Should You Do It Yourself?

LegalZoom™ advertises itself as a cheaper alternative to an attorney. Intuit, through its "Quicken WillMaker™", and other do-it-yourself programs, entice people to forgo professional advice, assuring them that the documents they create will be "just as good as one created by an attorney."

These programs and web sites are popular with lawyers, too! Why? Because they make more work for lawyers in the future.

Recently, *Consumer Reports* magazine recently evaluated LegalZoom, Nolo, and Rocket Lawyer in an article "Legal DIY sites no match for a Pro" (September 2012, p. 13.) The editors concluded that unless your needs are very simple, the will writing products of these companies not only are unlikely to meet your needs, but can even lead to unintended results. Among other issues, too often the documents produced are not properly tailored to individual jurisdictions (states). As stated in the article, "Many consumers are better off consulting a lawyer."

Laws are not static. They constantly change because of new case law and statutes. And lawyers keep up with these changes in order to best advise their clients. That's why these online legal sites issue significant disclaimers. For example, on the top left-hand corner of its estate planning questionnaire, LegalZoom reveals that 80 percent of people who fill in blank forms to create legal documents do so incorrectly. Despite this disclaimer, LegalZoom tries to reassure its customers that professionals are there to help; that customers can have "peace of mind" knowing that LegalZoom professionals will customize their will based on their legal decisions.

The hard fact is that people who use do-it-yourself estate planning kits end up with a false sense of security. They create documents that they believe will address their estate planning needs. But with estate planning documents, they are unlikely to discover their mistakes.

Why? Because the mistakes will not become evident until after they become incapacitated or die. And the people who will be left to deal with the mistakes are usually the people the documents were supposed to protect.

Attorneys don’t simply fill in forms. Rather, we use the knowledge we have acquired during our many years of schooling and practice to advise you on the best way to protect your family, and preserve and distribute your assets in the manner you choose. And yes, that has a price.

Should You Give It Away?

For wealthy individuals and couples, gifting has always been an important part of estate planning. And now that the gift tax exemption stands at $5 million (5.12 million adjusted for inflation in 2012) and the top gift tax rate is 35%, the tax environment is especially favorable for making large gifts. Gifts of up to $5.12 million ($10.24 million for couples) in 2012 incur no gift tax. BUT – these levels are scheduled to expire after 2012, with the exemption automatically shrinking to $1 million and the top tax rate jumping to 55% on January 1. So – should you take advantage now? If you do, are there any pitfalls? .

1. <u>If you think Congress will act before next January 1 to make the $5 million exemption and 35% tax rate permanent, there’s no pressure to act</u> (and I’ve got a bridge I’d like to sell you).
2. <u>On the other hand, if you expect Congress to allow</u>

the estate tax to revert to 2001 levels – a $1M exemption and 55% top tax rate – you should seriously consider a gifting strategy – but you should be aware of a potential pitfalls.

First, the advantages. If you can afford to give up some or all of the benefit of the gifted property, it will remove from your estate all of the appreciation on and income from the property and avoid state estate taxes in states, such as Maryland, where there is no state gift tax.

Second, the pitfalls. Your donees will loss the benefit of the "step up" capital gains basis (although this will not be a problem if the asset already has a high basis), and gifts will still be included in your federal taxable estate and subject to the unlikely, but possible "clawback" tax, a scenario in which you might lose the benefit of the $5.12 million exemption.

To understand the "clawback" issue you should know how the estate tax actually is calculated (optional reading for the mascohistic):

Example 1. Assume a man is unmarried and owns assets worth $6 million, and makes a gift of $5 million in 2012, fully shielded by his $5 million exemption. He then dies, also in 2012, owning the remaining $1 million. When the trust or estate attorney prepares his federal estate tax return, the 2012 taxable gift of $5 million must be added back into the taxable estate at the date-of-gift value for purposes of calculating the estate tax amount. (Yes, it doesn't make sense. Write your Congressperson.) Thus the full $6 million would be included in the man's taxable federal estate, but would be offset by full use of his $5 million estate tax exemption[1]. This is done so that the remaining $1 million is "bumped" into a higher estate bracket, if there are higher brackets at the time of death. As long as the estate tax exemption available at death ($5 million in this example) is at least the same as the gift tax exemption used during life (also $5 million in this example), however, only the $1 million would be taxed.

<u>In this example, the only advantage to making the gift is that any future appreciation in the gifted asset's value is shielded from gift and estate taxes</u>, although there may be a capital gains income tax disadvantage because of loss of the "stepped up" basis to the donee of the gift.

Example 2. Now assume the gift and estate tax exemptions are $5 million in 2012, as in Example 1. Also assume future legislation establishes the exemption at $3.5 million after 2012, keeping the estate tax rate at 35% (a legitimate possibility if Congress finally gets its act together next year). Assume you own $6 million and in 2012 you gift $5 million to your adult children, fully shielded by your 2012 exemption. You die in 2013, owning the remaining $1 million.

Following the methodology described above in Example 1, to calculate your estate tax, you must include the gifted $5 million in your estate tax calculation, and then make full use of your estate tax exemption, which we have assumed to have decreased to $3.5 million. The result is to expose to the 35% estate tax not only your remaining $1 million, but also another $1.5 million (i.e., the decrease in exemption from $5 million to $3.5 million). The result could be an estate tax of $875,000 on an estate of $1 million. If the estate tax rate in 2013 is assumed to be 45%, the result could be an estate tax of $1,125,000 on an estate of $1 million – and Internal Revenue Service might try to collect $125,000 from the gift recipients!

This result is the "recapture problem" or "Clawback." Important – despite the Clawback, making the gift does NOT incur any additional tax. The estate ultimately receives just the benefit of the applicable exclusion amount at the individual's death if the Clawback applies. But liquidity certainly is an issue in this example – how will the estate tax will get paid, and which beneficiaries will bear the cost

Will Clawback happen?

Probably not, at least according to most tax experts, who contend that the Clawback interpretation is flawed. Many point to the obvious public policy concerns raised by such a tax – it obviously is unfair for taxpayers to make gifts in reliance on the current tax law and later be subject to tax because those laws change, and it is "likely not what Congress intended."[2]

But if Clawback happens . . .

If Clawback happens, the donor's estate still is likely to have benefited from the gifts made in 2012. The Clawback would be at the amount of the taxable gift, not the current value of the property given away. Therefore, the appreciation on the property given will not be taxed.[3] If the gift had not been made, the amount of the gift plus appreciation would be subject to tax. In a large estate, this can be significant.

In summary . . .

On balance, taking advantage of a $5 million exclusion that likely will disappear in 2013 is a great opportunity, and it is recommended for large estates with high basis assets that are likely to substantially appreciate. But – as always, a cost-benefit analysis should be made of the risk and timing of the gift, and the loss of control in the assets.

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[1]Technically it's not an exemption, but a credit equivalent.

However, it is more understandable to refer to it as an exemption.
[2]Am. Bar Ass’n, Estate and Gift Tax Comm., *Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 27 (2011)*
[3]But this must be balanced against the loss of the “stepped up” basis of the assets that would be available if the assets passed at death.

Revocable Trust Myths

Articles constantly appear and seminars proliferate lauding the benefits of “revocable” or “living” trusts and urging all people of sound mind to create them. These articles or seminars **invariably prompt clients to ask me why their estate plan fails to include one of these miraculous devices**. This Memorandum will highlight some of the advantages and disadvantages of Revocable Trusts vis-à-vis Wills in Maryland and the District of Columbia

Revocable (living) trusts are basically plain vanilla revocable trusts established during a person’s lifetime. The person retains the right to income and principal and the right to amend or revoke the trust prior to death. The trust becomes irrevocable when the person dies and the trust assets are disposed of according to the trust instrument. The trust instrument at death acts essentially as a **will substitute**.

The claims made for a revocable trust as a will substitute are that it saves taxes, avoids the expenses associated with probate, and avoids delays in distributing assets after death. There is also the claim that it ensures a greater degree of privacy than probating a will. <u>Let’s briefly dispel some myths and then highlight situations when a revocable trust may make sense</u>.

***Estate, inheritance, and income taxes*.** The first myth to be dispelled is that a revocable trust is a tax-savings device. The assets in the trust at death are included in the person's estate and subject to estate tax. **There simply are no inheritance or estate tax savings**.

As far as income tax, an estate offers several advantages over the revocable trust, the most important of which is the ability of the estate to elect a fiscal year. While a trust must report on a calendar year basis, the ability of the estate to choose a fiscal year may enable the beneficiaries to postpone payment of tax for a year on post-death income.

Avoiding probate costs and delays. The other major claim made for revocable trusts is that they save probate costs. This is literally true, except that there are important counterbalancing expenses involving revocable trusts. Probate fees themselves tend to be rather reasonable in Maryland, for example. In fact, revocable trusts can involve probate fees because it is frequently necessary to have a "Pour-over" Will for assets not in the trust, in which case there are probate fees.

Of more importance, however, is the fact that the cost of preparing the trust agreement and related documents, such as a pour-over will, and the costs of transferring property to the trust, can be significant. Moreover, transferring assets to the trust can be more than a documentary formality. Permission may be necessary to transfer interest in partnerships, closely held businesses, and cooperative apartments. With respect to real estate, deeds must be prepared.

It is true that there is no interruption in trust administration when the person establishing the revocable trust dies, but there are usually only minimal delays in having a will admitted to probate and special procedures are available to expedite the process. As a practical matter, distributions by both trustees and executors are generally delayed until assets are valued, federal and state inheritance taxes are paid, and the appropriate releases secured. The legal fees would be fairly constant whether or not a revocable trust is issued, provided that you retain an attorney who is compensated based upon professional services rendered rather than getting a “cut” or percentage of the size of the probate estate. Although a revocable trust does not have to be filed for probate like a traditional will and has “privacy” advantages, its privacy may be compromised by the requirement of banks and brokerage firms that they review the trust agreement before they will open an account. In addition, the assets in a revocable trust must be reported on an information report in Maryland which needs to be filed.

Avoiding contested wills. Because a “trust” and a “will” are separate legal concepts, a trust is not subject to a will contest. However, trusts are subject to attack on the basis of lack of capacity, undue influence, and fraud. These same grounds can be used to contest a transfer by will.

BUT – there is an additional problem with trusts. When a will is probated, the disposition of the assets come under the supervision of the Court through the Register of Wills, an administrative agency of the court. This includes the auditing of accounts and distributions by the Register of Wills auditor’s office. **Contrary to popular belief, this is a good thing that is – unfortunately – avoided by having a trust.** Recently I spent two years representing – and litigating – a revocable trust set up by a mother for her two adult children. She named only one child as trustee, and unfortunately the two children did not agree on the valuation or method of distribution of the trust. There were considerable legal fees and emotional costs that would have been avoided had the mother simply left the assets in her will, because the executor would have been under the supervision of the court, with prescribed valuation methods and distribution procedures.

Avoiding creditors' claims. During your lifetime, assets in a living trust are subject to the claims of your creditors. After your death, these assets are subject to the claims of your estate's creditors.

Avoiding your spouse's claim to a share of your estate. Most state laws provide that a surviving spouse may claim a share of revocable trust assets.

Avoiding the expense of guardianship. While a living trust may avoid the expense of a guardianship in case of your future incapacity, a durable power of attorney is a simpler and less costly alternative to achieve the same goal.

Avoiding lengthy probate delays. There are rare circumstances where families and others clash for an extended period after a death. Such disputes can cause delays in the administration of either a probate or a living trust (as noted above). In other circumstances, disputes with the Internal Revenue Service can cause more delays. However, in most circumstances the administration of a living trust is no more time efficient that the administration of a will in probate.

The living trust is the only way to avoid probate. If your goal is to avoid probate, there are several ways to do so. Joint tenancy with rights of survivorship, multiple party accounts with financial institutions, and transfer on death or pay on death (TOD or POD) designations of securities and bank accounts are common and inexpensive methods of avoiding probate.

When revocable trusts work. Let me identify a few specific situations as being particularly suited to revocable trusts:

- Where a person has significant real estate holdings in a number of states. Here a revocable trust could avoid the necessity of a probate filing in each locale.
- For a elderly surviving spouse with an uncomplicated asset structure (e.g., one or two brokerage accounts),

the revocable trust may be the appropriate instrument. This is because the costs and aggravation encountered with the transfer of the assets to the trust (e.g., re-titling brokerage accounts) is minimal. In these cases, the assets would pass upon death simply and without delay.

- For what might be called Machiavellian estate planning, there are some states, including Maryland, where the revocable trust – unlike a will – may still be used in certain instances to bar the grantor's surviving spouse from obtaining a statutory share of such trust property.
- A revocable trust may be an excellent tool for the orderly management of the affairs of an elderly person or someone otherwise unable or unwilling to manage his or her property. A similar result can usually be achieved through the use of a Durable General Power of Attorney – a document appointing another individual to manage your affairs. Maryland even permits a "springing" power which would not take effect until the incapacity arises. Nonetheless, the revocable trust may be the proper tool in certain situations. It is certainly preferable to a formal guardianship or conservatorship.

There are other situations where the revocable trust may be beneficial. However, the purported advantages of a revocable trust do not seem to stand up to a close comparison with more traditional estate planning vehicles in many situations. In short, the decision to use a will or a revocable trust needs to be evaluated based upon a client's specific circumstances. In this regard, please feel free to contact us to discuss these issues more closely.

Estate Planning Fees

How much do you charge for estate planning documents?" or "How much does a will cost?" These are the most asked questions of estate planning attorneys. Fees generally are less than you fear but more than you wish to pay – but hey, you're not buying a flat screen tv here. It really IS about your family's security, and estate planning costs are a significant financial commitment for most clients.

Wherever possible, however, we try to charge a predetermined or "flat" fee that takes into account the time spent in an initial conference with you as well as later conferences, whether in person or by phone, and the necessary time to draft and revise all documents. But note that I said "whenever possible." In many years of experience I have encountered a wide variety of situations: Clients are both old and young; married to the same person for many years, or divorced three times; wealthy and very poor; come from dysfunctional families or have a close-knit family, etc. Estate planning is the process of evaluating your specific financial and family circumstances and preparing appropriate documents that will comply with your dispositive wishes and minimize taxes.

Because of the variety of persons and situations, I tell clients that after the initial consultation, I will be able to evaluate their needs and answer the question "How much will it cost." Although we have standard estate planning fees, situations that do not fit neatly into these "Plans" will require a different fee quote.

Why You Need A Will

Contrary to a widely-held belief, dying without a will doesn’t mean your property passes to the State, which then uses the money to buy new park benches. Instead, local laws determine your estate’s beneficiaries; these are the laws of “intestacy.” In most states, one half of non-jointly owned property (titled in your name alone) passes to your spouse, the other half to your child or children. If you are single and have children, your assets generally pass to your children and/or your parents, if alive. If you don’t have children, typically your assets pass to your parents and/or siblings.

Having a will allows you to name the individuals you wish to inherit your assets, and the manner they will do so, regardless of state law. In addition, if you do not have a will, the local court will appoint your “personal representative” – an executor to administer your estate, based on statutory rules of priority. Again, this might not be the person you would prefer. You also may wish to specify funeral arrangements,.

If you are married with children, and you and your spouse die together in an accident, your child or children would receive your entire estate, but a court would have to choose the child’s legal guardian. Judges usually appoint the nearest relatives of the child, often causing titanic court battles between sets of grandparents. Even worse are those situations where the child’s closest living relative is Uncle Harold, a tambourine player with the Hare Krishnas. A properly drafted will names your beneficiaries, your child’s guardian and a trustee for his or her estate while a minor. (The guardian and trustee you select need not be a relative).

Both husband and wife should have their own wills. Although joint wills are legal, it’s generally undesirable to tie yourself together in this way; you run the risk of being unable to deal with changed circumstances arising from the death of one spouse

Perhaps you’re interested in going online, buying a book or computer program that tells you how to write your own will. These can be informative tools, but in some cases might cause you to miss an essential requirement or have less than the best plan. Making the best plan and the best usually takes knowledge and expert advice. For example, do you know that property held jointly with another may not be distributed by will? Or that life insurance may or may not be distributed by will, depending who is named as beneficiary? Or that the same can be said of individual retirement accounts, pension plans and other assets? That the beneficiary designation on retirement plans can have major tax consequences? That a spouse has a right to a large share of your property no matter what your will may say? The best plan recognizes that the best will is only part of the total plan for the distribution of your property.

When choosing a lawyer, seek references from friends and co-workers. Lawyers generally charge a flat fee for routine wills and estate planning. Preparation of a detailed estate plan and tax-saving wills, however, is done on an hourly fee basis.