

ESTATE PLANNING

The following documents can be utilized to achieve your specific objectives, to best protect your assets, and to provide for your beneficiaries. Each document is described and compared with other options.

1) POUR-OVER WILL

Historically, most individuals utilized a Last Will and Testament. Based upon statutory changes and advancement in estate planning strategies, the modern trend in estate planning is to utilize a Revocable Living Trust. When a Revocable Living Trust is used, a Last Will and Testament is not necessary. Instead your estate planning package includes a Pour-Over Will.

Description:

- An abbreviated Will used in conjunction with a Revocable Living Trust
- Transfers assets not titled to the trust into the Trust on the Testator's death
- Parents can designate a permanent guardian for minor children

Advantages:

- If no Will is in place, Pennsylvania statutes control the distribution of assets
- Keeps private information off the public record, which occurs in probate court

2) REVOCABLE LIVING TRUST

Description:

- The Grantor places assets in trust for the benefit of others
- The Trust is managed by a Trustee appointed by the Grantor
- The Grantor can be the Trustee and/or a beneficiary of the Trust

Advantages:

- Provides for distribution of assets to heirs and beneficiaries
- Avoids probate if all assets are titled to the Trust prior to death
- Grantor may amend or terminate a Revocable Trust at any time
- Homestead Exemption is not lost when title is transferred to a trust
- Transfer of real estate to a trust does not trigger a mortgage due on sale clause
- May include spendthrift provisions when money management skills are of concern

Disadvantages:

- Assets in Revocable Living Trust are not protected from the Grantor's creditors
- Does not eliminate federal estate taxes or state inheritance taxes
- For an asset to be owned by the trust it must be retitled in the trust name

Capital Gains:

- Assets in a Revocable Living Trust receive a “step-up in basis” which avoids capital gains:

When property and assets are conveyed to a beneficiary by a Revocable Living Trust, the beneficiary receives a step-up in basis of the value of the asset. When an heir sells an inherited asset, the basis for capital gains tax purposes is not based on gift value (as no consideration is paid) or on the price the grantor paid but is based on fair market value on the day that the decedent died. The beneficiary is responsible to pay capital gains on asset appreciation after the passing of the grantor but not before.

- Taxable basis of Trust assets is determined when assets are distributed to the beneficiaries

3) IRREVOCABLE TRUST

Description:

- Grantor places assets in trust for the benefit of others
- The Trust is managed by a Trustee appointed by the Grantor
- Is a separate taxable entity with an EIN which files Pennsylvania Form PA41

Advantages:

- Provides for distribution of assets to heirs and beneficiaries
- Avoids probate if all assets are titled to the Trust prior to death
- Assets in an Irrevocable Trust are generally not taxed on the death of the Grantor
- Assets in an Irrevocable Trust cannot easily be reached by Grantor’s creditors
- Assets owned by an Irrevocable Trust are protected from divorce, bankruptcy, and are beyond the reach of creditors
- Conveying ownership of the primary home to an Irrevocable Trust benefits Medicaid planning. The maker of an Irrevocable Trust typically continues to live in the home and pay the expenses as long as desired. The Department of Human Services for Medical Assistance (Medicaid) looks back and considers transfers that occurred in the 5 years before application to pay for nursing home.

Disadvantages:

- Grantor generally may not amend or revoke an Irrevocable Trust
- Irrevocable trust assets are no longer accessible to the creator of the Trust

Capital Gains:

- A step-up in basis of assets is not guaranteed and depends upon the language of the Trust

4) GENERAL DURABLE POWER OF ATTORNEY

A document that appoints and authorizes another person, known as an Agent or an Attorney-in-Fact, to act on behalf of the grantor (“Principal”), which can grant specific rights for a limited time or broad authority until death, including the authority to handle financial affairs, whether or not the Principal is incapacitated. The Principal may revoke the Power of Attorney at any time.

5) ADVANCE HEALTHCARE DIRECTIVE

Combines a Medical or Health Care Power of Attorney and Living Will.

a) Health Care Power of Attorney

The Principal grants the Health Care Agent the authority to make broad health-care decisions (not limited to terminal illness) when the Principal cannot communicate and waives medical privacy laws to allow communication directly with doctors.

b) Living Will

A written statement that documents medical treatment choices such as use of a feeding tube, ventilator, life-sustaining treatments, resuscitation, nutrition and hydration, organ donation, and pain medications and management, which obligates doctors and family to abide by the stated health care choices when the signor is terminally ill or permanently unconscious.

6) STANDBY GUARDIANSHIP FOR MINOR CHILDREN

- Designates a standby guardian for unforeseen circumstances other than death
- Parents choose and define which “triggering events” will activate the guardianship

Parents can designate a “Testamentary Guardian” in their Pour-Over Will to direct the care of their children in the event of death. In Pennsylvania, parents may also designate a Standby Guardian to care for children in the event of unforeseen circumstance other than death. A Standby Guardian is authorized to make parental decisions upon the occurrence of a triggering event, which is defined by the parents in the Standby Guardian Designation. Examples of triggering events are serious illness, incapacitation, or being out of the area for an extended period. The Standby Guardian may act as guardian for sixty (60) days and must, within that time, file a petition with the court to have the guardianship confirmed as effective until a parent regains capacity.

.....

COMPARING A LAST WILL AND TESTAMENT AND A POUR-OVER WILL

Last Will and Testament: A Last Will and Testament governs the distribution of probate assets, sets forth the directives of the Testator, appoints the Executor who will administer the estate, and takes effect only upon the death of the Testator. The Testator may amend the Will at any time during the Testator’s lifetime so long as the Testator is mentally competent. Probate assets consist of assets that do not pass

automatically by operation of law upon the death of the Testator (now the decedent), that are solely owned by the decedent and are not governed by a beneficiary designation. Testators with minor children should designate and appoint (known as a testamentary designation) a guardian to care and provide for the children upon the passing of the Testator.

Pour-Over Will: A Pour-Over Will is used in combination with a Revocable Living Trust. The goal of the creator of a Revocable Living Trust (“Trustor”) is to transfer ownership of assets and property into the Trust. If the Trustor fails to place all assets into the Trust and continues to own assets in his or her own name, the Executor of the Pour-Over Will is appointed to place all such assets into the Trust upon the death of the Testator for management and distribution by the Successor Trustee of the Revocable Living Trust. The Testator in a Pour-Over Will should also designate and appoint a guardian to care and provide for minor children upon the passing of the Testator; however, the Revocable Living Trust addresses in detail the financial authority of the guardian and financial planning for related expenses.

COMPARING A WILL AND A REVOCABLE LIVING TRUST

Can going to probate court be avoided?

- Last Will and Testament: A Will cannot be enforced (no assets transfer to beneficiaries under the Will) until a probate court proves the Will is authentic and valid. The probate process, which includes court supervision and intervention, can be a lengthy process (up to 18 months) and court costs are incurred.
- Revocable Living Trust: Assets held in a Revocable Living Trust are not subject to the probate process. The assets pass automatically by operation of law and can be distributed to beneficiaries as set forth in the document, without court intervention.

Will financial privacy be maintained?

- Last Will and Testament: When transferring assets via a Will, upon the death of the Testator, the Personal Representative must probate the Will at the county courthouse. The content of the Will, including all financial information and family dynamics, is made part of the public record available for inspection. Further, all actions of estate administration must be reported to the court, which become part of the court filing and thus the public record.
- Revocable Living Trust: A Revocable Living Trust is not recorded on the public record and remains confidential during and after the lifetime of the Trustor.

Can assets be controlled in the case of disability?

- Last Will and Testament: A Will is enforced only upon the death of the Testator and offers no ability for another capable party to protect and control assets upon disability.
- Revocable Living Trust: In the event of disability (a party cannot manage assets), property and assets held in a Revocable Living Trust are controlled by the Successor Trustee, which is generally a trusted family member appointed by the Trustor. The Successor Trustee has the authority to step

in immediately to manage Trust property, without court intervention. The Revocable Living Trust specifies and describes the authority the Successor Trustee will have to manage Trust assets during the lifetime of the Trustor.

Can property be held and managed for minor beneficiaries?

- Last Will and Testament: If the Testator dies and a minor child is the beneficiary under a life insurance policy, IRA, or pay-on-death bank account, the probate court will step in to appoint a guardian to hold the proceeds in a sequestered account until the child reaches the age of majority (usually 18), at which time the child gains control of the assets.
- Revocable Living Trust: A common objective of Revocable Living Trusts is to protect the Trust assets that will pass to a minor beneficiary upon the death of the Trustor. The Trust is named as the beneficiary of the policy or accounts, which allows the Trustor to determine how and when the asset is to be distributed and provides investment options to continue the growth of principal assets until the age of majority or distribution is reached.

RELATED ESTATE PLANNING INFORMATION

THE PENNSYLVANIA UNIFORM TRANSFERS TO MINORS ACT

The Pennsylvania Uniform Transfers to Minors Act (20 Pa.C.S.A. § 5301, et seq) is an estate planning tool that allows custodians to use property transferred to a person under the age of 21 by will, trust, or gift for the benefit of a minor without a court order. The custodian is authorized to spend the minor's funds for the support of the minor. The Act is used to ensure the minor has the right to enjoy the benefit of real or personal property without a formal trust.

The custodian holds legal title to the custodial property, and has the power to collect, hold, manage, invest, and reinvest the property, and any right that the custodian has over his/her own property, except that the value of the property must be used for the benefit of the minor. The custodian is obligated to exercise the standard of care that a prudent person dealing with the property of another would use. Caution must be exercised when appointing a custodian as the Act grants the custodian wide discretion in managing the assets.

The custodian must keep records of all transactions concerning custodial property, including information necessary to prepare the minor's tax returns, and must make those records available for inspection by a parent or legal representative of the minor or by the minor if the minor is 14 years of age or more. The court may require that custodian provide a full accounting of actions. Generally, the custodian is required to transfer the custodial property to the minor when the minor reaches the age of 21. The custodian may be reimbursed for reasonable expenses incurred in performing his/her duties



Estate Taxes, Gift Taxes, and Inheritance Taxes on the Federal and State levels, and Capital Gains Taxes must be considered when generating a comprehensive and effective estate and asset protection plan.

➤ **ESTATE TAX (ALSO KNOWN AS DEATH TAX):**

- Assessed against the entire value of the estate
- The estate is responsible to pay any estate taxes due
- Imposed after a person dies but before the assets are distributed to heirs

1) Federal Estate Tax:

- Due when the value of the estate is over 11.4 million

2) Pennsylvania Estate Tax:

- None

➤ **GIFT TAX:**

1) Federal Gift Tax:

- Due if the Gifting Party gives over 11.4 million in their lifetime
- Unlimited gifts under \$15,000 are tax exempt if made to separate individuals
- When a single gift is over \$15,000, the Gifting Party must file Form 709 with the IRS

2) Pennsylvania Gift Tax:

- None

➤ **INHERITANCE TAX:**

- A tax imposed on certain beneficiaries on the assets inherited
- The spouse of the deceased is 100% exempt from inheritance taxes

1) Federal Inheritance Tax:

- None

2) Pennsylvania Inheritance Tax:

- Unlike the majority of states, Pennsylvania imposes a state inheritance tax
- Transfers of property are subject to inheritance tax when the transfer occurs under a last will and testament, by intestate succession, or through a Revocable Living Trust
- Life Insurance benefits are not subject to the Pennsylvania inheritance tax

- A Pennsylvania inheritance tax form must be filed, and taxes must be paid within nine months of the death of the Grantor
- Gifts made in the 12 months before the Grantor's death are considered part of the decedent's estate and are subject to the Pennsylvania Inheritance Tax
- Revocable Living Trust: If someone dies owning assets in a Revocable Living Trust over which the Trustor has retained access and control, the assets held by the Trust are subject to the Pennsylvania Inheritance Tax.
- Irrevocable Trust: Whether Pennsylvania inheritance taxes are due depends upon the language contained in the Irrevocable Trust.
- Life Estate: When property is conveyed and the Grantor retains a Life Estate, the interest of the Remainderman is taxable as an inheritance when the Grantor dies even though the property is gifted while the Grantor is living. Upon the death of the Life Tenant, the value of the entire property is subject to the inheritance tax.

What Amounts Must Be Paid and by Whom?

- Class A Beneficiaries - Grandparents, parents, and lineal descendants (natural, adopted, and step-descendants)
 - a) Pay 4.5% on the value of the asset over \$3,500
 - b) Receive a \$3,500 family exemption from the Pennsylvania inheritance tax
- Class A1 Beneficiaries - Brothers, half-brothers, sisters, and half-sisters - persons having at least one parent in common with the decedent either by blood or by adoption
 - a) Pay 12% on the total value of the asset
 - b) Receive no exemption from the Pennsylvania inheritance tax
- Class B Beneficiaries - All other beneficiaries
 - a) Pay 15% on the total value of the asset
 - b) Receive no exemption from the Pennsylvania inheritance tax

Estates of Pennsylvania residents should file Pennsylvania inheritance tax return, Form REV-1500, on behalf of their beneficiaries. It's due no later than nine months after the decedent's date of death. The inheritance tax should also be paid within the same time frame or interest will begin to accrue.

➤ CAPITAL GAINS TAX:

Description:

- Relates to assets that appreciate after the date acquired and are due when the asset is sold
- Short term capital gains impose standard tax rates and apply when an asset is owned under 12 months
- Long term capital gains rates are 5% to 20% and apply when an asset is owned over 12 months

- No Capital Gains Taxes are Due When:
 - 1) Sale proceeds are under \$250,000 for unmarried asset owners
 - 2) Sale proceeds are under \$500,000 for married asset owners
 - 3) When a personal residence is sold which the owner lived in 2 of the last 5 years

Step-Up in Basis:

Inherited assets that appreciated while owned by the decedent receive a step-up in basis for capital gains purposes. The value of the asset is determined when inherited rather than when acquired. Without a step-up in basis, the value is the original purchase price. For example, if an asset purchased for \$100,000 is sold for \$500,000, capital gains taxes are due on \$400,000. With a step-up in basis, the value of the asset is determined on the date of the inheritance. For example, when an asset purchased for \$100,000 is worth \$500,000 when inherited, capital gains taxes would be due on any proceeds greater than \$500,000 when the beneficiary sells the asset.

Pennsylvania does not allow a step-up in basis for property acquired as a surviving spouse or other joint tenant with right of survivorship.

- Life Estates: When a home owned by a Life Tenant and Remainderman is sold while the Life Tenant is alive, there is no step-up in basis and capital gains taxes are based on the increase in price compared to the original purchase price of the home.

When a home owned by a Life Tenant and Remainderman is sold after the passing of the Life Tenant, the exemption allowance of \$250,000 is not available to the Remainderman; however, there is a step-up in basis and the Remainderman must pay capital gains only on the amount of any sale over current fair market value at the time of the Life Tenant's passing.

➤ ESTATE PLANNING USING BUSINESS ENTITIES:

Limited Partnerships are an excellent vehicle to convey gifts to minors because the fair market value of the gift can be discounted up to 30%. The IRS acknowledges that Limited Partnership ownership has a lower fair market value. Investors are less interested in purchasing a share of a company that the purchaser would have no control over. This allows faster gifting of assets from parent to child when a parent is the General Partner and a child or children are the Limited Partners.