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PRE-MORTEM PLANNING

When your estate plan was prepared, it was probably drafted to accomplish your dispositive goals if you died on that date, but it also anticipated that you may live a great many more years. In the case of a married couple, the estate plan was probably drafted to obtain a balance of tax planning results regardless of which spouse died first.

But once you realize that a death is near, there may be certain planning opportunities which may not have been pursued when your estate plan was originally drafted. The purpose of this memorandum is to discuss some of the options which may be available under such circumstances.

This memorandum is intended to be general in nature and not to recommend specific legal or tax advice. The purpose of this memorandum is to merely discuss in general terms some of the estate planning options which you may wish to consider when death appears to be near.

Each person's situation is unique, and what may be recommended for one person may be inappropriate for another person. There is no substitute for competent legal advice when it comes to estate planning.

The issues raised in this memorandum are addressed for the smaller to intermediate size estates with typical investment assets, and do not address many issues which might be relevant to a larger estate or to assets with more complex planning aspects, such as partnerships, S Corporations, installment notes, non-U.S. citizen spouses, and generation skipping transfer tax issues.

One of the reasons for my preparing this memorandum is that I often see family members recommend certain actions, such as retitling property in the names of the children, when such actions may have very serious tax and other implications which the parent (and children) have failed to consider.

This memorandum has been prepared based on the assumption that your doctor has just told you that you have only two to four months to live. With this new information, how might you plan your estate and what other actions should you take?

Personal and Medical Care Decisions: Although you can still make your own decisions regarding your personal and medical care, the day may come soon when you cannot.

You should consider executing a living will if you haven't already done so. A living will is the document which says that if you are terminally ill and comatose, life support equipment shall be discontinued.

You should also consider executing a power of attorney for health care in which you designate those persons you would want to make health care decisions for you if you are unable to do so. Both documents should be delivered to and discussed with your personal physician.

You should also consider nominating a guardian and a conservator in the event that one needs to be appointed by the court to make personal (guardian) and financial (conservator) decisions for you.

Both of these documents are often included in a typical estate plan. Even if you have executed these documents, now would be a good time to review them in detail to see if any changes are needed.

Funeral and Burial Arrangements: Your desires concerning your funeral and burial arrangements should be communicated to your family. You may wish to consider prepaying your funeral and purchasing a grave site at this time. Such pre-planning can save your family the hassles of trying to make these arrangements during a time of grief.

Moreover, it is easier to find and negotiate a good deal while you are still alive, than it is for your family after you are gone and immediate decisions have to be made.

Guardians: In addition to considering the nomination of a guardian for yourself, you should consider nominating a guardian to have the custody of your minor children. Has your will done so and is that designation up to date to reflect your current desires? What if your nominated guardian is unwilling or unable to serve, is an alternate named?

Financial Affairs while You are Alive: A durable power of attorney can be a useful document to allow someone else to take care of your financial affairs. Drafted properly, it can survive your incapacity and grant to the designated person(s) the power to pay your bills, buy and sell your property, prepare and sign your tax returns, and even make limited gifts of your property. This latter power could be particularly important if your estate will be subject to estate taxes upon your death.

Gifting under a Power of Attorney: Let's assume that you are single and that your estate is $5,100,000. Your agent, acting under a durable power of attorney which specifically gifting powers to your agent, makes gifts of $13,000 to each of your four children in December of 2011, and then again in January of 2012. You die in February, 2012, with an estate of only $4,996,000; your family saved $35,000 in estate taxes by making these gifts.

Note that the power of attorney must <u>specifically authorize</u> the agent to make gifts of the principal's property.

This provision is not included in most powers of attorney, and is not in the Colorado Statutory Power of Attorney.

Note also that the gifts must be completed (checks must actually clear your bank) before you die. You can't hold checks or delay transfers. Other gifting techniques to reduce estate taxes are discussed below.

Uniform Gifts to Minors Act: If you have made gifts to minors under the Uniform Transfers to Minors Act or similar legislation, keep in mind that if you as donor are also the custodian for the benefit of the minor, the fair market value of such property will be included in your taxable estate upon your death. Consider designating someone other than you or your spouse as custodian and resigning before your death.

Bank Account: Consider adding a second person to your bank account, not as a joint owner, but on a deputy or power of attorney signature card. Use a joint tenancy card only if you want the named joint tenant to become the sole owner of the account on your death.

Joint Tenancy: The concept that the surviving joint tenant becomes the sole owner of the property is generally true with respect to all joint tenancy property, so check on how your accounts and other property are titled.

Property in joint tenancy passes only to the surviving joint tenant on your death and is not distributed pursuant to your will or trust. You may think your son will distribute the property to the other four children, but what if you son dies shortly after you do? His wife may not be as generous.

Moreover, even if he wants to share the property with his siblings, there may be gift tax implications. For married couples, joint tenancy can negate tax planning and other family planning aspects.

Direct Deposit of Checks: Arrange for the direct deposit of your retirement and other checks to your bank account if you have not already done so.

Such checks could be very hard for your family to cash or deposit if you are unable to endorse them.

Hint, if it is too late: Many banks will accept checks endorsed "For deposit only to account of payee" if you write the payee's name and account number on the back of the check and drop with a deposit slip in the night depository box. The same check might be rejected if presented at the teller window.

Direct Payment: Consider having certain bills (mortgages, public service, etc.) paid directly from your checking account to avoid missing any payments. Consider adding a third party notification option to such bills as Public Service Company so that the person you name will be notified if the bill is not timely paid and before service is discontinued.

Consider a Living Trust: Lastly, if you are concerned about incapacity and the inability to take care of your financial affairs, you should seriously consider creating a Living Trust.

Such a trust could permit you to manage your affairs until you are no longer able to do so, at which time your nominated successor trustee can easily take over without the need for a court-created conservatorship.

Dispositive Planning: On your death will your assets be distributed the way you want them to be distributed? Dying without a will or other written dispositive plan can be a big mistake. For instance, many married persons think that if one spouse dies without a will, everything will automatically go to the surviving spouse.

Laws vary greatly by state. Depending upon your family situation, in Colorado approximately one-half of the first spouse's probate estate may go to the surviving spouse and the other half equally among the decedent's children.

The first step is to review (or create) your will or your living trust. Is the dispositive plan therein consistent with your desires?

List Assets: On a separate sheet of paper, list all of your assets (including account numbers and location) and indicate the approximate value and exactly how title is held. Also indicate any beneficiary designations. This list of assets can be helpful both to you in planning your estate and to your family after you are gone.

Who is the Owner or Beneficiary? We often find that even though a person had indicated in his will that he wanted his assets to go equally to his children, he had inadvertently named only one child as the owner or beneficiary os a particular asset.

Often this was done for convenience (that child was the only one in town) or because he was in a hurry or it wasn't convenient-there was only room in the box for one name.

Remember, a co-signer on an account is usually the owner of the account upon your death. Inappropriate designations may result in unequal distribution of assets and hard feelings among family members.

To Whom will your property pass? A will only controls your probate estate. Property which passes outside of probate, such as joint tenancy property to the surviving joint tenant, IRA and insurance proceeds to the named beneficiaries, is not controlled by your will and, generally, there is no adjustment in probate for such non-probate transfers.

Don't guess! Check each insurance policy, IRA, employee plan, and the like. People are often amazed to find ex-spouses named as beneficiaries. I had a client who had been married for 16 years and had two children, but his father was still named as the beneficiary on his employee plans at work because he had never changed them after he got married.

Caution on Placing Property in Joint Tenancy: Be cautious about titling property in joint tenancy just to avoid probate. Such titling constitutes a gift; the other person becomes an owner of your property.

If you title property in joint tenancy with your son, you may find that you no longer own that property with your son, but with his creditors, the IRS or even his ex-spouse, any one of which can force the sale of your home to obtain your son's share of the proceeds. There may also be a loss of significant tax benefits through such ownership. There may be other significant adverse consequences.

A living trust can offer many of the advantages of joint tenancy without many of the disadvantages.

Is Outright Distribution Desirable? Do you want your beneficiaries to receive their inheritance all at once, or would it be better to hold all or part of such property in trust until they are more financially mature? Your dispositive document such as a will or trust can accomplish this; relying on joint tenancy or named beneficiaries typically does not.

Do you want any amounts left to charity? If you do, consider naming the charity as a (partial) beneficiary of your traditional IRA. Whenever distributions are made from a traditional IRA (assuming all contributions were deductible), they are taxable to the recipient. The charity doesn't pay taxes on the IRA distribution and your other assets go to your children generally income tax free.

If you hadn't used this technique, the IRA proceeds would have been all taxable to your children, while non-income taxable assets would have gone to the charity. Just make sure that it is clear (in writing) that it was your intent that the naming of the charity as a beneficiary is in full (or partial) satisfaction of the bequest in your will or trust.

Federal Estate Taxes: A married person can leave an unlimited amount to a surviving spouse (who is also a U.S. Citizen) and incur no federal estate taxes because of the unlimited marital deduction. In addition, anyone can leave up to $5,000,000 (in 20117) to anyone and incur no estate tax because of the estate tax exemption. There is also an unlimited charitable deduction. The value of any property you leave in excess of $5,000,000 and which is not eligible for the unlimited marital or charitable deduction is subject to estate taxes of 35%.

Your Gross Estate: Your taxable estate is far more encompassing than your probate estate. Your taxable estate generally includes everything that you own or control at your death, including the death benefit of your life insurance. Consult with an estate tax planning attorney if your spouse is not a U.S. Citizen or if your estate is anywhere near $5,000,000.

Estate Tax Planning for the Married Couple: You could leave your entire estate to your surviving spouse and there would be no estate taxes on your death, but on the death of your surviving spouse all of your assets as well as your spouse's assets will be subject to estate taxes at that time and subject to only that $5,000,000 exemption (2011), assuming that no estate tax return is filed on the first death.

If an estate tax return is filed, and a “portability” election is made, then the surviving spouse’s estate tax exemption may be as great as $10 million.

Gifting: But what if your are single? Or if you and your spouse have a combined estate which is larger than $10,000,000? How can you minimize estate taxes? The primary method is through gifting.

The Internal Revenue Code provides that you may gift up to $13,000 (2012) per year per donee without filing a gift tax return. Thus, a married couple with two children and four grandchildren could gift $156,000 per year. And that's without making any gifts to the children's spouses.

Obviously, a regular gifting program can significantly reduce your taxable estate. Any gifts in excess of $13,000 per donee per year, other than for tuition and medical expenses, will reduce the $5,000,000 exemption available on your death, dollar for dollar. No gift tax is payable until your cumulative gifts not sheltered by the annual exclusion exceed $5 million. Any excess is taxed at 35%.

Payments of medical bills and tuition for others (such as children and grandchildren) are also exempt from gift tax if the payments are made directly to the health care provider or educational institution, respectively.

You cannot give the funds to the child to pay the bill. The tuition expense exception is limited to tuition only and does not cover books, living expenses, and travel.

If you have a taxable estate and are terminally ill, you should consider maximizing gifts to the extent possible. If such gifts tend to favor one branch of the family, you may wish to provide an adjustment for such gifts in your will or trust.

Non-Cash Gifts: Gifts do not have to be made in cash; you can gift almost any property, including shares of stock, partial interests in real estate, stamp collections, partnerships, and the like. It is usually best to make gifts early in the year to obtain the benefits before the donor dies, before congress changes the rules, and to remove the earnings or appreciation from the taxable estate of the donor.

Assets with the greatest growth potential should be given away first, although property which has already grown in value should be retained until death.

The tax concept of " Step up in basis" is discussed below.

Fractional Interest Caveat: If gifting fractional interests, consult with your estate planning attorney as any retained interest in certain assets may result in the IRS including the entire value of the asset in the taxable estate of the donor.

Example: Mom and dad gift the home to their children, but continue to live their rent free. The full value of the property will be included in their taxable estate even though they no longer have any legal title to the property.

When you deal with fractional interests, treat the donee as you would any other non-family member owning a fractional share of such property.

Loss Property: Just as you should not gift appreciated property, you should not gift loss property. Rather than gift property in which you have a loss, you should consider selling it and gifting the proceeds.

The reason for this is that the basis for calculating gain on gifted property in the hands of the donee is the lower of the donor's basis or the fair market value on the date of gift. The tax deductibility of the loss will be lost if you gift loss property.

Even if you don't plan to gift loss property, consider selling it today to recognize the loss rather owning it on your death.

The loss can be deducted from other gains and income (within limits) if sold while you are alive, but will receive a "step down" in basis on your death and neither you nor your heirs will benefit from the deductibility of the loss.

Thus, never gift depreciated (or loss) property - Sell it while you are alive and deduct the loss against other gains or against other capital gains (unlimited) and other income (up to $3,000 per year).

Worthless Securities: If there is no market for a "worthless" security, sell it to a non-family member (your broker or attorney) for one dollar.

Keep copies of the documentation for tax records. You generally cannot take the deduction until the property is sold.

Appreciated Property: On the other hand, you should generally continue to hold appreciated property until you die. Do not gift such property. Such property will receive a step up in basis upon your death.

For example, you purchased 100 shares of stock many years ago for $10 per share. Today it is worth $100 per share. If you sold it today, the gain of $90 would be subject to capital gains tax at about 20% (including state tax), and $18 in tax per share would have to be paid.

The result would be the same if you had gifted such stock while you were alive, and regardless of whether the donee sells the stock before or after you die, the donee's basis will be your basis, and the tax on the donee's gain will be the same as it would have been in your hands (assuming the donee is in the same tax bracket).

But if you continue to hold the stock and leave if to your family upon your death through your will or trust or otherwise, there is a full "step up in basis," meaning that when your family sells the stock after your death, their basis for calculating gain is the fair market value on your death.

Thus, if the stock was worth $100 on your death and it is subsequently sold for $100, there is no taxable gain! If it is sold for $120, the gain would only be the $20 increase after your death.

Step up in basis is one of the last major "loopholes" for completely avoiding tax. Step up in basis is applicable whether or not the decedent had a taxable estate. Thus, the general rule is, never gift appreciated property.

The Terminally-ill SHOULD own property: This concept leads us to another planning technique which is just the opposite of what most people do. Let's assume you own a rental property. Not only has the property appreciated from when you purchased it, but you have also taken depreciation for many years. The property is worth $150,000; your basis is $10,000.

If you were dying, many people would recommend that you transfer your rental property (which we will assume that you own jointly with your wife) out of your name and into your wife's name or children's names.

By now, of course, you realize that you would not want to do that because of the loss of step up in basis.

But what about retitling the entire property in your name? That is often a good idea, but keep in mind that the tax law provides that if the transferee dies within one year of the gift and it goes back to the transferor (your wife), then step up in basis is denied. So you either have to live one year, or leave the property to someone other than the transferor.

Consider two possibilities: First, assume you and your wife have a gross estate of $1,900,000 and that you have an estate plan which includes "Marital Trust-Family Trust" estate tax planning. If your wife transfers her interest in the property to you, and then you die and leave the property to the family trust, there should be a full step up in basis, if the family trust is properly drafted. If your wife (as trustee of the family trust) sells the property right after you die, no taxable gain.

Another option is for you to leave the property to your children upon your death. Tax on the entire gain would also be avoided.

Thus, one recommendation is to NOT transfer appreciated property out of the name of the terminally ill person's name, but might be to transfer property INTO his or her name.

Joint Tenancy Danger: Because the IRS presumes that the entire value of jointly owned property with a non spouse is considered in the taxable estate of the first to die, you may wish to consider severing any joint tenancies with such persons. You should discuss the advantages and disadvantages of jointly owned property with your attorney.

Community Property: Because community property is subject to a more favorable step up in basis on the first death, you and your spouse should make sure that such property will still be recognized as community property. This is particularly important if you once lived in a community property state (AZ, CA, ID, LA, NV, NM, TX, WA, WI, and AK) but have since moved to a non-community property state (such as Colorado). Be sure to discuss this aspect with your estate planning attorney.

Other Income Tax Planning Considerations: As previously mentioned, a dying person may wish to retain property which will receive a step up in basis upon death, and sell depreciated property while alive which would receive a step down in basis.

C Corporation Liquidations: If you own a major interest in a C corporation which owns property with significant gain, you may wish to consider a deathbed liquidation.

The IRS has typically refused to allow the deductibility of the potential income tax liability on the grounds that such liability is too speculative.

Estimated Payments: No estimated tax payments relating to the decedent's income need be made after the decedent's death, but the surviving spouse or children may wish to amend their estimated tax declarations.

Deduction Carry-Forwards: If you have net operating loss or charitable deduction carry-forwards, or unused investment tax credits or other deductions which would be lost at death, you may wish to cause income to be recognized before you die in order to obtain the tax benefits of such items.

Income with Respect to a Decedent: If you are in a lower tax bracket that your children or other beneficiaries, you may wish to accelerate the taxation of certain taxable items while you are alive, for instances, by cashing in EE bonds or making withdrawals from IRA's.

These assets are not eligible for step up in basis and are treated as income with respect to a decedent, and thus taxable to the recipient.

Favorable Negotiations: Consider trying to sell or at least negotiate a sales price before your death on assets you own for which you could get a better price or more favorable terms that your family could after you are gone. Minority interests in a closely held business or partnership are examples of such interests.

Other Income Tax Aspects: If a substantial portion of your income is derived from a partnership, discuss the tax implications of income tax allocations at year end with your tax advisor.

If you own stock in an S corporation, review your documents to ascertain that the ownership of such stock after your death will continue to qualify for S corporation status.

Consolidation Of Accounts: If you own accounts in several banks, I would encourage you to consolidate your accounts to make things easier for your family later on. Similarly, if you own stock certificates in numerous companies, consider holding record title in one (local) brokerage account. That will make things much easier for your family upon your death or disability.

Insurance: Although you may not be able to qualify for a new policy, review your existing policies to see if they offer any options to increase coverage.

Be sure to keep all policies in force. Some credit cards offer life insurance on the outstanding balance without insurability.

Such insurance is very expensive for those in good health, but may be a great buy for those who are terminally ill. Run up a large balance and make minimum payments.

Credit unions often offer life insurance for long time depositors, a dollar of insurance for each dollar of deposit. Be cautious about closing out such accounts.

Medicaid Planning: This memorandum does not discuss nursing home/Medicaid planning which is a whole separate topic and is best discussed on an individual basis as the rules are constantly changing.

I hope this memorandum has given you some food for thought with respect to planning the estate of someone who is terminally ill. If I can be of further assistance, please call to schedule a consultation.

This summary of Pre-Mortem Planning was prepared by Stewart W. Fleisher and is intended to give general information, and not specific legal advice. IRS Publication 230 requires that we advise you that you cannot rely on the advice given in the memorandum to avoid tax penalties.

Mr. Fleisher's law practice is limited to Estate Planning. He is available to consult on pre-mortem planning at his usual hourly rate. To arrange for an appointment, call 303-488-9888.

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