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An Overview of Strong Estate Planning Tools

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Some people manage to postpone estate planning indefinitely. Many others create an estate plan – then "put it away" -- and simply chose not to update their plans to correctly reflect significant changes in their family, their assets, and the law. While both approaches may be understandable, neither is very prudent. There is simply too much at stake, and the only guaranteed benefactor of procrastination is the IRS.

Smart estate planning can avoid family conflict; protect assets during disability; transition wealth smoothly after death; and save hundreds of thousands of dollars in estate taxes. In short, ***estate planning enables you to protect everything that you own, and everyone that you love.***

If you think of estate planning as a "process" you will quickly realize that it is merely a ***continuation*** of a tradition you started long ago. Over the years, you have accumulated wealth, created a family, and possibly given to your broader community. If you are like most, your decisions prioritized safeguarding your family and your assets. Estate planning carries this tradition forward – benefiting you, your family, and your community.

At Lennington Law Firm, we listen to your story and your tradition. We seek to understand what you value and desire. And in the end, we endeavor to create a plan that translates your story into an enduring legacy.

Planning Your Estate

Our goal is to give you peace of mind. Your estate plan should not only reduce your taxes, but should also fulfill your specific goals and objectives. This brochure provides you with an overview of the estate planning process we follow with our clients, and further provides you with summaries of the planning strategies we commonly implement.

No two estates are the same. Consequently, some of the topics covered will not be applicable to your individual case. Before undertaking any estate planning, consult a competent attorney who practices in the area of wealth preservation, estate planning and elder law.

Initial Steps

Uncovering Your Objectives

Begin with the end in mind! Your personal objectives determine everything. Consequently, tax planning must necessarily take a back seat to carrying out your wishes and goals. During our initial interview process, we assist you in articulating how you want your assets to be used, as well as who shall ultimately inherit them.

Consider making a list of your personal estate planning goals and pinpoint the needs of specific beneficiaries. (Our Estate Planning Organizer walks you through this exercise). Some of the more common planning objectives are these:

- Maximizing the enjoyment of your assets during your lifetime
- Providing for your spouse after death
- Educating your children or grandchildren
- Preserving asset values
- Protecting your family's future from unwanted creditors and predators
- Reducing taxes and expenses
- Providing for a "special needs" child or grandchild
- Leveraging the use of tax exemptions
- Passing control of a family business to particular family members or key employees
- Supporting particular charities

Make an Inventory of your Assets and sources of Income

Our Estate Planning Organizer helps you make an accurate list of all your property, both real and personal, as well as your various income sources.

This step is vitally important for several reasons. First, the nature of a particular asset will determine just how it will pass at your death. For example, certain assets pass by beneficiary designation, while other assets will pass through probate (unless owned by a trust). Second, the overall fair market value of your assets will determine the extent to which you should consider estate tax planning – to reduce your tax liability at death.

Identify Other Unique Issues

Everyone has particular issues unique to his own family. You will want to make sure you identify and discuss these issues with an attorney before implementing any estate plan. For example, it is important to list any health concerns or special needs of individual family members. You may also want to estimate the emotional maturity and financial needs of your children, grandchildren, or other beneficiaries. Once again, our Estate Planning Organizer will assist you in this exercise.

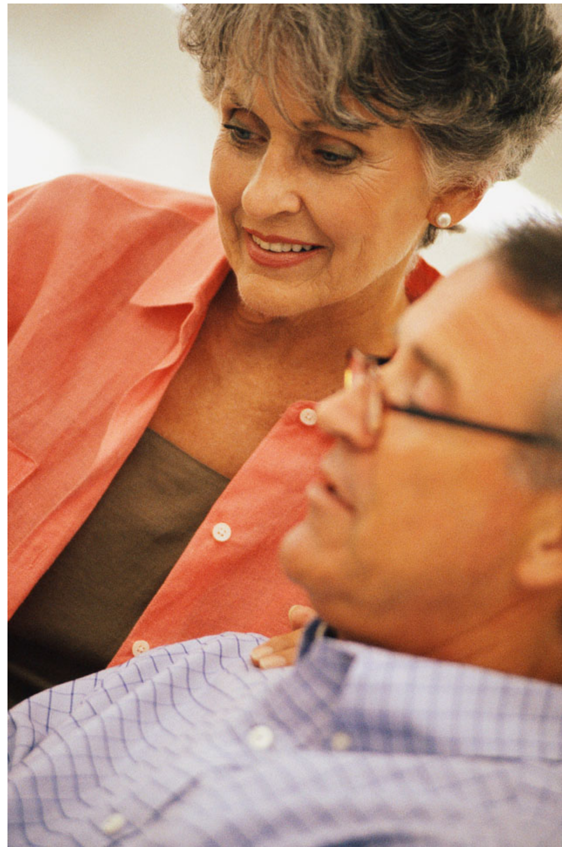
Consider the Impact of Taxes

Americans spend countless hours each year working with tax advisors to help reduce annual income tax -- and rightly so. Significant savings can be achieved through proper income tax planning. Nevertheless, few individuals pay any attention to the impact federal estate taxes will have on the transfer of wealth after death – even though proper estate tax planning could result in even larger overall savings.

The risk is large. In fact, the top federal estate tax rate is currently at 48% (in 2004) and will incrementally decrease to 45% in 2009.

Many believe that their estates are simply "too small" for estate taxes to be an issue. They may, however, be laboring under a misconception. While both the federal and state government "exempt" certain smaller estates from tax liability, it doesn't take much for an individual to gravitate into the "taxable" estate column. For example, in Minnesota, estates in excess of $850,000 are susceptible to estate taxes (2004). And on the federal level, estate taxes are imposed on estates in excess of $1.5 Million (2004). When calculating your taxable estate, you must include everything you own – not just everything that you can currently "spend." Life insurance death benefits, real estate, retirement accounts, stocks, bonds, mutual funds, savings accounts, personal property, and other assets are included in the overall value of your taxable estate.

With proper planning, your ultimate estate tax liability can be drastically reduced, and in many cases, completely eliminated. Lennington Law Firm, PLLC will estimate your potential estate tax liability. With this information, we can recommend strategies designed to alleviate the tax burden on your beneficiaries.



Establish the "Building Blocks" of your Individual Plan

After we have determined your objectives and analyzed the nature of your estate, we can recommend a plan that will comport with your desires. In many cases, Lifetime Trusts, Wills, Powers of Attorney, and Health Care Directives satisfy a client's needs. In other cases, more complex planning is warranted.

Implementation and Follow-Up

When we have agreed upon a plan for you and your family, we will prepare the appropriate legal documents to implement your plan. When significant changes occur (e.g., changes to your beneficiaries, your financial situation, or your estate planning wishes), simply contact us so that we can advise you on modifying your estate planning documents.

Key Tax Provisions

The primary goal of estate planning should be to protect yourself and your family, and to ensure that your ultimate plans for transferring your wealth are achieved. Nevertheless, estate taxes are a major consideration, as they can devour a substantial portion of your accumulated wealth. Currently, estate tax rates can be as high as 48%, and that tax bill must generally be paid within nine months after death. There are, however, various estate planning strategies that can substantially reduce, and in many cases eliminate, these tax burdens.

The following section will introduce you to some of the more common aspects of the federal estate tax scheme.

The Federal Estate Tax Applicable Exclusion Amount.

Under current federal law, individuals are entitled at death to transfer $1.5 Million – free from federal estate taxes. This is referred to as the "Federal Estate Tax Applicable Exclusion Amount." We often refer to this exclusion amount as the "Federal Coupon." If the size of your estate at death is larger, estate taxes will be imposed.

This Federal Coupon is slated increase over the next several years. It increases to $2 Million in 2006, and then jumps to $3.5 Million in 2009. Then, for a brief period – 365 days, to be exact – federal estate taxes are repealed. This means that in 2010 the Federal Coupon is basically *unlimited*.

Regrettably, the much touted federal estate tax repeal shines for only a brief moment in time. On January 1, 2011, federal estate taxes spring back to life, and the Federal Coupon drops down to a measly $1 Million.

Year	Federal Estate Tax Exemption
2004	$1.5 Million
2005	$1.5 Million
2006	$2.0 Million
2007	$2.0 Million
2008	$2.0 Million
2009	$3.5 Million
2010	Estate Tax Repealed
2011	$1.0 Million

* It is important to note that any portion of the Federal Coupon you use *during your lifetime* (by making large lifetime gifts) will reduce the Federal Coupon available at your death. A discussion of the impact of lifetime gifts is set forth below.

Lifetime Gifting – Annual Tax-Free Gifts

Lifetime gifts to family members or other persons can effectively reduce the size of your taxable estate – if done correctly. In addition, "lifetime" gifts often give a greater sense of personal satisfaction.

As mentioned above, lifetime gifts can reduce the overall amount you can give at death (i.e., reduce your Federal Coupon). But the IRS currently permits you to transfer up to $11,000 each year to as many different people as you want without incurring any federal gift tax. If you are married, you and your spouse can combine your annual exclusion and gift up to $22,000 per person, per year.

By way of example, a married couple can make tax free gifts to each of their five (5) children in each of the next ten (10) years. That's $110,000 a year multiplied by ten years, totaling $1.1 Million – all without any gift or estate taxes. Once again, care must be taken when making and reporting these gifts.

In addition to these annual gifts there are exemptions for any direct tuition or medical payments made on behalf of another person.

Gifting to Charities

Gifts to qualified charities are fully exempt from gift and estate taxes. In addition, they may qualify for current income tax deductions. These lifetime gifts can reduce your estate both by the value of the gift itself and by any subsequent appreciation.

Various charitable arrangements can offer significant advantages over and above the basic charitable deduction. For example, private foundations can be established to provide an enduring legacy, and a vehicle for ongoing family philanthropic participation. Certain "split interest" trusts can also enable the donor to "give" and "receive" benefits in return. These trusts, commonly referred to as Charitable Remainder Trusts and Charitable Lead Trusts, are discussed later in this overview.

The Unlimited Marital Deduction

Any and all federal estate and gift taxes may be deferred by taking advantage of the marital deduction — this deduction allows you to pass an unlimited amount of property to your spouse, free of estate and gift taxes (assuming your spouse is a U.S. citizen). However, at the death of the surviving spouse, estate tax liability can result if the value of your spouse's estate (which may include assets received from you) is greater than the Federal Coupon.

The Generation-Skipping Transfer Tax Exemption

If you wish to transfer any assets to grandchildren, or even great grandchildren, you face the potential imposition of yet another transfer tax—the federal generation-skipping transfer (GST) tax. This tax is equal to the top federal estate tax rate and it is imposed on the value of the transferred asset. There is, however, a GST tax exemption that allows you to transfer assets to "skip" persons (that is, people who are at least two generations below the person transferring wealth) without incurring any GST tax. This exemption is equal to the Federal Coupon. The GST tax exemption is often used in connection with certain types of trusts, such as a life insurance trust, a "dynasty" trust or a charitable lead trust. (Discussed later in this overview).

The Good News – Proper Planning Can Reduce the Estate and Gift Tax Burden

If you plan ahead, there are ways to reduce your potential estate and gift tax liability. Determining which strategy is right for you will depend on a number of circumstances. And the tools we use vary significantly in the level of complexity involved. Below are just a few options that may be relevant to your particular situation:

- Married couples should plan to use "both" of their Federal Coupons – potentially doubling the amount that can be passed down to children and other beneficiaries.
- Consider instituting an annual gifting program to take advantage of the "annual gift tax exclusion."
- Donate assets to charities (the right way)
- Place life insurance death benefits beyond the reach of the IRS through specialized trusts
- Place a residence in trust to remove all future appreciation from your taxable estate.
- Form a family holding company to hold certain assets and use as a gifting vehicle
- Leverage your generation-skipping transfer tax exemption (and transfer more tax free to grandchildren)

Place Your Trust in Trusts

Understanding the Many Uses and Advantages of Trusts

Many methods and strategies used to reduce estate tax liability involve trusts. Trusts can also be flexible devices designed to solve particular issues. They can provide for your own future care during periods of incapacity; support your surviving spouse and children after your death; and greatly enhance the quality of life for family members with special needs or other special circumstances.

When preparing their estate plans, many clients decide to pass their wealth to their children or grandchildren – not outright – but "in trust." These trusts, which can continue for generations, can protect the transferred wealth from "creditors and predators." The inherited wealth can be protected from future divorces, judgments, bankruptcy, etc. In other words, you can give your chosen beneficiaries the gift of an "asset protected" inheritance.

To the uninitiated, trusts can "seem" very complicated. But at their core, trusts involve the application of a fairly simplistic concept. A trust is typically a straightforward legal relationship in which you, as the owner (or "grantor") transfer legal title to certain property to another party (or "trustee") who in turn holds it for your benefit and/or for the benefit of another person or persons (called the "beneficiary"). The terms and conditions under which the property is held by the trustee are set forth in the trust document.

With "revocable" trusts, you reserve the right to control the assets and change the terms of the trust at any time. If a trust is "irrevocable," you give up rights to the trust property and cannot amend the terms of the trust.

Primary Trusts

There are a number of popular trusts used by everyday people, everyday. These trusts address commonplace issues with extraordinary results. Whether it's tax planning for a typical couple, or a family wanting to simply maintain protection over their modest wealth, these trusts can be powerful tools. Here are just a few examples:

Revocable Living Trust

Perhaps the most universally accepted and understood trust is the "Revocable Living Trust" – or simply "Living Trust." Thousands (perhaps millions) of Americans use this type of trust to control the management and distribution of assets in the event of incapacity or death; streamline the distribution of wealth after death; avoid probate; and ensure the expedient and cost effective administration of their estate. In short, you can:

- Maintain complete control of your assets as long as you are able
- Avoid costly and completely unnecessary court proceedings called "conservatorships" when you're incapacitated
- Provide for the proper management of your investment and other assets on your terms
- Transfer property to your family members and other beneficiaries on your terms
- Avoid the often costly and unnecessary probate lawsuit that is required to enforce the terms and conditions of traditional Wills
- Provide privacy for your family
- Speed up the wealth transfer process after death
- Reduce the risk of court contests challenging your intentions after death
- Reduce estate settlement expenses

Credit Shelter Trust

Simply stated, a Credit Shelter Trust – sometimes referred to as a Family Trust, or Bypass Trust, or A/B Trust – is a trust for married couples. Through proper planning, it enables a husband and wife to effectively double the amount they can give tax free at death to their children or other intended beneficiaries. If drafted correctly, this trust can:

- "Shelter" trust assets from federal estate taxes
- Provide the surviving spouse substantial access to trust income and principal for the remainder of his or her life
- Protect substantial sums from "creditors and predators" that can prey on a surviving spouse
- Manage property for the benefit of an incapacitated surviving spouse
- Seamlessly transfer the retained trust principal to other family members at the death of the surviving spouse
- Keep trust assets out of the surviving spouse's taxable estate

Qualified Terminable Interest Property (QTIP) Trust

Today, many families are "blended." Whether because of death or divorce, often a married couple will have children from a prior marriage. A spouse may desire to provide for the support of his or her surviving spouse. But at the same time there is a desire to ensure that whatever money that is left to the surviving spouse is ultimately redirected back to the children of the first marriage after the surviving spouse dies. A Qualified Terminable Interest Property (QTIP) Trust for the benefit of the surviving spouse can achieve this goal. The surviving spouse receives all the net income and also may have rights to the principal – but the assets remaining at the surviving spouse's death go back to the children of the first marriage (or other beneficiaries chosen by the first-to-die spouse).

Irrevocable Life Insurance Trust (ILIT)

One of the biggest myths is that life insurance death benefits are estate tax free. This myth is, however, somewhat understandable because of the confusion between income taxes and estate taxes. While it is true that there are no "income taxes" due on life insurance death benefits, they are subject to estate taxes. Nevertheless, with proper planning, we can insulate life insurance from estate taxes by placing life insurance inside of a specially drafted Irrevocable Life Insurance Trust (ILIT). With an ILIT, you can:

- Provide income and/or principal to your heirs
- Prevent life insurance proceeds from being included in your estate
- Provide family with funds to pay estate taxes and other estate settlement expenses
- Provide your surviving spouse with "access" to the death benefits for his or her "health, education, maintenance, and support."
- Protect the life insurance proceeds from "creditors and predators"

Heritage Trusts – Lifetime Inheritance Protection Trusts

Instead of leaving your assets equally to your children, consider leaving it to your children in "Lifetime Inheritance Protection Trusts"--sometimes called "Heritage Trusts."

Lifetime Inheritance Protection Trusts are created by you, today, naming your child as a trustee and beneficiary when you die. These trusts, if properly drafted, can:

- Protect your child's inheritance from her spouse in the event of divorce
- Protect your child's inheritance from her creditors in the event of a financial hardship; and
- On your child's death, direct the unused assets to your blood relatives (usually grandchildren) instead of in-laws or others.

With a Heritage Trust, your children have significant access to the income and the principal of their trusts during their lifetime -- so that you're not giving them a "gift with strings attached" or "ruling from the grave."

***Overview:** Properly Established Trusts Can Be Used to:*

- Manage and protect assets during your lifetime
- Provide continuity in the management of your affairs after your death
- Control how and when your assets are distributed
- Avoid much of the costs and delays of probate
- Ensure privacy and confidentiality in the handling of your affairs
- Control income and principal distributions to children and grandchildren
- Reduce estate and gift taxes

Advanced Trust Strategies

There are a host of more advanced planning opportunities with trusts. These trusts can be used to accomplish more sophisticated financial and estate planning objectives. Typically, these trusts are irrevocable and can be used by themselves or with other trusts. Some of the more popular are:

Charitable Remainder Trust (CRT)

Charitable Remainder Trusts (CRT's) can help individuals diversify asset holdings, defer capital gains tax, and benefit charities at the same time. CRT's provide an "income stream" back to you or other family members over a specified term and then distribute the remaining trust assets to charity at the end of the payment term.

If you create a CRT during your lifetime, you will receive a federal charitable gift tax and income tax deduction. If you create the CRT at death, your estate will receive an estate tax charitable deduction.

These trusts are "tax exempt entities," so they can sell appreciated assets and achieve diversification and perhaps a higher yield without incurring income/capital gains. Consequently, they may also provide you (or other family members) with a higher after-tax payment stream than would otherwise be received if appreciated assets were sold outside of the CRT (where the sale would be subject to income taxes). Family members can defer the payment of capital gains tax on appreciated assets sold by the CRT at least until their receipt of annual payments from the CRT.

Charitable Lead Trust (CLT)

Charitable Lead Trusts (CLT's) are the opposite of CRT's. These trusts allow you to transfer assets to younger family members at a reduced federal gift tax cost, while benefiting charity at the same time. The CLT provides a payment stream to charity over a specified term and then distributes the remaining trust assets, generally free of federal estate and gift taxes, to family members at the end of the charity's payment term.

If you create a CLT during your lifetime, you will receive a federal charitable gift tax deduction. Some (but not all) types of CLT's may give you a federal charitable income tax deduction as well. If you create the CLT at death, your estate will receive a federal estate tax charitable deduction.

Grantor Retained Annuity Trust (GRAT)

A GRAT is a non-charitable trust. It enables you to "transfer" future asset appreciation to younger family members at a reduced federal gift tax cost. This trust is an irrevocable trust. You transfer assets to the trust, and take back a fixed annuity payment for a specified term of years.

If you are still alive at the end of the annuity payment term, the remaining trust assets will pass to your chosen beneficiaries free of estate and gift taxes. (If you die before the end of the annuity payment term, some or all of the remaining trust property will be included in your estate and subject to federal estate tax).

Qualified Personal Residence Trust (QPRT)

With a QPRT you transfer your home to a trust, but retain the exclusive use of the residence for a specified term of years. You are treated as making a gift to the QPRT beneficiaries (usually your children) equal to the value of the home less the present value of your retained use. When the trust term expires, the home will pass to the beneficiaries specified by you (again, usually your children) free of estate and gift taxes. But if you die before the end of the trust term, the home will be included your estate and subject to estate tax.

Dynasty Trust – GST Trusts

As the name implies, a Dynasty Trust can last in perpetuity for the benefit of multiple younger generations (children, grandchildren, great-grandchildren, etc.). It is an irrevocable trust you create during your lifetime for the benefit of younger family members. The trust must be established in a jurisdiction that permits trusts to last for multiple generations.

In many cases, the trust is funded with that amount of assets equal to your remaining federal generation skipping transfer tax exemption. Dynasty Trust assets (including any appreciation) generally will not be includible in your estate and grow inside the trust free of estate, gift, and generation-skipping transfer taxes. In addition, trust distributions generally can be made your beneficiaries free of gift, estate and generation-skipping transfer taxes.

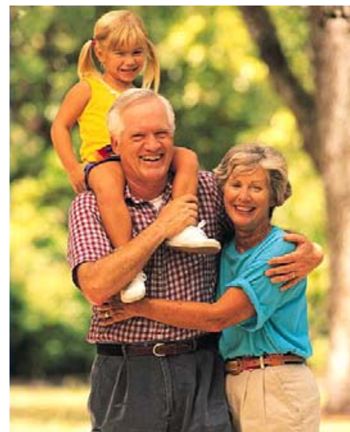
Other Advanced Strategies

Family Holding Companies

Giving "limited interests" instead of outright ownership of specific assets may produce substantial discounts in valuation for gift and estate tax purposes. In addition to any transfer tax savings, a Family Holding Company provides a good way to manage assets over an extended period of time and helps protect assets from the claims of creditors of family members or from inheritance by the spouse of a family member.

Private Foundations and Donor Advised Funds

These charitable vehicles create flexibility in your charitable giving while providing upfront tax benefits. They also allow the family to retain control over which charities will receive benefits and in what amounts. Private Foundations, in particular, also enable family members an avenue for philanthropic involvement over their lifetime.



The Need for Estate Planning—Major Warning Signs

As you reflect on your objectives, please note that the presence of one or several of the following conditions may entail the need to review and make some critical arrangements, if you have not already done so.

• All or almost all assets jointly held

• Property ownership in multiple states

• Substantial qualified plan benefits and individual retirement account assets

• Life insurance owned in your name or your spouse's

• Highly appreciated assets with low cost bases

If any of these apply to you, call your Financial Consultant to help develop strategies for dealing with them.

Estate Planning: The Lennington Law Firm Advantage

At Lennington Law Firm, PLLC, our goal is to give you peace of mind. Concentrating on Estate Planning, Estate and Trust Administration, and Elder Law, our firm helps families plan for life, deal with death, preserve wealth, and protect inheritances. Our clients engage us when planning for the two most important aspects of their lives: ***Everything they own*** *and* ***everyone they love***.

Our firm is equipped with the most cutting-edge research, analysis, and technology available. By actively listening to our clients, our attorneys create and administer highly personalized plans that reflect our clients' own unique situations. ***It's not just the law, it's how the law affects you!***

We routinely represent clients in the areas of: Estate Planning (including the creation of Wills and Trusts); Incapacity Planning (including the creation of Durable Powers of Attorney and Health Care Directives); Elder Law; Medical Assistance (Medicaid); Estate Administration; Trust Administration; Probate; Business Succession; and Small Business Formation.

We work with individuals and families living throughout Minnesota. With offices in St. Paul, Edina, and Minnetonka, we are able to conveniently address our clients' needs.

Call 952-837-2580 for a complementary initial consultation.

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**** This overview is intended as general educational material and does not constitute legal advice. Always remember: The general rule may not apply to your particular case. Consult your attorney before implementing any of the estate planning options identified in this overview.***