Buskey & McCarthy, LLP
Attorneys At Law
175 Federal Street
14th Floor
Boston, Massachusetts 02110
Telephone: (617) 447-2330
Facsimile: (617) 447-2367
www.buskeymccarthy.com

Lynn A. Buskey, Esq.
also admitted in Florida
lynn@buskeymccarthy.com

Shawn B. McCarthy, Esq.
also admitted in New Hampshire
shawn@buskeymccarthy.com

Of counsel to White, Freeman & Winter, LLP
30 Colpitts Road, Weston, Massachusetts 02493
(T) 781-893-4700 / (F) 781-893-5935

Smart Estate Planning for Your Family

Estate planning is something that many people "know" they need to get done, but put off doing anyway. Some people feel they are too busy, too young, or just not ready to face the reality of aging and death. Some people, on the other hand, feel that they don't need estate planning, either because they wrongly assume their spouse gets all of their assets under the law or they don't have enough assets to worry about. Finally, there are those people that believe that estate planning helps only those you leave behind and prefer to leave that up to them, "what do I care, I'll be dead!"

The biggest hindrance to estate planning is misinformation. There are so many myths and general assumptions floating around that people either fail to see the need for estate planning or believe they have their financial affairs sufficiently in order. For our discussion, we have chosen to present some very common scenarios to show how estate planning can benefit you and your family, while trying to ward off some of the misinformation that seems to perpetuate itself among the public.

This outline presents some common problems people face (some we all must face), points out some misperceptions about estates, and generally discusses some of the ways to address these problems.

"Estate planning is for the elderly; I don't need to plan yet."

But what if you are in an accident or suffer an unexpected illness and are hospitalized for any length of time? Even if it is "only" a few months before you are recovered and return home, what happens during those few months? Who pays your bills? Who completes the sale of your home that was pending? Who closes that important business deal? While it is true that a spouse can *sometimes* manage these things for you, this is not always the case. What if your spouse is also injured or ill? What if you are both needed to sell the house? What if your spouse cannot transact your business for you?

No planning

A family member, friend, state worker, or even a creditor can petition the probate court to have a guardian appointed for you because you are not able to handle your financial matters. If you have no planning in place, the court will not know who should be the person to trust in this job and will simply do its best in choosing someone. If the petitioner for a guardianship *seems* like a good choice, and nobody objects, then he or she will likely be appointed and be in charge of all your assets. If it's a state worker or a creditor petitioning for your guardian, then the court will likely appoint a neutral party, usually an attorney, to handle your finances.

Why do you care?

First, in this situation, wouldn't you want the person of *your choice* handling your finances? If its up to the court, it could be a child that has spending problems or a person that works with the court that you have never met.

Second, the probate court process costs money – legal fees, court fees, report fees, and so on. Also, if a family member is not appointed, the neutral party gets paid (attorneys often get paid their usual hourly rate to serve as guardians). Worst case scenario, if there is a fight over who should be guardian (perhaps among your children), the legal costs can be exorbitant. Where does all the money come from? You.

Third, the probate court is a public forum. First, it is necessary to prove in open court that you cannot handle your finances, which is not so bad if you have a good excuse, like a coma, but what if you are having other more private problems like dementia or addiction. Once someone is appointed guardian, then it is also necessary to inventory all of your assets for the court and account for all transactions during the period of the guardianship. What this means is that anyone can go to the courthouse and review your file to learn about your medical condition, what your assets were when you became ill, what your expenses are, and what is left at any given time.

Smart Planning

Now, while you're healthy, you should take steps to address these issues so that you, and your loved ones, are ready if the unexpected happens. A Durable Power of Attorney is a document wherein you appoint the person or persons (referred to as your "Attorney-in-Fact") you choose to handle your finances if you are unable.

First, you appoint the person(s) you trust. There is no need to go to probate court and have a guardian appointed because you have already made an appointment. Nobody can guarantee you that there will not be a dispute over who handles your finances (we all know the power of money, particularly in family relationships), but a Durable Power of Attorney goes a long way to ensuring that these disputes are avoided, or at least kept under control. A

Durable Power of Attorney is generally drafted as broadly as possibly so that your Attorney-in-Fact can do anything that you could do. So, your Attorney-in-fact can pay your bills, complete the sale of your home, close that business deal, or even sue your business partner for not honoring the deal.

Second, the cost of preparing the Durable Power of Attorney is far less than the cost of someone seeking a guardianship through the probate court and continuing to account to the court for the actions taken as guardian (which, again, is all paid out of your assets). Having an attorney prepare the initial petition will likely cost more than the legal fee for preparing a Durable Power of Attorney! This does not take into consideration going to court, filing additional requested documentation, fighting off disputes, and filing the inventory and annual accounts.

Third, because you do not have to go to probate court to get a guardianship, the court does not maintain any supervision over your assets. There is no inventory and no accounts put on public record to the court. All of your information (medical and financial) remains private.

Smarter Planning

In many cases, we recommend that you engage in trust planning in addition to having a Durable Power of Attorney. There are far too many types of trusts that serve all kinds of purposes to discuss here, but generally we recommend that you hold your assets in trust instead of in your own name. You can, in most cases, serve as your own trustee and nothing changes in the way you handle your every day financial matters. What differs is the ease of administration of your assets if you become ill or disabled or in the event of your death.

A trustee is very similar to an Attorney-in-Fact in many ways. The trustee has the power to manage all assets that are held in the trust. Having your assets in trust is the first layer of protection and the Durable Power of Attorney is the safety net for any assets that might not be in the trust.

"If I am sick or in an accident, my family will take care of me."

But what if they are unsure what you would want in any given situation, or worse, what if they disagreed with regard to your care? Do you want anything medically and scientifically possible to be done to save your life, or would you refuse artificial life support if you were not expected to recover? Are there any procedures that you would refuse because of your religious or other beliefs? If there was a dispute, who would have the final word?

No Planning

If you have not told anyone what you want in any given situation, even the closest of families can argue, especially when emotions are running high. The subject of health care, and the degree to which science can sustain life, is a very sensitive one, as we all saw in the Terri Schiavo case. If you are not familiar with Terri's case, she was kept alive with artificial life support for a long period of time while her husband and her parents fought over what was best for her. Her husband felt that she would not want to be kept alive with little to no hope of recovery, while her parents wanted the doctors to sustain her life using life support systems. The fight went on and on, in the hospital, in the courts, and on TV. Although doctors do generally look to a spouse, or to the children if there is no spouse, to make decisions for a loved one, if there is any sense of disagreement among the family members, problems arise.

Smart Planning

In a Health Care Proxy you identify who you want to make your health care decisions for you if you are unable to do so for yourself. With this document in hand, your doctor will know who to turn to and who has the final word for your

care. You can also tell your doctor, your health care agent, and your family what you want in certain circumstances. This goes a long way to preventing disputes and giving your family the peace of mind that the right decision is being made.

Smarter Planning

A Living Will Declaration is a written statement to your family, physicians and the courts, that expresses your wishes in certain circumstances. You can actually spell out what you want done and what you do not want done if you suffer from certain conditions. The questions are answered for everyone in your own words, for example:

> *If there is any possibility that I may recover, I want the doctors to do whatever they can to save me.*
>
> *If I have no reasonable chance of recovery, do not sustain my life with artificial life support systems. I do/do not want nutrition and hydration for my comfort. Give me whatever medication is necessary to alleviate my suffering, even if it hastens my death.*
>
> *If I have no reasonable chance of recovery, I want my body frozen and placed next to Ted Williams so that I can be brought back when science is able and finally meet my baseball hero.*

"When I die, my spouse and children will get everything."

There are a lot of misunderstandings about how our assets pass on our deaths. If you do not take action with estate planning, the law will govern how your assets are distributed on your death. Commonly, assets pass directly to a surviving spouse, but this is not because the law directs. Assets that spouses hold jointly will pass to the survivor, and since most spouses hold their assets jointly, the misunderstanding is perpetuated. On the other hand, if you hold assets in your own name, and not jointly with your spouse, it will pass through your estate and be distributed in accordance with state law.

No Planning

Consider this real life scenario. John died owning a large interest in a lucrative business he had built with his partners. John and his wife, Sue, had one child, but he is now deceased. John's interest in the business supported their comfortable lifestyle and was the primary source of their income. John's interest in the business was in his own name. He did not add Sue as a joint owner because he never thought about it. They shared everything, "why wouldn't it all be Sue's if I died". Based on this assumption, John also did not have an estate plan in place.

Because Sue was not a joint owner, the business interest did not pass to her automatically upon John's death. John's estate had to go through probate administration, and the court would oversee the distribution of his assets. Because he had no estate plan in place (no Will, Trust or other document stating that it all goes to Sue), the court must follow the Massachusetts law of intestacy (intestacy is the state of dying without a Will). In Massachusetts, the law says that if John died with a spouse and no children, then his estate is divided as follows:

Sue receives $200,000 plus one-half of all remaining property.

John's "next of kin" receives the one-half of the remaining property.

Who is John's next of kin that is going to get a sizeable amount of his assets, and with it, a large portion of the income that Sue was supposed to live on for the rest of her life? Well, the law tells us that too. Since there are no children, the next of kin are your parents. John's parents were already deceased, so the next in line were his siblings. John had one brother who would receive the balance of his estate. John had not spoken with that brother for decades because, and John would "roll in his grave" as they say if he knew his brother was getting even a dime, let alone almost half of everything and to Sue's detriment.

Everybody knew of the dispute. John's business partners knew about John's dispute with his brother, and they also disliked his brother for various reasons. Nobody, even the brother, thought that John would leave him anything. Unfortunately, it doesn't matter what people "know" to be true. The brother gets his share and walks away.

Also consider if the brother was a kind man (which he was not in this case) and wanted to give Sue the entire estate. He still could not have done so without significant federal gift tax consequences that impact the planning and savings he can do for his family and may even cost him an out-of-pocket gift tax if the value of the business was high enough. Even the good guys can't fix this mess.

Finally, if John and Sue had children (or if John had children from another marriage), the intestacy law in Massachusetts provides that Sue would receive one-half of the estate and the children will share the other one-half.

Smart Planning

If John had done any planning, the situation would have been improved. If he had at least named Sue as a joint owner on the business interests, or named her a beneficiary of the interests in the company records, this problem could have been a lot less costly.

Obviously, a Last Will is a better option to simply naming someone as a joint tenant. Not only is it more certain, it also tells the court and everyone what happens to your property if your spouse dies before you or at the same time as you. State law does not affect how your assets will pass at your death if you die "testate" – with a Will. Your Will controls how your assets are distributed.

Smarter Planning

Although a Will enables you to avoid the state law and pass your assets where you want them to go, trust planning is a better option for many reasons.

Estate Taxes: A discussion of state and Federal estate taxes is beyond the scope of this outline, but please note that estate taxes are owed to Massachusetts on all assets exceeding $1 million, and estate taxes are owed to the Federal government on all assets exceeding $2 million, at the time of your death. These figures are called "exclusions" because you are allowed to exclude those amounts from your estate when calculating your estate taxes. Trust planning is the most efficient way to ensure you *double* these numbers by using your exclusions and your spouse's exclusions. If you die and leave everything to your spouse, there is no tax because of the full marital deduction. When your spouse dies, he or she has the exclusions noted above. You, as a couple, used a $1 million Massachusetts exclusion and a $2 million Federal exclusion. What happened to your exclusions? Some relatively simple trust planning can ensure

that you and your spouse each use your exclusions so that $2 million passes to your children free of Massachusetts estate tax and $4 million passes to your children free of Federal estate tax. This can save your family as much as $1 million in estate taxes! And this is just the first step of estate tax planning with trusts.

Probate Avoidance: With trust planning, you control where your assets go on your death, just like with a Will, but without interference from the probate court. Assets held in trust do not fall into the jurisdiction of the probate court. Your family saves significant money on legal fees and court costs, and your estate remains private because no inventory or account needs to be filed with the court either. Only your beneficiaries know what was in your estate, and only your beneficiaries know who benefited from your estate. The general public (or your son's greedy ex-wife) cannot go to the court and browse your personal information.

Heirs: Instead of providing for your family in your Will, you can provide for them privately in your trust. In your trust instrument you can accomplish many, many important goals. Just to name a few:

- You can save significant estate taxes while still providing for your surviving spouse and children.

- You can provide financially for a second spouse without risking your children's inheritance.

- You can protect your spouse and your children from creditor problems.

- You can divide your assets among your children however you think it will be fair. If someone got more during your lifetime, you may want to give

more to the other on your death. Oftentimes an estate is simply divided into equal shares, but there is no limit to the options for dividing your assets (including children, grandchildren, other relatives, friends, and charities).

- If you have a disabled or special needs child, you can protect their inheritance while the government benefits provide for that child's needs. Oftentimes, a disabled person living on government benefits inherits money outright and is disqualified for those benefits until the inheritance is spent. Not only is there a financial loss, there is also a loss of security (hopefully the benefits will resume in the future, which is expected) and a need to reapply for benefits and jump through all of the hoops necessary to receive the benefits again.

- If you have a child with spending problems, addiction, or a risky profession (such as a surgeon), you can use the trust to protect the assets from being squandered or lost to a plaintiff, or even a divorcing spouse.

- If your children are young, you can ensure their education is paid from the inheritance before giving them access to use it as they please.

- You can choose who will manage the trust assets for your children after you are gone – an older child, a trusted relative or advisor, or a large corporate trust company. You even control how a new trustee is chosen if the one(s) you have chosen can no longer serve.

Again, these are just a few of the unlimited goals that can be met with trust planning. Whatever is important to you and your family, a trust will help you achieve it.

"I have life insurance, so my family will be all set."

As just a brief introduction to the topic being covered this Sunday, October 15, 2006, on Insurance Strategies to Protect Your Family, we offer you the following surprising facts, using John and Sue as our example couple again.

John and Sue have a mortgage and three children. They buy a $1 million life insurance policy on John to cover the mortgage and help Sue with the children if something should happen to him. Good idea. But:

- What if Sue dies? She is a stay-at-home mom, so no income is lost, so what's the problem? John still has to go to work and make money to pay the bills. Who watches the children? Now John needs to pay for day care, babysitters, and housekeeping. A life insurance policy on Sue would have been a big help.

- What if John later dies and the children collect on the policy? Great, except that there is an estate tax to be paid. Depending on the circumstances, and particularly on the size of the estate that he leaves the children, the children may pay in excess of $500,000 for state and Federal estate taxes on that policy. So, the $1 million of life insurance that John and Sue purchased left their children only $500,000 of net proceeds. This estate tax is avoidable with some relatively simple planning! With the proper advice, the death benefit can pass to the beneficiaries free of all estate taxes. What a trap for the unwary! And unfortunately, many insurance agents are more concerned with making the sale to slow things up by telling you to speak to an estate or financial planner.

Finally, John and Sue live long and fruitful lives. They are enjoying their retirement and have a combined net worth of $10 million. Recall the estate tax exclusions mentioned above. Even with their trust planning, their children are facing a large estate tax – as much as $3.5 million after paying the state and the Federal taxes! How can they preserve all that they have struggled to earn and save to give a better life to their children and grandchildren?

Let's ask Albert Li if he has any ideas how to turn this mountain of an estate tax problem into a molehill with *proper* life insurance planning!

DISCLAIMER: This information is provided for educational purposes only. It is not intended, and should not be construed, as legal advice.

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