YOUR FUTURE DESERVES

FORETHOUGHT

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Family Protection Trusts: What Are They and Do You Need One?

Scenario 1: You have competent adult children and you would like to leave your assets outright to your children. However, you also want to (1) protect the assets from your children's creditors, (2) protect the assets from a son/daughter-in-law (present, future or ex-), and (3) minimize estate taxes on your child's death. If you leave assets outright to a child and that child subsequently dies, gets divorced or has other creditor issues, the monies the child inherited from you will not end up with your ultimate beneficiaries (typically your grandchildren). Instead, the assets could be at risk to your child's creditors or to equitable distribution in a child's divorce. Further, if the child passes away, the inheritance will pass to your child's beneficiaries (often, their spouse). Finally, when your child passes away, the assets which they have inherited from you may be subject to estate taxes a second time at their death. By leaving assets to your children in Family Protection Trusts at the time of your death, you can protect the assets from: (1) your children's creditors, (2) a son/daughter in-law (present, future or ex-), and (3) estate taxes upon your child's death. Additionally, you can control where the assets pass when your child ultimately passes away. You can even designate your child as Trustee of the trust so that they can make investment and distribution decisions regarding the trust assets. Family Protection Trusts for adult children are wonderful vehicles to use to protect your assets and make sure your life's savings ends up where you want it most.

Scenario 2: You want to be proactive about your long-term nursing home/assisted living care planning and are considering giving assets away to your children in order to get them out of your name and start the five (5) year clock ticking for Medicaid. (Medicaid imposes a five (5) year look-back and assesses a penalty for gifts made during that period.) If you give assets to your children, the assets: (1) are at risk to the children's creditors, (2) are at risk to the child's spouse (including in the event of a divorce), and (3) may not be available if you need some of the gifted money back to pay for your expenses. Instead, if you make a gift of assets to a Family Protection Trust, we can start the five (5) year Medicaid clock ticking and protect your assets. By transferring assets to a Trust, the assets can be protected from the creditors of a Trust beneficiary. Likewise, if a child is a beneficiary and the child either gets divorced or dies, the assets of the Trust are not at risk. The assets remain, safely, in the Trust. Your children can be both the co-trustees and beneficiaries of the Trust. Accordingly, if a rainy day comes along and you need assets from the Trust, your children (as Trustees) can make distributions to themselves (as beneficiaries) and then pay for your expenses. So long as you do not require Medicaid within five (5) years from the date of the transfer to the Trust, the assets in the Trust are protected and you can qualify for Medicaid. Family Protection Trusts are the perfect vehicle to protect your assets and be proactive about Medicaid planning.

If you would like to discuss the establishment of a Family Protection Trust, either for your children or for Medicaid planning purposes, please call our office to schedule an appointment.

Reminder: When You Should Update Your Estate Plan

Marriage: Whether it is your first or a later marriage, you will need to update your estate plan after you get married to ensure that your spouse and your other beneficiaries (perhaps, children from a prior marriage) receive what you intend for them to inherit.

Children or Grandchildren: Once you have children, it is important to update your estate plan to name a guardian for your minor children and also to establish trusts for their benefit. If your children are adults, you may want to update your plan to reflect their changed circumstance or to provide directly for grandchildren.

Divorce or Death of a Spouse: If you get divorced or your spouse dies, you will need to revisit your entire estate plan. It is likely that your spouse is named in some capacity in your estate plan. You will also need to change the beneficiary on your retirement plans and insurance policies.

Increase or Decrease in Assets: If your estate exceeds $675,000 and you are a New Jersey resident, you may want to create a plan that minimizes your estate taxes. If you have tax planning in your documents and your assets decrease, you may want to simplify your plan.

Other reasons to have your estate plan updated could include: (1) moving to another state; (2) changes to the Federal or state estate tax laws; (3) a guardian, executor, or trustee is no longer able to serve; and (4) you wish to change your beneficiaries.

Contact our office if you would like to discuss an update to your plan.

Giving Your Home to Your Children Can Have Tax Consequences

Many people wonder if it is a good idea to give their homes to their children during their lifetimes. While it is possible to do this, giving away a house can have major tax consequences, among other undesirable results.

When you give anyone property valued at more than $13,000 in any calendar year, you have to file a gift tax return. Under current law you can gift a total of $5 million over your lifetime without incurring a gift tax. If your residence is worth less than $5 million, you likely won't have to pay any gift taxes, but you will still have to file a gift tax form. (And Congress may change the gift tax exemption, which is now scheduled to revert to $1 million at the end of 2012 unless Congress acts.)

While you may not have to pay gift taxes on the gift of your house, when your children ultimately sell the house, they may be facing steep taxes. The reason is that when you give away your property, the tax basis (or the original cost) of the property for the donor becomes the tax basis for the recipient. For example, suppose you bought the house years ago for $150,000 and it is now worth $350,000. If you give your house to your children, their tax basis will be $150,000. If the children then sell the house, they will have to pay capital gains taxes on the difference between $150,000 and the selling price. The only way for your children to avoid this tax is for them to live in the house for at least two years before selling it. In that case, they can exclude up to $250,000 ($500,000 for a couple) of their capital gains from taxes.

Inherited property does not face the same taxes as gifted property. If the children were to inherit the property from you, the property's tax basis would be "stepped up," which means the basis would be equal to the current value of the property as of your death. This avoids, or greatly reduces, any gain on the sale. However, the home will remain in your estate, which may have estate tax consequences if you are a New Jersey resident and your estate exceeds $675,000.

Beyond the tax consequences, gifting a house to children puts your home at risk to your children's creditors. You also risk that your children might ultimately force you out of the home; you no longer have any control over the property. Finally, gifting your home to your children can affect your eligibility for Medicaid coverage of long-term nursing home and/or assisted living care.

There are other options to giving your house to your children, including putting it in a trust, retaining a life estate or selling it to your children. Before you give away your home, please call our office to schedule an appointment to discuss your options.

Current State of the Federal and New Jersey Estate Taxes

THE FEDERAL ESTATE TAX

As many of you know (if you have been reading our newsletters over recent years), the federal estate tax has been very much in flux since 2001. The two key components to this changing federal estate tax climate have been the rate of tax and the amount of assets an individual can own at death without triggering a federal estate tax. This amount is often referred to as the "exemption" amount or the "Credit Shelter Amount." In 2002, the Credit Shelter Amount was $1,000,000 and the rate of tax, on all assets over such amount, was 45%. Over the years, the Credit Shelter Amount increased (peaking at $3,500,000 in 2009) and the rate of tax deceased (bottoming out at 35%). In 2010 we saw an all out repeal of the federal estate tax. In 2011, the federal estate tax returned with a $5,000,000 Credit Shelter Amount and a 35% rate of tax. That is the state of the federal estate tax today. However, as of January 1, 2013, the federal estate tax exemption is scheduled to be reduced to only $1,000,000 per person and the rate of tax is scheduled to jump back up to 55%.

Both major Republican presidential candidates would work to repeal the federal estate tax in its entirety. President Obama recently suggested that he would like to fix the Credit Shelter Amount at $3,500,000 with a 35% rate of tax. Stay tuned. If we know one thing for sure, it is that we are uncertain as to where the federal estate tax will lie at the beginning of 2013. With that in mind, we are drafting documents with as much flexibility as possible so that your estate plan will adjust to the changing federal estate tax climate.

NEW JERSEY ESTATE TAX

Unlike the federal estate tax, the New Jersey estate tax appears to be here to stay. The New Jersey Credit Shelter Amount is $675,000 and the tax on assets over such amount is at a graduated rate. By way of example, the New Jersey tax on a $1,000,000 is approximately $35,000. While it is true that assets passing between spouses at the first spouse's death are exempt from both New Jersey and federal estate taxes, saving estate taxes on the second spouse's death, when assets pass on to your children and grandchildren, is important to our clients. *If your estate (whether you are married or single) exceeds $675,000, we should review your estate planning documents and your overall estate plan to be sure that we are doing all that we can to minimize and, in some cases, eliminate, the New Jersey estate tax.*

The Five Components of a Good Estate Plan

Many people believe that if they have a will, their estate plan is complete. However, there is much more to a solid estate plan. A good plan should be designed to avoid family disagreements, save on estate taxes, protect assets (in case you need to move into a nursing home or assisted living facility), appoint someone to act for you if you become disabled and, in certain cases, avoid probate.

All estate plans should include, at minimum, three important estate planning instruments: a will, a durable power of attorney, and a health care power of attorney. A trust can also be useful to protect your privacy, avoid probate and to manage your estate both during your life and after you are gone.

WILL

A will is a legally-binding statement which directs who will receive your property at your death. If you do not have a will, the laws of the State where you live will determine how your property is to be distributed. Those laws are called "intestate laws," and they may not provide for the distribution of assets that you would prefer. A will also allows you to appoint a legal representative (an "Executor") to handle your affairs and carry out your wishes. Your Executor is charged with winding down your affairs, paying final expenses, and preparing and filing final income tax returns, as well as any death tax returns which may be due. Finally, the Executor is responsible for distributing your assets to your beneficiaries. If you do not have a Will, the laws of the State where you live will specify who can serve as Administrator of your estate. Again, the person given legal priority to serve as your Administrator by law may not be the person you want handling your affairs. A will is especially important if you have minor or incapacitated children because it allows you to name a guardian for the children. Failure to designate a Guardian for your minor or incapacitated children can result in a great deal of family feuding and be detrimental to the wellbeing of your child(ren).

However, it is important to remember that a will covers only "probate property." Many types of property or forms of ownership pass outside of probate. For example, jointly-owned property, property held in trust, life insurance proceeds and property with a named beneficiary (such as IRAs or 401(k) plans), all pass outside of probate (and, outside of the terms of your will). Jointly owned property and beneficiary designated assets override the terms of a will. Therefore, it is important to remember that even if you have established a Will, if your beneficiary designations are not properly prepared to coordinate with your Will, your wishes may not be carried out.

TRUST

A trust is a legal arrangement through which one person (or an institution, such as a bank or law firm), called a "trustee," holds legal title for another person, called a "beneficiary." There are several different reasons to set up a trust. The most common reason is to retain control over what happens to the assets placed in trust, both during life and after death. Certain trusts can also result in tax advantages both for the donor and the beneficiary. Other types of trusts may be used to protect property from creditors or to help the donor protect assets and still qualify for Medicaid. Unlike wills (which become public record after you pass away), trusts are private documents and only those individuals with a direct interest in the trust need know of trust assets and the terms for distribution. Trusts can also be used to help avoid probate and, therefore, not only preserve privacy, but in certain cases, also save estate administration time and expense.

POWER OF ATTORNEY

A power of attorney allows a person you appoint — your "attorney-in-fact" — to act in your place for financial purposes when and if you ever become incapacitated. In that case, the person you choose will be able to step in and take care of your financial affairs. Without a durable power of attorney, no one can represent you unless a court appoints a conservator or guardian. That court process takes time, costs money, and the judge may not choose the person you would prefer. In addition, under a guardianship or conservatorship, your representative may have to seek court permission to take planning steps that she could implement immediately under a simple durable power of attorney.

MEDICAL DIRECTIVES

A medical directive may encompass a number of different documents, including a health care proxy, a durable power of attorney for health care, a living will, and medical instructions. The exact document or documents will depend on your state's laws and the choices you make.

Both a health care proxy and a durable power of attorney for health care designate someone you choose to make health care decisions for you if you are unable to do so yourself. A living will instructs your health care provider to withdraw life support if you are terminally ill or in a vegetative state. A broader medical directive may include the terms of a living will, but will also provide instructions if you are in a less serious state of health, but are still unable to direct your health care yourself.

BENEFICIARY DESIGNATIONS

Although not necessarily a part of your estate plan, at the same time you create an estate plan, you should make sure your retirement plan beneficiary designations are up to date. If you don't name a beneficiary, the distribution of benefits may be controlled by state or federal law or according to your particular retirement plan. Some plans automatically distribute money to a spouse or children. Although others may leave it to the retirement plan holder's estate, this could have negative tax consequences. The only way to control where the money goes is to name a beneficiary.

If you are missing any one of these valuable components to your estate plan, please call our office to schedule a consultation to complete your estate plan.

A Letter of Instruction Can Spare Your Heirs Great Stress

While it is important to have an updated estate plan, there is a lot of information that your heirs should know that doesn't necessarily fit into a will, trust or other estate planning document. The solution is a Letter of Instruction, which can provide your heirs with guidance if you die or become incapacitated.

A Letter of Instruction is a legally non-binding document that gives your heirs information crucial to helping them tie up your affairs. Without such a letter, it can be easy for heirs to miss important items or become overwhelmed trying to sort through all the documents you left behind.

The following are some items that can be included in such a letter:

- A list of people to contact when you die and a list of beneficiaries of your estate plan
- The location of important documents, such as your will, insurance policies, financial statements, deeds, and birth certificate
- The location of any safe deposit boxes
- A list of assets, such as bank accounts, investment accounts, insurance policies, real estate holdings, and military benefits
- Passwords and PIN numbers for online accounts
- A list of contact information for lawyers, financial planners, brokers, tax preparers, and insurance agents
- A list of credit card accounts and other debts
- A list of organizations that you belong to that should be notified in the event of your death (for example, professional organizations or boards)
- Instructions for a funeral or memorial service
- Instructions for distribution of sentimental personal items
- A personal message to family members

Once the letter is written, be sure to store it in an easily accessible place and to tell your family about it. You should check it once a year to make sure it stays up-to-date.

For our existing clients, we previously had provided you with a sample *"Letter of Last Instruction"* in your estate planning binder. However, if it was not filled in, then it will be of no help to you and your family.

Does your group need a guest speaker?

We are available to speak to your professional, civic, religious or special interest group on various topics (Estate Planning, Elder Law, IRA Planning, Special Needs Trusts, Disability Planning.) Give our office a call at **(856) 489-8388** to arrange a date and time or visit our website at www.fendrickmorganlaw.com.

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