Planning Your Estate:

A Comprehensive Guide for Connecticut

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1. <u>Introduction</u>

Many considerations go into estate planning, including the division of property and assets among children or other family members and the protection of assets from estate taxes. This publication summarizes important elements of Connecticut's estate planning laws from wills and trusts to the probate process and paying estate taxes. Understanding how to effectively plan your estate can provide you with peace of mind that your loved ones will be properly cared for.

2. Terminology

Before we delve into the elaborate details of estate planning and its various components, there are a few terms you should familiarize yourself with as they will be cited frequently in this publication.

- **Beneficiaries**: the persons or organizations who receive assets from a trust or will.
- **Bequeath**: to leave personal property to someone in a will.
- **CGS**: Connecticut General Statutes.
- **Codicil**: a written change or amendment to a will.
- **Decedent**: the person who passed away.
- **Devise**: to leave real property to someone in a will.
- **Disclaim**: to refuse to accept a bequest, devise, or other inheritance.
- **Domicile**: a person's primary and permanent place of residence.
- **Escheat**: common law doctrine that transfers property of a decedent lacking heirs to the state.
- **Estate**: the assets and debts left by an individual at death.
- **Executor**: person or institution named to carry out a will's instructions.
- **Fiduciary**: person who holds property in a position of trust for another.
- **Grantor**: person who establishes a trust.
- **Heir**: someone entitled by law to receive part of an estate.
- **Holographic will**: a handwritten will.
- **Intestate**: the condition of having died without a valid will.
- **Intestate succession laws**: the laws that govern when a person does not have a will at death.
- ***Inter vivos***: during life, i.e. a trust created while living.
- **IRC**: Internal Revenue Code.
- **Irrevocable**: in this context, a trust that cannot be changed or cancelled once established.
- **Probate**: the administration of an estate in court; involves paying debts and distributing assets.
- **Spendthrift**: provisions to protect the assets against wasteful spending.
- **Surviving spouse**: a spouse who outlives the decedent.
- **Testator**: a person who has written and executed a last will and testament.
- **Trust**: an arrangement where a trustee administers assets for the benefit of trust beneficiaries.
- **Trustee**: a person or institution that manages and distributes trust assets.
- **Will**: a written declaration of a person's last wishes.

3. Intestacy

After someone dies, attention naturally shifts to the decedent's survivors and his or her last wishes regarding how estate property should be distributed. The probate court in Connecticut is a specialized court that handles the distribution of the decedent's property and ensures that any debts, funeral expenses and taxes are paid prior to any distributions. If the decedent left a will, their wishes are carried out according to the will provisions, and the probate process is straight forward unless there is a challenge to the will. However, if the decedent did not have a will, estate property is distributed to heirs in accordance with Connecticut's intestate succession laws, in which case state statutes, not the decedent's wishes, govern the distribution of the estate.

A person dies intestate when they have done no estate planning and have no valid will. Under these conditions, their property will pass in accordance with the Connecticut Laws of Intestate Succession as described in the Connecticut General Statutes. More often than not, Connecticut's laws of intestacy result in a different distribution of the decedent's assets than what the decedent would have wanted had they took the time to create a will.

The laws of intestacy apply to most, but not all, property in a decedent's estate. Only assets that would have passed through a will and through probate are affected by Connecticut's intestate succession laws. This is called probate property. Non-probate property would not be affected by Connecticut state statutes because non-probate property usually has named beneficiaries. Some examples of non-probate property that are unaffected by the laws of intestacy are:

- Property in a living trust;
- Life insurance proceeds;
- 401(k) or other retirement accounts;
- Payable on death accounts or transfer on death accounts; and
- Property owned in joint tenancy.

If a person dies intestate in Connecticut, the following distributions of probate property are made under the statutory guidelines for a decedent who leaves a surviving spouse.

i. If the decedent is outlived only by a spouse and not his or her parents or children, the spouse will receive all of the decedent's property.

ii. If decedent has living parents, the surviving spouse will receive the first $100,000 plus 75% of the balance of the estate. The remaining 25% will go to the parents of the decedent. C.G.S. § 45a-437(a) (1), (2).

iii. If the decedent is survived by children of his or her current marriage, the first $100,000 plus 50% of the estate will go to the surviving spouse. The remaining 50% of the estate will be split equally among the surviving children. However, if these children are from an earlier marriage, the surviving spouse will have to split the entire estate 50/50 with the non-marital children. C.G.S. § 45a-437(a)(2), (4).

Intestate succession statutes also dictate to whom property is distributed when a decedent without a will passes without a surviving spouse. For instance, if a decedent is survived by children, parents, siblings or next of kin only, the surviving heirs will inherit and split all of the estate property evenly. Finally, if there is absolutely no one to distribute the decedent's property to, the property will escheat to the State of Connecticut.

Regardless of the value of an individual's property during life, it is always beneficial to have a will, both to ensure that last wishes are carried out and, as discussed below, to potentially reduce the amount of estate taxes owed. In the absence of a will, a decedent's estate will be distributed according to the intestacy statutes, which will not likely comport with the decedent's final wishes and will not provide any tax savings.

4. Wills

Every person should have a will to ensure that his or her wishes are carried out properly through the probate process, and not under the statutory intestacy scheme. A will disposes of a decedent's probate property at death. If a valid will exists, it will go through probate to dispose of the estate assets. Having a valid will also reduces the chances of an heir contesting the decedent's will, and may also help avoid conflicts among family members. In order to have a valid will in Connecticut, a number of formalities must be met. These formalities are discussed below.

i. Formalities of a Executing a Valid Will in Connecticut

In Connecticut, any person 18 years of age or older and of sound mind may dispose of his or her estate by will. C.G.S. § 45a-250. In order to have the proper capacity to execute a will, the testator must be able to understand the nature of their acts, the nature and extent of their property, the proposed disposition of such property, the natural objects of their bounty, and that they're executing a will that represents their last wishes. *Atchison v. Lewis,* 131 Conn. 218, 219 (1944). In simpler terms, a testator must understand what property their estate consists of, the family members who should be beneficiaries of the estate, and how the will distributes property to those individuals.

A will must be in writing and signed by the testator. At least two witnesses must be present at the time the will is signed, and they also must sign the will to verify that they were present. C.G.S. § 45a-251.The signature of the testator must be in the same manner that he or she signs all other documents, and the two witnesses should be disinterested--that is, they cannot be beneficiaries under the will. If the witnesses are not disinterested, the devise or bequest they were to receive under the will would be void unless two other disinterested witnesses signed the will, or if the subscribing witness/beneficiary is also an heir of the testator. C.G.S. § 45a-258.

It should be noted, Connecticut does not recognize oral (nuncupative) or non-witnessed handwritten (holographic) wills. See *Appeal of Stone,* 74 Conn. 301 (1901), see also *Owens v. Doyle,* 152 Conn. 199 (1956).

In addition, a will should include a self-proving affidavit. Under Connecticut General Statutes, a self-proving affidavit allows the attesting witnesses to sign, under oath, a statement of facts they would be required to testify to in court to prove the validity of the will. C.G.S. § 45a-285. This reduces costs, as well as disputes that can lead to litigation and the difficulty of finding subscribing witnesses years later to testify in the event of a will challenge. Ultimately, the affidavit confirms the essential elements of a duly executed will, and makes it more difficult to challenge it. *Wheat v. Wheat,* 156 Conn.575 (1968).

As a side note, individuals who die in Connecticut but who have a will executed in another state need not worry. Decedents with out of state wills are not prevented from going to probate if the decedent passes in Connecticut. The same formalities for in-state wills do not apply to wills executed outside of Connecticut. If a will was validly executed according to the laws of the other state, it will be admitted to probate in Connecticut even if the other state's formalities do not comply with Connecticut's laws. *Owens v. Doyle,* 152 Conn. 199 (1956). It is, however, advisable to update a will if the testator becomes a Connecticut Resident.

ii. Provisions of a Typical Will

a. <u>Publishing Clause</u>

The opening language of most wills states the testator's name, domicile, that the document is their last will and testament, and their desire to revoke all previous wills and codicils. In legal terms, this is called the exordium, which typically states:

> "I, John Doe, a Resident of Westport, State of Connecticut, hereby make, publish, and declare this to be my Last Will and Testament. I hereby revoke any and all other Wills and Codicils that I previously may have executed."

This language provides clear evidence of where the will should be probated and gives notice that all prior wills are now extinguished. Better still, simply publishing a new will in Connecticut automatically revokes any older ones even if the new will does not refer to revocation. C.G.S. § 45a-257.

Following the exordium, a typical will provides for the payment of debts, taxes and funeral expenses. These provisions direct the executor of an estate to pay all enforceable expenses the decedent left behind and anything necessary to the administration of the estate. Connecticut's General Statutes § 45a-392 provides that claims against the estate shall be paid in the following order:

- Funeral expenses and expenses of settling the estate;
- Debts due for last sickness of decedent;
- Taxes and debts due to the state and federal governments;
- Debts due to a mechanic or laborer for work performed within 3 months of death;
- Other preferred claims; and
- Other allowed debts in proportion to their amounts.

In addition, most wills often provide a glossary of terms up front. Such a glossary may seem unnecessary, but it actually serves a very important purpose. A will deals with a person's final intent, and the only way that intent can be understood or inferred is by reading and interpreting the will. If the language of the will is vague, the decedent's exact wishes might not be carried out, and it is more likely that the will may be challenged. A simple glossary helps to provide clarity and avoid will contests. For example, the glossary may define the term "children" by providing the names of the individual children who are beneficiaries under the will.

b. Bequests and Devises

Following the general provisions, a will next addresses bequests and devises, that is, how the decedent would like his assets and property distributed and to whom. Bequests are gifts of personal property while devises are gifts of real estate. There are three types of bequests: specific, general and residuary. Specific bequests are of named property (*e.g.,* my gold ring to my sister Taylor). General bequests are usually stated amounts (*e.g.*, $10,000 to my cousin Corey). Residuary bequests are distributions of a share or all of the remaining property after specific and general bequests have been satisfied.

With specific bequests and devises, Connecticut statutes govern how the assets or property are to be treated when the named beneficiary dies first; for example, if the testator leaves a specific bequest to his son, but the son predeceases him or her. In that case, one of two things can happen.

First, if the predeceased beneficiary is a member of the decedent's family and falls into a protected class, the property may still pass to that predeceased person's family members under the Connecticut anti-lapse statute. The anti-lapse statute prevents the bequest from "lapsing," *i.e.* not passing to the intended beneficiary, by giving it to the children (the "issue") of the predeceased beneficiary. In Connecticut, the protected classes of family members are children, step-children, grandchildren and siblings. C.G.S. § 45a-441. This statute applies to both bequests of personal property and devises of real property.

Second, if a beneficiary predeceases the decedent but is not a family member, or is a member of the decedent's family but not of a protected class, the anti-lapse statute will not apply. In that scenario, the bequest intended for that individual will instead lapse and pass according to the residuary clause of the will. This could unintentionally result in disinheriting a family member or, conversely, giving a windfall to a residuary beneficiary.

One way to prevent the anti-lapse statute from applying is to include language in the will that takes into account the contingency of beneficiaries predeceasing the testator. There are many ways to do this, but one of the most common is to provide that property be distributed to descendants *per stirpes* or *per capita*. *Per stirpes* means by right of representation, and property passing in this manner will be distributed to each branch of the family equally. This language is used when the testator intends for the children of the predeceased beneficiary to take that predeceased beneficiary's share of the estate. A *per stirpes* bequest will prevent the anti-lapse statute from applying, or any other statutory scheme that may be in place upon the time of the testator's death.

By way of example, let's say testator "A" left three children, "B," "C," and "D." Child B dies before testator A leaving two children, "B1" and "B2." Testator A's will says that his property is to be divided equally among his descendants *per stirpes.* Upon testator A's death, C and D will each get 1/3 of the estate (the amount originally gifted had B survived) and B's children, B1 and B2, will divide the 1/3 share their parent was owed equally (*i.e*. they each get 1/6 share of the estate). *Warren v. First New Haven Bank,* 150 Conn. 120 (1962).

This method differs entirely from *per capita* distribution at each generation, which gives heirs of the same generation the same amount of the estate. The number of shares is equal to the number of original members either surviving or with surviving descendants. Each surviving heir of a generation gets a share, and the remainder is equally divided among the next generation descendants in the same manner.

Using the same scenario as before, with children C and D surviving testator A, the estate would be divided at their generation level. As there were three children originally, each surviving child would receive 1/3. The remainder, B's share, would then be divided in the same manner among B's surviving descendants. In this example the result is the same because B1 and B2 will receive 1/2 of 1/3 or 1/6 of the A's estate. These results would differ if child D also predeceased testator A and left one child, "D1." In that instance, child C would get 1/3 of testator A's estate and the remaining 2/3 of the estate would be divided equally among the 3 surviving grandchildren, B1, B2, and D1. Each grandchild of A would receive 1/3 of 2/3 (because there are 3 of them splitting the 2/3 that should have gone to their parents B and D) or 2/9 of testator A's estate.

Another common issue with bequests is abatement. Abatement occurs when the will contains bequests that exceed the value of the estate assets available to satisfy such bequests. If this occurs, some or all of the bequests will be reduced, or abated. The most common pattern of abatement of property in a will is for the residuary to abate first, then general bequests, and specific bequests abating last. This is to protect and ensure that specific distributions are funded and achieved before general distributions.

One last note on bequests of personal property is that a testator can only bequest property they actually own. It may seem like common sense, but wills often include bequests of property no longer owned by the testator because he or she failed to update their will after a given property was disposed of. As an example, assume you once owned a Buick, but now you own a Cadillac. Either way, you know you want your son to inherit the car at your death. Unfortunately, your will states "my Buick goes to my son." In this instance, the bequest would adeem. This means the gift of the Buick would fail and the beneficiary would receive nothing because the property is not in existence or owned by the testator at death. This occurs due to the doctrine of ademption. So, although you wanted to give your son whatever car you owned at the time of your death, that is not what the provision provided. The will provided to give him a Buick, something you no longer own. Therefore, the car would likely fall into the residuary clause of the will unless a provision for a general bequest of all remaining property was included.

There are two theories when this occurs during the probate of a will, the intent and the identity theories of ademption. Under the identity theory, which is most popular in America, the specific bequest would fail – *i.e.* the beneficiary would get nothing, if the specific item (the Cadillac) is not in the testator's estate at death. Alternatively, according to the intent theory, the bequest would fail unless evidence established that failure would be inconsistent with the testator's intent. If such evidence is shown, the value of the property or substitute property may be awarded to the beneficiary. As a note, Connecticut generally follows the intent theory of ademption.

Besides tangible personal property, testators often own real estate at death. A gift of real property in a will is called a specific devise. The rules for specific devises of real property are similar to bequests of tangible personal property with one important exception. While paying the debts of the estate, an executor may have to sell assets the testator intended to give away to specific beneficiaries. If this happens, there is a certain order the executor must follow. Devises of real property happen to be at the bottom of the list and the last item an executor can reach to pay any debts of the estate. C.G.S. § 45a-428. This statute was put in place to protect what is often the most valuable asset of many estates, the homestead.

Another factor to take into account when devising real property is any encumbrances that may be outstanding at death. A will should always provide whether debts secured by a mortgage or lien should be paid. Unless the will specifically states the opposite, an executor is not responsible for discharging such encumbrances, and the real property will pass to the intended beneficiary with such encumbrance intact. C.G.S. § 45a-266. This could result in an unintended heavy burden on a beneficiary.

c. The Residuary Estate

After specific bequests and devises, a will must set out provisions for how to handle the residuary estate. The residuary estate consists of the property that remains undistributed after specific and general bequests have been satisfied. In smaller estates, most of the property is distributed in large shares through the residuary estate. The residuary estate is very flexible as it can be distributed to numerous beneficiaries or trusts. These gifts can be stated as pecuniary amounts or fractional shares.

Pecuniary amounts are easier to account for upon administration of the estate, but fractional shares to each beneficiary, like 1/3 or 1/2, are more common.

The largest benefit of using specific pecuniary amounts over fractional shares is that they will not diminish if the estate shrinks in value. For example, assume you are worth one million dollars when you execute your will and you left your sister one hundred thousand dollars in your will. Regardless of if your estate shrinks by the time you die, your sister will receive that hundred thousand dollars. Alternatively, if you instead gave her a 1/10 share of your estate, assuming that would be one hundred thousand dollars, and your estate shrunk to five hundred thousand dollars by the time of your death, your sister would only receive fifty thousand dollars. Then again, if your estate grows, her share could grow with it while a specific pecuniary amount would not. Additionally, if your estate only consists of one hundred thousand dollars, she would be receiving the entirety of your estate and you would disinherit everyone else.

d. Appointment of Executors, Trustees and Guardians

All wills contain a provision that names the executor(s) and/or trustee(s). The executor or trustee is responsible for the administration of the estate or trust and is responsible for the assets contained therein. These provisions should also provide for successors to these fiduciaries in the event that they decline to take the position or predecease the testator. Each fiduciary will be entitled to a reasonable fee payable from the estate for their work. This fee is usually a small percentage of the total estate value ranging from 2-4%. Often, these individuals should reside in state, or be able to travel because of the localized work of a fiduciary. Unlike witnesses of a will, beneficiaries can serve as executors or trustees with impunity.

Many individuals will appoint a bank, trust company, or other professional to serve in a fiduciary capacity. Often, this is the family accountant or attorney. While these individuals may charge for their services, their fiduciary duties are intensified, and they are generally held more accountable for their actions than a family member who may serve in the same capacity. It is also common for married couples to appoint each other as executors. This complies with Connecticut law as the only requirement for an individual to serve in such a fiduciary capacity is for them to be capable of carrying out their duties.

The will should also contain provisions setting the powers the fiduciaries will hold. Often, these powers are included in a will by referencing the Connecticut Uniform Fiduciary Powers Act. This act contains a laundry list of powers that can be incorporated into a will by simple reference to it. Of course these powers can be supplemented or limited however the testator sees fit by language in the will.

Wills should also name a guardian, or guardians, of a minor’s person and estate. In Connecticut, if a minor inherits more than five thousand dollars, a guardian must be appointed. C.G.S. § 45a-631. This can be avoided by a provision in the will that allows the executor to distribute the minor’s gift either to the minor’s custodian, by the rules of the Uniform Transfers to Minors Act, or to a testamentary trust for the minor’s benefit that will mature when the minor reaches the age of majority or some other later date. The age of majority ranges from 18-25.

e. Disaster Provision for Married Couples

A will should also take into account the possibility, however remote, that both spouses or parents could die at the same time. A proper will should outline what happens when survivorship cannot be determined (i.e. who outlived whom) such as in a plane crash, car accident, or house fire. Rightly so, this is called a disaster provision, and can also be used to save on estate taxes.

For example, if one spouse’s estate is much smaller than the others, it may be beneficial for the provision to say, in the event of a simultaneous death, that the spouse with less wealth should be determined to have outlived the wealthier spouse. This would ensure the wealthier spouse can take advantage of their full lifetime exemption from estate taxes (as of 2014, each individual has a $5.34 million exemption) and then pass the remaining property to the less wealthy spouse. In this scenario, hopefully the couple could save on estate taxes because the remaining property of the wealthier spouse will go to the less wealthy spouse who will get to use another full lifetime exemption. If the situation were reversed, with the less wealthy spouse determined to have passed first, the couple would miss out on full use of both spouses' lifetime exemptions. This could result in thousands of dollars in additional estate tax that could have been avoided.

f. Trust Provisions

It has become extremely common for a will to provide that the bulk of the decedent's probate property is to be distributed to one or more trusts that were created during the testator's life (*inter vivos*). In that instance, the terms of the trust will dictate how the property is to be distributed. This is called a pour-over will provision (discussed in greater detail later). The main benefit of this type of will is to provide the decedent's wishes with privacy from the probate process. While probate procedure is public and the will must be probated, it will only contain a few statements directing all assets to pour-over into the trust. Thus, the distribution of property will be kept out of the public eye because the administration of the trust is private.

iii. Changing Your Will After Execution

Many people do not want to create wills because they claim they are unsure about how they want their property to be distributed at death. While it can be a difficult major life decision, such considerations should not hold anyone back from executing a will. Wills can be changed or revoked at any time and in a number of ways. While there is some finality in executing a will, a will is only final if the testator chooses not to change it. In reality, changing a will is a fairly common practice. Actually, individuals should update and make changes to their will and overall estate plan about every five years if feasible. Another good benchmark for updating a will is when you go through a major life event such as buying a home, getting married, having a baby, inheriting a substantial sum of money, etc.

To revoke a previously executed will, a testator may burn, cancel, shred, tear, or obliterate the document. Additionally, Connecticut law states that an older will is revoked upon proper execution of a new one. C.G.S. § 45a-257. Connecticut also provides a safe harbor provision in case a decedent revokes a previous will by executing a new, but invalid, will. This is called dependent relative revocation or DRR.

Dependent relative revocation is a doctrine Connecticut adopted in *Connecticut Bank & Trust v. Coles,* 150 Conn. 569 (1963), that provides if a previous will is revoked through the execution of a new one, and that new will is later found invalid, the previous will shall be revived. Said differently, the former will is revived when the new will is found invalid, thus guaranteeing the decedent has a will and does not have to resort to the rules of intestacy. Without DRR, both wills would be invalid and the rules of intestacy would then govern the disbursement of assets in a decedent's estate. If the former will is revived pursuant to the DRR doctrine, the decedent would still have a will, even if some of its provisions may be a bit outdated. The theory and supporting argument behind DRR is that the testator only revoked the previous will on the condition that the new one was going to be valid. In the case that the first will is not what the testator would have wanted, intestacy can be petitioned for upon the showing of proper evidence.

5. <u>Estate Planning Documents in Addition to a Will</u>

In addition to a will, there are a few other very important estate planning documents. These documents are healthcare instructions, a power of attorney, a living will, an appointment of a healthcare representative and/or conservator, and a HIPAA (Health Information Portability and Accountability Act) release. These documents are necessary elements of a proper estate plan because they provide guidance on what decisions the testator wants made, and who should make them in case the testator becomes incapacitated.

i. Healthcare Instructions

Connecticut citizens who are 18 years of age or older have the right to put in writing the kinds of healthcare they would or would not want to receive if they became unable to make those decisions personally and coherently. C.G.S. § 19a-574. This comes in the form of healthcare instructions that direct someone, acting on their behalf, to follow their wishes upon incapacitation. Most often, these instructions provide an individual with guidance on how to act if the testator enters into a coma or falls into a vegetative state. Additionally, these instructions can document a testator's intention to make an anatomical (organ) gift. Just like a will, these instructions must be executed when of sound mind and in front of two witnesses.

ii. Living Will

A living will lists what treatment a testator would like upon the occurrence of the above mentioned events. This document will only be followed if there is a terminal prognosis or a permanent coma. In this instance, terminal means the medical problem cannot be cured or reversed, and without live prolonging treatment, the individual would soon pass away. A permanent coma means that at least two doctors believe that the individual will not awaken from the current coma they are in. These determinations must be made in writing by the attending physician. C.G.S. § 19a-579.

Typical statements in a living will include whether the individual would request CPR if they stop breathing, whether they desire to be fed food or water through a tube, and/or whether they would like to survive on a respirator or another life sustaining device. One may also include specific healthcare requests that are unique to their person. Also, most living wills have a provision for acceptance of pain medication to maintain physical comfort. This statement directs that while the individual will accept sufficient pain medication and do not intend any direct taking of their life, they also do not want their life to be unreasonably prolonged.

A living will may be revoked at any time and in any manner. Such a revocation will be made part of the individual's medical records. C.G.S. § 19a-579a.

iii. Appointment of Healthcare Representatives/Proxy

Connecticut law further allows the appointment of a heath care representative. C.G.S. § 19a-576. This person can be anyone who is at least 18 years of age and who will make health decisions for the incapacitated individual if they cannot communicate them on their own. C.G.S. § 19a-577. With married couples, this is often a spouse or child of the marriage. This individual should be a trustworthy person and someone who is willing to follow the incapacitated individual's wishes.

A healthcare representative will look for instructions from a living will but they are *not* bound by law to follow them. The instructions are mere guidelines of wishes, and decisions are the responsibility of the representative. This is why it is essential to select a trustworthy representative. For insurance purposes, and as a failsafe in case the initial choice is unavailable or cannot make a healthcare decision, there also should be a back-up healthcare representative named.

iv. Conservator of the Person

A conservator is someone appointed by the court to make sure an incapacitated person is properly cared for if they cannot care for themselves. If a healthcare representative has already been named, they will usually continue to make healthcare related decisions for that individual. Unfortunately in Connecticut, one cannot choose their own conservator, but it is possible to state the desired conservator in the healthcare instructions. A judge will look to these instructions and take guidance when appointing an appropriate conservator. Unlike a healthcare representative, a conservator *must* comply with an individual's validly executed healthcare instructions. C.G.S. § 19a-580e.

v. HIPAA Release

In order for the healthcare representative or conservator to gain access to medical records, the healthcare instructions need to contain a HIPAA release. HIPAA is the Health Insurance Portability and Accountability Act of 1996. This act was created to protect the privacy of healthcare information and prohibits healthcare providers from releasing personal medical information unless they are provided with a release form. Including this release in healthcare instructions allows a healthcare representative or conservator to access medical files and make an informed decision regarding treatment.

vi. Power of Attorney

A power of attorney is a document that grants another person the power to perform specified acts on the principal's behalf. In this document the principal grants certain powers to an attorney-in-fact/agent. Anyone 18 years of age or older and you may appoint one, or multiple individuals. As opposed to appointing just one individual, two individuals may be appointed thereby making the power of attorney authority joint and only exercisable by the unanimous action of both agents. (3 Am. Jur. 2d Agency, Section 172).

A power of attorney form usually has various powers listed that can be either checked off to grant that power or stricken to not grant a given power. The most typical powers on the form are to handle real estate transactions, chattel and goods transactions, bond, share and commodity transactions, banking transactions, business operating transactions, insurance transactions, estate transactions, claims and litigation, personal relationships and affairs, benefits from military service, records, reports and statements, and any other matters that may be relevant.

Most individuals appoint one “durable” power of attorney, which is “durable” because the power remains in effect even if the individual becomes incapacitated. C.G.S. § 45a-562. With married couples, the durable power of attorney is often the spouse. This document is separate from the will and confers the power immediately upon valid execution of the document, *i.e.* it goes into effect before, and not after, death. The proper form of this document and the text that should be contained therein can be found in C.G.S. § 1-56b.

Although the durable power of attorney goes into effect immediately upon execution, the power can only be used by the attorney-in-fact if they are given a copy of the executed document. Some clients choose to hold onto this document because the immediate nature of a power of attorney causes them unease. Depending upon the individual they appoint, clients are often nervous about turning over the document because the attorney-in-fact will have immediate access to their property, bank accounts, and other assets. It is important to note that this document does not take away the original owner’s rights over the property. The principal still retains the right to do whatever they would like with their property, however now an attorney-in-fact has coexisting powers over such property.

As a way to counter some of these concerns, Connecticut has adopted what is called a “springing” power of attorney. C.G.S. § 1-56h. A “springing” power of attorney does not become effective until a specified triggering event takes place. C.G.S. § 1-56h(b). Thus, it springs into action upon a listed event and does not grant its powers until such event occurs. When the springing event does occur, the appointed attorney-in-fact will be vested with the power of attorney and must complete a written affidavit stating that the triggering event has taken place. The form of the affidavit to prove the springing event's occurrence can be found in C.G.S. § 1-56i.

A drawback of the newly adopted "springing" power of attorney is that many financial institutions (i.e. banks) simply will not recognize them. The issue most institutions have is of acquiring proof that the specified springing event actually took place. While the Connecticut statute grants banks immunity if they accept such powers of attorney accompanied by an affidavit, many institutions are still reluctant to accept them. C.G.S. § 1-56b(f).

In addition, many clients are surprised to find out that there is no state oversight of persons granted a power of attorney. The Probate Court has limited jurisdiction over the actions of someone with a power of attorney and can demand that they produce an accounting of their actions upon the request of the person who granted the individual such power. If the grantor of the power is incapacitated, the court, *sua sponte*, or the grantor's conservator can make such demand. Once this accounting is made, if the Probate Court finds a breach of trust or abuse of powers by the attorney-in-fact, it may subject the attorney-in-fact to criminal penalties. Improper use of a power of attorney can also constitute grounds for a civil action. Of course, individuals should appoint someone they know well and trust to avoid such impropriety from occurring.

Finally, a power of attorney may be revoked at anytime. If a principal has even the slightest notion that their attorney-in-fact may be stealing, they should revoke the power and give notice to all institutions that hold their property. The power of attorney may be revoked by destroying it or executing a document that states a clear intention to revoke all previously granted powers of attorney. The power of attorney will be automatically revoked upon the principal's death.

6. Contesting a Will

Should it become necessary to contest or defend a will for whatever reason, in Connecticut there are only limited grounds on which to bring such a challenge.

i. Undue Influence

The first ground for challenging a will is undue influence. Undue influence occurs where the testator was improperly influenced by someone when executing or before executing the will and is the most common reason for contesting a will. For example, suppose your grandmother was ill and was being cared for by a visiting nurse named Ben. Your grandmother was 91 and executed a will just two months before her death. Now suppose that every day, unbeknownst to you, Ben bad mouthed you and your siblings until your grandmother executed a new will that disinherited all the grandchildren and gave the majority of her estate to him. That situation is ripe for a will contest based upon undue influence.

In order to succeed on a claim of undue influence, one must prove that the testator was susceptible to influence, there was a confidential relationship between the testator and the person accused of undue influence, there was an opportunity for such influence to be exerted, there is evidence that the accused had intent to exert such influence, and there was a suspicious transaction that resulted in a benefit to the accused.

ii. Lack of Mental Capacity

Another common basis for a will contest is to challenge the testator's mental capacity. As previously mentioned, a valid will requires the testator to be of sound mind. If a testator executed a new will while going through a mental health problem, or if a prior will was executed by the testator during a period of mental anguish, the will may be susceptible to challenge.

A testator's capacity involves the understanding of his or her property, the typical beneficiaries of such property, and the legal effect of signing his will. To prove the testator lacked such capacity, there must be evidence that the testator lacked one of these requirements. Capacity is often very subjective and needs to be proven by sufficient evidence. For example, imagine you got into a car accident and suffered some brain trauma. While at the hospital, you executed a new will giving all your property to the nurse who changed your sheets thinking she was your daughter. In that instance, someone would have valid grounds for contesting your will based upon a lack of testamentary capacity.

iii. Failure to Meet Statutory Requirements

Connecticut, like all states, has various statutory requirements for a will to be valid. As discussed above, to be found valid in Connecticut a will must be:

- In writing;
- Signed by a testator 18 years of age or older;
- When the testator is of sound mind; and
- Signed in the presence of two disinterested witnesses (excluding immediate family members).

Thus, if any of these requirements are not met, a will can be contested for failure to meet Connecticut's statutory requirements. Typical challenges of this sort are often about the lack of a signature on the will.

Conclusion of Wills

The information above involving wills, traditional will provisions, and relevant doctrines is meant to be a starting point for understanding the complexity of estate planning. While we have discussed many of the most important aspects of wills and the laws that shape them in Connecticut, this is by no means an exhaustive guide. There are various complex techniques for tax, Medicare, special needs, and financial planning that are outside of the scope of this general publication. For more information, one of the experienced attorneys of Maya Murphy, P.C., can be reached at 203-221-3100 or by emailing ask@mayalaw.com.

7. An Introduction to the Probate Process

As the Connecticut Probate Court website aptly describes, "the administration of a decedent's estate is a legal process by which any outstanding financial obligations of a deceased person are paid, and the person's property is transferred to those entitled to receive it." The probate process normally does not take longer than a year, but it can last longer under certain circumstances. Contrary to what most people believe, the probate process is relatively inexpensive unless there is a will contest, unlawful actions taken by the executor, or an ambiguous will.

It is important to remember that the probate process only applies to probate property. Probate property is all property directly owned by the decedent for which there is no legally recognized death beneficiary designation. Some examples of probate property include real estate owned outright or by tenancy in common; non-joint bank accounts and bank accounts that do not have payable on death designations; interests in partnerships, corporations, or limited liability companies, and tangible person property like cars, jewelry, and home furnishings. Ray Madoff *et al*., *Practical Guide to Estate Planning,* § 2.03 (2014).

Property that will not qualify for this process is called non-probate property. This property will bypass the probate process and be distributed directly to the designated beneficiaries. Some examples of non-probate property include real estate held in joint tenancy, life insurance, retirement accounts, payable on death accounts, joint bank accounts, and interests in trusts. Many individuals who wish to avoid probate convert their probate assets to non-probate property by placing them into an *inter vivos* revocable trust that terminates the grantor's interest at death. The various options for trusts will be discussed in greater detail later in this publication.

In Connecticut, when a person dies, the probate court serves many purposes. First, the court provides a medium for locating and taking control of a decedent's assets. The court also ensures that all proper debts, administration expenses, and taxes are paid from the assets of the estate. Once all debts are paid, the court determines how the remaining property should be distributed according to the terms of the will, trust documents, or laws of intestacy. By overseeing the administration of estates, the probate court also provides individuals with a forum to hear and settle any disputes that may arise.

Much of the probate process involves filing forms and paying fees, but there are many steps to the process. This is a detailed overview of normal estate administration, but there is also a simpler procedure for estates that do not exceed $40,000 in value. If you are interested in that process, there is a form entitled "Affidavit in Lieu of Administration," or form PC-212, which can be found on the probate court website along with detailed filing instructions.

i. To Begin: File a Petition With the Probate Court

For the probate process to begin, one must petition the court where the decedent was domiciled at death. This is usually the responsibility of the executor, but the petition can be filed by any person who wants the estate administered. This petition should be filed within 30 days of the testator's death and submitted with a certified death certificate, the original will, and any original codicil or trust documents. The application, form PC-200, can be found on the Connecticut probate court website at ctprobate.gov. The form requires information regarding date of death, name of spouse, names of heirs, and intended beneficiaries under the will.

Once the petition is received, the court will schedule a hearing to admit the will to probate and appoint an executor of the decedent's estate. If the decedent died intestate (without a will) the court will have to appoint an administrator for the estate. Before either can be appointed, the court must determine both if there is a will and if the document is the valid last will and testament of the decedent. Once this initial hearing is complete, the court will give the executor or the administrator fiduciary certificates to prove they have authority to act on behalf of the estate. Without such certificates, the executor or administrator would not be able to manage and dispose of the estate assets.

ii. Appoint a Fiduciary to Handle Administration Duties

The executor or administrator of an estate is called a fiduciary. This means they hold a position of trust in the handling of another's property. A fiduciary owes a duty to properly manage and dispense the decedent's property and can be held liable for certain failures or unlawful acts. Once appointed, the fiduciary will take over the decedent's assets, determine and pay proper debts, and distribute the remaining property to the decedent's intended beneficiaries. Naturally, the fiduciary must not commingle the estate assets with their own. Throughout this period, the fiduciary must file all necessary documents such as estate tax forms, gift tax forms, and certificates for land records. The exact duties of a fiduciary are discussed in greater detail below.

a. File Certificates for Land Records

If the decedent owned real estate that was devised in his will, the court will provide certificates for land records that the executor or administrator must record at the town clerk's office to show the executor or administrator has been appointed to manage and dispose of that property. This form, PC-251, must be filed within two months of appointment as fiduciary.

b. File Inventory of Estate

Also within two months of being appointed, the fiduciary must file an inventory of all estate assets. This inventory must include all property the decedent owned in their name such as real estate, bank accounts, retirement accounts, cars, household items, and personal effects. Any property held with a partner, but not with right of survivorship, must also be listed. In addition, if life insurance policies are payable to a decedent's estate, those must be included in the accounting as well. Once all property is listed, it must be valued according to the fair market value at the decedent's time of death. This can be completed through getting verified appraisals.

Any assets not intended for probate need not be listed, such as property held with right of survivorship, life insurance policies with named beneficiaries, joint bank accounts, and other payable on death accounts.

c. Sell Estate Property to Pay Expenses and Claims

Next, the fiduciary must determine the validity of any claims against the estate and pay all proper debts and taxes. The process of determining valid claims starts with the fiduciary placing a notice in the local paper within 14 days of appointment requesting creditors to present their claims. Once this occurs, creditors have 150 days to present their claims. The proper form, PC-234, can be found on the probate court website.

Within 60 days of the conclusion of the 150 day creditor claim period, the fiduciary must file a return of claims and list of notified creditors, form PC-237, with the court. After the 150 days concludes, a fiduciary can, in good faith, distribute all remaining estate assets.

In addition to settling creditor's claims, the fiduciary must also pay all administration expenses, fees, and taxes. These expenses include fiduciary fees, attorney's fees, probate court charges, legal notice charges, and any other expenses relating to the maintenance of the decedent's property. If there are not enough assets in the estate to settle all debts, the estate is deemed insolvent.

d. File Estate Tax Returns and Pay Taxes

Within six months of the date of death, an estate tax return must be filed by the executor with the State of Connecticut. This deadline may be extended up to six months upon filing of a request, form

CT-706/709. The appropriate tax forms should be filed with the probate court for the district in which the decedent resided at the time of death. If the decedent was a non-resident, the forms may be filed in a probate district where the decedent owned property.

Federal estate taxes are due on estates larger than $5.34 million (2014, adjusted for inflation each year). If a decedent's estate is less than that amount, no federal estate tax is due. The majority of estates, therefore, do not end up owing federal estate taxes.

As for Connecticut state estate taxes, the exemption amount is $2 million for those passing after January 1, 2011. This figure is drastically less than the $3.5 million exemption that was available in 2010. If the decedent's estate is less than $2 million, a simplified tax return, form CT-706 NT, should be filed. In cases where the decedent's assets exceed $2 million, form CT-706/709 must be filed to determine the tax due. If a decedent's estate is less than $2 million, there will be no federal or state estate taxes due.

Remember, these are just the exemption amounts for Connecticut and the federal government. There are many ways to decrease or avoid the amount of taxes owed at death. Many of these options are outside of the scope of this publication and highly complex. If you have an estate that is worth more than either of the exemption amounts, you will want to discuss proper estate and financial planning with an experienced attorney. Every estate is different, and there are numerous ways to plan for and reduce estate taxes. Only a specialist can help you decide the best tools for your estate.

e. File Final Financial Report

Within 12 months of the decedent's death, a fiduciary must file a financial report with the court when the administration of the estate is complete. There are two forms of this report, a simpler form PC-246, and a more complex form PC-241 or 242. The latter forms will be needed by a fiduciary when there are trusts that disperse income and principal to separate beneficiaries due to more complex tax implications.

Once the financial report is submitted, the probate court will hold a hearing to allow beneficiaries to question or object to the accounting or the way the assets were handled. This hearing can be avoided if all parties waive their rights to the hearing through form PC-245. This form states that all parties received a copy of the final accounting and waive their right to such a hearing. This is most common when no one questions the estate and how it was handled.

If the estate cannot be closed within a year, the fiduciary must file status updates with the court. The first report must be filed within three months of the day the fiduciary was appointed and then annually thereafter. These reports must include detailed financial accounting and the reason why the estate is open longer than the usual year.

f. Distribute Remaining Assets to Beneficiaries

Once the fiduciary has completed all other tasks and settled all other debts, assets may finally be distributed to beneficiaries.

g. File Affidavit of Closing Estate

Finally, to complete their duties, the fiduciary must file form PC-213, the affidavit of closing. This form is used to report receipts and disbursements that occur after the final accounting was submitted. If directed to do so by the court, this form must be submitted within 30 days after the distribution of all assets.

Probate Process Conclusion

Although the fiduciary may have many steps to take, the probate process is not as daunting as it may seem. The beneficial oversight the probate court supplies to a decedent's estate outweighs the probate court fees and process. With proper planning, and a trustworthy executor, most of these costs can be avoided completely.

8. Gifts

In addition to bequests through a will or a trust, property may also be gifted during life. Of course there are tax implications to making lifetime gifts, but there is also an annual exclusion individuals can utilize each year to make gifts free of tax. As of 2014, each year an individual may gift up to $14,000 per person, $28,000 if married, to as many individuals as they desire. This is called the annual gift tax exclusion and it is adjusted for inflation each year. In order for the transfer to qualify as a gift, it needs to be a transfer of property for less than full and adequate consideration in money or money's worth. I.R.C. Reg. § 25.2512-8.

Additionally, for the gift to qualify for an annual exclusion amount, it needs to be a gift of a present interest as opposed to a future interest. A future interest is an interest that is limited in use, possession or enjoyment at some future date or time. I.R.C. Reg. § 25-2503-3. Generally, this means that outright gifts of property qualify and interests in trust do not qualify unless specific requirements are met. These specific requirements are called "Crummey" powers because of the famous *Crummey v. Commissioner* tax case. This case created a rule in which a gift of an otherwise future interest to a trust would qualify as a present interest for gift tax purposes if certain requirements were met. The case requires gifts in trust to be drafted in such a way as to give the beneficiary a right to withdraw the gift principal for a defined period of time, usually 30 days. The withdrawal right of the beneficiary creates the present interest needed to qualify the gift for an annual exclusion free of tax.

9. Estate and Gift Taxes

The main goal for most individuals is to avoid or minimize estate taxes, which can be done through proper estate planning. It is helpful to know that 99% of Americans do not pay any federal estate tax. That means only 1% of America's wealthiest individuals, or two out of every 1,000 people who die, owe any federal estate tax. Urban-Brookings *Tax Policy Center Table T13-0019.* That may seem extraordinarily low, but federal estate taxes are expected to result in $200 billion worth of revenue by 2022 and account for more than $20 billion each year. *Id*. These figures do not align with state estate taxes, which apply to closer to 30% of individuals in Connecticut. The most important aspect of many estate plans is the appropriate use of the annual gift tax exclusions and the lifetime exemption amount.

i. Federal and State Exclusion Amounts

As of 2014, every U.S. citizen has $5.34 million of estate and gift tax exemption. For married couples, that number doubles (this now includes same sex marriages as well). This lifetime exemption amount can be used during life, at death, or a mixture of the two. Additionally, each year an individual can make gifts of up to $14,000, per individual, to as many individuals as they would like free of any estate, gift, or transfer tax. If married, and an election is made on the gift tax return, this number can double to $28,000 per individual. This is called the annual gift tax exclusion amount and it is adjusted each year for inflation. Every dollar transferred over those exemption amounts results in a flat 40% rate of tax.

Also, if the transfer is subject to generation-skipping transfer taxes, an additional 40% may be imposed. The generation-skipping transfer tax imposes a tax on transfers in trust or for the benefit of unrelated persons who are more than 37.5 years younger than the donor, or to related persons more than one generation younger than the donor (such as grandchildren). I.R.C. § 2601.

It should be noted that these numbers change quite frequently and only apply for the year of death. For example, the $5.34 million lifetime exemption may increase or decrease by the time of your death (or maybe even by the time you read this). Just last year, the American Taxpayer Relief Act of 2012 was passed and set the above numbers. This new act increased exemption amounts by almost one million dollars as well as increased the rate of tax 5%. Due to this volatility, it is necessary to keep estate planning up to date.

As of 2014, the Connecticut estate tax exemption is $2 million and applies to gifts during life as well. This amount is completely separate from the federal tax structure and is owed in addition to any federal taxes, or owed despite not owing any federal estate tax. Although Connecticut lowered its exemption amount, it also eliminated its “cliff” structure. Pre-2010, an estate of $2 million paid no estate taxes, but an estate of just one dollar more paid $101,700 in taxes. Connecticut’s estate tax structure caused the state to be listed in the 2013 Forbes Magazine article “Where not to die.” Thankfully, rates are now staggered from 7-12% depending upon total estate value. For example, a $3 million estate is taxed at 7.2%, a $5 million estate is taxed at 8.4%, and a $10 million estate is taxed at 11.4%. This remains much lower than the federal rate of 40% of the entire estate if its value exceeds $5.34 million.

Even with these tax structures in place, there are three ways to transfer property free of any tax and in an unlimited amount. These are called tax exemptions. The first exemption is the unlimited gift tax exclusion for amounts paid on behalf of an individual for medical or educational expenses. This is often referred to as the “Med-Ed” exclusion. I.R.C. § 2503(e). Any amounts paid directly to a medical or educational provider will transfer free of tax and not count towards an individual’s lifetime exemption amount.

The next way to transfer property without limitation and without tax is to give it to a spouse. This is called the unlimited gift tax deduction for marital transfers. I.R.C. § 2523. However, in order to qualify for the unlimited transfer amount, the transfer must be in the form of a qualifying interest. Much like the present interest rule for gifts, outright transfers of property will normally qualify for the deduction. But, transfers of less than the entire interest in property must meet the requirements of the terminable interest rule. I.R.C. § 2523(b). This rule denies the marital deduction for transfers of interests that terminate or fail upon the lapse of time or the occurrence or nonoccurrence of an event, if a person other than the spouse will receive the property from the donor after the termination of the spouse's interest. *Id*. While this publication will not delve deeper into how to properly gift assets to a spouse, it is helpful to note that exceptions to this rule do exist. The most common exception is the qualified terminable interest property or QTIP trust (discussed in greater detail at pg. 37 below).

The final method to transfer property free of transfer tax is to gift it to a charity. The gift tax provides an unlimited deduction for property transferred to a qualifying charitable, religious, or governmental organization. I.R.C. § 2522. Much like transferring property to a spouse, outright transfers will generally qualify without issue. But, if someone wants to transfer less than the entire interest in a piece of property, special requirements need to be met. The most common ways of achieving this result would be through charitable remainder trusts (also known as CRATs or CRUTs).

The above list of exemptions and deductions is not meant to be exhaustive, and proper tax planning is essential if your assets are anywhere near the exemption amounts. Tax planning is essential for everyone because the estate tax exemptions change so frequently. The various methods of proper estate tax planning are highly complex and outside of the scope of this publication. If you are interested in hearing about some of these methods, you should contact the experienced estate planning attorneys of Maya Murphy, P.C., at 203-221-3100 or via email at ask@mayalaw.com.

ii. Assets Subject to Tax

The estate tax is imposed on all property owned or controlled by the decedent at death, whether or not the property passes through the probate process but only if the estate exceeds the federal and state thresholds. This means that trust assets can be subject to taxes as well. Also, estate tax is imposed on any property in which the decedent had incidents of ownership at death. Incidents of ownership are generally defined as the ability to control any of the economic benefits of the property. I.R.C. Reg. § 20.2042-1(c)(2).

iii. Value of Assets

Property in a decedent's gross estate will be taxed according to its fair market value. I.R.C. Reg. § 203.2031-1(b). The fair market value is defined as the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. *Id*.

The date for valuing such property in the gross estate is generally the date of death. I.R.C. § 2031(a). This date is used unless the executor of the estate elects for an alternate valuation date. To avoid hardships caused by reductions in market value during administration of an estate, executors may elect to value the decedent's property as of the date that is six months after the date of death. I.R.C. § 2032. This election may only be used if the election will reduce the value of the gross estate and, accordingly, reduce the total amount of taxes due. I.R.C. § 2032(c).

iv. Income Tax on Property Received by Gift or Inheritance

Property received through gift or inheritance is not subject to any income tax. Thus, a recipient can enjoy the full value of property received without worrying about income tax liability. However, if the recipient subsequently sells the property they received, they may be taxed on any gains or losses.

For example, if a gift or inheritance of property like stocks is made, and the recipient chooses to sell it before it increases in value, they might not be taxed on any portion of the sale.

The tax liability of selling property received by gift or inheritance is based on the recipient's basis in the property. Basis is the cost, or value, of the property acquired. This number is usually the value of the item received based on the decedent's date of death value. For example, if an aunt left a niece ten shares of Disney stock, valued at $100 per share on the date of her death, the niece would have received $1,000 worth of Disney stock. The $1,000 would be the niece's basis in the property regardless of whether the aunt's basis would have been ten dollars (the price that she paid when first acquiring the stock). This is called a stepped up basis in property. This stepped up basis allows all of the gain, $90 per share, to go untaxed. Thus, it is often very beneficial for a decedent to leave stock they have a very low basis in, and that appreciated significantly, to a beneficiary in their will.

10. <u>Trusts</u>

i. Introduction

Many complex, and even simple estate plans now include some type of trust. A trust is an extremely flexible estate planning instrument that can be used for a variety of purposes. It has been said that "the purposes for which trusts can be created are as unlimited as the imagination of lawyers." 4.01 *Frachter, Scott on Trusts*, at 2 (4th ed. Little, Brown 1987). For instance, there are marital trusts, tax-avoidance trusts, minor trusts, charitable trusts and even pet trusts in some jurisdictions.

While many people have heard of a trust, not many fully understand the concept and requirements of a trust. For example, most people mistakenly believe that all types of tax can be avoided by placing assets into a trust. Although trusts can be structured in a way to lower or avoid taxes, simply placing property into one does not eliminate taxes entirely. Besides tax incentives, the real advantage of a trust is the ability for the donor to impose restrictions on the use of property while still keeping that property out of the donor's estate for privacy and estate tax purposes.

Essentially, a trust is a device for holding property in which ownership is divided between a trustee and a beneficiary. *Madoff*, § 4.02.The trustee holds legal title to the property contained in the trust and has both the right and duty to manage the property for the benefit of the beneficiary. Any named beneficiary of the trust has an equitable interest in the property because of a right to the economic benefit of the property. *Id*. This interest is also a property interest that is capable of being transferred by the beneficiary, or attached by the beneficiary's creditors unless there is a spendthrift provision (something that will be discussed later in this chapter). *Id*.

A trust is created when a person transfers property to another person with the intent that the recipient holds the property for the benefit of someone else. The trust instrument, a written document, will provide the trustee with instructions on how to manage and distribute the transferred property. This is an important responsibility, and the law imposes various duties on trustees to ensure proper performance. If a trustee breaches his duties, the law provides various remedies for the beneficiary.

ii. Parties to a Trust

There are typically three separate parties to a trust: a settlor, a trustee, and a beneficiary. The settlor is the person who creates a trust and is also known as the donor or the grantor. Ultimately, the intent of the settlor determines if a trust has been created. *Madoff*, § 4.03. If the settlor transfers property to an individual with the intent that the recipient use that property for the benefit of another, a trust has been created. If instead, the settlor transfers property to an individual for that recipient to use for their own benefit, no trust has been created.

The trustee is the person who receives the property from the grantor and accepts the obligation to hold such property for the benefit of the beneficiary. A trustee can be an individual, multiple individuals, or an institution. Many legally enforceable duties come with the title of trustee. In particular, once someone has accepted the role of trustee they must:

1. Use prudence in investing the trust assets;
2. Follow the terms of the trust;
3. Be loyal to the trust, its assets, and its beneficiaries;
4. Pay attention to trust assets and beneficiaries; and
5. Provide regular accounting to the beneficiaries.

Due to the many duties of being a trustee, an individual named as trustee must formally accept the position. The individual, or corporation named is also allowed to decline the position. If declined by the primary trustee and there is no other accepting trustee, the court will appoint one. In Connecticut, the appointed or accepted trustee will be paid a reasonable fee for their duties. What is reasonable has not been defined by statue in this state but is usually anywhere from 2-4% of the estate's total worth.

Of course, there must be a beneficiary or beneficiaries of a trust. This is the individual, or group of individuals set to receive benefits from the trust. In order for a trust to be valid, there must be at least one beneficiary. A trust cannot have one beneficiary that is also the settlor and trustee. When naming beneficiaries, they must be described with sufficient detail if they are separate individuals, or a class of beneficiaries can be named (such as grandchildren or children). If the description of beneficiaries is too vague, the trust will fail. *Madoff*, § 4.04.

Finally, in order for a trust to be formed, it must contain property. Trust property is known as the trust corpus or the body of the trust and is transferred by the settlor to the trustee for the benefit of the trust beneficiaries.

iii. Forms of Trusts

a. *Inter Vivos* and Testamentary

While there are a variety of forms of trust, discussed below are some of the most common forms, as well as the elements that are common to all trusts, regardless of form.

All trusts in estate planning can be categorized as *inter vivos* or testamentary trusts. A trust created during the life of the settlor is called an *inter vivos* trust. A trust created at his or her death is called a testamentary trust. Any property contained in an *inter vivos* trust is not part of the settlor's probate estate and will pass directly to the beneficiary when the settlor dies. *Madoff*, § 4.05(b)(1). An *inter vivos* trust is most popular with settlors who wish to take advantage of the annual gift tax exclusion of $14,000 by making gifts of that amount, for one or more beneficiaries, to the trust each year.

A testamentary trust on the other hand is created at death by the settlor's will. Since this is a part of a will, the terms of the trust will be made public during the probate process. This type of trust lacks the privacy many settlors look for because it is subject to the continuing jurisdiction of the probate court, and because the trustee must file a public inventory of the initial assets the trust was funded with. *Id*.

b. Revocable or Irrevocable

Additionally, trusts are either revocable or irrevocable. As their names suggest, a revocable trust may be revoked by the settlor, and an irrevocable trust may not be revoked. Revocable trusts have the benefit of allowing the settlor to retain control of the assets in the trust, to revoke the trust, and to change the terms of the trust at any time. These trusts are also known as living trusts, and allow for assets to be protected during life and at death. Typically, a simple pour-over will (discussed below) ensures that the rest of a settlor's assets are transferred into an already created revocable trust at death.

With an irrevocable trust, the assets no longer belong to the settlor, they belong to the trust. Typically, trust terms cannot be changed without consent of the beneficiaries and the trustee. The main reasons for creating an irrevocable trust are to reduce taxes and to protect property. This type of trust is most often created at death through a will or otherwise. After death, any living revocable trust will transform into an irrevocable trust.

iv. Types of Trusts

The various types of trusts are surely endless, but the following are the most common trusts that are drafted today.

a. <u>Pour-Over Trust</u>

A pour-over trust is a revocable living trust that is structured to receive and dispose of assets at the settlor's death. This is usually done through the settlor's will, normally called a pour-over will. This type of trust is separate, and not contained in the will itself, which distinguishes it from a testamentary trust. This difference provides numerous advantages. For instance, a pour-over trust is administered without court supervision, the instrument itself is not a public record, it can provide for disposal of all assets (both probate and non-probate), and can be merged with other trusts to provide one unified plan. *Madoff*, § 4.05(B)(3).

b. <u>A-B Trust / Marital Deduction Plan</u>

One estate plan that has become very common for married couples with wealth that exceeds the lifetime exemption amount is the optimal marital deduction plan. This plan ensures full use of both spouses' lifetime exemptions and postpones any estate taxes until the second death. This is often accomplished by the couple having reciprocal wills that, upon the first death, divide the first estate into two trusts, an "A" trust (also called the marital share), and a "B" trust (also called the bypass or credit share). When the first spouse dies, an amount equal to their lifetime exemption gets placed in the "B" or bypass trust, with the residue of the estate funding the "A" or marital trust. Each trust will be irrevocable and benefit the surviving spouse for life.

This plan saves the most in estate taxes because the bypass trust uses the first spouse's full lifetime exemption and then keeps that property out of the second spouse's estate by placing it in a trust for the benefit of any children and the surviving spouse. It remains outside of the surviving spouse's estate because they only have a discretionary income interest (discretion lies in the hands of the trustee to make distributions) in the trust. As for the marital share, that passes to the surviving spouse free of estate tax on the first spouse's death because of the unlimited marital deduction. The surviving spouse will continue to benefit from the property as a beneficiary of the trust, usually a QTIP (discussed below), and the property will be included in the surviving spouse's estate. More often than not, individuals like to place the marital share in a trust instead of giving it to the surviving spouse outright so they have some control over the disposition of the property and protection from creditors. This "A-B" plan has become extremely popular with married couples who have estates that may owe federal estate taxes (*i.e.* estates over $5.34 million).

One key factor in ensuring the trust's success is dividing the marital assets appropriately between the two spouses. If the first spouse to die does not have enough assets in their estate to take full advantage of the estate tax exemption and the second to die has too many, the intended purpose of the plan would be defeated. Therefore, it is important to properly sever assets and convert jointly held assets into assets held by only one spouse. Jointly held assets would pass to the surviving owner at death and not qualify for the credit shelter trust ("B" trust).

Once assets are placed into the credit shelter trust, they are free from estate tax, even upon growth of the assets. The surviving spouse can use and receive income for life from the trust property but will never own the property. Because the surviving spouse never owns the property, the property in the credit shelter trust will remain outside of their estate at death and pass to the trust's remainderman, usually a child. Thus, this trust plan takes advantage of both estate tax exemptions, allows for the surviving spouse to receive a benefit from the first spouse's property during life, and remains free of any estate tax.

For an example of how much couples can save using this type of trust, compare what happens in the following two scenarios. In scenario one, there is no credit shelter provision in either will, and each spouse owns $5 million in assets. Each will provides that the surviving spouse receives all the property outright. When the first spouse dies, all property will go to the spouse tax free because of the unlimited marital deduction. Assuming the property has not grown, when the second spouse dies their estate will be valued at $10 million. After using the full estate tax exemption (we will use $5 million for ease of math), the second spouse's remaining estate of $5 million will be taxed at a 40% rate. This would result in federal estate taxes of $2 million (ignoring any other deductions or credits).

Alternatively, if the couple had provisions for credit shelter trusts in their wills, when the first spouse died, their $5 million would go into a credit shelter trust and be exempt from any federal estate tax due to the $5 million lifetime exemption. The income from the $5 million would be given to the surviving spouse for life. When the second spouse died, their $5 million estate would be free of estate taxes because of the lifetime exemption. Also, the income they received from the credit shelter trust would have no effect on their estate, and the $5 million in the credit shelter trust would remain outside of the second spouse's estate. At the second spouse's death the estate would owe no taxes whatsoever. Accordingly, by establishing this trust, the federal tax savings are $2 million.

c. QTIP Trust

Another trust frequently used by married couples is the qualifying terminable interest property trust, or QTIP trust. This trust is used in estate planning for U.S. citizens to postpone the payment of estate taxes until the second spouse's death. Often, this trust is preferred in families that have divorces, remarriages, and stepchildren because the grantor can provide his current spouse with income for life while also ensuring the trust assets ultimately pass to his or her children of a first marriage, or other named beneficiaries.

This trust can qualify for the marital deduction on the first spouse's death but needs to meet strict guidelines to do so. First, the surviving spouse must be entitled to receive all income from the trust, at least annually, during life. During the surviving spouse's lifetime, they cannot decide on the ultimate disposition of the trust assets and cannot withdraw any principal from the trust. Finally, the executor of the first spouse to die must elect QTIP treatment of their property on the estate tax return in order for it to qualify for the beneficial tax treatment.

When the second spouse dies, the assets in the QTIP will be distributed according to the first spouse's specifications, and the property will be included in the second spouse's estate. Therefore, there is no estate tax until the second death. However, any increase in estate taxes on the second spouse's estate as a result of the trust is usually paid using the QTIP's remaining trust assets.

There are two main benefits of this trust-- flexibility for the executor and control for the settlor. First, a QTIP does not become a QTIP until the estate's executor makes the election. So, if it is unclear what a testator's estate tax situation will be at the time of death, it may be prudent to provide flexibility for an executor to elect between either claiming a marital deduction for the amounts transferred into the QTIP, or foregoing that deduction. This will allow the executor to make a calculation and determine which option will minimize the total estate taxes paid by the testator and their spouse.

Second, and often a more compelling reason for some, is that a settlor may want to utilize the marital deduction for transfers into a QTIP but also limit the power and ownership rights their surviving spouse has over the trust assets. As mentioned before, this trust is very helpful in divorced families and with remarried individuals. If a settlor is concerned that his current spouse may not provide for his children from a previous marriage, this trust can be used to limit the current spouse's interest and ensure the children are provided for.

d. <u>QDOT</u>

A qualifying domestic trust, or a QDOT, is a trust established for the benefit of a spouse who is not a U.S. citizen and therefore does not qualify to receive assets tax free from the federal unlimited marital deduction. Individuals who still want to pass property to their non-citizen spouse tax-free must transfer the property to this type of trust. In order for this trust to qualify for beneficial tax treatment, at least one trustee must be a U.S. citizen or domestic corporation, and the trust can provide no distributions, other than income, to the surviving non-citizen spouse unless the trustee has the right to withhold special estate taxes. The reason for these more stringent rules is to ensure property passing tax-free to a non-citizen spouse will not evade ultimate taxation by the IRS if the non-citizen decides to return to their home country.

e. Life Insurance Trust

An irrevocable life insurance trust, or an ILIT, will remove life insurance policies from the estate, can help pay estate costs, and help provide heirs with a large amount of cash. This trust is created during life and the beneficiaries are often the grantor's spouse, children, or grandchildren. Instead of the grantor owning the policy, the ILIT would buy a policy on the testator's life with assets they transferred into it. Alternatively, a testator may choose to transfer ownership of a current policy to an ILIT. The grantor of such a trust must completely give up all rights to the policy transferred and retain no right to revoke or alter the trust.

Additionally, this trust can be formed as a "Crummey" trust so the grantor can provide gifts in the amount of the annual gift tax exclusion (currently $14,000) each year to pay for the insurance premiums. For example, if there are four beneficiaries, the grantor can transfer up to $56,000 to the trust, per year, to pay insurance premiums without having to pay any gift tax on the transfer. If a grantor does not want to choose this option, they can fund the trust initially with a large amount of money to pay for the future insurance costs.

The use of this trust will keep the insurance policy proceeds out of the taxable estate of the decedent as long as: (i) the trust is irrevocable; (ii) the grantor is not the trustee; (iii) the grantor has no incidents of ownership; (iv) the insurance proceeds do not directly benefit the grantor's estate; (v) and the insured grantor lives for at least three years after funding the trust if the trust is funded with an existing life insurance policy.

Also, and as an added benefit, the Crummey trust can be used to provide liquidity to the grantor's estate even though the estate cannot directly benefit from the trust. This can be accomplished by authorizing the trustee to purchase non-liquid assets from the estate upon the grantor's death with the insurance policy proceeds, or by authorizing the trustee to give loans to the estate to pay taxes and fees. In either scenario, cash can flow to the estate if needed. As long as this is in the trustee's discretion, not mandatory, the proceeds will remain outside of the grantor's estate while also providing some insurance for the estate upon death.

f. Spendthrift Trust

When transferring property to a beneficiary, many individuals worry that the assets given may be confiscated by creditors or spent frivolously. Spendthrift trusts are designed to relieve both of those worries by preventing creditors from attaching the beneficiary's interest in the trust and/or limiting a beneficiary's ability to transfer assets in the trust. Basically, the beneficiary is prohibited from assigning his present or future income from the trust and from selling his or her rights to creditors.

The trust must be irrevocable and should be funded with income producing assets. When appointing a trustee, the trust provisions must give the trustee broad discretion regarding distributions. Additionally, to afford greater protection from creditors, the trustee should not be the beneficiary. Further, due to the fraud of a grantor attempting to evade creditors, most states, including Connecticut, do not allow a grantor to establish a spendthrift trust for their own benefit. Because a spendthrift trust enables a donor to provide for a beneficiary while also protecting that beneficiary against their own impudence, they have become very popular estate planning tools. However, they have also become very controversial because the beneficiary's property interest is immune from creditors and allows the beneficiary to enjoy the wealth without bearing its responsibilities.

It is prudent to note that spouses and children that have claims against a beneficiary of a spendthrift trust for alimony or child support have generally been able to obtain that beneficiary's interest in the trust despite the spendthrift provisions. This has held true more for child support than alimony because child support is a common law duty while alimony merely represents a court imposed adjustment of economic interest. *Madoff*, § 4.05(C)(4).

g. QPRT Trust

An irrevocable qualified personal residence trust, or a QPRT, is a trust that allows the settlor to gift their personal residence or a vacation home into trust for the benefit of children and potentially remove it from their taxable estate. In addition, thanks to favorable IRS regulations, the residence can be gifted to the trust at a discounted value. This trust is most commonly used when a settlor wishes to transfer a personal residence to family members at some time in the future, desires to still reside in the residence, and wants to save on estate and gift taxes of the transfer.

Ultimately, a QPRT is a lifetime transfer of a personal residence in exchange for continued rent-free use of the residence during the trust term. Often, a QPRT also provides that if a settlor outlives a trust term, the property can be rented back to the settlor at the fair market value. When the term of the trust ends, the residence passes outright to the beneficiaries or remains in trust for their benefit.

The real benefit from the use of this trust comes in the federal tax savings. These tax savings rely upon the current rate set by the IRS in the month of the transfer. For instance, when transferring the property to the trust, there will be a gift tax on the gift of the remainder interest to the beneficiaries. The amount of gift tax will be determined by taking the fair market value of the property and subtracting the value of the retained interest of the settlor. The retained interest is calculated using the tables published by the IRS and consists of the length of the trust term along with the applicable federal rate as shown in I.R.C. § 7520. Generally speaking, the longer the term of the trust, the larger the value of the retained interest by the settlor, which results in a smaller value of the remainder to the beneficiaries and thus a smaller taxable gift. In most instances, the gift taxes will be offset by using some of the settlor's lifetime exemption.

A QPRT can remove property from an estate and increase tax savings, but it is not without some risk. If the settlor dies before the trust term is over, the residence is included in their estate and taxes will be due. This is because the settlor had retained use of the property in a period that did not end before their death, *i.e.* the purpose of the trust is defeated. Alternatively, if the settlor dies after the term, the property is distributed to the beneficiaries free of any further transfer tax. Setting the term of the trust becomes extremely important and depends on various factors. Essentially, the trust term is a bet against the settlor’s life expectancy.

The true potential benefits of a QPRT are best shown in an example. Take Bob, aged 50 and in good health. He decides to transfer his $1 million home in Miami to a QPRT for the benefit of his two children Karen and Thomas. In the trust, he retains a right to use the home as his residence for a term of 20 years. That means the trust will terminate, and the property will transfer to his children when he is 70 years old. If the tax rate in effect was just 1% when he made the transfer, his initial gift after doing the calculation would be $475,000. If he had made no previous gifts, $475,000 would be counted against his $5.34 million lifetime exemption. If he outlives the 20 year term, the property will transfer to his children, and be removed from his estate. If the home increases in value to $2 million over that 20 year term, Bob would have transferred a $2 million property to his children at zero cost (besides a reduction in his lifetime exemption) and removed $2 million from his estate. Effectively, both children received a $1 million gift while Bob continued to live in his house for 20 years.

If however Bob died during that 20 year time period, he would have used $475,000 of his lifetime exemption and the property would have been brought back into his estate for tax purposes. Thus, the purpose of the QPRT would be defeated.

h. Family Pot

A family pot or family trust is a type of trust designed to hold assets for minor children of a married couple in case the parents meet untimely deaths. Usually, this trust will give the trustee discretion to distribute income and principal to the children according to their appropriate needs, and will terminate when the youngest child reaches majority, normally 18 to 25 years of age. When the trust terminates, the remaining property is usually divided into separate shares for each child and can be placed into new trusts, or given outright.

i. Minor's Trust

This is a type of trust established for the benefit of a minor that will qualify for the annual federal gift tax exclusion and the federal exclusion for generation-skipping transfer tax. This is also called a Section 2503(c) trust after the Internal Revenue Code section that provides for its tax savings.

To achieve the above stated benefits, the trust must provide the trustee with no restrictions on distributing income and principal to the minor beneficiary until they reach age 21. When the beneficiary is of age, all trust property must be paid to him or her. During the trust term, the beneficiary must have a general power of appointment by will, or the trust property must pass to the beneficiary's estate if they die before 21.

Additionally, Connecticut has adopted the Uniform Transfers to Minors Act (UTMA). This provides that transfer of property to a child under the UTMA takes the form of an irrevocable gift to a custodian for the child. A UTMA account can be opened at most major banks, and is an advantageous way to save money for a child, and to save on taxes as well. A UTMA account is basically an investment account that allows a parent to invest money in the names of their children and for the benefit of their children.

The parents of the child may be the custodians of the property, or someone else may be appointed. Once the property is transferred to the account, it becomes the property of the child and must be used for that child's benefit. The custodian has powers over the property and duties to the child much like those of a trustee. If a custodian was to misuse the funds, they would be held accountable for breach of fiduciary duty.

As for the tax savings of a UTMA account, currently the first $1,000 of unearned income is tax exempt, the next $1,000 of unearned income is taxed at the child's tax rate, and unearned income over $2,000 is generally taxed at the parent's tax rate if the child is under the age of 19 or is a full time student under the age of 24. There are no maximum contribution amounts, and parents can transfer up to $14,000 each, or $28,000 together, to the UTMA account each year free of federal gift tax. Contributions must be made before the minor's statutory vesting age (between 18 and 25) and, as discussed above, the custodian must turn over the balance of the UTMA account at the appropriate vesting age of the child.

Finally, there are also accounts for minors known as 529 plans. A 529 plan is a higher education trust, known as a CHET account in Connecticut. This account allows for a maximum contribution of $300,000. The contribution amount must be used to pay for the child's higher education expenses. Run by Connecticut, CHET is an investment account that deals mostly in mutual funds. Contributions of up to $5,000 per year by an individual, and up to $10,000 per year by a married couple, are deductible in computing Connecticut taxable income.

Additionally, qualified distributions for higher education expenses such as tuition, fees, books, supplies and equipment are exempt from state taxes. Non-qualified distributions to the beneficiary are also exempt from Connecticut state tax. As for federal taxes, individuals may gift $14,000 to the account each year or $28,000 if gifted as a couple. The withdrawn earnings are excluded from income if used for qualified high education expenses and non-qualified withdrawals are subject to tax and a 10% federal penalty. There are no age or time restrictions on the account beneficiary and the beneficiary can be changed at any time to another member of the beneficiary's family.

j. Pet Trust

In Connecticut, as of 2009, a trust for the benefit of a family pet is valid. This is also true for 40 other states. According to C.G.S. § 45a-489a, a testamentary or *inter vivos* trust may be created to care for a pet. The appointed trustee is called a trust protector and their "sole duty shall be to act on behalf of the animal or animals." *Id*. This type of trust terminates when the last surviving animal named in the trust dies. If a settlor wants the trust to continue for all pets, they can achieve that goal by naming a class of pets such as "dogs I own" or "pets I own."

Sometimes there are limits to the amount of assets that can be placed in a pet trust. For example, in New York, hotel mogul Leona Helmsley attempted to leave $12 million to care for her small dog “Trouble.” The Surrogates Court found this excessive, and returned the excess millions to her estate to be distributed amongst her heirs. A Connecticut Probate Court has the same authority, but this issue can be addressed by designating in the trust who will receive any excessive funds.

k. GRATs

A grantor retained annuity trust, or a GRAT, is an irrevocable trust in which a grantor retains an annuity payable for a term of years. At the end of the trust term, anywhere from 5-15 years, the trust property will go to the beneficiaries (either outright or in trust). The initial transfer of property to the trust constitutes a gift for tax purposes that will be counted against the grantor’s federal lifetime exemption. The value of this gift is calculated based upon actuarial tables provided by the IRS that are based upon the life of the grantor and the current I.R.C. § 7520 rate (also known as the "hurdle rate"). Because of this valuation, if assets transferred in the trust appreciate at a rate faster than the hurdle rate (which recently has been historically low and easy to beat), the grantor can transfer all excess appreciation free of gift tax to his heirs. One downside of a GRAT is that a grantor must outlive the term of the trust. If not, all trust assets are included in the grantor's estate, thereby defeating the purpose of the GRAT.

A fairly common strategy used by individuals with significant wealth is a “rolling GRAT.” The rolling GRAT involves creating a series of consecutive short-term GRATs (typically two to three years) with each successive GRAT funded by the previous GRATs annuity payments. Rolling GRATs minimize the risk of grantor mortality due to their short terms, and increase the success of transferring wealth tax-free by capturing rapid appreciation. A two year term for a rolling GRAT is the shortest allowable by the IRS according to recent revenue rulings. These short-term GRATs can take advantage of asset volatility by capturing rapid appreciation and transferring it free of additional tax.

For example, rolling GRATs are often utilized with U.S. stocks that have the possibility of rapid appreciation. Take Tesla's stock performance over the 2013/2014 time period for example. The company saw its stock price grow over 200% in a little over a year. If someone had placed Tesla shares into a two year GRAT, they would be able to transfer that rapid appreciation free of tax on the gains.

If the short-term GRAT strategy is effective (*i.e.* assets appreciate faster than the I.R.C. § 7520 rate within the trust term), wealth is removed from the taxable estate and transferred to beneficiaries at little cost. If the strategy is not effective (*i.e.* assets do not outperform the I.R.C. § 7520 rate), all of the assets would go back to the grantor by way of the annuity payments and none of the lifetime gift tax exemption would be wasted. Thus, there is almost no risk and potential for a very high reward in using a GRAT as an estate planning vehicle. The only real disadvantage of a short-term GRAT is that a particularly low Section 7520 rate will not be locked in long-term.

Rolling GRATs also offer the advantage of flexibility. The grantor can stop the rolling process at any time and for any reason. For example, the grantor may wish to stop funding these rolling GRATs if he or she needs the income from the trust assets, no longer has an estate tax concern, wants to transfer wealth to the beneficiaries sooner, the assets' growth rates drop too low, or his or her health has deteriorated and is not expected to live for another two or three years.

While rolling GRATs offer advantages for liquid assets, such as publicly traded stock, non-liquid or hard-to-value assets are better suited for long-term GRATs. In particular, non-liquid assets would require frequent valuations that may be subjective, cumbersome and costly.

It is important to note that a provision in President Obama's 2014 budget seeks to eliminate the use of short-term GRATs. The proposal would require that any new GRAT have a minimum ten year term, and that the remainder interest retained by the grantor have a value greater than zero at the time of creation. This minimum ten year term would not eliminate the use of GRATs, but it would increase the risk that the grantor would fail to outlive the GRAT term and lose the anticipated transfer tax benefit. Effectively, this would eliminate the short-term rolling GRAT strategy.

I. Charitable trusts

Charitable trusts are established for a recognized charitable purpose. Due to their beneficial societal impact, the IRS has made qualifying charitable trusts tax exempt and eligible to receive tax deductible contributions. Additionally, and unlike most other trusts, charitable trusts can last forever. For those with a desire to give to charity, or simply to save on taxes, charitable trusts are a great way to take advantage of a rare double-benefit, income tax deduction during life and estate tax reduction at death.

A common way for individuals to give large amounts to charity is by establishing a charitable remainder trust. A charitable remainder trust is one in which a non-charitable beneficiary is given an income interest in the trust, and a charity is given the remainder interest in the trust property. *Madoff*, § 4.05(L)(2)(b). These trusts, like GRATs, come in unitrust and annuity trust form. These are most popular with high wealth individuals who utilize the tax savings while also continuing to benefit from the property for a term of years.

A charitable remainder unitrust, or a CRUT, is a trust where the non-charitable beneficiary receives an annual distribution of a fixed percentage (at least 5%) of the trust property for a term of years (not to exceed 20) for the life of one or more individuals. I.R.C. § 664(d)(2). When that term ends, the remaining property will pass to the selected charity. For tax purposes, the donor of the trust is treated as having made a charitable contribution equal to the value of the trust property minus the value of the interest passing to the non-charitable beneficiary. I.R.C. § 664. The primary advantage of a

CRUT over a CRAT (see below) is that the distribution is more likely to keep pace with inflation since the amount of the annual distributions from the CRUT will rise and fall with the value of the assets in the trust. *Madoff*, § 10.06(B)(3)(b).

A charitable remainder annuity trust, or a CRAT, is a trust where the non-charitable beneficiary receives an annual distribution of a fixed dollar amount (at least 5% of the initial value of the trust property) for a term of years (not to exceed 20) for the life of one or more individuals. I.R.C. § 664(d)(1). At the end of the term, the property transfers to the selected charity. The value of the charitable contribution is valued in the same manner as the CRUT (see above). The primary advantages of a CRAT over a CRUT is that the donor will receive a fixed annuity regardless of the performance of the trust, and they can avoid the expense of revaluing the trust property each year.

When choosing how to fund a charitable remainder trust, most estate planners recommend using greatly appreciated property such as a stock with a very low basis *i.e.*, basis is what was paid for the stock and is compared to the stock's current worth. The reason for this recommendation is to avoid capital gains taxes. For example, Bob owns 100 shares of Google common stock that are worth $100.00 a share. He purchased those shares at just $10.00 a share and wants to avoid capital gains taxes on the $90.00 of appreciation per share. If Bob simply sold the stock, he would owe capital gains taxes on the $90.00 of appreciation. If instead he gives the shares to a charitable remainder trust which then sells them, there would be no immediate capital gains taxes. Rather, the beneficiary of the trust would be taxed over time as distributions were made. I.R.C. § 644(c).

Trusts Conclusion

The previously discussed information involving trusts, how to establish a valid trust, and various trust forms is meant to provide a brief overview of the subject and give you some insight into understanding their format, usefulness and complexity. While we have discussed many of the most important aspects of trusts and the laws that shape them both federally, and in Connecticut, this is by no means an exhaustive explanation. There are various complex techniques dependent on each client's unique circumstances that are outside of the general scope of this publication. For more information, or for a consultation about establishing a trust, one of the experienced estate planning attorneys of Maya Murphy, P.C., can be reached at 203-221-3100 or by emailing ask@mayalaw.com.

Final Words

While this is not an exhaustive document of Connecticut estate planning, it should provide you with a general basis of the subject. Whenever you are considering doing estate planning, it is always recommended that you consult with an experienced attorney. The Estate Planning Group at Maya Murphy has been practicing for over a decade and can tailor an estate plan that fits your specific needs. Please feel free to call our offices at 203-221-3100 or email ask@mayalaw.com.