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Estate Planning

Business “succession planning” and estate planning are quite similar adventures. On a personal level, a typical husband and wife estate planning takes the following form:

**I. General Estate and Gift Tax Law.**

A husband and wife can transfer an unlimited amount of assets to each other without estate or gift tax consequence. This is called the "unlimited marital deduction". On the other hand, an unmarried person, like the surviving spouse, (for 2007 and 2008) can transfer only up to \$2,000,000 in assets without estate or gift tax, either during his life or upon his death.

For 2009, this increases to \$3,500,000, for the year 2010 only, there is an unlimited exemption, and for 2011 and thereafter the limit is reduced again to \$1,000,000, indexed for inflation. Most estate planning attorneys expect the U.S. Congress to change these limitations either before the year 2010 or close to that date.

The limitation set out is called the "unified estate and gift tax credit", since it applies to any combination of gifts or inheritance. Thus the entire estate can go to one spouse without tax and the surviving spouse later gets the individual \$2,000,000.00 exemption. Then, there can be tax on everything remaining over that amount when the second spouse dies.

Since each spouse has a separate “unified credit”, there is a way they can use both and transfer up to twice that amount of assets without estate tax. This is through the use of two trusts.

The plan would be set up so that each has a living trust. All assets are divided into approximately equal shares so that at least \$2,000,000.00 (on the 2007 schedule) is in one trust or the other. The plan then provides that upon the death of the first spouse, \$2,000,000.00 of that first spouse's trust assets will not be given outright but will remain in trust for the benefit of the surviving spouse and/or other beneficiaries. Since this

amount is exempt, there is no tax. . As long as the surviving spouse is not the sole trustee of this trust or has too much control, he/she will not technically "own" the assets in this trust upon death and those assets will pass to the ultimate beneficiaries without being subject to estate tax. Thus there was no tax on this portion when the first spouse died since it was excluded, and there is no tax when the second spouse dies either.

After this first \$2,000,000.00 is set aside in trust on the death of the first spouse, the remainder of the first spouse's trust can be given to the surviving spouse outright. Even if it is over \$2,000,000.00 there is no tax since an unlimited amount can be given to a spouse anyway. On the surviving spouse's later death, the separate \$2,000,000.00 "unified credit" of the surviving spouse is then used to shelter that much of the remaining assets. In this manner, you set aside \$2,000,000.00 into one trust for the survivor's benefit and gave another \$2,000,000.00 to the survivor, so you successfully transferred \$2,000,000.00 of assets without estate tax.

Some couples provide that the excess over the first \$2,000,000.00 is not distributed outright to the survivor but is placed into a second trust. This second trust is referred to as a Marital Trust. This trust is often created so that the surviving spouse will not change the ultimate beneficiaries (i.e. in the event of remarriage).

Using a second, or marital trust does not mean the survivor loses the benefit of the funds, though. Typically the second trust provides that the surviving spouse gets all of the income regularly, and the principal is also available as needed from time to time.

You can of course provide that someone other than the surviving spouse will be the beneficiary of the assets when the first dies. However, you lose the unlimited exemption since all assets are not transferred to a spouse. Those assets in excess of the \$2,000,000.00 unified credit will then be subject to estate tax immediately upon the death of the first spouse.

These tax exclusions are in addition to the annual gift tax exclusion of \$11,000 per beneficiary (or \$22,000.00 for gifts by a married couple). So a husband and wife can protect \$2,000,000.00 by using the two trust plan, and in addition transfer \$22,000.00 to each child annually.

With this overall plan, here are some specifics to consider:

## **II. IRAs and Pension Plans**

IRA's and Pension Plans are usually comprised of pre-tax funds. As a result, they are subject to income tax upon distribution to you or a designated beneficiary. The exception is if the proceeds go to a beneficiary who is your spouse. If a husband names his wife as the beneficiary of his IRA or Pension Plan, his wife can "roll over" the proceeds into her own IRA

and continue to defer the income. It is not wise to name your Trust as beneficiary to take advantage of all the trust provisions, however. The reason is that it is the same as naming another individual who is not a spouse, and if an IRA or Pension Plan names “someone else”, the proceeds will be subject to income tax upon your death.

### **III. Estate Plan Documents (for each spouse)**

1. Revocable Trust
2. Will
3. Living Will
4. Medical Durable Power of Attorney
5. Financial Power of Attorney

#### **1. Revocable Trust**

In order to use your unified credit, assets should not be owned in joint names. Assets owned jointly automatically go to the surviving spouse and do not take advantage of estate tax planning fully. And, assets in an individual name would have to go through lengthy and more expensive probate administration. This is another reason to use a living trust. It will avoid probate and also provide for your benefit if you become disabled.

You would be your own initial trustee to administer the assets. The trust then names a successor trustee and provides for continued administration on your death. In other words, your assets (except IRA’s and pensions) go into a trust and on your death they are divided into two shares - one share goes into trust for the survivor and the second share is either distributed to the survivor outright or goes into a second trust (the marital trust).

The trust provides that the surviving spouse gets all or some of the income generated, with the principal also being available. You can also include a provision which allows the survivor to withdraw five percent of the principal each year for any reason.

In naming a successor trustee, however, the surviving spouse should not be the sole trustee. If so, the Internal Revenue Service may take the position that it is really not a separate trust since the beneficiary is the same as the trustee. You can name the surviving spouse and a second person or a trust company as co-trustees. The successor co-trustee can be an individual or a corporate trustee. If you are going to keep the assets in trust for your children even after you are both gone, then you should name a corporate trustee as an ultimate trustee.

After the trusts are signed, you then need to fund each of them by transferring title to your assets into the name of one or the other. This is more of an arithmetic than a legal problem, since the object is divide everything you have in approximately equal shares, one into each trust.

## 2. The Will

Even though the plan is to transfer all your assets into the trusts and avoid probate, you each should still have a Will. The purpose is to manage assets that for some reason are still in joint or individual names. The Will is commonly called a "pour-over" Will because it says that any assets still in your name will "pour over" into trusts. The Will then directs that all the provisions of the trust apply.

3. **Living Will.** A Living Will expresses your wishes as to the use or termination of certain medical procedures if you have a terminal condition. This is a personal and not a legal decision. While I usually recommend a trust, a will, and a medical power of attorney, a living will is not legally required and is a personal choice.

4. **Medical Power of Attorney.** The Medical Power of Attorney authorizes an agent, typically each other, to make medical decisions on your behalf in the event you are unable to do so.

## 5. Financial Power of Attorney.

A financial power of attorney is necessary in the event of disability, but only if you do not have your property in one trust or the other. Since the trusts will provide for a trustee to manage the funds of either party, and will name a successor trustee. If there is no trust for property, you should have a financial power of attorney naming each other as agent to manage money in the event of disability, and naming a successor agent.

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