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ESTATE PLANNING

Estate planning is more than simply signing a will and living trust. It is your comprehensive plan for the enjoyment, use and disposition of your assets during your lifetime, while you are disabled and after death. It may also include asset protection and income tax considerations through the use of living trusts, beneficiary designations and asset re-titling. A good estate plan has three primary goals:

1. To create and document your plan to care for you, your family, loved ones and charities;
2. To minimize exposure of your assets to taxes, creditors, probate, fees, expenses and publicity; and
3. To control the efficient distribution of your assets by a person who you choose to act as fiduciary.

It takes a lifetime of hard work to accumulate assets. People plan to use their assets to provide for needs during life and then to benefit their family, friends and charities. Spending time now will make it more likely that your estate plan will accomplish your desires. We only practice law in Illinois and this Memo is addressed to persons who are citizens of the United States and residents of Illinois.

Documents

A typical estate plan includes the following documents:

- Declaration of Trust (also known as a revocable living trust) to handle assets during your lifetime and after death;
- Will;
- Power of Attorney for Health Care to facilitate communication between doctors and your chosen agent and to allow your agent to make decisions on your behalf;
- Living Will;
- Power of Attorney for Property to enable your agent to deal with assets in your name;

- Asset re-titling instructions to assist you in your work to title assets into your name as trustee of your living trust.

Your Will

Every competent adult should consider signing a will, regardless of wealth, age, marital status or health. A will is a formal written document which becomes operative at your death in order to:

- Appoint a guardian for minor children;
- Direct how your assets are to be distributed (e.g., to pour assets over into your living trust); and
- Designate an executor who is responsible for taking inventory of your property, paying debts and taxes and distributing assets as you direct.

If You Die Without a Will (“Intestate”)

Illinois law contains “default” rules on how your assets will pass to family members if you die without a will. These default rules may conflict with what you would have selected in your will. The Probate Court will select its own choice of guardian for your minor children and appoint an administrator to handle your financial matters (after purchase of a surety bond). Although disclaimers may be carefully and quickly implemented in some instances to minimize estate taxes, your estate will not automatically benefit from estate tax planning which is available by having a will and trust.

Probate

Assets which pass under Probate Court administration include assets owned in your own name alone at death without a surviving joint tenant or “pay on death” beneficiary. Small estate affidavits can sometimes be used to transfer assets in Illinois when the assets in a decedent’s name total under \$100,000.

Non-Probate Assets

Examples of assets which often do not require Probate include:

- Assets titled in a revocable living trust (i.e., owned by you in your name as trustee of your living trust);
- Assets which are established with provisions to “pay on death” to named surviving beneficiaries (e.g. securities, bank accounts, life insurance, retirement accounts); and
- Assets held in joint tenancy (with rights of survivorship) which pass to one or more surviving joint tenants.

Living Trust

You retain the ability to spend, save and manage your assets in your living trust as you see fit while you are competent and you are not required to file additional income tax returns or reports. Most persons act as trustee of their own living trust and name a spouse, child, relative and/or trusted friend to act (one at a time) as successor trustee (when you, as grantor, are unable to act as trustee). A bank or trust company is typically named as final successor trustee in the event the named individuals do not act. Living trusts direct your chosen successor trustee to manage assets for you during a time when you are disabled and upon your death without the time, expense and exposure of probate. Importantly, you can change or revoke your living trust any time while you are competent.

In your living trust, you declare that property which you re-title into your name as trustee of your living trust is held subject to the terms of the trust. If you become mentally disabled, your successor trustee is empowered to use assets in your living trust to support you and your loved ones who you have selected in advance. Upon your death, the successor trustee follows your direction to distribute or hold the assets for one or more of your beneficiaries. Assets which you leave in trust for your children can be protected from many of their own creditors.

Assets in your living trust (and other assets over which you have control) are included in your gross estate for estate tax purposes. These assets are also typically counted when determining Medicaid eligibility. Living trusts do not shield your assets from your own creditors.

Distribution of Assets at Death

One or more additional trusts are typically created under your living trust. They are designed to spring into existence upon your death. In this way you direct how, when and to whom trust property will be distributed. You can include trusts for your spouse, trusts for children, special needs trusts for disabled beneficiaries, spendthrift trusts, trusts to protect beneficiaries from creditors and other provisions. Your trustee will hold property in a manner designed to minimize estate taxes and limit interference by subsequent spouses, creditors and others. The successor trustee can be directed to hold money for minors until they reach certain ages, staggering principal distributions over a period of several years while still providing for the beneficiary's needs. Assets can also be held for future generations. Living trusts are administered privately and do not subject your personal and financial matters to public probate proceedings.

Irrevocable Insurance Trusts (“ILITs”)

For larger estates, persons sometimes create ILITs (in addition to living trusts) to minimize estate and gift taxes. As with other gifts, you surrender power and forego benefit from the ILIT’s income and principal. Unlike living trusts, ILITs cannot be amended and do require steps to be taken each year. ILITs are used in advanced estate planning and are not discussed in detail in this basic Memo.

Federal Estate and Gift Taxes

You can give unlimited amounts to your spouse and qualified charities without incurring gift or estate tax. Assets remaining in your surviving spouse’s estate at death are subject to estate taxes. Current law imposes a gift tax when assets are given to someone other than your spouse or a charity. However, each person may make an unlimited number of tax-free gifts totaling up to \$13,000 per donee per calendar year without incurring gift tax. You can also directly pay certain education and medical expenses without gift tax. In addition to annual gifts, each person can gift (through the end of year 2012) a total of \$5,120,000 to friends, family or others during life without incurring gift tax, provided that gift tax returns are timely filed. As the law is now written, the lifetime gift exemption amount will decrease to \$1,000,000 in year 2013 and beyond. Larger gifts (in excess of \$13,000 per year) which you make during your lifetime will impact the “exemption equivalency amount” which is available to shelter your estate from taxes at death.

At death, persons are entitled to pass the “exemption equivalency amount” to one or more beneficiaries without liability for estate taxes. The exemption equivalency is \$5,000,000 per decedent for year 2011 and \$5,120,000 for year 2012. Larger gifts made during lifetime impact the exemption amount available at death. Legislation allows executors the option to apply the 2010 or the 2011 estate tax laws to estates of decedents dying in 2010. “Portability” of the exemption amount between spouses is allowed if certain steps are followed. If no changes are made to the law, the exemption equivalency amount and lifetime gift exemption thresholds are scheduled to revert to \$1,000,000 for year 2013 and beyond. A substantial tax is payable on all amounts in a person’s gross taxable estate over the exemption equivalency amount. Every estate valued in excess of the exemption amount is required to file a federal estate tax return with the Internal Revenue Service and with the Illinois Attorney General.

When valuing your estate for purposes of calculating your gross taxable estate, the fair market value of assets over which you have ownership or control and the value of certain taxable gifts made during your lifetime are included. Such assets may include your interest in joint tenancy assets, some recently gifted assets, payable on

death assets, assets you hold as custodian for another, life insurance policies in which you have ownership or a right of control (i.e., “incidents of ownership”), tax deferred retirement assets such as IRAs and 401(k) pension plans, annuities and so on. In certain situations, taxes will be payable from living trust assets, gift recipients and/or others based on the value of assets which were given away in the months or years prior to death. Your executor may deduct from the gross taxable estate various estate administration fees and costs, funeral expenses, debts and charitable donations.

Importantly, if you leave assets in one or more trusts for your spouse, your exemption equivalency can be sheltered from estate taxes upon your death and minimized upon the subsequent death of your spouse. Such trusts (which “spring out of” your living trust at your death) are referred to as “bypass trusts,” “family trusts” and “credit shelter trusts.” If you fail to plan for estate taxes, your estate may be unnecessarily diminished by substantial taxes.

Various protection and control objectives are met by married couples’ use of marital trusts, qualified terminable interest property (“QTIP”) trusts and other trusts to hold assets which exceed the exemption amount for the benefit of a surviving spouse.

It is likely that changes to estate and gift tax laws will continue. We recommend that all persons keep up to date and consult regularly with their legal, accounting, financial and insurance advisors.

Generation Skipping Tax

Generation-skipping transfer tax (“GST”) may be due, in addition to estate and/or gift tax, if a taxable transfer of property is made to children of a child who is living at your death, to children of a living sibling or to other beneficiaries who are more than one generation younger than you. GST taxes are imposed at the maximum estate tax rate to the extent that the transfer is not covered by your available GST tax exemption. The GST tax exemption amount currently mirrors the current exemption amount.

Illinois Estate Tax

Illinois has its own estate tax system which is “de-coupled” from the federal system and currently imposes a tax on amounts which do not pass to a surviving spouse in a resident decedent’s estate in excess of \$3,500,000 for year 2012 (increasing to \$4,000,000 in 2013). A well-drafted living trust will include provisions designed to delay the payment of this tax until after the death of the

surviving spouse without losing the benefit of the full federal exemption equivalency amount.

Powers of Attorney

Powers of Attorney are useful during your lifetime to enable you to designate and empower another person (your agent) to handle matters without the need for probate to appoint a guardian, even if you become mentally disabled. A power of attorney for health care deals with your physical care and treatment and includes the release information under federal HIPAA laws. A power of attorney for property relates to the management of your assets which are not titled in your living trust.

Getting Started

The first step is to make a list of your assets, including estimated values, how assets are titled and any debts, ownership obligations and restrictions (e.g. pre-nuptial agreement and divorce decree) which may limit your ability to dispose of your property. Then, consider your goals regarding distribution of assets and how and when you want assets available for your beneficiaries. Consider the impact of taxes on your estate and take simple steps now to protect your assets from future creditors. Minimizing income tax should be considered. It is also a good time to review your insurance policies (e.g., life, professional, business, liability, auto, real estate, umbrella, collectibles, long term care, property, casualty, liability) and consider the amounts and types of coverage, the pros and cons of keeping or increasing coverage, who is named beneficiary and related matters.

We recommend that you review your estate plan at least every few years. Following are some significant factors for you to consider from time to time:

- Couples can shield their marital home from creditors of one spouse by holding title as tenants by the entirety;
- Consider creditor protected categories of assets which may include qualified retirement plans, IRAs, cash surrender value life insurance payable to your family, trusts established for you by another person and so on;
- Consider the pros and cons of a pre-nuptial agreement if you are planning to marry;
- Consider ownership and beneficiary designations for all of your property;
- Update your estate plan documents if your assets, family, marital and/or personal circumstances change;

- If you expect or receive an inheritance, consider disclaimers, possible exercise of a power of appointment and other options (encourage your loved ones to do their own estate planning);
- Consider required minimum distributions, options for payout, naming of primary and contingent beneficiaries as well as income tax and estate planning aspects of your IRAs and other retirement accounts;
- Monitor changes in state and federal estate tax laws;
- Ask your lawyer to review employment agreements, stock ownership agreements and other contracts before signing and later, to consider the impact on your living trust;
- Have a succession plan for your business; keep your buy/sell agreement up to date;
- Consider life insurance options (e.g., need, insurability, replacement policies, ownership, beneficiaries and so on); and
- Review your estate plan documents if you move to another state or country; documents executed in one state are typically valid in other states, but it is a good idea to have your documents reviewed by a lawyer in your new home after you move.

Conclusion

This Memo addresses basic elements of estate planning. Many legal and tax law requirements apply to the general principles mentioned in this Memo. The guidance of an experienced lawyer should be sought before taking any action with regard to your estate plan.

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Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This memo is not intended to provide legal advice on specific subjects, but rather to provide insight into legal issues. The reader should always consult with legal counsel before taking action on matters covered by this memo.