Estate Planning Insights

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2017 TRANSFER TAX NUMBERS & OTHER MATTERS

Relevant Transfer Tax Items. We will start with the relevant "transfer tax" exemption amounts for 2017. $5,490,000 is the new estate tax exclusion amount, lifetime gift tax exclusion amount and GST exemption amount for 2017. This is an increase of $40,000 above the 2016 amount. The annual gift tax exclusion amount remains at $14,000 per *donor* (gift-giver) per *donee* (gift recipient). The transfer tax rate (i.e., estate, gift and GST tax rate) remains at 40%.

President Trump has indicated that he intends to cut the income tax rates. We are not going to discuss any of those income tax proposals in this newsletter. President Trump has also proposed repealing the federal estate tax. If the federal estate tax is actually repealed, the Generation-Skipping Transfer (GST) tax would probably also be repealed. However, even if both the estate tax and the GST tax are repealed, it is not necessarily true that the federal gift tax will be repealed. That is because the federal gift tax serves as a "back stop" to the federal income tax.

How does the gift tax help to enforce the income tax laws? If there were no federal gift tax, a parent in a high income tax bracket who owns and wants to sell a highly appreciated asset could give that asset to his child, who is in a low income tax bracket, and the child could sell it. After the child sells the asset and pays taxes on the gain in the child's tax bracket, the child could give the net proceeds back to the parent. So, if there is no gift tax, there is no method to stop this sort of "game-playing" with the income tax laws.

President Trump has also proposed replacing the estate tax with a capital gains tax at death. That is the type of "death tax" that applies in Canada. A capital gains tax at death could potentially affect many more people than the current estate tax. We have also heard, however, that there would be a $10 million exclusion from the capital gains tax at death. Presumably, that is a per couple exemption, but we don't know yet.

If the estate tax is completely repealed, that will significantly change estate planning as we know it and have known it for the past 36+ years. Standard estate planning techniques that we have been using to avoid estate taxes could no longer be beneficial and, in fact, could be *detrimental* under a new regime. We will let you know about actual changes to the transfer tax laws if and when they become the law.

Financial Durable Power of Attorney Issues. In Texas, we often use the "Statutory Durable Power of Attorney" as the standard version of a financial durable power of attorney (POA). In the POA, the *principal* (the person granting the POA) appoints a primary agent and one or more successor agents to handle her property and financial matters on her behalf. The POA can be made effective immediately (the better choice in most cases because it covers more situations and is easier to use) or effective only in the future, if and when the principal becomes mentally incapacitated and her doctor is willing to write a letter saying that. Note that a good POA is *durable*, which means that it is still valid even after the principal loses her mental capacity.

Certain financial institutions (banks, brokerage firms, investment companies, title companies) refuse to accept a POA, even if it was validly executed and has not been revoked. In addition, some companies refuse to accept a POA that is "too old." The position of these companies is not based on the law, it is simply the "policy" of that particular company. In our newsletters dated July 31, 2015 and October 31, 2015, we discussed, in detail, "Company Law"–a third "body of law" (in addition to applicable state and federal law) that clients and lawyers must contend

with. Technically, the only 2 legitimate questions regarding a presently effective POA from a legal standpoint are (i) "Is the principal still alive?" and (ii) "Has the POA been revoked?" A POA terminates on the principal's death. A POA can be revoked. Most POAs indicate that the POA is revoked when the principal executes a Revocation of the POA and files it in the public records in the county where she resides. Under Texas law, if the principal is still alive and she has not revoked her POA, the POA is (still) legally valid, no matter how "old" it is.

If a person becomes mentally incapacitated and she does not have a valid POA, it may be necessary for her loved ones to open a court-supervised guardianship in the probate court. Guardianships are cumbersome, expensive and demeaning. Therefore, everyone should have a POA. If you have a POA, you should find out *now* whether the financial institutions you deal with will *accept* your POA when the time comes for your agent to help you.

The "Big Lie." One of the biggest "lies" out there is this: If you "avoid probate" when you die, *nothing* has to be done as a result of your death. That is simply not true. Further, if you choose the *wrong* methods for avoiding probate, you can cause serious problems for your survivors.

We have discussed the 3 parts of the post-death process many, many times before. *See*, for example, our newsletters dated July 31, 2004, October 31, 2004, January 31, 2005 and July 31, 2013. In general, the 3 parts of the post-death process can be summarized as (i) probate *and* estate administration matters, (ii) federal tax "due diligence" matters, and (iii) asset distribution and re–titling matters (including trust funding). Even if you avoid a probate proceeding, *everything else must still be done!*

Note that part 1 of the post-death process includes probate *and* "estate administration matters." What are *administration matters*? Those are the things that have to be handled and amounts that have to be paid ("post-death charges") when someone dies. The post-death charges include funeral expenses, debts (such as credit card bills, medical bills, utility bills), final income taxes you owe, asset maintenance charges (such as homeowner's insurance, property taxes, and other charges relating to your home), estate income taxes (i.e., *income* taxes owed by your estate), federal estate taxes (if applicable), and estate administration expenses, including accounting fees for preparing income tax returns and legal fees for providing legal assistance with the post-death matters. Normally, if you die with a Will and there are sufficient *probate* assets, your Executor will be able to handle the post-death matters and will use the probate assets to pay the post-death charges. If *everything* you own passes outside your Will directly to named beneficiaries, you will not have any probate assets and the Executor will not have any funds in his hands as Executor to pay the post-death charges. The Executor will have to try to collect amounts from the beneficiaries or will end up paying your post-death charges, personally.

Since the tax laws may be changed, we will omit discussing part 2 of the post-death process, i.e., the federal tax *due diligence* matters. Remember, however, that even if a decedent's estate is not large enough to require the filing of a federal estate tax return, the decedent's "capital assets" (*see* our October 31, 2016 newsletter) will receive an adjustment to income tax basis (hopefully, a "step up" in basis) at death. Thus, all of the capital assets must be revalued when the decedent dies and those new tax basis figures must be noted/recorded for future reference.

A deceased person cannot own anything. Therefore, when a person dies, whatever he owned at death will need to be "distributed" to the new owner(s). This will require some sort of "re-titling" of the assets (part 3). In other words, the decedent's assets cannot remain in his name and under his Social Security Number. Re-titling may be easy in certain cases–it depends on the type of asset. The main point is that some work must be done to re-title the decedent's assets after his death, whether there is a probate proceeding or not.

Certain forms of "non-probate transfers" may be simple and will "avoid probate" when you die, but they also prevent your Executor from having Estate funds to pay the post-death charges. These non-probate transfers include (i) joint accounts titled as "Joint Tenants with Right of Survivorship" (JTWROS or JT TEN) or otherwise having a "Right of Survivorship," and (ii) joint or individual accounts having either a "Pay on Death" (POD) or "Transfer on Death" (TOD) arrangement. This means these assets will be transferred on your death completely outside your Will and completely outside your estate plan. It is very important to understand the effect of these

non-probate arrangements and what it is, exactly, you are avoiding when you choose to make transfers outside your Will at death. Recognize that you may be changing your estate plan and also causing problems for your Executor by using these "non-probate transfers" for everything you own.

If you really want to "avoid probate, you should create a revocable trust and re-title all of your probate assets in the name of your revocable trust *before you die*. With a fully funded revocable trust, you get to skip probate without causing any of the problems discussed above. In fact, a fully funded revocable trust makes it easy for your successor Trustee to handle the post-death matters and pay the post-death charges. However, even if you die with a fully funded revocable trust, so that you get to skip probate, again, that does not mean that *nothing* has to be done after you die. Probate is only part of the 1st part of the 3 parts of the post-death process.

Costly Collision: Community Property and Beneficiary Designation Assets. Very few people really understand community property law. We have discussed community property many times in these newsletters (*see*, for example, our newsletter dated July 31, 2016). This time, we want to focus on just one issue involving community property. It is the "collision" of community property law and "beneficiary designation assets."

The 4 types of "true" *beneficiary designation assets* are: (i) life insurance, (ii) employee benefit plans (such as 401(k) plans and profit-sharing plans), (iii) IRAs, and (iv) annuities. If a married couple does not have a Marital Property Agreement defining *beneficiary designation assets* titled in their respective names as their respective separate property and if those *beneficiary designation assets* were acquired during their marriage while living in Texas, those assets are community property. This is true even though each *beneficiary designation asset* is titled solely in one spouse's name as the "owner."

Texas is not a "title" state, it is a community property state. In Texas, the title of an asset does not tell us the owner of the asset. The title, alone, simply indicates the manager of the asset. To determine whether the asset is community property or separate property, one must find out exactly *how* and *when* the asset was acquired. In addition, there is a legal presumption that all assets on hand when a marriage terminates (by death or divorce) are community property. It takes "clear and convincing evidence" to overcome this legal presumption.

Although most *beneficiary designation assets* owned by married persons living in Texas are community property, because of federal law and contract law, only the spouse who is the "named owner" of the particular beneficiary designation asset has the right to complete the beneficiary designation form for that asset. That spouse, as manager of the asset on behalf of both spouses, has a fiduciary duty to consider his spouse's ownership interest in the asset when completing the beneficiary designation form. Ideally, the surviving spouse should always be named as the beneficiary of at least 50% of the beneficiary designation asset, which represents the surviving spouse's community property ½ interest in the asset. With respect to qualified plans governed by ERISA, the plan participant's spouse must be named as the 100% beneficiary of his qualified plan (and, in the case of defined benefit plans, must receive a prescribed type of annuity) unless the participant and his spouse sign the necessary paperwork required by the plan administrator to alter that result.

So, if you are married and the *beneficiary designation asset* titled in your name is community property (the usual case), and if you name someone other than your spouse (such as a child) as a beneficiary of *more than 50%* of that asset, you will be causing your spouse to make a gift to that beneficiary (i.e., to that child) upon your death of the excess above 50%. If the value of that gift exceeds the $14,000 gift tax annual exclusion amount, it is a "taxable gift" and your spouse will need to file a Form 709, US Gift Tax Return (Form 709), to report that gift to the IRS. That taxable gift will use up some of your spouse's lifetime gift tax exemption amount, as well as some of your spouse's estate tax exemption amount. Example: You have an $800,000 IRA rollover titled in your name that is community property. You name your child as the 100% primary beneficiary of that IRA. You die, survived by both your spouse and your child. Your child will receive the $800,000 IRA rollover per the beneficiary designation form on file with the IRA custodian, but unless your spouse files a lawsuit and obtains a judgment that your beneficiary designation was fraudulent (impossible if your spouse consented), your spouse will be making a $386,000 taxable gift ($400,000 - $14,000) to your child at the time of your death, reportable in a Form 709 (US gift tax return).

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Certain Clients Should NOT Wait To Review Their Estate Plans. Many clients are taking a "wait and see approach" to their estate planning matters in view of the uncertainty regarding the tax laws. If these clients already have all of the usual documents in place and those documents were signed within the recent past, that may be OK. However, certain people need to come in for an estate planning check up NOW! These particular people should not wait! Here are the people at "high risk" of having an undesirable estate plan:

1. You are married and you and your spouse are in your 70s, 80s or 90s.
2. You and your spouse have a "traditional marriage" (no children from prior marriages).
3. Your Wills were executed prior to January 2013.
4. **Your Wills contain a Bypass Trust**.
5. **Your combined estate is well below $5 million** (and not growing).

A number of clients in this situation have already died with Bypass Trust Wills that are no longer desirable and, in fact, are detrimental due to changes made to the tax laws by the American Taxpayer Relief Act of 2012 passed in January 2013. Once a person dies, his/her Will becomes "irrevocable" (unable to be changed). Thus, if the Will creates a Bypass Trust, the Executor cannot simply ignore those provisions in the Will. The Executor has a *fiduciary duty* to set up and fund the Bypass Trust created in the Will when the first spouse dies, even if it is no longer beneficial. The solution is to obtain a new Will *before you die*!

Please review the very specific list to the left and, if that list applies to you, please contact our office to schedule an estate planning check up soon.

Contact us:

If you have any questions about the material in this publication, or if we can be of assistance to you or someone you know regarding estate planning or probate matters, feel free to contact us by phone, fax or traditional mail at the address and phone number shown above, or by email sent to:

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