

# Understanding Estate Planning and Wills

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It is not an understatement to suggest that every adult needs to have a will. Without one, the law decides what happens to a person's property on death and, often, the government may take a larger share for itself in the form of estate taxes. Unless a person has no objection to his or her property potentially going to a "long lost relative" (whom he or she has probably never met) or going to the government, a will must be executed to pre-empt the laws of intestacy and is therefore greatly important.

Basic terms: A "will," in its most basic form, is a legal document that expresses a person's desires as to how to distribute his or her assets upon death. Parents of minor children execute a will in order to appoint a guardian for the children (complex domestic relations issues, such as the disinheritance of a spouse, and the requirements of a valid will are beyond the scope of this very basic primer). "Beneficiaries" are the people receiving property. The person who dies is the "decedent." A person who dies without a valid will is said to have died "intestate." A person who dies with a valid will is characterized as having died "testate." An "executor" is the person the decedent names to administer his or her estate and distribute the property of the estate. An "administrator" is the person, whom the law decides, who administers the estate and distributes the property of a person who dies intestate. "Probate" is a court proceeding in which the court decides if a will is valid and supervises the transfer of assets from the decedent to the beneficiaries.

The Better Business Bureau has a simple and straightforward definition on "an estate," which is all a decedent's property, such as real estate, personal property, any business, bank accounts, life insurance, pensions, investments and debts. Thus, anyone who owns anything will have an estate. In addition, there could be properties that are not assets of an estate, but are considered part of the estate, nonetheless, for estate tax purposes.

"Estate planning" is, again deferring to the Better Business Bureau for a simple but highly elegant definition, "the process of deciding what will happen to [a person's] assets and belongings after [his or her] death." However, a complete estate plan also addresses the administration and protection of assets during a person's lifetime, reducing or eliminating estate and inheritance taxes, and decision-making in the event of a disability, including decision-making for health care.

What happens when a person dies without a will: In New York, the estate (i.e. property) of a person who dies intestate (without a will), will pass by operation of law to a set roster of people. This is commonly referred to as "the law of intestacy." A surviving spouse receives the first \$50,000 from the estate. The surviving spouse gets the entire estate if there are no children or other descendants (referred to as "issue"). If there is one child, the surviving spouse also receives one-half of the remaining estate (after the \$50,000 has been removed) and the sole child receives what is left. If there are two or more children, the

surviving spouse receives one-third of the remaining estate (after the \$50,000 has been removed) and the children share the remaining two-thirds equally. Grandchildren inherit under the laws of intestacy if the decedent's own child died before the decedent. In that case, the grandchildren would share equally in the property that would have gone to the deceased parent. For example, in the case of a \$150,000 estate with a surviving spouse and two children, the surviving spouse receives \$75,000 plus one-third of the remainder (\$25,000) for a total distribution to the surviving spouse of \$100,000. Each child then gets \$25,000.

If the decedent did not leave behind a spouse or any issue (children, grandchildren, etc), the next relatives in line would be parents of the decedent, then siblings, then nephews and nieces, then aunts and uncles, and lastly cousins. The last "long-lost relatives" in line would be great-grandchildren of the decedent's grandparents. If none of these people exist at the time of the decedent's death, the state gets it all (i.e., "the estate escheats to the state.")

Before leaving the laws of intestacy, it should be pointed out that a surviving spouse will not inherit under several conditions: if 1) the marriage was validly terminated prior to the decedent's death; 2) a final decree of separation was rendered against the surviving spouse; 3) the surviving spouse obtained a divorce in another jurisdiction; 4) the marriage was bigamous or incestuous; 5) the surviving spouse abandoned the decedent which abandonment continued until the decedent's death; or 6) the surviving spouse failed or refused to support the deceased spouse.

A will is important because it can circumvent most of the rules of intestacy: As noted, a will is used to direct the distribution of an estate according to the desires of the decedent and to appoint a guardian for minor children. In addition, a will 1) permits the decedent to choose who will administer the distribution of the estate; 2) allows for specific distributions to specific individuals (known as "bequests"); 3) allows for the sale of assets to cover death taxes and probate expenses; 4) allows for the continuation of the decedent's business if the decedent so chooses; 5) can defer distribution to minors via trust provisions until they reach an age older than 18; 6) can have provisions allowing for tax savings opportunities.

**Estate Taxes:** If "death and taxes" are the only certainties, then the existence of death taxes should come as no surprise. These taxes, referred to as "estate taxes," "inheritance taxes" or "death taxes" may be imposed by both the Federal and state governments upon an estate. All assets owned by the decedent or in which he had an interest and/or certain retained rights or powers may be included in his or her "gross estate" for estate tax purposes, and can include assets that will pass to designated beneficiaries "by operation of law" (rather than pursuant to the will) such as certain joint accounts, interests in certain trusts, qualified retirement plan and IRA assets and life insurance policies.

The Federal estate tax can be nearly as much as 50% of the "taxable estate" of a decedent. A decedent's taxable estate is the value of the gross estate - consisting of all assets that he or she owned at death or in which he or she had an interest - reduced by the marital deduction (for assets passing to or for the benefit of his or her surviving spouse) and the charitable deduction (for assets passing to qualified charities).

The Federal estate tax is calculated based on the value of the taxable estate. Then, each estate is entitled to a credit against the tax calculated. A credit is a dollar for dollar reduction of the tax so calculated. The credit relates to the value of assets that pass at death to or for the benefit of beneficiaries other than the surviving spouse or charities. The credit is capped so that if the total value of assets passing to non-spouse/non-charitable beneficiaries is less than a designated threshold amount (called the "applicable exclusion amount" or "AEA"), the credit reduces the tax otherwise imposed to \$0.

Although the Federal estate tax is also eliminated where all of the decedent's assets pass to his or her spouse or charities, any assets passing to the surviving spouse may be included in the surviving spouse's estate, and subjected to Federal estate tax, at his or her death. Instead, if assets valued at no more than the AEA are allowed to pass to other beneficiaries, then the value of these assets will not be subject to estate taxes at either spouse's death. However, most decedents wish to protect the decedent's surviving spouse and might be reluctant to have assets pass to other beneficiaries, to the potential detriment of the surviving spouse. In this case, an amount of the assets of the decedent's estate can be paid to a certain type of trust, often referred to as the "by-pass trust". The surviving spouse will have access to the assets of the bypass trust, but any assets remaining in the bypass trust at the surviving spouse's death will not be subject to Federal estate taxes.

For 2005, the AEA is \$1,500,000. The table reproduced below shows the changes in the AEA during the next several years and includes the Federal estate tax rates applicable in each of such years.

<b>YEAR</b>	<b>APPLICABLE EXCLUSION AMOUNT</b>	<b>MAXIMUM ESTATE TAX RATE</b>
2005	\$1,500,000	48% / 47%
2006, 2007 and 2008	\$2,000,000	46%/ 45% / 45%
2009	\$3,500,000	45%

With some exceptions, the estate tax laws of the state of New York generally track the Federal estate tax structure.

#### Trusts

While this article is primarily a primer on intestacy and wills as an estate planning tool, trusts, when appropriate, are crucial in the estate planning process, and usually dovetail with a will. For example, in New York, where probate is costly and time-consuming, a basic revocable trust or "living trust" can be used to avoid or reduce the complexities of probate. A revocable trust is an instrument executed by a person (the "grantor") and a trustee that creates a trust, a separate legal entity, that will own and control the management of assets transferred to the

trust. The grantor of a living trust usually names himself or herself as the trust's "trustee", thus retaining control over the property. At his or her death, however, the assets of the trust will pass to the beneficiaries named in the trust, without the need for any probate proceedings. Because the trust is revocable and can be terminated by the grantor at any time, the assets of the trust are treated as if owned by the grantor at his or her death, and thus no estate tax benefits may be derived from this technique.

Wills and trusts come in several varieties, each one designed to accommodate the financial situation of the estate and the ultimate goals of the decedent. There are basic wills, wills with a contingent trust, pour-over wills, Testamentary Credit Shelter Trusts ("tax-saving wills"), living trusts without tax planning, Living Credit Shelter Trusts, Qualified Terminable Interest Property Trusts ("Q-tip trusts") and Qualified Domestic Trusts. Each has a specific role in an overall estate planning arrangement and is applied to specific and often unique situations. In the end, however, each of these instruments must address the simple and important goal of the estate planning process to ensure that the property a person has earned over a lifetime of hard work, education, training and experience passes exactly to the beneficiaries that the decedent wants to enjoy his or her assets.

As wills and trusts are complex legal documents, it is important that an experienced professional is consulted for the drafting of such instruments, and that such instruments are reviewed frequently and amended as appropriate, including to address changes in the tax laws.

If you should have questions regarding, contracts, leases or transactional matters of any kind, please contact Mathew J. Levy, Esq. at 1-800-445-0954.