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**INTRODUCTION TO ESTATE PLANNING**

**PURPOSE OF THIS MEMORANDUM.** This memorandum is an introduction to some of the legal and tax issues that will be important in planning your estate. It will be helpful if you read this memorandum before our first conference. Becoming familiar with the concepts we will discuss at our first conference will make the conference more productive for you.

**CHARGES FOR ESTATE PLANNING WORK.** We will discuss fees at our first conference and give you an estimate of our charges after we have an idea of how much work your estate plan will require. There is no fee for the initial conference in our office.

**WHAT IS ESTATE PLANNING?** Estate planning serves to arrange for the efficient and economical management of your property in the event of your incapacity, and the distribution of your property in accordance with your wishes upon your death. In planning for your estate, we determine what property you have, ascertain your wishes as to its disposition, and draft the appropriate instruments, including a will and in many cases one or more trusts, a health care proxy, living will, HIPAA authorization and release form and durable power of attorney. We will examine the tax consequences of different ways of disposing of your property during your lifetime and upon your death, as well as the tax consequences of the ownership of particular kinds of assets, advise you how to minimize taxes, and consider how to provide for the liquidity needed to pay taxes and other estate expenses. We will also advise you on how to avoid the probate of your assets upon your death.

**INFORMATION REQUIRED FROM YOU.** We cannot plan your estate without information about your property and certain aspects of your personal affairs. Considerable time can be saved if you gather the information requested on an estate plan questionnaire and make it available to us before or at our conference. Approximate figures are fine, so do not be overly concerned about getting exact information. If you are uncertain about whether to include something, please make a note and ask us about it.

**FIDUCIARIES.** Personal representatives, guardians of minor children, and trustees are all fiduciaries. We can advise you on the persons who can serve in these various capacities, and on who might be the most appropriate in your own case. Our discussion will be facilitated if you think in advance about who you would like to serve as a personal representative, guardian, or trustee. For a brief description of these three positions, see the glossary below.

**DISPOSITION OF YOUR PROPERTY.** Many considerations may influence your plans for disposing of your property by will. Our advice concerning how to minimize taxes may suggest a particular dispositive plan, but you may wish to adopt a different plan in spite of higher taxes. This is certainly acceptable. We will make you aware of the tax consequences of any given plan under consideration.

## **GLOSSARY OF TERMS**

At our first conference, and later in reading drafts of the instruments we have prepared, you may encounter unfamiliar terms. The following short glossary may be helpful. Most of these terms will be relevant to your own estate plan.

**ADOPTED CHILD PROVISION:** Under Massachusetts law an adopted child is treated as though he or she is the natural child of the adopting parents for most purposes. There are exceptions, however, and an adopted child provision is ordinarily included in our wills so that not only the adopted child but also his or her descendants, including adopted descendants, are treated as if the adopted child were born to the adopting parents.

**DISCRETIONARY TRUST:** In a discretionary trust, the trustees are given discretion to pay the income (and usually some or all of the principal) to or among a class of beneficiaries, for example, the donor's descendants (children, grandchildren and great-grandchildren). The scope of the discretion granted will vary but the advantage of this type of "spray" trust is that the trustee has flexibility to meet situations which call for varying amounts of financial support for different beneficiaries. This discretion may present income tax-saving opportunities, because income distributed from a trust is taxed to the recipient rather than to the trust. Where beneficiaries have different income tax brackets (for example, surviving spouse and children) it may be advantageous to the family as a whole to make distributions to the beneficiaries with lower tax brackets.

**DONOR:** The Donor is a person who puts property in a trust. The terms *Settlor*, *grantor*, or *trustor* are sometimes used instead.

**DURABLE POWER OF ATTORNEY:** Massachusetts law permits a person to designate in writing another person as his or her "attorney-in-fact" (also known as an agent). When the power granted by the instrument is "durable," the power will continue notwithstanding the subsequent disability or incapacity of the person granting the power. A durable power of attorney thus permits the attorney-in-fact to handle the affairs of a person when he or she is no longer able to do so himself or herself.

**PERSONAL REPRESENTATIVE:** A personal representative is a person or institution named by the decedent and appointed by the Probate Court to carry out the provisions of the decedent's will. If the will does not name a personal representative, a suitable person will be appointed by the Probate Court. The personal representative's job lasts for a minimum of one year. He or she collects the decedent's property, makes an inventory, pays the decedent's proper

debts, prepares estate and income tax returns and pays the taxes when due, distributes the remaining property according to the terms of the will, and, when everything else is completed, prepares a final account.

**PERSONAL REPRESENTATIVE'S POWERS:** A proper will explicitly sets out the personal representative's powers. This greatly simplifies and expedites the personal representative's job. The powers granted to the personal representative should be consistent with the requirements of the law and the personal representative's duties towards the beneficiaries of the estate. In most of our wills the personal representative's powers are substantially the same, and vary in important ways only when required by special circumstances.

**GUARDIAN AD LITEM:** A guardian ad litem is a "guardian for the purpose of this litigation." Guardians ad litem are appointed by the Probate Court to protect the interests of one or more beneficiaries who cannot represent themselves in court proceedings. Such beneficiaries may include minor children or persons yet to be born who may have an interest in a trust when it terminates at some future time. In most cases, the interests of these persons are adequately represented without the appointment of a guardian ad litem. Consequently, a Massachusetts statute permits a person, in his will, to excuse the appointment of a guardian ad litem in many cases. In a few cases, the statute still does not permit this, but we include this provision to remove the necessity for a guardian ad litem whenever possible.

**GUARDIAN/CONSERVATOR OF MINOR CHILDREN:** The guardian of a minor has custody of the person of minor children. The conservator of a minor manages property left to minor the minor child. The guardian and conservator may be the same person or may be different people, if desired.

**GROSS ESTATE:** For federal and Massachusetts estate tax purposes, the gross estate includes all property, real or personal, tangible or intangible, which a decedent owned or possessed an interest in at the time of death. In certain circumstances, property may be included in the gross estate even though the decedent did not have absolute control over the property during his or her lifetime. For example, a trust over which the decedent had a general power of appointment and life insurance on the decedent's life are usually included in the gross estate. Real estate and other property situated outside Massachusetts will not ordinarily be included in the Massachusetts gross estate, although it is included in the federal gross estate. Separate probate proceedings may be necessary in other states to deal with such property when the owner dies.

**HEALTH CARE PROXY:** Under Massachusetts law you may designate in a health care proxy a person (your agent) to make health care decisions, including decisions about life-sustaining treatment, on your behalf in the event you are unable to do so yourself. The health care proxy may, but need not, contain limitations on your agent's authority. A health care proxy differs from a living will (see below) in that the proxy authorizes another individual to make decisions for you, whereas a living will sets forth the specific choices you have made in advance as to what medical treatment you wish to have in specific situations. The proxy is more flexible

and covers a wider range of situations because it is impossible to address all situations in a living will or in any other document. In any event, living wills are not formally recognized in Massachusetts.

**HIPAA AUTHORIZATION AND RELEASE:** The HIPAA authorization and release form allows an individual to provide one or more people with access to his or her protected medical information.

**INTESTACY:** A person dying without a will is said to die "intestate." If this happens, the law of intestate succession provides for the disposition of the decedent's property among his or her heirs and next-of-kin. In your will you may wish to refer to the laws of intestacy as a means of determining who would receive your property under certain circumstances.

**JOINTLY OWNED PROPERTY:** Property which is jointly owned passes by operation of law to the other joint owners upon the death of one of the owners. For estate tax purposes, a husband and wife, if both are U.S. citizens, are each regarded as owning 50% of joint property. The indiscriminate use of joint ownership can adversely affect the ultimate disposition of your property and the tax consequences of such disposition. Creating a joint interest may also cause gift tax liability.

**LIVING WILL:** A living will provides directions for a person's family and physician concerning the use of artificial life support systems when he or she is disabled. Such wills are not formally recognized in Massachusetts, but they are useful as statements of a person's intentions as of the date of the will and may figure in decisions of courts and doctors about whether to employ life support systems. (See above discussion of Health Care Proxy.)

**MARITAL DEDUCTION:** The federal and Massachusetts estate tax laws both permit deductions from the gross estate for property passing from a decedent to the surviving spouse. (The rules are different when the surviving spouse is not a U.S. citizen.) Property "passing" to the surviving spouse means property left either to the surviving spouse outright or to a "marital deduction trust." If such property is not consumed or disposed of during the surviving spouse's lifetime, it is taxable in the spouse's estate. The federal and Massachusetts marital deduction is unlimited, so if the deceased spouse gives everything to the survivor, there will be no federal or Massachusetts estate tax on the deceased spouse's estate.

We usually accomplish tax minimization by the use of formulae which describe in words the amounts the trustee is to set aside for the marital deduction trust.

**OMITTED DESCENDANTS:** We normally include a provision dealing with omitted descendants to clarify that the absence of a bequest to a child or grandchild is intentional. This helps to insure that neither your own descendants nor anyone else claiming to be your descendants will have a claim against your estate which might upset your estate plan.

**BY RIGHT OF REPRESENTATION:** The meaning can be illustrated by an example: Suppose A dies leaving three living children. In addition, A leaves two grandchildren, both of whom are children of a fourth, deceased child. If A gives his property to his descendants by right of representation, his property will be divided into four shares, one each for the three living children and one share to be divided among the children of the deceased child (A's grandchildren). Thus, the children of the deceased child are "represented" by their deceased parent when his one-fourth share is divided among them. Each grandchild will thus receive one-half of this one-quarter share.

**PROBATE - AND THE AVOIDANCE OF PROBATE:** Probate is the judicial process whereby the administration and distribution of a decedent's property is supervised by the Probate Court. A personal representative must be appointed by the Court to deal with such property, and accounts showing the handling of the property and its ultimate disposition must be presented to the beneficiaries of the estate, and in some instances filed with and allowed by the Court. This process, including a court appointed "guardian ad litem," is often expensive. Accordingly, costs of administration can be saved by avoiding probate. Probate can be avoided in large part by the use of trusts, in some special circumstances by joint ownership, and even through lifetime gifts. Nevertheless, there may be reasons for creating an estate plan that contemplates some or all of your property passing through probate, and you should by no means consider that probate must be avoided at all costs.

**PROPERTY:** Your property, or assets, may be categorized as follows:

**REAL PROPERTY:** Land and any improvements situated on and attached to the land. A condominium is real estate; shares in a cooperative apartment are not. A gift of real property in a will is called a devise.

**PERSONAL PROPERTY:** There are two kinds of personal property. Tangible personal property consists of things you can touch and transport. Jewelry, furniture, and automobiles are all examples of tangible personal property. Intangible personal property includes stocks, bonds, currency, savings accounts, contract rights and all other property not included in real property or tangible personal property. A gift of personal property in a will is called a devise.

**RESIDUE: RESIDUARY ESTATE:** The residue, or residuary estate, is the property of a decedent remaining after the payment of debts, administration and funeral expenses, taxes, and devises. A proper will contains a residuary clause which disposes of this residue. In our wills, the residuary estate is generally called the "Remaining Estate." The residuary beneficiary is often a revocable inter vivos trust.

**REVOCABLE INTER VIVOS TRUST OR REVOCABLE LIVING TRUST:** This kind of trust is a commonly used estate planning device. A separate trust document is prepared and signed by the donor of the trust, and is a valid trust even though it may contain no property during the lifetime of the donor. A revocable trust is often used as a residuary beneficiary of the

donor's will or the recipient of life insurance proceeds. There are substantial advantages to funding this trust during the donor's lifetime.

**SURVIVORSHIP:** If a decedent and a beneficiary die under circumstances such that the order of their deaths cannot be established by proof, a Massachusetts statute provides the decedent will be presumed to have survived the beneficiary. If a husband and wife die simultaneously, the tax advantages of the marital deduction can nevertheless be obtained by reversing this presumption by the terms of the decedent's will or trust. Thus, a provision concerning survivorship is often included in instruments containing marital deduction provisions.

## **ESTATE TAXES:**

**MASSACHUSETTS ESTATE TAXES:** The Commonwealth of Massachusetts imposes an estate tax for Massachusetts residents and residents of other states owning real property in the Commonwealth who die on or after January 1, 2003, based on the value of a decedent's estate. The Massachusetts estate tax filing threshold is \$1,000,000 and will hold at \$1,000,000 barring any change in current legislation. As a result, a tax will be due and payable to Massachusetts where the decedent's taxable estate exceeds \$1,000,000 even though no federal estate tax would be due. The amount of the tax will be equal to the amount of the credit for state death taxes that would have been payable by a decedent's estate as computed under IRC Section 2011, as in effect on December 31, 2000.

The credit for state death taxes in effect on December 31, 2000 was determined by multiplying the federal adjustable taxable estate (the federal taxable estate reduced by \$60,000.00) by rates ranging from .8% to 16 percent.

**FEDERAL ESTATE TAXES:** The United States imposes an estate tax based on the value of a decedent's estate. The federal estate tax filing threshold in 2014 is \$5,340,000 (adjusted annually for inflation). Married couples may take advantage of the "portability" of the federal estate tax credit, which allows a surviving spouse to use the unutilized portion of his or her deceased spouse's federal estate tax credit, thus allowing married couples to leave up to \$10,680.00 (adjusted annually for inflation) free of federal estate tax. A federal tax rate of 40% will apply to the amount the net taxable estate exceeds \$5,340,000. Certain deductions from the gross estate (see definition above) are allowed in determining the taxable estate. Federal law permits the deduction of debts, administration expenses and gifts to charity, and provides for a marital deduction (see definition above). Federal law also permits certain credits, the most important of which is the "unified credit," which also operates as a credit against the gift tax (see below).

**GIFT TAX:** A federal gift tax is imposed on gifts made by a person during his lifetime. The gift tax is designed to prevent a person from avoiding the estate tax on his property by giving it away during his life. The tax is imposed on the person making the gift, but if it is not paid it can be collected from the gift in the hands of the recipient. In many instances, the first \$14,000 (adjusted periodically for inflation) of gifts to each donee in a given tax year can be

exempt from the gift tax. This is the "annual exclusion." A person's spouse may join in any gift, thereby effectively increasing the annual exclusion to \$28,000 per recipient per year. There is also an unlimited gift tax exclusion for certain amounts paid on behalf of a donee directly to an educational organization for tuition or a health care provider for medical services. Gifts between spouses generally are not taxed at all if the recipient spouse is a U.S. citizen. The gift tax on amounts in excess of any available exclusion is calculated according to the same rate schedule as the federal estate tax, and the unified credit (referred to above in the discussion of estate taxes) is available to offset the tax so calculated. If a person has made taxable gifts during his lifetime, his federal estate tax is adjusted so that his estate tax rate bracket will be the same as if his estate still included the property given away, and his unified credit is reduced to the extent it was used to offset gift taxes otherwise due while he was living. Gift taxes paid during life are credited against the estate tax due -- as if they were a kind of down payment toward estate taxes.

The gift tax exemption is the same as the federal estate tax exemption, which is currently \$5,340,000 and is subject to annual adjustments for inflation.

There is no Massachusetts gift tax. However, gifts made in excess of the annual exclusion amount are added back into the gross estate for the purpose of determining whether a Massachusetts estate tax filing is required. Although the amounts gifted are not considered in calculating the Massachusetts estate tax, under the Massachusetts estate tax system, once the reporting requirement is triggered, it is possible that an estate valued at less than \$1 million may be subject to Massachusetts estate tax liability.

**GENERATION-SKIPPING TRANSFER TAX:** The federal generation-skipping transfer tax is intended to prevent a person from avoiding estate and gift taxes directly to a lower generation (i.e., skipping a generation). For example, an estate tax is imposed on property bequeathed by a parent to his or her children. When the children bequeath the same property to their children, an estate tax is once again imposed. If there were no generation-skipping tax, the parent could avoid this second tax by bequeathing the property directly to the grandchildren. The generation skipping tax eliminates this tax "loophole" by imposing a tax (at a flat rate of 40%) on gifts (either made directly or made by means of a trust) to persons at least two generations below the person making the gift. An exemption equal to the federal estate and gift tax exemption (currently \$5,340,000), (the "GST exemption"), however, is provided for each person making a generation-skipping transfer in 2014. A husband and wife, therefore, may give \$10,680,000 to grandchildren or more remote descendants without incurring any generation-skipping transfer tax. The tax is extraordinarily complex, and careful planning is necessary for persons with large estates who desire to make generation skipping transfers or to avoid the unintended imposition of the tax.

**TESTATOR:** A testator is a person who has made a will.

**TRUST:** A trust is a device for separating the legal and beneficial ownership of property. Ordinarily, the person who holds title to property also enjoys its benefits and burdens. However, when property is placed in trust the trustee holds legal title but is required by the trust to manage,

invest, and distribute the property and any income from it in accordance with the donor's directions to or for the benefit of designated beneficiaries. Trusts are often created to provide for the welfare of children without giving control of the property placed in trust to the children themselves.

**TRUSTEE:** A trustee performs two major functions: (i) the administration of the trust, including safekeeping of trust assets, making investment decisions, collecting and disbursing income and preparing tax returns and annual accounts, and (ii) the exercise of authority in carrying out the terms of the trust, including discretionary payments of income and principal. Co-trustees are common; often individual family members serve with a professional trustee, such as a trust company or experienced attorney.

**UNIFORM TRANSFERS TO MINORS ACT:** This act, formerly the Uniform Gifts to Minors Act, permits a person to transfer property to a custodian for safekeeping until the minor, in general, attains the age of twenty-one. The custodian, therefore, resembles a trustee or guardian, and has discretion to make payments for the use and benefit of the minor from the transferred property.

**FINAL NOTE.** We will be happy to answer any questions you have about the topics discussed in this memorandum, or any other matters which you think may be relevant to your estate plan.