Estate Planning
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Legal Matters®

Lack of estate tax may create problems for people with older wills

The federal estate tax expired at the end of 2009, and believe it or not, the lack of an estate tax is creating a serious problem for many people who have not revised their wills in a while.

The federal estate tax applied in 2009 to estates of more than $3.5 million. It is slated to come back in 2011, and apply to estates of more than $1 million. Most people expected that Congress would "fix" the estate tax before it expired, and there would be a new exemption amount, such as $3.5 million, for 2010 and beyond.

However, Congress has done nothing so far – at least as of when this newsletter was written – and while it might seem great that there is no estate tax yet in 2010, it's actually a problem in many cases.

Here's why: Many older wills were set up to avoid taxes by giving children an amount of property equal to the exemption amount, and having the rest go to the surviving spouse. For instance, if the exemption amount were $1 million, then $1 million would go to the children (or to a trust for the children), and the rest would go to the surviving spouse (or a trust for the spouse).

But in 2010, there's no exemption amount. So in some cases, the result is that *the entire estate* goes to the children, and *nothing* goes to the surviving spouse.

Now it's possible that Congress will fix this by retroactively reinstating the estate tax for 2010. But it's also possible that it won't – or that even if it does, the changes it makes won't apply to the particular language in your will. So if you have a will with such a provision, it would be wise to review it now so you don't wind up accidentally disinheriting your spouse.

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Similarly, if you have a pre-nuptial or post-nuptial agreement with provisions tied to the federal estate tax (such as that one spouse must leave the other a fraction of his or her federal estate),

continued on page 4

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How is your real estate titled? It makes a big difference

When two or more people own real estate, the relationship between the owners is known as a "tenancy." There are a number of different kinds of tenancy. Understanding the differences is important, because different kinds of tenancy can mean different rules for whether an interest in the property can be inherited outside of probate and whether creditors can claim the property.

Tenancy comes in three main forms: tenancy in common, joint tenancy, and tenancy by the entirety. Each form has its advantages and disadvantages.

Tenancy in common. With a tenancy in common, each owner has a percentage interest in the property and can transfer that interest however he or she wants. For instance, one tenant might own 60% of the property, another might own 35%, and a third might own the remaining 5%. The owner of the 5% can sell that interest, or leave it to someone in a will. The person who buys or inherits the land will then become a tenant in common with the other owners. The main advantage of a tenancy in common is that it allows the owners the greatest flexibility to transfer the property as they wish.

Joint tenancy. With a joint tenancy, on the other hand, each owner must have an equal ownership interest in the property. In other words, if a property has three owners, each would have a one-third interest in the property. Also, you can't leave your interest to someone in a will. If one of the joint tenants dies, his or her interest immediately ceases to exist and the remaining joint tenants own the entire property.

The advantage to joint tenancy compared to tenancy in common is that if an owner dies, his or her interest in the property passes to the other owners outside of probate.

A disadvantage to both joint tenancy and tenancy in common is that a creditor can go after a tenant's interest in the property to collect a debt. So, for example, if one tenant fails to pay a debt, the creditor can sue in court and have the property sold, even if the other owners object.

Tenancy by the entirety. A third form of tenancy that is allowed in some states, called "tenancy by the entirety," is generally available only to married couples. As with a joint tenancy, if one spouse dies, his or her interest automatically goes to the other spouse outside of probate. Unlike other kinds of tenancy, though, one spouse cannot transfer his or her interest in the property unless the other spouse agrees.

The main advantage of a tenancy by the entirety is protection against creditors. If one spouse owes a debt, a creditor can't force a sale of the property unless the other spouse agrees to the sale. A creditor can place a lien on property, which means that if the property is eventually sold, the creditor can collect from the proceeds. However, if the debtor spouse dies and the property goes to the other spouse, the creditor is out of luck because the lien will disappear and the surviving spouse will own the property with no obligation to repay the debt. (For this reason, if a couple owns a home as tenants by the entirety and they have a mortgage, both spouses have to sign the mortgage.)

In most states, if it's unclear from the deed what form of tenancy the owners intended to have, the law will assume that they have a tenancy in common. (However, if the owners are a married couple, some states will assume they have a tenancy by the entirety.)

Understanding the different types of real estate ownership is important, because different types of ownership can mean different rules for whether an interest in the property can be inherited outside of probate and whether creditors can claim the property.

Illegitimate child collects from trust

A Florida couple created a trust to benefit their grandchildren. The trust stated that it was to benefit only grandchildren who were related by blood.

One of the couple's sons got divorced in 1971. A girl, Catherine, had been born during the marriage. The son acknowledged the girl as his child and paid child support for her.

In 1999, however, when Catherine was 32 years old, a DNA test proved that she wasn't really the son's daughter.

In response, the other grandchildren went to court and argued that she shouldn't be able to collect from the trust, since she wasn't related by blood.

However, a Florida appeals court sided with Catherine. It said that while she might not be *physically* related by blood, she was *legally* related by blood. That's because there's a long legal history in Florida (going back many years before DNA tests) that considers any child born during wedlock as a blood relative.

The court also noted that the grandparents apparently never knew about the DNA test and always considered Catherine to be their grandchild.

If you're concerned about potential illegitimate heirs or adopted heirs, there are other ways to draft trusts that can help carry out your wishes.

Things to consider if you're remarrying later in life

Not only are people living longer these days, but there's a growing trend of widows and widowers remarrying in their 60s, 70s and 80s. A remarriage late in life can bring happiness, but it can also create complexities for estate planning.

For most elderly people who remarry, the chief issue is that they want to look out for their adult children and make sure those children have an inheritance. Lack of estate planning can result in a new spouse receiving the assets that could have gone to adult children and grandchildren.

Here are some things to consider:

• In most states, a spouse is entitled to a certain percentage (usually a third) of the other spouse's assets at death *even if* the other spouse has provided differently in a will. If you don't want this to happen, the best way around it is for your spouse to waive this right in a pre-nuptial or post-nuptial agreement.

A pre-nuptial agreement is good for other reasons, too, because it allows you and your spouse to specify exactly how your assets will be divided when one of you dies.

If you're thinking of signing a pre-nuptial or post-nuptial agreement, don't do so without having it reviewed by an attorney. There are many technical requirements for these agreements, and an attorney can make sure that the agreement is legally valid and that you're not inadvertently giving up important rights. (And make sure you have your *own* attorney review it; don't assume that the same attorney can fairly represent both you and the other spouse!)

• When a person dies, many retirement accounts automatically go to the person's spouse, unless the spouse has signed a disclaimer. This is true even if the person's will and pre-nuptial agreement state otherwise. Be sure you know where your retirement accounts will go if something happens to you.

• Many people who remarry later in life provide in their will that certain of their assets will go into a trust. The trust will pay income to their spouse for the rest of the spouse's life, and when the spouse dies, the assets will go to their own children. This allows a person to take care of a spouse but also make sure that their own children ultimately receive an inheritance.

Oftentimes, such a trust is called a "Qualified Terminable Interest Property" trust, or QTIP. Another big advantage of a QTIP is that all the property in the trust is treated as having gone to your spouse for estate tax purposes, so there is no estate tax on the assets at the time of your death.

Think carefully about how you want the trust invested. Your spouse will likely want investments that generate income, while your children will favor growing the principal. If you don't specify how the assets are to be invested, your spouse and your children might end up arguing about it. (A possible solution is to create a "unitrust" that will pay the spouse a percentage of the total assets each year – that way everyone benefits if the assets are appreciating.)

• While a QTIP can be a good idea, it might not be a good idea if you're marrying someone considerably younger than yourself. If you're 70 and you're marrying a 50-year-old, then there's a chance your new spouse will outlive your children and your children will never receive an inheritance. In such a case, it might be better to protect your children's interest by buying a life insurance policy with your children (or a trust for them) as the beneficiary.

• Consider buying long-term care insurance. Generally, if one spouse requires expensive nursing home care, the other spouse is legally required to pay for it. And few things can drain a child's potential inheritance faster than paying for a step-parent's expensive medical care.

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continued from page 1

then you might want to have that agreement reviewed as well.

There are other problems, too. For instance, while the federal estate tax has disappeared in 2010, so in many cases has the "step-up" in basis.

Here's an example of how this could affect you: Suppose you purchased shares of stock many years ago for $100,000, and they're now worth $300,000. If you died in 2009, your heirs would get those shares with a "stepped-up" basis of $300,000, so if they sold them right away, they wouldn't owe any capital gains tax.

But if you died in 2010, your heirs might get those shares with a basis of only $100,000, so if they sold them right away, they would owe tax on a $200,000 capital gain.

This problem won't affect everyone, because a spouse can still get a stepped-up basis on $3 million worth of assets in certain circumstances, and it's possible to "assign" a stepped-up basis to certain other assets worth $1.3 million.

However, it might be wise to reconsider what property goes where in the event that Congress does nothing. If you're planning to leave assets to charity, for instance, you might want to give assets that have a low basis rather than a high basis, or that have a basis that's hard to determine.

And of course, the fact that the estate tax may come back next year with a threshold of only $1 million means that if you haven't adjusted your estate planning accordingly, now is the time to do so. Unless Congress changes the $1 million threshold, the effect will be dramatic. In 2009, when the threshold was $3.5 million, some 5,500 estates were subject to the federal estate tax. But if the figure drops to $1 million in 2011, more than 44,000 estates are likely to end up paying the federal tax.

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