HERMENZE & MARCANTONIO LLC
ESTATE PLANNING PRIMER FOR
SINGLE, DIVORCED, AND WIDOWED PEOPLE - 2016

(New York)

I. Purposes of Estate Planning.

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

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

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

D. Minimizing, to the extent advisable, surrogate's court supervision over the settlement of your estate.

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 or as tenants by the entirety.

1. Passes automatically by operation of law to surviving joint tenant(s).
2. Passes outside of probate.
3. Subject to estate taxes.

B. 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. Passes outside of probate to person(s) named as beneficiary.
3. Subject to estate taxes.

C. Property titled in your own name.

1. Includes most types of property not covered by A and B above.
2. Passes at death according to the terms of your Will.
3. Subject to estate taxes.

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

5. <u>Disadvantages of intestacy</u>:

    a. Prevents you from choosing the beneficiaries of your estate and the amount of property they will receive. Instead, this would be determined by New York law. <u>Example</u>: In New York, if you die without a Will and with no surviving spouse, 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 will pass to your parents, or if they are deceased, to your siblings.

    b. Complicates estate administration and increases costs.

    c. Prevents you from selecting your own Executors, Trustees, and Guardians.

    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.

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

A. People with children but no spouse often leave their estates to their "descendants, per stirpes." This means that their property will be divided equally among their living children, with the share of any deceased child passing equally to that child's children, if any. Some people leave all or a portion of their estates to other family members, friends, or to charities.

B. Your beneficiaries may receive their inheritances either outright or in trust.

C. Trusts can be drafted to provide for distributions of income (i.e. interest, dividends, rents) and principal to the beneficiaries, as needed for their health, support, and education. The trusts can also provide for distributions to guardians of minor beneficiaries to help defray their expenses.

D. Trusts can last for the beneficiaries' lifetimes or can terminate at various ages to be determined by you.

E. Trusts are appropriate for minor and disabled beneficiaries, and for other beneficiaries who require assistance with the management of their inheritances.

F. Properly drafted Lifetime Trusts can better protect a beneficiary's inheritance from certain claims by spouses and other third parties (such as creditors).

G. A Supplemental Needs Trust for a beneficiary with a disability can preserve that beneficiary's eligibility for means-based government entitlement programs (such as Title XIX and SSI), and can be used to supplement such benefits. See our outline on this topic: A Financial Safety-Net for your Child with a Disability.

IV. Selection of Fiduciaries.

A. Executor - Administers estate.

1. Collects and protects estate assets; pays debts, taxes and expenses; and distributes probate property pursuant to terms of Will.
2. Personally liable for proper administration of estate.
3. Appointment terminates when estate is distributed.
4. When the bulk of a deceased person's assets are held in a Revocable Living Trust (see section XI below) and no Executor is appointed, the Trustee of the Revocable Living Trust performs these functions.

B. Trustee - Administers continuing trusts.

1. Holds and invest trust assets; pays taxes and expenses; and distributes income and principal to beneficiaries pursuant to terms of trust.
2. Considerable discretion in areas of investment and distribution of trust funds.
3. Personally liable for proper administration of trust.
4. Appointment ends when trust terminates, so appointment can last for many years.

C. Who can serve? Either individuals (such as family members or trusted friends) or professional fiduciaries (such as banks, trust companies, accountants, and attorneys) can serve as Executors and Trustees depending upon family, investment, and tax considerations.

D. Guardian - Protects minor children.

1. Makes personal decisions on behalf of minor child.
2. Appointment terminates when child attains majority.
3. Essentially acts as "surrogate parent" to child.
4. Person or couple should be capable of and willing to raise your child.

V. **Federal Estate and Gift Tax Overview**.

A. Federal estate and gift tax rate.

1. Federal estate and gift tax rate is 40%.
2. Rate applies to lifetime and at-death transfers in excess of your exemption amount ($5,450,000 in 2016).

B. Unlimited marital deduction.

1. Transfers between spouses are free of federal estate and gift tax.
2. Example: A spouse with an estate of $100 million can leave entire estate to a surviving spouse, and there will be no federal estate tax due.
3. Not an exemption, but rather a deferral for transfers between spouses–U.S. will collect its tax at the survivor's death when property passes down to the next generation.

C. Federal estate and gift tax exemption.

1. Each person has a federal estate and gift tax exemption of $5,450,000 in 2016.
2. Exemption amount is indexed for inflation. Amount was $5,430,000 in 2015.
3. The exemption amount is a combined exemption for both federal gift and estate tax purposes, meaning that 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 estate and gift tax. The 40% rate applies to non-marital transfers in excess of your exemption amount.

D. Exemption "portability".

1. Beginning 1/1/11, estate tax law provides for "portability" of a deceased spouse's exemption by a surviving spouse.

2. If election is made by the deceased spouse's Executor on a timely filed federal estate tax return, the surviving spouse may keep ("port") the otherwise unused gift and estate tax exemption of the deceased spouse for the surviving spouse's own future use, in addition to the survivor's own exemption amount.

3. For example, if a spouse dies in 2016 leaving his or her estate to a surviving spouse, without otherwise using his or her federal estate and gift tax exemption, if portability election is properly made, the survivor will have an exemption after the first spouse's death of $10,900,000, consisting of the survivor's own $5,450,000 exemption plus the deceased spouse's unused $5,450,000 exemption "ported" by the survivor.

4. Ported exemption of first spouse to die is lost by surviving spouse if surviving spouse remarries and then is predeceased by his or her new spouse. This cancels out the ported exemption of the first deceased spouse, and replaces it with the unused exemption of the second deceased spouse (which may have been used up by that spouse).

E. Annual and "med-ed" gift exclusions–do not reduce your estate and gift tax exemption.

1. You can make "annual exclusion" 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 annual exclusion is increased periodically for inflation.

3. Medical payments on behalf of others made directly to providers do not use up any of your estate and gift tax exemption, and do not count toward your $14,000 annual exclusion amounts.

4. Tuition payments on behalf of others made directly to schools do not use up any of your estate and gift tax exemption, and do not count toward your $14,000 annual exclusion amounts.

F. <u>Charitable deduction</u>.

Transfers to qualified charities are gift and estate tax free.

G. <u>Capital gains tax</u>.

1. Capital gains tax on most assets subject to estate tax are eliminated at death. Beneficiaries receive an unlimited cost basis "step-up" on appreciated assets equal to their fair market value at the date of death. For example, if father purchases a stock for $1, and at his death when the stock passes to his son, the stock is worth $100, son's new cost basis in the stock is $100. If son sells the stock for $100, there would be no capital gain.

2. Beneficiaries of assets gifted during life do NOT receive basis "step-up". For example, in the preceding paragraph, if father gifted the stock to son the day before he died, when the stock was worth $100, son's cost basis in the stock would remain $1. If son sells the stock for $100, there would be a capital gain of $99.

VI. New York Estate Tax Overview.

A. <u>New York estate tax rate and exemption</u>.

1. The maximum New York estate tax rate is 16%.

2. Each person has a New York estate tax exemption of $3,125,000 until April 1, 2016. This exemption will increase annually, as shown below.

3. The exemption is not available to all estates. The benefit of the exemption is phased out for estates valued between 100% and 105% of the exemption amount. Estates valued at 105% or more of the exemption amount lose the

benefit of the exemption altogether, thereby subjecting the entire estate to New York estate tax.

4. The following table contains the increasing New York estate tax exemption amounts and the dollar amount at which they are fully phased out:

Date of Death	New York Exemption	Full Phaseout of Exemption
April 1, 2015 to March 31, 2016	$3,125,000	$3,281,250
April 1, 2016 to March 31, 2017	$4,187,500	$4,396,875
April 1, 2017 to December 31, 2018	$5,250,000	$5,512,500
January 1, 2019 and after	Will match federal estate tax exemption	105% of federal estate tax exemption

5. New York estate tax exemption of a deceased spouse is not portable.

B. Unlimited marital deduction.

1. At death, transfers between spouses are free of New York estate tax.

2. Operationally identical to federal estate tax unlimited marital deduction described above.

C. New York has no gift tax. However, taxable gifts made within three years of death will be subject to New York estate tax unless they were made before April 1, 2015, or on or after January 1, 2019, or unless they were made when the decedent was not a New York resident.

VII. Estate Taxes of Other States.

A. Fifteen states and the District of Columbia have an estate tax, and seven states have an inheritance tax.

B. States with estate taxes include Connecticut, Massachusetts, Rhode Island, Vermont, New Jersey, and Maine, and other popular second home locations.

C. Ownership of real estate or personal property in a state with an estate tax exposes you to the estate tax of that state. Special planning considerations may apply.

VIII. Ownership of non-U.S. assets.

A. Assets located in foreign countries owned by U.S. citizen or resident are subject to U.S. estate and gift tax, and may also be subject to tax law of the country of location.

B. Special disclosure obligations may apply to such assets.

C. Special planning considerations apply.

IX. The Next Level of Planning After Utilizing Your Federal Estate Tax Exemption.

A. Gifting - Even though federal estate and gift tax rates are the same, making lifetime gifts may be more tax efficient than holding property until death.

1. $14,000 annual exclusion and direct tuition and medical payments are available only for gifts, not at-death transfers.

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

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

4. Consider capital gains tax consequences upon sale of gifted property. Recipient of gift receives the donor's cost basis in the property, whereas if the recipient inherited the property through the donor's estate, the property would receive a stepped-up basis.

B. Look for things that are relatively cheap to give away now. Allow appreciation to accrue in the hands of future generations, and outside of your estate.

C. Prime Example -- Life Insurance.

1. Can have little current value.

2. Value for gift tax purposes is current cash value plus cost of annual premiums.

3. Effective lifetime gift of policy entirely removes from your taxable estate the much greater face value of policy at your death.

4. Consider the use of an irrevocable life insurance trust.

    a. An effective way to remove life insurance proceeds from your taxable estate.

    b. Insurance proceeds would be payable to the trust at your death (rather than directly to your beneficiaries).

    c. Your children or other family members can be beneficiaries of the trust and have access to income and principal to maintain their lifestyles.

D. See our Advanced Estate Planning Primer for additional planning techniques.

X. <u>Generation-Skipping Transfer Tax Overview</u>.

A. As wealth passes from generation to generation, federal government assesses a federal estate tax at each generational level.

B. Prior to 1986, you could "skip" the estate tax on the wealth passing to your grandchildren by leaving the property in trust for your children, with them having access (but not unlimited access) to the trust property. At children's later deaths, trust property would pass to your grandchildren, free of estate tax <u>at that time</u>, because the children’s access to the trust property would not be enough of an ownership interest in the trust property to bring it into their taxable estates.

C. In 1986, Congress passed the Generation-Skipping Transfer Tax ("GST"). The GST is a flat tax equal to the maximum federal estate tax rate (40%). It is imposed on transfers during lifetime or at death, whether outright or in trust, to grandchildren or more remote descendants, if the transferred property is not subject to estate tax at each generational level.

D. Each person has an exemption from the GST equal to $5,450,000 (indexed periodically for inflation). Thus, a single person can structure an estate plan so that up to $5,450,000 of the person’s estate (<u>after</u> the payment of estate or gift taxes) can be held in lifetime trusts for his or her children. Children will have use of the trust property to maintain their lifestyles, but at their later deaths, the trust property passes to the grandchildren free of estate, gift, and GST tax. Assuming no growth in the trust assets during the lifetimes of the children, transfer tax savings at the children's later deaths can be $2,180,000 ($5,450,000 x 40%). Assuming trust asset growth over the lifetimes of the children, savings is much greater. There may also be significant state estate tax savings.

E. In addition to significant transfer tax savings, trust structure may also better protect children's inheritance from creditors or from a spouse in the event of the child's divorce or death.

F. If you do not have children, generation-skipping tax planning utilizing lifetime trusts can be beneficial to transfer wealth to nieces and nephews, and other younger beneficiaries.

XI. Using Revocable Living Trusts to Minimize Surrogate's Court Supervision over Estate and Trust Administration.

A. A Revocable Living Trust is a property ownership arrangement set up by you during your lifetime dictating how property in the trust will be managed for you and your family during your lifetime and after your death.

B. You can be the Trustee of the trust. If you are unable to act as Trustee, a successor Trustee will take your place. Your successor Trustee can be an individual (such as your spouse, other family member, or trusted friend) or a professional Trustee (such as a bank, trust company, accountant, or attorney).

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

D. If you become incapacitated, your successor Trustee can manage the trust assets for you, and make distributions to you and other family members, as needed for health and support. This could avoid the need for a surrogate's court appointed "Conservator".

E. Revocable Living Trust can act as a "Will substitute" after you die and direct the distribution of your property to family members without mandatory surrogate's court supervision. This could simplify and expedite the settlement of your estate and reduce estate settlement costs.

F. A Revocable Living Trust is suitable for detail oriented people who seek as much family control as possible.

XII. **Planning for Incapacity – Planning for the Management of Your Assets and Your Person if You Are Living but Incapacitated.**

A. Durable Power of Attorney.

1. Gives another person (your "attorney-in-fact") power to execute financial and business transactions on your behalf (e.g. paying your bills, managing and selling your assets, and filing your taxes).
2. Purpose: To avoid the necessity of a surrogate's court-appointed guardian or conservator to manage your affairs in the event you become incapacitated.
3. Virtues: Easy, inexpensive, largely effective.
4. Cautions: Can be immediately 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. See Section XI.D. above.

C. Living Will and Health Care Proxy.

1. New York statute allows you to appoint a health care agent to make health care decisions on your behalf in the event you are unable to do so yourself. These decisions include the withdrawal of life support systems in the event of terminal illness.
2. Authorizes your health care agent to have access to your medical records under the federal privacy law (HIPAA).

3. New York Court of Appeals decision suggests you may sign a Living Will stating the type of treatment you would desire in the event of physical or mental disability, including your wishes regarding the withdrawal of life support.

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.

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