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YOUR INTRODUCTION TO ESTATE PLANNING

Welcome to your estate planning!

Simply by reading that first sentence you are generating the momentum to sustain the creation or revision of your own estate plan.

Please spend some time with an initial browsing through this Introduction, which is organized into related but separable topics. As you work with us and your other advisors, or discuss your planning with family members, you may find it helpful to revisit specific topics.

Effective estate planning may help you achieve many important goals, including:

- During your lifetime, build, preserve and enjoy your resources
- Provide education for your children, or grandchildren
- Create financial resources and a structure for your "retirement"
- Provide financial security for your surviving spouse, and other family members
- Provide your surviving spouse with the desired level of control over assets
- Manage assets for your children, until they are able to take that responsibility
- Protect assets from potential creditors and other risks
- Minimize income, gift, estate and other taxes
- Provide support for charitable programs, under the direction of your family

Ultimately, effective estate planning enables you to choose the arrangements that work best for your family. When you know all of the relevant choices, and then make your decisions, you will also achieve one of the paramount goals of estate planning: **peace of mind.**

If you own a closely-held business, estate planning can also provide you with an "exit plan." Examples of exit plans include:

- Succession of family members to the ownership and management of the business
    - Equitable provisions for family members who are not involved in the business
- Sale of the business to employees
- Sale of the business to third parties
- Creation of a publicly-held company.

Our approach also helps you explore planning opportunities within your extended family: parents, children, grandchildren and siblings.

This Memorandum introduces you to several of the key concepts and terms that you will use to shape your estate planning:

A. Wills and Trusts in General

B. Federal Estate, Gift and Generation-Skipping Taxes

C. Massachusetts Estate Taxes

D. Revocable Trusts

E. Irrevocable Life Insurance Trusts

F. Gifts to Children

G. Closely-held Businesses

H. Retirement Plans

I. Charitable Gifts

J. Durable Powers, Health Care Proxies and Living Wills

K. Letters of Instruction

L. Total Wealth Control

M. Probate of an Estate

N. Costs of Planning

O. Costs of Probating an Estate

As companions to this Introduction you may also wish to read *Beyond Death & Taxes: A Guide to Total Wealth Control*, and *Seasons of Decision: A Practical Guide to Life's Financial and Legal Decisions*. Written by Greg Englund, these books explore the journey of the "Roberts" family through the planning process.

A. <u>Wills and Trusts in General</u>

A Will is a document that directs the disposition of certain property owned by the <u>testator</u> (the person making a Will) at his or her death.

In order to be effective in Massachusetts and most other jurisdictions, the testator must sign the Will in the presence of at least two adult witnesses. To avoid the need for witnesses to appear in court, a <u>notary public</u> must acknowledge the testator's signature.

You may change your Will at any time, so long as you are not legally incompetent. An amendment to a Will is called a <u>codicil</u>.

Your Will governs only the disposition of property actually owned by you and held in your <u>sole name</u> at the time of your death, <u>and</u> which does not pass to someone automatically upon your death. Property fitting this description is referred to as "probate property," or your "probate estate."

You may own several types of property that are NOT probate property. For example, you and your spouse may own property such as your home, or a bank or securities account, in <u>joint names with rights of survivorship</u>, or with the designation <u>"Transfer on Death" (TOD)</u>. Similarly, you use <u>beneficiary designation forms</u> to direct insurance proceeds, retirement plan benefits, and deferred compensation arrangements. These forms of property pass automatically to the surviving spouse or other beneficiaries, without regard to your Wills.

We cannot overstate the importance of coordinating the <u>form</u> of asset ownership with the <u>design</u> of your estate planning documents. The wrong form of ownership may defeat the purpose of your documents, resulting in unnecessary taxes, loss of asset protection, and a distorted flow of property.

A typical Will directs <u>specific bequests</u> of cash or other property to named persons and a disposition of the <u>residuary estate</u> (all of the property remaining after payment of the specific bequests, debts, expenses and taxes). Most Wills direct that some part or all of the residuary estate be held in a <u>Trust</u> for the benefit of the surviving spouse, children, or other persons (<u>beneficiaries</u>).

If you have children who are minors, you use your Will to indicate your choice of the person or persons whom you would like to serve as <u>guardians</u> for your minor children. Usually your Will designates the surviving parent, and then one or more <u>successors</u>. Although the Probate Court has the final say, ordinarily the Court will give great weight to your preferences.

In Massachusetts and many other states the Courts enforce <u>no contest clauses</u>, which provide that if anyone contests your Will, that person loses all inheritance or other benefits under the Will.

Marriage will revoke your Will, unless the Will expressly states that you are signing it in contemplation of your marriage.[1]

Suppose that you pass away having created a Will that leaves $1 to your surviving spouse. The surviving spouse may waive the Will and claim an elective share of your estate. The amount of the share depends upon whether you are survived by descendants, parents, or other relatives.

Divorce will generally terminate bequests left to the former spouse.

A Trust is a legal entity whereby a person or an institution (the Trustee) holds legal title to property, and invests and manages it for the beneficiary or beneficiaries. The beneficiary receives payments of income or principal (the Trust property) as the testator or donor directs in the Will or Trust agreement.

You may create a Trust by Will (a Testamentary Trust). You may also create a Trust by an Agreement of Trust or Indenture of Trust during your lifetime (an inter vivos or Living Trust). In Massachusetts it is customary to use Living Trusts, because unlike Testamentary Trusts, Living Trusts may be kept private and confidential. Furthermore, a Testamentary Trust may be subject to the supervision of a Probate Court, which may result in significant loss of time, money, privacy, and flexibility.[2]

The Will names one or more persons or institutions to serve as Personal Representative.

The Personal Representative has several duties: collect the property of the testator, pay creditors, pay death taxes and expenses of administration, and distribute the remaining property as directed in the Will, typically to the Trustees of a Revocable Trust.

You may amend or revoke your Revocable Trust. During your lifetime your Revocable Trust is ignored for income tax purposes, meaning that you report any income generated by the Trust on your personal income tax returns.

During your lifetime your Revocable Trust does not protect Trust property from the claims of your creditors.

If you die without a legally valid Will, your personal property (property other than real estate) will pass under the laws of intestacy of the state where you live at the time of your death. Real estate owned in your name will pass under the intestacy laws of the state in which it is located.

If you die and are survived by your spouse and descendants, all of whom are the descendants of you and your spouse, under the intestacy laws of Massachusetts your spouse receives all of your probate estate. If you die intestate leaving a spouse but no descendants,

[1] Under Massachusetts law marriage will revoke your Will only to the extent that you do not leave property to your descendants. Your surviving spouse will be entitled to a portion of such property.
[2] Massachusetts courts may exercise less supervision over testamentary trusts.

your spouse receives the first $200,000 of the estate, plus three-fourths of the remaining estate. The remaining property passes to your parents in equal shares. If you die leaving neither a spouse nor descendants, your property passes to your parents, if they are living, or, if they are not living, to your siblings or the children of deceased siblings.

In designing your Wills and Trusts, control is a critical issue. How much, if any, control will your beneficiaries have over assets? At what ages? Over what proportion of assets? The same estate tax savings may occur over a wide range of control.

Selection of control mechanisms should also take into account the need for protection of assets from potential claims of creditors, including former spouses, business associates, and so forth.

Choosing Personal Representatives and Trustees

In choosing Personal Representatives and Trustees we recommend that you consider these criteria:

- Integrity
- Practical common sense and sound judgment
- Communication skills

These roles do not require that the person(s) you choose have expertise in the law, investments, or accounting. However, the person must realize that experts and other advisors should be consulted and engaged to provide their services.

Especially when the beneficiaries of a Trust include children or young adults who have not reached the age of control over their shares of a Trust, e.g. age 35, good communication skills are critical. The Trustee must gather information from the beneficiaries in order to determine their needs, and to explain decisions regarding distributions. The Trustee should also help prepare the beneficiaries with skills necessary for the operation of the Trust once the beneficiaries reach the age of control.

A person serving as Personal Representative would expect to serve anywhere from a year and half to three years or more, depending on the complexity of the estate.

Unlike an estate, Trusts are generally designed to continue for many years, often exceeding the life expectancy of the original Trustees. However, the age of the prospective Trustee should not disqualify a person who otherwise meets the criteria. *Choose the person who best meets the criteria, and rely on mechanisms in the Indenture of Trust to designate successors if and when the need arises*. Your Indenture may also designate one or more successor Trustees.

Your Letters of Instruction (please see Item K below) may provide invaluable guidance for both the Personal Representative and the Trustee, including a list of recommended advisors, descriptions of assets, the raising of children, running a family business, and investment criteria.

Your options for Personal Representatives include a surviving spouse, adult children, other family members, friends, professional advisors, and institutions such as banks or trust companies.

Please see Item O below for a discussion of compensation.

B. Federal Estate, Gift and Generation-Skipping Taxes

The Federal Estate Tax

The federal estate tax applies to a decedent's taxable estate -- the value of the gross estate less deductions.

The amount of your taxable estate that may pass free of estate tax is referred to as the estate tax exclusion.

Please note that your taxable estate may be substantially larger than your net worth. Your gross estate includes virtually all property in which you have an interest, such as the death benefit of life insurance policies that you own, jointly-held property, options, deferred compensation, and retirement plan/IRA benefits.

The estate of a person who dies in 2018 has an estate tax exclusion of $11,180,000.[3]

Federal law provides portability of estate tax exclusions between spouses. If your estate does not make full use of your exclusion, the estate of your surviving spouse may use the remaining portion. Thanks to this feature married couples may now transfer up to $22,360,000 with no estate tax, even if the first spouse to pass away has no estate.[4] However, in most situations it will still be advisable for spouses to equalize the size of their estates.

If your taxable estate exceeds $11,180,000[5] the estate will pay tax on the excess at a rate of 40%.

If the value of your gross estate exceeds the amount of the estate tax exclusion, your Personal Representatives must file an estate tax return within 9 months from the date of your death.[6] The estate tax return is normally due nine months after the date of death. If any estate tax is due, the Personal Representatives must pay the tax with the return.

Transfers to your spouse at your death pass free of estate tax if the transfers qualify

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[3] **PLEASE NOTE** that the amounts of the federal estate and gift tax exclusions and the GST Exemption (please see below) will automatically revert to $6.2M on January 1, 2026.

[4] **Please note** that portability requires the filing of a federal estate tax return, even if the estate is under $11,180,000.

[5] Or $22,360,000 in the case of a surviving spouse, subject to the portability rule. **Please note** that if the surviving spouse remarries, the unused exclusion of the deceased spouse will be lost.

[6] However, please see footnote 4 above.

for the unlimited marital deduction. Outright transfers and transfers to certain trusts for the benefit of your spouse qualify for the marital deduction. Through proper use of the unlimited marital deduction you may postpone federal transfer taxes until the death of your surviving spouse.

Many spouses with combined estates larger than $22,360,000[7] will use Trusts to take maximum advantage of both the estate tax exclusion and the marital deduction, even though you may eliminate estate tax at the death of the first spouse by use of the marital deduction alone. Under this approach, you create a Trust that will not be taxed at the death of your surviving spouse. This Trust receives all or a portion of the Estate Tax Exclusion amount (a credit shelter trust, often referred to as the "Family Trust"). The Trustees hold the balance of the Trust property for the benefit of your surviving spouse, to be taxed only when he or she passes away. Typically, your Family Trust provides for your spouse and children, although you may include parents, siblings or other persons as beneficiaries.

Under a common variation of this basic plan Trustees hold the marital deduction portion of the Trust property in a QTIP Trust ("qualified terminable interest property trust"). The surviving spouse must receive all of the income for life. The Trustees may distribute principal only to or for the benefit of the surviving spouse. When the surviving spouse dies, the Trustees distribute the remaining principal of the QTIP Trust as the Trust instrument directs-typically, to the Family Trust.

Often the Trust instrument permits the surviving spouse to vary the distribution, within specified limits, by means of his or her Will--a limited power of appointment. This powerful tool gives the surviving spouse great flexibility to adjust estate planning arrangements long after the passing of the first spouse.[8]

The deceased spouse's Personal Representatives may elect to qualify part or all of the QTIP Trust for the marital deduction. The full value of the portion of the Trust subject to the election will be taxed as part of the estate of the surviving spouse at the time of his or her death.

In some families one of the spouses owns the bulk of the family assets. In such a situation, consider transferring property to the other spouse so that the smaller estate at least equals the Massachusetts Estate Tax Exclusion.[9] However, before you make such a transfer, carefully weigh any increased risk that creditors may reach the transferred assets.

If your surviving spouse is not a U.S. citizen, several special rules and limitations apply to the marital deduction. For example, you will need to create a Q-DOT Trust.

When you pass away you may leave all or any part of your estate to a qualified

[7] Even if your combined estates are less than $22,360,000 your estate plan should employ trusts, e.g., to minimize state estate taxes, manage assets for young heirs, provide asset protection, and take advantage of your generation-skipping transfer tax exemptions. Please see B.4 below.
[8] By itself, a limited power of appointment will not cause inclusion of the property subject to the power to be included in your taxable estate.
[9] Please see the discussion in Part C below. As noted above, Massachusetts does not have portability.

charitable organization[10]. Your bequest will qualify for the estate tax charitable deduction. There is no limit on the amount of the estate tax charitable deduction.

The Federal Gift Tax

The federal gift tax applies to the fair market value of the gift as of the date of the gift.

You have a $11,180,000 aggregate Lifetime Gift Tax Exclusion[11].

The tax rate for lifetime gifts in excess of $11,180,000 is 40%.

If you own appreciating assets, such as real estate, or stock or other interests in a closely-held business, you may create tax savings by lifetime gifts that absorb all or a portion of your Lifetime Gift Tax Exclusion. The potential savings arise from the fact that the *appreciation on the property during the period between the gift and your death (or the death of your surviving spouse) escapes estate tax*.

Think of it this way: if your Uncle (Sam) offered you $11,180,000 today or $11,180,000 in 25 years (your hypothetical life expectancy), which would you choose?

Gifts that you make to your spouse[12] qualify for an unlimited gift tax marital deduction, subject to requirements that apply to the estate tax marital deduction.

There are many circumstances in which your lifetime gifts to persons other than your spouse may achieve substantial tax savings.

For example, you may make tax-free gifts of up to $15,000 to as many individuals ("donees") as you wish: the annual gift tax exclusion (the "Annual Exclusion").

You and your spouse may pool your Annual Exclusions to permit tax-free transfers of $30,000 per donee, even if all of the property comes from only one of you. This technique is referred to as gift-splitting.

If you are able to make gifts without compromising your own financial security, you should seriously consider gifts of cash or property to your children or other persons in amounts up to $15,000 per donee per year--for married couples, $30,000 per donee. Since there is no gift tax on such gifts, and because the gifts reduce the size of your estate subject to estate tax, you may achieve significant tax savings.

Aside from potential transfer tax savings you may have the satisfaction of providing children or grandchildren with financial assistance when they really need it.

If you use a portion of your Lifetime Gift Tax Exclusion, you reduce your Estate Tax

[10] As discussed below, a bequest to a Family Foundation may qualify for the estate tax charitable deduction.
[11] Scheduled to revert to $5.6M on January 1, 2026.
[12] Transfers to a non-citizen spouse are limited to $152,000 per year, indexed for cost of living increases.

Exclusion by that amount.

When you consider making gifts of appreciated property, keep in mind the tax cost basis used for determining the amount of gain on a subsequent sale or exchange of the property. For property that you transfer at death, the beneficiaries' basis in the property will generally be its date-of-death fair market value (the step-up in basis). Any increase in value ("appreciation") during your ownership of the property will not be subject to income tax when the beneficiaries sell the property.

Example: you paid $100 for a share of Sure Fire, Inc. At the date of your death it had appreciated to $500. Your beneficiaries will have a "stepped-up" basis of $500 in the share.

A donee's basis for lifetime gift property, however, is generally the same as that of the donor ("carryover basis"). When the donee (or a Trust for the benefit of beneficiaries) sells or exchanges the property, capital gain tax will apply to the appreciation that occurred during your ownership of the property, as well as to any appreciation after the gift.

If you make a gift that exceeds the amount of the Annual Exclusion, you must file a gift tax return on or before April 15 following the year that you made the gift, even if you will not owe any gift tax.

If you pay tuition for a child or grandchild, directly to the school, or if you pay health insurance premiums or medical expenses directly to the provider, you are taking advantage of non-taxable gifts. Such gifts are over and above the Annual Gifts and the Lifetime Gift Tax Exclusion.

Your lifetime transfers to charities avoid gift tax if the transfers qualify for the gift tax charitable deduction.

When you make a gift to a charitable organization, you may be entitled to an income tax charitable deduction, subject to certain limitations.

A New Paradigm: Maximizing the Step-Up in Basis

As noted above, you should carefully consider the loss of a step-up in basis in deciding whether to make a gift.

Furthermore, due to the recent dramatic increase in the amount of the federal estate tax exclusion, very few estates will owe any federal estate tax. However, the federal income tax rates for capital gains remain in place[13]. For these reasons the goal of maximizing the step-up has taken on greater importance.

The portability of the federal estate tax exclusion enhances the ability to take advantage of the step-up.

[13] The highest rate for federal income tax on capital gains is 20%. That rate could be increased by 3.8% for the net investment tax and also by any applicable state income tax on capital gains.

For spouse with combined estates anticipated to be less than $22,360,000, a new paradigm is emerging.

Consider this simplified example. John and Abigail are married, and residents of Massachusetts. Each of their taxable estates has a value of $4,000,000. Each of them owns stock in Sure Fire with potential capital gains of $1,000,000. If both of them die in Massachusetts, there will be no federal estate tax. The basis in their shares of Sure Fire would be stepped up to $1,000,000, thereby eliminating the capital gains tax that their heirs would otherwise have had to pay.

Now assume that John dies in Massachusetts, survived by Abigail. Under his classic estate plan the Trustees of his Revocable Trust would create a Family Trust funded with $1,000,000 (equal to the Massachusetts estate tax exclusion) and a Marital Trust funded with $3,000,000. The Personal Representatives would make the QTIP election for Massachusetts purposes, but not for federal purposes. Result? The basis of the assets in John's estate would be stepped up to $4,000,000. However, any increase in the value of the assets in the Marital Trust between the date of John's death and the date of Abigail's death would not be stepped up, because the assets in the Marital Trust would not be included in Abigail's federal taxable estate.

Under the new paradigm of planning, the Personal Representatives of John's estate could make the QTIP election for both federal and Massachusetts purposes. No federal or Massachusetts estate tax would be due. The basis of the assets in John's estate would have been stepped up to $4,000,000. His estate would have an unused federal estate tax exclusion of $10,180,000, which would be available to Abigail's estate ("portable").

Assume that by the time of Abigail's death the assets in the Marital Trust would have increased in value by $1,000,000. Upon Abigail's death the assets in the Marital Trust would be <u>included</u> in her federal estate, resulting in a further step up and eliminating the capital gains on the $1,000,000 increase in value. Her estate would have no federal estate tax liability, so long as the value was less than $21,360,000 (Abigail's exclusion of $11,180,000, plus John's unused exclusion of $10,180,000).

In a state like Florida, which has no state estate tax, the step-up could apply to all of the assets that were in John's estate.

Under this new paradigm you may wonder whether trusts are still needed. *However, trusts remain very important because they provide asset protection against potential claims of creditors, for example, claims of an ex-spouse in the event that a child is divorced.*

As this discussion indicates, planning under the new paradigm involves careful analysis of assets and potential reconfiguration of QTIP elections. The complexity may add to the cost of estate planning. However, for John and Abigail and their children, saving $230,800 in capital gains tax[14] was well worth the extra effort and expense.

[14] 23.8% x $1,000,000.

The Federal Generation-Skipping Transfer Tax

The federal generation-skipping transfer tax ("GST") generally applies when you transfer property to a person who is two or more generations younger than you. For example, you transfer $10,000 to a grandchild. Unless an exemption applies, you would owe GST of $4000.

If the GST applies, the rate of tax is the same as the highest rate of federal estate tax. The rate is 40%.

You may structure your estate plan so that principal and/or income will be available for the use and benefit of your children. However, **if your children do not consume all of the property**, you may structure your plan so that at the death of the children the remaining Trust property passes to their children or other descendants, free from another round of estate taxes.

The vehicle for this arrangement is known as a generation-skipping Trust, sometimes referred to as a GST Trust. Federal tax law recognizes and limits the availability of this technique. However, you may take advantage of very important exceptions.

You and your spouse each have an $11,180,000 GST Exemption[15].The most Exemption enables you to transfer property having a value of up to a total of $11,180,000, either by lifetime gifts or at death, to or for the benefit of your grandchildren or even younger generations--with no additional transfer tax. **Your estate plan should take full advantage of this opportunity!**

If both you and your spouse make full use of your $11,180,000 GST Exemptions, you could create Trusts with a value of up to $22,360,000 that would be *available to benefit your children if needed*, but that the Trustees could otherwise accumulate and/or distribute for the benefit of your grandchildren or younger generations, **with no additional transfer tax**.

Any appreciation and/or accumulation of income that occurs within such a Trust *would also escape additional transfer tax*.

If your children's estates would ultimately incur a combined federal and state marginal tax rate of 56%, the potential estate tax savings are enormous. For this reason alone, your Trusts should take advantage of your GST Exemptions.

What about your parents and their estate planning? What about your adult children? Are they taking advantage of their Exemptions?

Estate Planning for Same-Sex Spouses

The 2013 Supreme Court decision in *Windsor* transformed estate planning for same-sex spouses.

[15] Scheduled to revert to $5.6M on January 1, 2026.

Although the full impact of the decision will develop over several years, one fundamental change applies now: spouses who were married and reside in states that recognize same-sex marriages are entitled to the federal gift and estate tax marital deductions.

C. <u>Massachusetts Estate and Gift Tax</u>

Massachusetts has a much lower exclusion than the federal Estate Tax Exclusion. As a result, your estate plan must reckon with the Massachusetts estate tax–even if your estate would not be subject to federal estate tax.

The Massachusetts Estate Tax Exclusion is $1,000,000.

Massachusetts estate tax rates range from 4% to 16% depending on the size of the estate.

For example, if the taxable estate of the surviving spouse is $2,000,000, the Massachusetts estate tax would be $99,600. If the estate were $10,000,000 the Massachusetts estate tax would be $1,067,600.

Even though the impact of the Massachusetts estate tax may be far less than the impact of the federal estate tax, the Massachusetts estate tax encourages most clients to consider the same tax planning strategies previously inspired by the federal estate tax. Few clients will gladly pay $1,000,000 or more in tax that could have been avoided.

You may eliminate the Massachusetts estate tax when the first spouse passes away by having the appropriate formula in your Revocable Trusts.

When the first spouse passes away, the formula allocates to the Marital Trust the smallest amount of Trust property that will minimize the federal and state estate taxes. The formula allocates the remaining Trust property to the Family Trust.

To illustrate the operation of the formula in Massachusetts, upon the death of the first spouse the formula allocates up to $1,000,000 to the Family Trust and any remaining property to the Marital Trust.

The Trust authorizes the Trustees to divide the Marital Trust so as to reflect the difference between the federal and state estate tax exclusions.

If and when the amounts of the exclusions change, the formula adjusts automatically.

Massachusetts does not have a gift tax. Taxpayers with large estates may therefore save Massachusetts taxes by making gifts.[16]

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[16] For example, assume Amelia has a $2,000,000 estate at death. She made $1,500,000 of taxable gifts. Her estate would owe Massachusetts estate tax of $99,600. If Amelia had not made the lifetime gifts her

These provisions apply to same-sex spouses who are residents of Massachusetts and who were married in Massachusetts or in another state that recognizes same-sex marriages.

Other States

If you are domiciled in Massachusetts but you own real estate or tangible personal property located in another state, that property may trigger estate tax under the laws of the other state.

Furthermore, even if no state estate tax applies to such property, if you own the property in your individual name at the time of your death your estate may have to undergo ancillary probate in the other state. To avoid the time, trouble, and considerable expense of ancillary probate, we recommend that you use your Revocable Trust to own such property. (Please see discussion below in Part D).

D. Use of Revocable Trusts

An inter-vivos or Revocable Trust is a popular estate planning vehicle, for many good reasons. This type of Trust is sometimes referred to as a "Living Trust," because you create it during your lifetime.

A trust is revocable if you may amend it or revoke it.

As explained in Part A, you frequently create a Revocable Trust in conjunction with your Will. In many cases your Revocable Trust may not receive property until your death. However, you may find it advantageous to transfer some or all of your property to your Revocable Trust during your lifetime. (Please see below.)

Typically, your Revocable Trust instrument provides that during your lifetime, you, your spouse, and your children or other descendants may receive income and principal as you direct, or, if you become incapacitated, as the Trustee may deem advisable. Upon your death the Trust directs distributions to a Family Trust and one or more Marital Trusts.

As the donor of a Revocable Trust, you reserve the right to amend the terms of the Trust, or to revoke it entirely.

There are two advantages to funding your Revocable Trust during your lifetime. First, a funded Revocable Trust permits someone else (generally your spouse acting as Trustee) to manage the Trust assets if you wish to avoid the burdens of such management or in the event you become too ill to handle the assets, since the Trustee may act without regard to your legal incapacity.

Second, assets held in your Revocable Trust avoid probate. To that extent, the probate

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Massachusetts taxable estate would have been $3,500,000, resulting in Massachusetts estate tax of $229,200. Amelia's lifetime gifts resulted in $120,600 of Massachusetts estate tax savings.

process will generally be less complex, with fewer reporting requirements, since little or no property will pass by your Will. Furthermore, assets held in your Revocable Trust are immediately available for the trust beneficiaries. Not least, as noted above, using your Revocable Trust to own real property located in a state other than Massachusetts will avoid the time, trouble, and expense of ancillary probate in that state.

In addition to holding assets in your Revocable Trust, you should create a general and durable power of attorney, which permits your spouse, adult children, or another person to manage your property if you are incapacitated or otherwise unavailable. The power of attorney terminates upon your death and therefore will not avoid probate. (Please see Part K below.)

During your lifetime your Revocable Trust does not produce any income, estate, or gift tax benefits. The income, including gains on sales or exchanges of Trust assets, is fully taxable to you. Federal and state estate taxes will be the same whether or not you had a Revocable Trust.

What is the advantage of a Revocable Trust compared to a Will that simply leaves assets outright to your surviving spouse and/or to your children? First, in states like Massachusetts that have a state estate tax, you need a Revocable Trust in order to take advantage of the state estate tax exclusion in the estate of the first spouse who passes away. That could save $100,000 or more. Second, if you and your spouse's combined estates exceed or may exceed $11,180,000, you need a Revocable Trust to take advantage of the GST Exemption in both of your estates. Third, and perhaps more valuable than the potential transfer tax savings for most families, after you pass away the Revocable Trust may protect assets from claims against beneficiaries arising from divorce, business, injuries to persons or property, and other types of liability. **A Will that passes assets directly to beneficiaries provides no protection against such claims**.

Bear in mind that in most states a beneficiary under a Will who is a minor will be entitled to outright ownership of inherited assets at age 21. Especially when you have young children, after your death your Revocable Trust typically will defer control until a more appropriate age, such as 35, and thereafter the Trust will continue to provide asset protection.

E. Irrevocable Life Insurance Trusts

Owning life insurance in an Irrevocable Trust gives you a very powerful estate planning tool.

Unlike a Revocable Trust, you may not amend or revoke an Irrevocable Trust. However, your Irrevocable Trust may include provisions that create a surprising degree of flexibility.

With a properly-drafted Irrevocable Trust, (i) the cash proceeds from the life insurance may be made available for the payment of administration expenses, debts and taxes on your estate[17]; (ii) gifts that you make to the Trust may qualify for Annual Gifts; (iii) the proceeds may be available to your surviving spouse, children and others *without becoming subject to federal estate tax in either spouse's estate*, or when your children pass away; and (iv) the Trust may prevent creditors from taking the assets.

New insurance policies purchased by an Irrevocable Trust may avoid estate tax entirely. However, if you give an existing policy to an Irrevocable Trust, it will be taxed in your estate unless you live for at least three years following the transfer.

The use of joint life insurance has become popular as a planning tool for married couples. Also referred to as "second-to-die" insurance, a joint life policy pays the death benefit upon the death of the surviving spouse--exactly when liquid assets may be required in order to pay estate tax. Since the insurance company spreads the risk of payment over two lives, the annual premium for joint life insurance may be 30% to 40% lower than the premium for the same amount of insurance on the life of one spouse.

Joint life insurance may also be the key to your version of Total Wealth Control. Please see Section L below.

Certain types of life insurance build cash value, free of income tax. Dividend rates vary from company to company, but historically these rates have compared favorably with earnings from other investments of equivalent risk.

F. Gifts to Children or Grandchildren

Gifts to younger generations of family members may be key elements of your estate planning.

If your child or grandchild is an adult, you may make your gift directly to the recipient, outright and free of trust. However, to take advantage of your Generation-Skipping Tax Exemption and/or to protect the gifted assets from creditors (including former spouses of the beneficiaries), you may prefer an Irrevocable Trust as the vehicle for such gifts. As discussed in Section E above, an Irrevocable Trust that owns life insurance is a classic example of this technique.

If the recipient of the gift is a minor (under age 18), you have several ways to qualify such gifts for the annual exclusion, including custodianship under the Uniform Transfers to Minors Act, a Trust drafted to qualify for the exclusion, and a Section 529 plan.

The main advantage of a custodianship is its apparent simplicity: no trust agreement is necessary. You transfer title to the property to the name of an appropriate custodian,

[17] Warning: the Irrevocable Trust must not require the Trustees to pay expenses, debts or taxes with respect to your estate. Such a requirement would cause the life insurance proceeds to be included in your taxable estate.

including your spouse[18]. Under the Act the custodian may use the funds--both interest and principal--for the minor beneficiary.

The main disadvantage of a custodianship is that in most states, including Massachusetts, the custodianship terminates on the child's 21st birthday. The child then owns the property outright. Many parents fear that outright ownership of property at 21 could have an adverse impact on the child's development--as well as on the property.

The preferred type of Trust used as the vehicle for gifts (whether to young donees or adults) is referred to as a spray Trust with Crummey powers. The spray Trust offers flexibility because the Trustee may allocate principal or income among a group of beneficiaries, in whatever amounts or proportions deemed appropriate. The beneficiaries of a spray Trust may include children or grandchildren born after the creation of the Trust. A spray Trust with Crummey powers may defer distribution until any age or ages that you specify[19].

The term "Crummey" power arises from the name of a taxpayer who was victorious in a court case with the Internal Revenue Service. The IRS challenged Mr. Crummey's method for enabling gifts to a spray Trust to qualify for the Annual Exclusion (currently $15,000). This method entitles the beneficiaries to withdraw their pro rata share of gifts to the Trust, during a short withdrawal period. Although beneficiaries rarely exercise this power, the court in the *Crummey* case held that the right to make a withdrawal created a sufficient present interest to qualify for the Annual Exclusion.

If you use Trust or custodianship funds to meet your legal obligation to support your child, the income generated by those funds will be taxable to you. Depending on your state law, private schools, camps and private lessons for all children, and education expenses for children over age 18 may not constitute legal support obligations.

Before making trust distributions to a child below the age of 25, determine whether the Kiddie Tax rules will tax certain amounts of "unearned income" from the Trust at the highest marginal rate that the child's parents would have paid had the income been theirs.

Section 529 plans have become very popular. You create an account, for the benefit of a child or grandchild. Your gifts to the account qualify as Annual Gifts[20]. Income generated by investments in the account grows free of income tax. If the account is distributed for tuition or other costs of education, the distribution is also free of income tax[21]. You may change the beneficiary of the account.

Although these features are certainly attractive, you should consider other alternatives for funding education expenses, including the Spray trust discussed above.

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[18] If you are the custodian, any property attributable to your gifts to the custodial account will be included in your taxable estate.
[19] To take advantage of your GST Exemption, you would not require distribution at any specific age.
[20] You may make up to five years' worth of Annual Gifts in one year. However, if you pass away within five years from the date of such gifts the Annual Gifts will be reduced pro rata.
[21] Certain limitations apply to education expenses prior to college or other higher education.

Bear in mind also that a custodial account, an Irrevocable Trust, or a Section 529 Plan may disqualify a child or grandchild for financial aid for his or her education.

G. Closely-Held Businesses

If you own an interest in a closely-held business, you should know that coordination of business planning and estate planning will be essential to the ultimate success of your efforts.

You will want to make arrangements for the continuing management and ownership of the business. You may use stock redemption or buy-sell agreements to help meet these objectives.

You may also want to ensure that your estate qualifies for the installment payment of federal estate tax attributable to the business interest.

One of your most important decisions may be the choice of tax entity for the business, whether the company has been in business for several years or is just starting. For example, you could have a double tax upon the sale of assets by a regular or "C" corporation. Your alternatives include an S corporation, a limited liability company ("LLC"), or a limited partnership.

The LLC has emerged as the preferred vehicle. It offers a single layer of income tax, flexibility in the number and nature of owners, and the ability to separate management of the LLC from ownership of LLC Units.

You will want to coordinate your estate plan with pension and profit sharing plans adopted by the business for its employees.

One way to provide liquidity for your closely-held business is to create an Irrevocable Trust that owns insurance on your life. At your death the proceeds avoid both estate tax and income tax. The Trust may use a portion of the proceeds to purchase stock from your estate, which then has funds to pay the taxes. The Trust also protects the insurance proceeds from potential claims by creditors of the business.

In a family business succession planning will be critical to the continuing success of the business. Through continuing discussions with family members you can guide the process of transferring business interests to the members who are active in the business, while using other assets including life insurance to provide equitable treatment for members who are not in the business.

H. Retirement Plans

The design, funding, and eventual distribution of benefits from retirement plans are an integral part of the estate planning process. The plans provide significant income tax benefits before retirement as well as a pool of funds to support participants and their beneficiaries after retirement.

Your participation in individual retirement accounts (IRA's) may not be permitted if either you or your spouse is covered by a retirement plan sponsored by an employer. However, through prior years' participation in IRA's and/or rollovers from qualified retirement plans, you may have built up large balances in your IRA's, thereby creating significant assets that you must take into account in your estate planning.

As an owner of a closely-held business, you have several types of qualified retirement plans to consider. Your choices include defined contribution plans, in which the employer's annual contribution is optional from year to year, and defined benefit plans, in which a certain level of contributions will be mandatory, regardless of whether your company has profits in that year. Generally speaking, for company owners who are 45 years or older, larger benefits may be accumulated through the use of defined benefit plans, but careful consideration must be given before adopting a plan that imposes the burden of annual contributions for all plan participants.

One common type of retirement plan is the 401(k) plan, a form of defined contribution plan. This type of plan permits employees to make contributions to the plan, by means of salary reductions that reduce their taxable income. The employer may adopt a plan that permits it to make matching contributions. Employees often appreciate 401(k) plans because they may generate larger annual contributions (and tax deductions) than they could through the use of an IRA. Furthermore, 401(k) plan participants may enjoy the limited ability to borrow from their account balances; IRA loans are not permitted.

Roth IRA’s are among the more recent additions to the galaxy of retirement vehicles. Contributions to Roth IRA’s are not deductible. However, distributions taken after age 59 ½ are not included in taxable income[22].

As retirement age approaches, the estate planning process will focus on distribution requirements and benefit payment methods. In general, payment of benefits must commence by April 15 of the year following the year when you reach age 70 and 1/2. Required Minimum Distributions (“RMD’s”) are generally based upon the life expectancy of the beneficiary.

Choosing a method of payment for your retirement plan benefits involves analysis of tax considerations, cash flow requirements and availability, the health of you and your spouse, and consideration of certain statutory rights that spouses have in regard to the method of payment.

Generally speaking, it will be advisable for one spouse to designate the other spouse as the beneficiary for any post death retirement plan benefits, due to the unique ability of a

[22] You may convert a traditional IRA to a Roth IRA, regardless of the amount of your income. You must include the value of the IRA in your taxable income. The decision to convert involves a complex set of variables.

surviving spouse to roll over such benefits into an IRA. The rollover IRA would permit the surviving spouse to continue to take advantage of the tax deferred accumulation of funds, at least until age 71.

In the case of beneficiaries other than a surviving spouse, careful planning and engineering are required in order to take maximum advantage of deferred distributions. You should seriously consider designation of your Revocable Trust as the contingent beneficiary, rather than outright to your children.[23]

I. Charitable Gifts

The Internal Revenue Code is generous when it comes to your charitable planning.

You may take advantage of income and gift tax deductions for outright charitable gifts, subject to certain limits in the case of income tax deductions.

You may also make gifts to Trusts that are only partly charitable (split-interest Trusts.) Under the terms of such Trusts, one or more qualified charities receive either (i) an annuity for a term of years with the balance (remainder) thereafter paid to one or more non-charitable beneficiaries, or (ii) the remainder, after annuities are paid to one or more non-charitable beneficiaries for a term of years or for the beneficiaries' lifetimes.

One planning technique combines the use of Charitable Remainder Trusts ("CRT's") and Irrevocable Trusts that own life insurance to provide a number of benefits for you, your family, and your community. In the typical arrangement, you transfer appreciated property to a Charitable Remainder Trust. The Trust then sells the property--*and pays no capital gains tax*. You direct the reinvestment of the proceeds. You and your spouse receive annual distributions of cash for the rest of your lives. Upon the death of the surviving spouse, the Trust property passes to one or more designated charitable organizations that you have chosen (you may change the designations).

Appreciated property may include your closely-held business. Using a CRT to sell all or a portion of your business may optimize the benefits for you, your family, and your community.

Remember: if you have already signed an Agreement to sell your business, real estate, or other appreciated property, it is **too late** to use a CRT.

Simultaneously with the creation of the CRT, you may establish an Irrevocable Trust that owns insurance on the lives of you and your spouse. This form of insurance is called a joint life or second-to-die policy.

With such an arrangement you may achieve many benefits:

[23] If you designate your Revocable Trust as the contingent beneficiary, the Trust must have special provisions to enable the individual beneficiaries to take RMD's based upon life expectancy.

- You avoid capital gains tax on the appreciation in the property sold by the Trust
- You increase cash flow for yourself and your spouse
- You may receive a charitable deduction for income tax purposes
- You replace the value of the transferred property, for eventual distribution to your family, free from estate tax; and
- You create cash flow to pay the premiums on the insurance

You have also enabled one or more charities to serve their purposes. The charities may include a family charity, such as a Family Foundation, created by you during your lifetime and then controlled by your adult children after you pass away.

If you own land that has either appreciated substantially or has the potential for such appreciation, the use of a conservation easement granting development rights to one or more charitable organizations may provide many benefits. If you grant the easement during your lifetime, you may be entitled to a charitable deduction for income tax purposes.

For estate tax purposes, whether you grant the easement during your lifetime or at death, the elimination or restriction of development rights will substantially decrease the value of the property, thereby reducing estate taxes, which otherwise might force your estate to sell the property in order to raise funds to pay the taxes. Development restrictions will help you preserve farm land, forest land or open spaces.

J. Powers of Attorney, Health Care Proxies, and Living Wills

If you become legally incapacitated, due to illness or for any other reason, your legal affairs may be in limbo.

One solution is to have a family member, friend, or advisor appointed by the Probate Court as guardian or conservator. However, this procedure is often prolonged and costly, and the Court does not always grant the desired outcome. Even if the Court appoints a guardian or conservator, the Court will supervise decisions made by the guardian or conservator.

We strongly recommend that you execute a General and Durable Power of Attorney. Such a power enables the holder of the power to act in your place, for all legal purposes (other than health care decisions). This authority continues even though you subsequently become incapacitated.

You may wish to make arrangements for your health care in the event you lose the capacity to make such decisions. To do this you create a Health Care Proxy.

The Proxy often includes provisions sometimes referred to as a Living Will, which sets forth your wishes regarding medical treatment in the event of a terminal illness or other extreme and irreversible medical condition.

You may also arrange for the post-death donation of transplantable organs.

K. Letters of Instruction

Up to this point we have discussed several estate planning instruments and arrangements created by our clients. Virtually all of these instruments are legally binding.

Not all of these instruments and arrangements apply to every client.

However, we highly recommend that <u>every client</u> create and maintain a Letter of Instructions.

Most of the information you provide in your Letter of Instructions is not legally binding. Yet it may ultimately provide you, your family, and your advisors with a wealth of information. It may greatly reduce the time, confusion, anxiety, and cost of managing your affairs in the event of your death or incapacity.

For example, you may use your Letter of Instructions to provide information and guidance in one or more of the following areas:

- Burial and funeral arrangements
- List of family and friends to contact
- List of advisors to contact
- Guidance for raising your children
- Guidance for managing your business
- Guidance for investments
- Special needs of family members
- Guidance for a Family Foundation or other charitable arrangements
- Passwords and other information related to your cyber legacy

We provide you with a format for the Letter, which then becomes a work in progress.

We can also provide you with an encrypted digital storage arrangement for your Letter of Instructions and other sensitive information.

L. <u>Total Wealth Control[24]</u>

Suppose that you and your spouse have combined taxable estates of $30,000,000. You have two children. After you pass away you would like each of them to have $11,180,000, free and clear of transfer tax. Suppose that the federal estate tax due on the

[24] Please see the discussion in Part B above.

passing of the surviving spouse would be approximately $7,528,000, leaving approximately $11,180,000 for each of your children and their descendants.

Your $7,528,000 estate tax bill is a form of "**involuntary philanthropy.**"

Upon the death of the surviving spouse, your assets that exceed your combined federal Estate Tax Exclusions-approximately $7,528,000 in our example-will pass to one or more charitable organizations--leaving no taxable estate for federal estate tax purposes. You may use a Family Foundation, controlled by your adult children, to receive the $7,528,000. You have created your version of "**voluntary philanthropy**."

If you wish to provide your children with a larger inheritance, you and your spouse may create an Irrevocable Trust that acquires a second-to-die insurance policy on your lives. The death benefit will not be included in your taxable estates. You make Annual Gifts to the Trust to enable it to pay the premiums.

The model of Total Wealth Control transforms the planning process:

- You determine the evolving balance among Personal Capital for your children, your charitable program and estate taxes
- Your plan revolves around your values and vision
  - Instead of the vicissitudes of tax law and the Dow Jones Average.

Please note that the model of Total Wealth Control could apply to many more estates as of January 1, 2026, when the federal estate tax exclusion is scheduled to revert to $5,600,000 per person. Please consider contingency planning for this potential change in circumstances.

M. Probate of an Estate

The probate of your estate is both the culmination and the continuation of the planning process. It helps to organize and protect your estate. It also serves as a platform for further planning by your surviving spouse, your children, and other heirs.

The word “probate” conjures up Dickensian images of interminable delay, complication and expense. Fortunately, with proper planning you can help your family navigate this process in an orderly way, at a reasonable cost.[25]

Broadly speaking, “probate” refers to the entire process of administering and settling an estate. The Personal Representative has primary responsibility for overseeing this process. He or she will work closely with the same team of advisors who helped you create your plan: the attorney, accountant, investment advisor, life insurance agent, financial planner and so forth.

[25] Massachusetts has adopted its version of the Uniform Probate Code, which greatly simplifies the probate process for most estates.

Your Letters of Instruction will provide invaluable organization, information, and guidance to your Personal Representative.

The probate process involves many tasks, including:

- Identifying and securing the assets of the estate
- Allowance of the Will and appointment of the Personal Representative
- Mobilizing financial resources for surviving family members
- Managing the assets of the estate
- Preparation and filing of the estate tax returns
- Preparation and filing of the required income tax returns
- Distribution of assets in accordance with the Will
- Creation of various trusts in accordance with the terms of the Revocable Trust
- Review and revision of the estate plans of surviving family members

N. Costs of Estate Planning

As the earlier sections of this Introduction have illustrated, estate planning may provide you and your family with a broad array of tangible and intangible benefits. To generate these benefits requires many areas of expertise. You will engage the appropriate team of experts and advisors, each of whom will seek compensation for their skills and services.

Be prepared to pay reasonable compensation for the services that your planning requires. In order to understand what is "reasonable," you will want to ask questions of your providers, to confirm the specific terms of their services and compensation. You should confirm your arrangement in writing.

Most attorneys will provide you with an Agreement for Legal Services, describing the services they will provide and the fee arrangement. Make sure that you understand and confirm the fee arrangements before proceeding.

Legal fees for estate planning depend on many factors: extent of the work, expertise required, the nature of the assets, special circumstances involving the health or relationships of family members, interstate or international issues, and so forth.

Ultimately these and other factors translate into an equation of costs and benefits. Benefits include such items as financial resources for your family, protection from potential creditors, creation of a support system of fiduciaries and advisors, potential tax savings, the satisfaction of generosity for your community, and **your peace of mind**.

Legal fees come in two basic forms: a fixed amount, or based upon hourly rates. For more complex situations fees are often arranged on the basis of hourly rates rather than fixed fees.

For a young married couple, with no children and limited assets, you would expect legal fees in the range of $2500 to $3500. For a couple with children and substantial assets, you would expect estate planning fees ranging from $4000 to $25,000 or more for more complex situations.

Compare the costs of planning to the costs of no planning. With proper estate planning a thimble of expertise can spare you and your family from a mountain of expense, anxiety and conflict.

O. Costs of Probating an Estate

Many of the factors that apply to the costs of planning also apply to the expense of administering and settling an estate, often referred to as "probating an estate."

For an estate that requires the preparation and filing of either or both federal and state estate tax returns, you would expect legal fees of at least $15,000, ranging up to $50,000 or more, again depending upon the complexity of the actual circumstances.

Due to the open-ended nature of estate administration and settlement, you would expect fees based upon hourly rates rather than fixed fees.

The estate may deduct the legal fees for estate tax purposes. If no estate tax is due, the estate may elect to deduct a portion of the fees in computing the taxable income of the estate for purposes of the federal fiduciary income tax. Either way, the resulting tax savings may significantly lower the net cost of the fees.

In addition to legal fees, probating your estate may involve other expenses, such as appraisals and valuations, accounting fees, and fees for management of investments. Personal Representatives and Trustees may require compensation, especially if they are not members of the family or close relatives.

Depending upon the difference between estate tax rates and income tax rates, it may be advantageous for a surviving spouse or adult children to receive compensation for serving as Personal Representative.

PLEASE NOTE

Your use of the estate planning principles, strategies and techniques outlined in this Introduction will depend on your individual circumstances. None of the information presented in this Introduction is offered or intended as legal advice for any specific individual or situation. No reader should undertake any of the arrangements described in this Introduction without first consulting competent professional advisors.

Your Planning in Progress…

We hope that you have found this Introduction to be informative and stimulating, and that it has added to your awareness of the profound difference that your planning can make in the lives of you and your family.

Our firm has extensive experience in working with clients to develop an estate plan tailored to their unique situations.

In this process we also welcome and encourage the participation of your other professional advisors, including accountants, investment advisors, insurance agents and financial planners.

We look forward to working with you.

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