

GALLIGAN & MANNING

A Partnership of Professional Corporations

Attorneys at Law

802 W. Alabama, Houston, Texas 77006 • (713) 522-9220 • Fax: (713) 522-9633

www.galliganmanning.com

Mary Galligan*

Laura Jennett*-Of Counsel

***Board Certified -**

Estate Planning and Probate Law

Texas Board of Legal Specialization

Tammy C. Manning

Jason A. Cox

Susan Shank-Of Counsel

BASIC CONSIDERATIONS IN ESTATE PLANNING

Why A Will or a Funded Trust?

Dying without a will or a fully funded trust has many disadvantages. Unless all of the decedent's heirs agree to apply to the court for an independent administration, the administration of the estate of a person dying intestate (meaning without a will) will be supervised by a judge who will appoint an administrator answerable to the judge. Often the administrator will have to post a bond. In addition, the administrator will have to request the court's permission almost every time the administrator wishes to deal with an asset of the estate. There will be no opportunity for tax planning to minimize death tax liability. The heirs of the estate will be determined under Texas law, which may or may not reflect the decedent's wishes. Before the property of the estate may be distributed, there will have to be an heirship proceeding for which the court will appoint an independent attorney (other than the estate's attorney) to represent the decedent's unknown heirs, minor heirs, and heirs who may be incapacitated and unable to enforce their own rights to the estate. This independent attorney, known as an attorney ad litem, will investigate the decedent's background and will make a report to the court. The fees for the attorney ad litem will come out of the decedent's estate. During the heirship proceeding, two witnesses who are not heirs of the decedent must appear in court and testify as to the decedent's family background. If property from the estate is to be distributed to a minor child or an incapacitated person, another court proceeding may be

necessary for a guardian of the estate of the minor child or incapacitated person to be appointed to accept the property.

When you make a Will or a fully funded trust, it is you, and not the State of Texas, who decides how your property should pass. You also end up saving your family the time and expense of dealing with a court supervised estate administration. (Most people want their estate to go to their loved ones without being reduced by the unnecessary legal fees involved when a person dies without a will.) In addition, if you have a taxable estate (more on that later), with the appropriate estate planning, you minimize the death taxes applicable to your estate, thus allowing more of your assets to pass as you wish them to pass.

What Should A Will or Trust Accomplish?

At the very least, your will or trust agreement should provide for the distribution of your assets, name one or more executors (in the case of a will) to act independently of the court in administering your estate, include a trust arrangement in the event a minor or incapacitated person is a beneficiary of your estate, name a trustee for any trusts that are established under your will or trust agreement, and appoint a guardian who will raise your minor children in the event there is no parent surviving. In addition, your will or trust agreement may include provisions to minimize death taxes. It is best to consult your attorney to determine whether a will or a trust agreement suits your particular situation. If you decide that a revocable trust is the best estate planning vehicle for your needs, it is still prudent to make a will so that any assets not transferred to the trust during your lifetime pass to the trust at your death.

What is an Independent Executor?

An Independent Executor is charged with the responsibility of gathering and identifying your assets, paying your debts and distributing your property as you specify in your will (which may be to the trust you created during your lifetime). You may appoint one or more Independent Executors. An Independent Executor may be an individual or a bank or trust company with trust powers. It is prudent to name at least two backups in case your first choice is unable to act as Independent Executor.

What is a Trustee?

A trustee is one to whom property is transferred for the benefit of the beneficiary. In a revocable trust, the creator of the trust, the trustee and the beneficiary are often one and the same while such person is alive. The revocable trust agreement should name a successor trustee to manage the assets after the creator of the trust dies or is otherwise no longer able to act as trustee. A trustee named in a will is responsible for receiving certain estate assets from the Independent Executor, carrying out the provisions of the trust established under the will, and investing and managing the assets and determining distributions to the beneficiary. As with the Independent Executor, more than one trustee may be appointed. The trustee may be an individual or a trust company or bank with trust powers. It is prudent to name one or two backups in the event the originally named trustee is unable to act.

What is a guardian of the person for my minor children?

The guardian of a child's "person" has the responsibility for making sure that the child's physical needs are met. You may designate in your will an individual to be the guardian of your child's (or children's) person and to assume the care of your minor child or children upon the death or incapacity of the last of the child's parents to die or become incapacitated. The guardian of a child's person and the trustee holding the portion of your estate passing to your minor child may be the same person. On the other hand, you may prefer to have the guardian of the person and the trustee be different persons. It is contemplated that the trustee would make distributions to the child's guardian to take care of the child's physical needs. Again, it is suggested that you name a backup in the event the first guardian is unable to act.

What is death tax planning?

Both the federal government and the State of Texas levy a tax on the transfer of wealth (not resulting from a sale; in other words, a gift) if the amount transferred exceeds certain limits. The tax on this transfer of wealth is based upon the value of the property

when it is transferred. If the transfer is made during a person's lifetime, the tax is a gift tax. If the transfer is made upon a person's death, the tax is an estate tax. The tax is levied on the transferor and the transferee takes the property without being liable for the tax.

On June 7, 2001, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 into law. Highlights of this legislation affecting the federal estate tax are as follows:

Federal Estate Tax Changes

The amounts which may be transferred free of estate tax and the estate tax rates are as follows:

Year In Which Death Occurs	Amount Which Can Be Transferred Free of Federal Estate Tax (The "Applicable Exclusion Amount")	Highest Estate and Gift Tax Rates (Gift tax exemption remains at \$1,000,000)
2001	675,000	55%
2002	1,000,000	50%
2003	1,000,000	49%
2004	1,500,000	48%
2005	1,500,000	47%
2006	2,000,000	46%
2007	2,000,000	45%
2008	2,000,000	45%
2009	3,500,000	45%
2010	Federal estate tax and generation skipping tax fully repealed.	Gift tax is the top individual income tax rate.

Notice that, in the year 2010, federal estate tax is actually repealed. However, under the new legislation, repeal is ONLY FOR THE YEAR 2010. As of January 1, 2011, without future legislation to make extensions, THE ENTIRE NEW LAW EXPIRES and we revert to the law existing prior to passage of the Tax Relief Act of 2001. This rather strange provision was created because of a legislative rule which requires 60 votes in the Senate to alter revenue beyond a 10 year period. By including the "sunset" provision which causes the legislation to "expire" in less than 10 years, this 60 vote requirement was bypassed, making it easier to pass the new law.

The effect of the possible reversion to old law will be to potentially create federal estate tax on estates exceeding \$1,000,000 in 2011 and beyond, since the prior law would have escalated the exemptions to that level. Although, even if federal estate tax is not repealed long term, the \$1,000,000 exclusion will protect the vast majority of people from federal estate tax. Do consider inflation and growth when deciding whether federal estate tax planning is necessary for you. All assets you own are included for purposes of calculating federal estate tax, including life insurance death benefits, retirement assets, real estate, etc. Many people don't realize that they have a federal estate tax issue, and therefore don't plan for it, creating huge amounts of unnecessary tax. If the total value of your assets and your spouse's assets combined (including death benefits on life insurance you own) approach the \$675,000 level today, with a 5% inflation factor, you will have an estate exceeding the \$1,000,000 allowance for 2011. It is important that federal estate tax planning included in current plans be reviewed with the new law in mind, to be certain that language protects assets as necessary, yet is not now more restrictive than necessary to minimize or eliminate tax.

It should be noted, though, that the transfer of all of one's property to a surviving spouse does not take advantage of the right of the first spouse to die to transfer the applicable exclusion amount free of estate tax. Worse, this kind of transfer increases the surviving spouse's estate leaving only the surviving spouse's credit to offset the estate tax liability ultimately imposed on both estates. This may not be an issue if the combined estates of both spouses is less than the applicable exclusion amount for one person. If the combined estates are over the applicable exclusion amount, without tax planning, the credit allowed the first spouse to die may be wasted.

Basis Adjustments to Forgive Capital Gain on Death

For the year 2010 when federal estate tax is repealed (for that year only under the new law), the federal treasury balances that benefit to taxpayers by eliminating a current tax benefit. Currently and through 2009, when the owner of appreciated assets dies, all capital gain on that asset is eliminated, so the asset could be sold for the date of death value with no capital gains tax due. For the year 2010, this benefit will be eliminated EXCEPT that capital gain on up to \$1.3 million of assets WILL still be forgiven at death,

PLUS an additional \$3 million of capital gain on assets transferred to a surviving spouse will be forgiven. For many estates with capital gain of less than \$1.3 million, this rule will have no effect, but for those with significant amounts of appreciated assets, or who have depreciated assets for income tax purposes during lifetime, this could be a very important change. The manner in which assets are titled is very important in making sure that each person receives all forgiveness of capital gain for which he or she is eligible.

Gift Tax Provisions

On January 1, 2002, the exemption amount for gift tax will increase to \$1,000,000 and will remain at that level. Previously, the gift tax exemption was equal to the federal estate tax exemption, but legislators were concerned that taxpayers would gift large amounts of assets to those in lower tax brackets so income generated by those assets would be subject to less income tax. Gifts may still be made in the amount of \$11,000 per person per year without gift tax ramifications, as long as rules are met in structuring those gifts.

Qualified Family Owned Business Interest Deduction

This deduction, which allows up to \$1.3 million of assets to be transferred when a family owned business is involved, is repealed as of Jan. 1, 2004. This deduction had many issues and was quite difficult to qualify for, so repeal is not a major factor.

Generation Skipping Tax (GST) Provisions

Through 2003, the GST inflation increases will still apply to the GST exemption which is currently \$1,060,000. As of 2004, the GST exemption will be equal to the federal estate tax exemption shown in the chart above. This tax applies only to transfers which skip a generation (so an individual can't gift to a grandchild or other person in a younger generation and thereby avoid federal estate in the child or next generation's estate).

What is a Statutory Durable Power of Attorney?

The Statutory Durable Power of Attorney is a document in which you name an agent to make financial and property decisions for you. The power of attorney may be effective immediately or when a doctor certifies that you are not able to handle your financial affairs. The Statutory Durable Power of Attorney helps to avoid a court appointed guardian if you ever become incapacitated. If you wish to grant your agent the power to make gifts, this must be specifically provided for in the power of attorney. (Sometimes it is advantageous for estate tax reasons to allow the agent this power.)

What is a Medical Power of Attorney?

The Medical Power of Attorney is a document in which you name an agent to make health care decisions for you in the event you are unable to do so yourself. Like the Statutory Durable Power of Attorney, the Medical Power of Attorney helps to avoid a court appointed guardian in the event you are not able to make health care decisions for yourself.

What is a Directive to Physicians?

The Directive to Physicians (sometimes referred to as a living will) states that if you are ever certified to have a terminal condition, you do not want your life prolonged by artificial means. This is a very personal decision and that is why this document is optional.