

**E**state planning is the process by which an individual or family arranges the transfer of assets in anticipation of death. In the absence of an effective estate plan, the state scheme known as “intestacy” will apply.\* Most individuals prefer to determine for themselves how their assets will be distributed at death, and thereby override the state scheme. The objective is to arrange a plan for the distribution of your assets as you intend upon death, and in some cases to minimize the tax and other costs involved. This is a complex process that requires the services of an estate planning professional.

Some individuals engage in their own estate planning, using many common “probate avoidance” techniques. While these plans may work, often they do not address all of the possibilities that are addressed in a well-planned estate. Some of the often-overlooked points are the possibility that one of your intended beneficiaries will not survive you, the care of minor children, divorce, debts and expenses of your beneficiaries, and incapacity of a beneficiary.

Sometimes there are technical problems with the self-prepared documents that prevent the best intentions from being given any effect at all, resulting in the state intestacy scheme coming into play. Other times, an asset is overlooked, again requiring that the intestacy laws determine how your assets are distributed.

While estate planning traditionally concerned distribution of assets upon death, modern estate planning also concerns the care of the individual during lifetime, and may include lifetime gifts if the individual has sufficient assets. For business owners, succession planning may be one of the primary goals of an estate plan.

\* In Illinois, the assets of a married resident who dies without a will are distributed ½ to the surviving spouse and ½ to the person’s descendants. Other states have different schemes.

## Where to Start

You should begin by considering all of the persons or charitable organizations that you would like to benefit and how you would like to benefit them. Then, your estate planning professional will put your wishes into effect through the use of the many tools available to them.

If you already have an estate plan in place, you should review the plan at least every two years to be sure that it still accomplishes your goals. You should also review the plan every time that there is a significant change in your personal or family situation. In addition, for persons who have estate tax planning as a concern, the estate plan should be reviewed whenever there is a major change in the estate tax laws.

## Death Taxes On Your Estate

### Federal Estate Tax

Many people think that estate taxes have been abolished. Actually, estate taxes at the federal level are scheduled to stick around through 2009, and then be replaced with some loss in step-up in basis during 2010. Unless the law is amended before 2011, it will revert to the law in existence before 2001, which will tax estates in excess of \$1 million.

### Estate Tax Exemptions & Rates

Year	Rate	Exempt Amount
2009	45%	\$3,500,000
2010	0%	Unlimited
2011	60%	\$1,000,000

This is all very complicated, but the bottom line is this: If you as an individual expect to be worth upwards of \$3.5 million by the time of your death, then your estate faces death taxation issues. And, if you did pre-2001 estate planning, your existing trust or other estate planning needs to be revisited and probably updated.

## Illinois Estate Tax

In 2009, the Illinois estate tax exemption will stay at \$2 million when the federal estate tax exemption amount will increase to \$3.5 million. This means that if your estate is \$2 million or more in 2009, but does not exceed \$3.5 million, you may owe Illinois estate tax, even though you will not owe any Federal estate tax.

The material presented below describes some of the common techniques employed in estate planning. Not all of these techniques are used in every estate plan, and sometimes there are other techniques that are better suited to accomplish the estate planning goals.

## Wills

A will is a legal document that appoints an executor, and tells your executor how you direct your assets to be distributed at your death. A will can also address other issues, such as the appointment of a trustee and a guardian for your minor children. Generally, a will must be administered in a state probate court proceeding in order to transfer your assets. Simply by having a will, your executor can usually save the cost of a surety bond that will be required in intestacy, thereby saving more than the cost of the will. A probate proceeding in Illinois takes a minimum of six months to complete.

Many people leave all of their assets to their surviving spouse. For estates that are large enough to be subject to estate taxes, this is not a good idea, and may result in a significant increase in the estate tax cost. Everyone is entitled to shelter a certain amount of their estate from estate tax, currently \$3.5 million, as indicated in the table above. A husband and wife, if structured correctly, can shelter \$7 million. This exempt amount can be left in a special bypass trust to maximize estate tax savings.

## Trusts

There are many kinds of trusts. The simplest is known as an intervivos revocable trust, or living trust. These living trusts avoid the cost and delay of the probate proceeding necessary for a will, if all the decedent’s assets are transferred to the living trust prior to death. Generally, there is also a will involved to leave assets to the living trust that have not been transferred to the trust prior to

death; but the will may not have to be probated in that situation if all of the assets are transferred. Living trusts are also often used to accomplish estate tax planning.

Generally, the individual who creates the living trust is the initial trustee. A successor trustee is named to serve as trustee if the individual becomes unable to serve. The successor trustee can step in and manage the trust assets without court appointment, which is another significant advantage of a living trust over a will. Even though there is no court involvement in the administration of most trusts, the trustee has a duty to account to the beneficiaries, and the trustee can be placed under court supervision if necessary for proper administration of the trust.

## Irrevocable Life Insurance Trust

An irrevocable life insurance trust (“ILIT”) lets you reduce estate taxes and have more control over the proceeds of your life insurance policies. If the correct procedure is followed to make the ILIT (rather than you personally) the owner of your insurance policies, the proceeds will not be included in your estate at your death. However, the proceeds of the life insurance will be available to pay estate taxes and other expenses so that your other assets will not have to be liquidated. The trust agreement controls the management and distribution of the life insurance proceeds after your death. The life insurance proceeds will not be subject to probate and can generate income for your spouse for life, thereafter passing to your children free of estate and income taxes.

## Qualified Personal Residence Trust

You can reduce your estate taxes by transferring your residence to a qualified personal residence trust (“QPRT”). A QPRT is recognized by the Internal Revenue Code as a trust that can hold title to a personal residence but no other property, except for immediate cash needs for taxes or maintenance. The QPRT combines gift and estate tax planning. When you transfer your residence to a QPRT, the transfer is considered to be a gift to the person who will receive title to the property at the end of the trust’s term (the “remainder interest”) but you can continue to live in the residence at no charge until that time. The value of the gift depends

on your age, the length of the term, and the IRS specified interest rate in effect when the transfer in trust is made.

At the end of the term, your children (or other beneficiaries) would become the owners of the residence. If you wished to continue to use it, you would need to rent from them at a fair market value.

#### Limited Liability Company

A limited liability company ("LLC") is widely used by individuals in their estate plans to reduce estate and income taxes attributable to family assets, particularly family-owned businesses and real estate, and to protect those assets from claims of outside creditors.

An LLC combines the protection from liability offered by a corporation with the flexibility of operation and tax benefits of a partnership. LLCs can be especially beneficial to an individual who wants to transfer assets to other family members, yet retain control over those assets and protect them from claims of creditors of the members.

#### Retirement Assets

Many people have accumulated a great deal in retirement assets (IRAs, 401(k) plans, and other retirement plans) that have grown in value over the years. Careful planning is very important because retirement assets are often taxed twice: for estate taxes upon death of the individual, and for income taxes at the time distributions are made to the beneficiaries. Various techniques are available to reduce these taxes. They range from extending the distribution period by utilizing stretch IRAs (IRAs with younger generation beneficiaries, such as grandchildren) to naming charities as beneficiaries, thereby eliminating estate and income taxes.

#### Charitable Remainder Trust

A charitable remainder trust ("CRT") allows you to make a gift to charity without giving up your income on the transferred assets. A CRT makes distributions at least annually to the donor or other beneficiaries. At the end of the trust's term, often at the end of the income beneficiaries' lifetimes, assets remaining in the trust are transferred to one or more charitable organizations.

There are two types of CRTs: a charitable remainder unitrust (CRUT), and a charitable remainder annuity trust (CRAT). They differ mainly in the method for calculating the amount of the annual distributions. A CRUT distributes a fixed percentage of the trust assets, revalued annually, whereas a CRAT distributes a fixed dollar amount. Lifetime benefits include a substantial charitable income tax deduction, the avoidance of capital gains tax when the contributed asset is sold to produce income, and often, an increase in income from the asset. The benefit to the estate is the elimination of estate taxes on the assets ultimately transferred to the charitable organizations. The estate tax savings are equal to the amount of taxes that would have been due on the value of the assets had they been retained by the donor.

The donor who establishes a CRT may wish to replace the donated asset with life insurance. The heirs who otherwise would have received the asset transferred to the CRT are normally the beneficiaries of the insurance policy. Money to pay all or part of the annual premium is generated by the savings from the income tax deduction, plus some or all of the increase in income created by the gift. Often, the life insurance policy is placed in an ILIT (see above) to avoid estate taxes on the proceeds of insurance.

#### Gifts

Every individual can give away \$13,000 per year to any individual without incurring a gift tax and without having to file a gift tax return. In addition, every individual can give away \$1 million during lifetime without incurring a gift tax, but a gift tax return is required when the amount of the gift exceeds the \$13,000 per person limit, or when the gift is not of the type qualifying for the annual \$13,000 exclusion. In addition, certain payments of medical and educational expenses on behalf of an individual are not considered gifts.

#### Powers of Attorney and Living Wills

The estate planning tools discussed above have primarily focused on what happens after your death. No estate plan is complete without addressing your care and the administration of your assets during your lifetime. If you

have one or more trusted individuals who can manage your personal care and your assets, it is appropriate to appoint an agent for your health care and property under a durable power of attorney. In addition to providing for your care, the agent will avoid the substantial cost involved in a guardianship proceeding that could otherwise be necessary should you become incapacitated at any time prior to your death.

A living will serves as a backup to a durable power of attorney for health care, in the event that no one is available to make decisions concerning "death-delaying procedures" if you have a terminal condition, and to guide those family members and health care practitioners who may be faced with these difficult decisions.

Do Not Resuscitate Orders and Disposition of Remains forms are appropriate in some circumstances.

#### Mission Accomplished

These techniques will help you to accomplish your estate planning objectives, and can significantly reduce or eliminate death taxes on the transfer of wealth from one generation to the next. Your estate planning professional will assist you in determining how best to accomplish your estate planning objectives.

For more information, contact one of the estate planning attorneys at Goedert, Huntington & DeBoer:

Robert A. Huntington

Michael J. DeBoer

This publication is designed to provide accurate and authoritative information in regard to estate planning, but it is not intended to be legal advice. If legal advice is required, the services of a competent professional should be sought in connection with an attorney-client relationship.

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## ESTATE PLANNING BASICS



GOEDERT,  
HUNTINGTON &  
DEBOER

1011 LAKE STREET, SUITE 303  
OAK PARK, ILLINOIS 60301-1138

708.848.6066  
708.848.6067 FAX

www.ghdlaw.com  
Email: ghd@ameritech.net