, IN ORDER TO AVOID SURPRISES. FOR EXAMPLE, IF YOUR WILL GIVES YOUR ENTIRE ESTATE TO X, BUT YOU OWN ALL OF YOUR ASSETS WITH Y AS JOINT TENANTS WITH RIGHT OF SURVIVORSHIP, X WILL RECEIVE NOTHING!

III. An Effective Way to Set Up Your Estate Plan is to Utilize a Revocable Living Trust and Pourover Will.

A. A Revocable Living Trust is a trust established by you during your lifetime.

B. You may retitle your assets (with some exceptions, such as retirement plans and IRAs) in the name of your Revocable Living Trust while you are alive.

C. The terms of your Revocable Living Trust dictate how the property held in your trust will be managed and distributed to you and to others (such as your domestic partner) during your lifetime.

1. While you are living and competent, you can be your own Trustee, and have full access to and control over the property held in your trust. You can amend or revoke your trust at any time. Generally, no separate income tax return needs to be filed for the trust prior to your death.

2. If you become incapacitated, your successor Trustee (i.e., a domestic partner, other family member, trusted friend, or professional) can manage the trust assets for you, and make distributions to you and others, as needed for your health and support. This could avoid the need for a probate court appointed Conservator to manage your affairs (who could possibly be someone not of your own choosing).

D. A Revocable Living Trust also acts as a "Will substitute" after you die, and directs the distribution of your property to your beneficiaries without mandatory probate court supervision.

1. This can simplify and shorten the administration of your estate and reduce estate settlement costs. However, Revocable Living Trusts do not reduce probate court fees or estate taxes.

2. Unlike a Will, which can be examined by the public at the probate court, a Revocable Living Trust is a private document.

3. If you set up continuing trusts for your beneficiaries under a Revocable Living Trust, such trusts will not be subject to mandatory probate court supervision every 3 to 5 years as they could be if they were established under a Will.

4. If you own real estate in more than one state, a Revocable Living Trust can enable your estate to avoid the expense and delay of an additional probate proceeding in that state.

5. It is necessary also to have a "pourover" Will, which would add any assets you fail to title in the name of your Revocable Living Trust during your lifetime to your Revocable Living Trust at your death.

E. Revocable Living Trusts are ideal for detail oriented people who seek as much family control as possible.

IV. **<u>Planning for the Distribution of Your Assets After Your Death</u>.**

A. <u>Considerations when leaving property to a surviving domestic partner</u>.

1. If you have a domestic partner, you can leave all or a portion of your estate to that individual, either outright or in trust. Although an outright distribution is simple and quick, trusts offer many advantages.

2. A trust is appropriate in the following circumstances:

a. <u>You wish to designate the individuals or charities who will receive the remainder of your estate after your domestic partner's death</u>. If you leave an outright inheritance to your domestic partner, he or she can select the beneficiaries to receive your assets remaining after his or her death, but if you leave the inheritance in trust for your domestic partner, the remaining assets pass according to your wishes.

b. Your domestic partner requires assistance with the management of the estate due to disability, lack of sophistication in financial matters, or an inability to manage money.

c. <u>You want the assets you leave to your domestic partner to avoid estate taxation at his or her later death</u>. An outright inheritance to your domestic partner would be subject to estate tax again at your domestic partner's death, but an inheritance held in a properly drafted trust can avoid estate taxation at that time.

d. You wish to protect your domestic partner's inheritance from creditors.

e. Your domestic partner is receiving means-based government benefits (i.e. SSI or Medicaid) which could be discontinued as a result of an outright inheritance.

3. A trust can be drafted to provide for the distribution of income (i.e., interest, dividends, and rents) and principal to your domestic partner, to maintain his or her accustomed lifestyle, and to provide for health, education, and other needs.

B. Considerations when leaving property to other beneficiaries.

1. If you have children, you can leave all or a portion of your estate to your "descendants, per stirpes". This means that your property would be divided equally among your living children, with the share of any deceased child passing equally to that child's children, if any.

2. Trusts, as opposed to outright inheritances, are essential for minor, disabled, or unsophisticated beneficiaries. Trusts provide management assistance, and protect a beneficiary's inheritance from creditors or from a beneficiary's spouse in the event of the beneficiary's divorce or death. A trust can last for a beneficiary's lifetime or can terminate at various ages chosen by you.

3. Provide for an appropriate distribution of your tangible personal property (i.e. personal effects like artwork and furnishings).

V. Selection of Fiduciaries.

A. Executor - Administers your estate.

1. Collects and protects estate assets; pays your final debts, taxes and expenses; and distributes probate property pursuant to the terms of your Will.

2. <u>Personally liable</u> for proper administration of estate.

3. Appointment terminates when estate is distributed.

4. If you use a Revocable Living Trust as part of your estate plan, your Trustee will perform the functions of an Executor.

B. <u>Trustee</u> - Administers continuing trusts for your beneficiaries.

1. Holds and invests trust assets; pays taxes and expenses; and distributes income and principal to beneficiaries pursuant to terms of trust.

2. <u>Considerable discretion</u> in areas of investment and distribution of trust funds.

3. <u>Personally liable</u> for proper administration of trust.

4. Appointment ends when trust terminates, so appointment can last for many years. It may be therefore advisable to name backups.

C. <u>Who can serve</u>? Either an individual (such as a domestic partner, other family member, or trusted friend) or professional fiduciary (such as a bank, trust company, accountant, or attorney) can serve as an Executor and Trustee depending upon family, investment, and tax considerations.

D. <u>Guardian</u> - Protects your minor children.

1. Makes personal decisions on behalf of minor child.

2. Appointment terminates when child attains majority (age 18 in Connecticut).

3. Essentially acts as "surrogate parent" to child.

4. Person or couple should be capable of and willing to raise your child.

VI. <u>Federal Estate and Gift Tax Overview</u>.

A. Federal estate and gift tax rate is 40%.

B. <u>Unlike married couples, there is no unlimited marital deduction for transfers made between unmarried domestic partners during life or at death</u>. Thus, during your lifetime, you cannot make unlimited lifetime gifts to your domestic partner free of gift tax. In addition, at your death, you cannot defer the payment of estate taxes on property passing at your death until your domestic partner's later death. Instead, taxes would be due within nine months of your death.

C. The federal estate and gift tax exemption is $5,450,000 (indexed periodically for inflation). You can give away a total of $5,450,000 during life or at death, or during life and at death, combined, free of any federal gift or estate tax. Through a concept called portability, a surviving spouse in a legal marriage whose spouse died on or after January 1, 2011 may be able to utilize the unused portion of the deceased spouse's federal estate and gift tax exemption. This privilege does not apply to unmarried domestic couples.

D. $14,000 annual gift tax exclusion--does not reduce your estate and gift tax exemption.

   1. You can make gifts of $14,000 per year to as many people as you wish, free of federal estate and gift tax, without using up any of your estate and gift tax exemption.

   2. $14,000 exclusion is increased periodically according to an inflation index.

E. Tuition payments made directly to schools and medical payments made directly to providers are also gift tax free -- do not use up your estate and gift tax exemption, and do not count toward your $14,000 annual exclusion amount.

F. Qualified transfers to charities are gift and estate tax free.

G. The law provides heirs with an unlimited basis step-up on appreciated assets equal to their fair market value at the date of death. This basis step-up eliminates the built-in capital gain on appreciated assets which are inherited.

VII. Connecticut Estate and Gift Tax Overview.

A. Connecticut estate and gift tax rates range from 7.2% to 12%, with the 12% bracket being reached on estates of over $10,100,000.

B. Unlike married couples, there is no unlimited marital deduction for transfers made between unmarried domestic partners during life or at death. Thus, during your lifetime, you cannot make unlimited lifetime gifts to your domestic partner free of gift tax. In addition, at your death, you cannot defer the payment of estate taxes on property passing at your death until your domestic partner's later death. Instead, taxes would be due within six months of your death.

C. There is a $2,000,000 exemption from the Connecticut estate and gift tax. There is no portability of this exemption between spouses.

D. Annual exclusion gifts, qualified tuition and medical payments, and qualified transfers to charity are not subject to Connecticut estate and gift tax.

MORAL: BE FAMILIAR WITH THE APPLICABLE TAX STRUCTURES, AND PLAN TO USE THE AVAILABLE EXEMPTIONS.

VIII. Basic Planning for Estate Taxes

A. Estate taxes are due six (with respect to Connecticut) or nine (with respect to federal) months after your death. Consider the use of life insurance to provide your domestic partner (or other beneficiaries) with immediate liquidity to pay estate taxes and other settlement costs after your death.

B. To prevent life insurance proceeds from being included as part of your taxable estate, you should not own your life insurance. Consider gifting your life insurance to an irrevocable Life Insurance Trust.

1. Life insurance can have little current value. Its value for gift tax purposes is essentially current cash value (which would be zero for term insurance), plus cost of annual premiums.
2. An effective lifetime gift of an insurance policy to a Life Insurance Trust removes from your taxable estate the much greater face value of the policy at your death.

3. Insurance proceeds would be payable to the Life Insurance Trust at your death (rather than directly to your beneficiaries).

4. The beneficiaries of your Life Insurance Trust (your domestic partner or other individuals) will have access to income and principal to provide for health, education, and support.

5. If you gift an existing insurance policy to a Life Insurance Trust, you must live for three years after the gift to exclude the insurance proceeds from your estate.

6. A new insurance policy purchased by the Life Insurance Trust itself is not subject to the three year waiting period.

C. Consider lifetime gifting where it makes sense.

1. Although federal estate and gift tax rates are the same, making lifetime gifts can be more tax efficient than holding property until death.

   a. $14,000 annual exclusion and medical and education exclusions are available only for gifts, not at-death transfers.

   b. All future income earned on gifted property is removed from your eventual taxable estate.

   c. All future appreciation of gifted property occurs outside of your eventual taxable estate.

2. See our "Advanced Estate Planning Techniques" primer for examples of lifetime gifting.

IX. A Few Points on Retirement Benefits

A. A domestic partner generally does not have the ability to select a "joint and survivor annuity" option under a pension plan, which would give a surviving domestic partner the ability to receive pension benefits after the deceased domestic partner's death. Life insurance can fill this gap.

B. Unlike a surviving spouse in a legal marriage, a surviving domestic partner cannot roll his or her deceased domestic partner's IRA or qualified retirement plan assets over to an IRA in the surviving domestic partner's own name. This means that the surviving domestic partner must begin taking required minimum distributions from the deceased domestic partner's IRA or qualified retirement plan roughly one year after the deceased domestic partner's death, rather than deferring the required minimum distributions until the surviving domestic partner turns age 70 ½ (which would be the case with legally married spouses). This accelerates the income taxation of the benefits.

C. Although a married employee cannot name anyone other than a spouse as the beneficiary of a qualified retirement plan without the spouse's written consent, there is no similar protection for a surviving domestic partner. Thus, one domestic partner can inadvertently (or intentionally!) name a beneficiary other than the surviving domestic partner without the surviving domestic partner's knowledge or consent.

X. <u>Planning for Incapacity -- Planning for the Management of Your Assets and Your Person if You Are Living but Incapacitated.</u>

A. <u>Durable Power of Attorney.</u>

1. Gives another person you designate (your "attorney-in-fact") the power to execute financial and business transactions on your behalf.
2. Purpose: To avoid the necessity of a probate court-appointed "conservator" to manage your affairs in the event you become incapacitated.
3. Virtues: Easy, inexpensive, largely effective.
4. Cautions: Can be <u>immediately</u> effective (you must completely trust your attorney-in-fact!); may not always be accepted by third parties; lack of specific directions to attorney-in-fact.

B. Revocable Living Trust. As discussed above, if you become incapacitated, your successor Trustee under your Revocable Living Trust can manage your trust assets for you, and make distributions to you and others, as needed for health and support. This could avoid the need for a probate court appointed "conservator".

C. Appointment of Health Care Representative.

1. Gives another person you designate (your "health care representative") the power to make health care decisions on your behalf, including the removal of life support.
2. Authorizes your health care representative to have access to your medical records under the federal privacy law (HIPAA).
3. Without this document, a health care provider may decide not to share your medical information with your domestic partner, or accept medical instructions from your domestic partner.

D. Living Will. Easy and generally effective way of communicating the wish that your life not be unduly prolonged by artificial means (i.e. artificial nutrition and hydration, artificial respiration, and cardiopulmonary resuscitation) if you are permanently unconscious or in the final stages of a terminal illness, and you are unable to make your own health care decisions.

E. Advance Designation of Conservator. Allows you to designate in advance the individual(s) you would like the probate court to appoint as conservator of your person to make personal decisions on your behalf, and as conservator of your estate to make financial decisions on your behalf, should it ever become necessary in the future.

XI. Custody of Remains.

If you want your domestic partner to have custody over your remains after your death and to direct their disposition, you should execute a statutory document to that effect. Otherwise, under Connecticut law, unless you are legally married, at the first domestic partner’s death, the deceased domestic partner’s blood relatives would have priority over the surviving domestic partner to receive custody of the first domestic partner’s remains and to direct their disposition.

MORAL: YOUR ESTATE PLANNING SHOULD INCLUDE CONSIDERATION OF HOW YOU WILL PLAN FOR INCAPACITY AND CUSTODY OF YOUR REMAINS.

This outline deliberately over-simplifies technical aspects of tax, property, probate and trust laws in the interest of clear communication. Examples are in some cases based upon unstated assumptions. Under no circumstances should you or your advisor rely on the contents of this outline for technical advice, nor should you reach any decisions with respect to planning without consulting a qualified advisor.

DATED JANUARY 1, 2016

CHANGES TO THE LAW OCCURRING AFTER THIS DATE MAY BE IMPORTANT AND MAY AFFECT THE ACCURACY OF INFORMATION PRESENTED!

Hermenze & Marcantonio LLC • Attorneys at Law • 19 Ludlow Road • Suite 101 • Westport, Connecticut 06880
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