CUMMINGS & LOCKWOOD LLC

ESTATE PLANNING: THE BASICS

A Private Clients Group Article

While estate planning can be very complicated, its purpose is straightforward: It aims to provide for the management and transfer of your property, in the event of your incapacity or death, at the smallest financial and emotional cost to your family.

We've created this brief introduction to the basics of estate planning to familiarize you with how it works. We encourage you to talk to an experienced planner for a comprehensive review of your own specific needs and circumstances.

Key Benefits

Sound estate planning offers a number of important benefits:

- Minimization of estate-related taxation
- Control over the distribution of your assets
- Protection of loved ones in the event of your death
- Designation of executors, trustees and guardians to manage your affairs in the event of death or incapacity

But an improperly structured estate plan can have potentially harmful effects:

- Assets may be passed to unintended beneficiaries or devalued by unnecessary taxes or unsound investments.
- Failure to name executors, trustees and guardians to manage your affairs invites conflict over who should fill these roles.
- Incapacitated people could have a court-appointed guardian or conservator who might not follow their wishes regarding medical and financial matters.

Focus on Minimizing Taxes

The federal government currently imposes a gift tax on lifetime gifts and an estate tax on asset transfers at death. Since the maximum federal estate and gift tax rate is 40%, the estate planning process typically focuses on reducing or eliminating these taxes.

A well-structured plan can dramatically reduce them by taking advantage of available deductions and exemptions, including:

- The gift and estate tax unified credit, which permits individuals to transfer a specified amount of assets (often referred to as an exemption) tax-free either during lifetime or at death[1]

- The unlimited marital deduction, which provides for tax-free transfers during life and at death from a married person and his/her U.S. citizen spouse[2]

Tax Planning for Married Couples

Married couples have a number of options to minimize their estate taxation.

I. Estate Tax Sheltered Trust. If you leave all of your assets to your spouse, the marital deduction may permit all federal estate tax to be postponed until his/her death — but it does not reduce the amount of taxes ultimately due.

Doing so requires a tax-efficient estate plan that utilizes the estate tax exemptions available to both of your estates. In most cases, this can best be accomplished at the first spouse's death by leaving an amount equal to the estate tax exemption in an Estate Tax Sheltered Trust (ETST), whose assets are available to the survivor during life but not included in his/her estate at death (*see example below*).

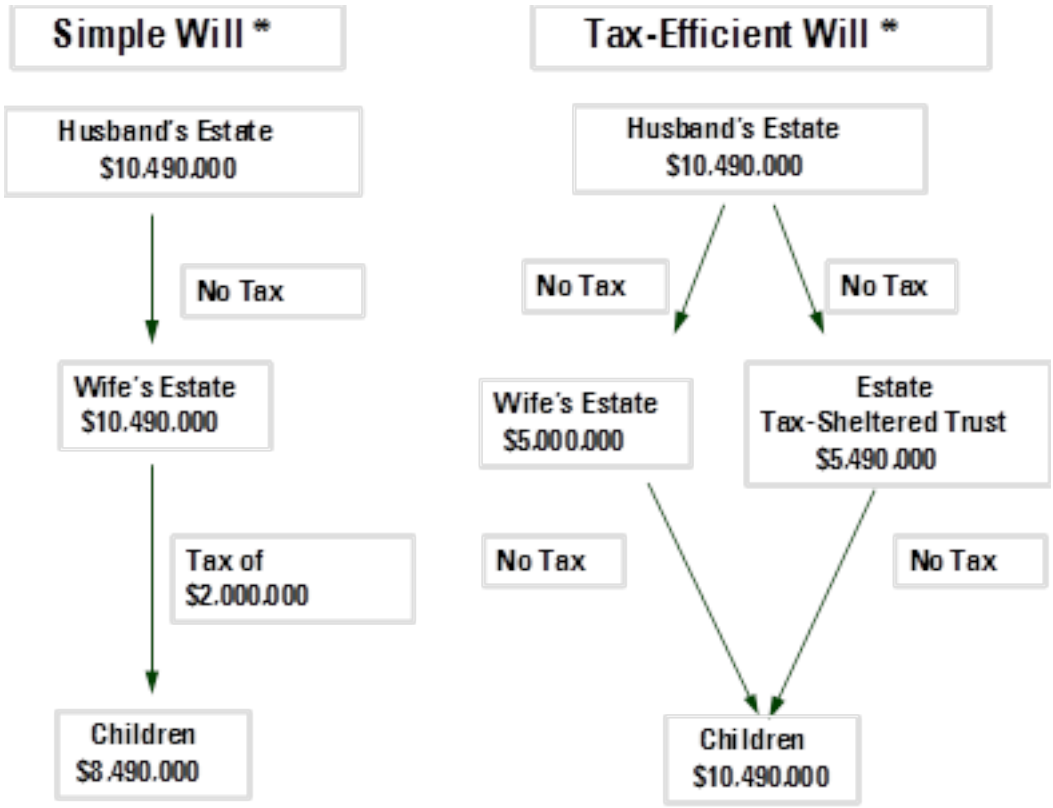
How An Estate Tax Sheltered Trust Works

Suppose a husband with assets worth $10,490,000.[3] died in 2017 with a simple will[4] leaving his entire estate to his wife. The wife dies later that same year with a taxable estate of $10,430,000. Federal estate taxes are roughly $2,000,000, leaving the children with a net inheritance of about $8,490,000.

By contrast, federal estate tax would be eliminated if the husband's will left the amount exempt from estate tax ($5,490,000 in 2017) to an Estate Tax Sheltered Trust (ETST) for his wife's benefit and the balance of his assets directly to her. At the wife's death, the ETST's $5,490,000 would not be taxable. Rather, her taxable estate would be limited to the $5,000,000 of assets that she received outright and would pass tax-free to the children by virtue of her estate tax exemption.

By taking advantage of the estate tax exemptions available to their respective estates, the couple could have transferred $10,490,000 free of federal estate tax to their children in 2017.

The following illustration contrasts the simple will leaving all assets to the surviving spouse with the tax-efficient will that includes an ETST:



** This simplified illustration assumes death in 2017 and a flat federal tax rate of 40%, and ignores the effect of state death taxes.*

II. Disclaimer Will. This hybrid of the simple and tax-efficient wills leaves your entire estate to your spouse, but allows him/her to decide whether a portion of your estate should be added to an ETST.[5]

III. Marital Trust. To postpone all federal estate tax until your spouse's death, the balance of your estate (after setting aside the estate tax exemption amount) typically is left outright to your spouse or in a qualifying Marital Trust for your spouse's benefit within certain broad limitations. The Marital Trust can be designed to reflect your wishes and provide your spouse with access to the level of trust assets you specify.

IV. Equalization. Whether you own your assets jointly or individually can greatly affect your estate plan's success. Ordinarily, both spouses will wish to equalize their estates by dividing ownership of their assets between their individual names, at least until both estates equal or exceed the estate tax exemption then in effect.

Planning for Children and Future Generations

If you leave property to your children and make no further provisions, each child generally will be entitled to full use and control of his/her inheritance upon attaining the state-defined age of majority, which is usually 18 or 21. A court-appointed guardian will manage the child's property until then.

To avoid the necessity and cost of a court-appointed guardian or provide for the management and protection of your children's inheritance beyond the age of majority, we recommend leaving the inheritance to a trust designed for that purpose under your will or Revocable Trust. [We cover Revocable Trusts in the Additional Estate Planning Vehicles section below.]

When planning for your children and future generations, consider the impact of the Generation-Skipping Transfer Tax (GST Tax), which is imposed on transfers to grandchildren and their descendants in addition to the federal estate and gift tax at a rate equal to the maximum federal estate and gift tax rate (40%). Every individual has a

$5,000,000 exemption indexed for inflation (which is $5,490,000 in 2017).

Careful use of the GST Tax exemption — which can pass assets to grandchildren and more remote descendants free of GST Tax — can achieve dramatic tax savings for your family.

Lifetime and Charitable Gifts

If your estate is large enough that an estate plan taking full advantage of available exemptions and deductions is not sufficient to eliminate the imposition of federal estate tax, lifetime giving may substantially reduce it.

Lifetime gifts are subject to a federal gift tax, which is imposed currently at the same tax rates as the federal estate tax, but such gifts can be sheltered by using some of the unified credit during lifetime. Connecticut, unlike most other states, also imposes a state gift tax on lifetime gifts, at graduated rates of up to 12% depending on the amount transferred.[6] Currently, no other state imposes a state gift tax.

Complete estate planning should include consideration of making charitable gifts as well. Charitable planning includes evaluating gifts' potential tax benefits, as well as implementing a variety of sophisticated techniques such as charitable lead trusts, charitable remainder trusts and family foundations.

Additional Estate Planning Vehicles

I. Life Insurance Trust. Although life insurance proceeds generally are not subject to income tax, they are subject to federal estate tax. It is thus advisable to include provisions for your life insurance in your estate plan. If you decide to give away your life insurance to reduce your estate, you likely will make that gift to an Irrevocable Life Insurance Trust specifically designed to hold such policies.

II. Revocable Trust. You may decide to utilize a Revocable Trust (also known as a Living Trust), rather than a will, as your primary estate planning document. As its name suggests, a Revocable Trust can be revoked or changed at any time during your lifetime.

III. Durable Power of Attorney. Regardless of whether you establish a Revocable Trust to guard against future incapacity, we recommend that you sign a Durable Power of Attorney naming a family member or trusted advisor to manage your assets in the event you are no longer capable of doing so.

IV. Living Will. Many states — including Connecticut, New York and Florida — have laws encouraging physicians and hospitals to follow the wishes of a terminally ill patient who has signed a Living Will expressing his/her desire that no extraordinary life support measures be used. The law also permits you to appoint a Health Care Representative to make medical and life-support decisions if you cannot act.

The Bottom Line: Talk to the Right Advisor

Clearly, estate planning is a complex endeavor requiring the guidance of a seasoned, highly knowledgeable professional. Contact a Cummings & Lockwood trusts and estates attorney who can discuss these issues with you in more detail and can assist you with the development of a comprehensive estate plan that meets your unique needs.

[1] As indexed for inflation, the federal estate and gift tax exemption for 2017 was set at $5,490,000.

[2] If your spouse is not a U.S. citizen, special rules apply. Specifically, the marital deduction is not available to shelter outright bequests to your spouse.

[3] As discussed in the equalization paragraph, we recommend that one spouse should not hold title to all of a couple's assets.

[4] As discussed in the Revocable Trust paragraph, many people use a Revocable Trust (aka Living Trust), rather than a will, as their primary estate planning document. While a Revocable Trust may help avoid some of the expenses and delays associated with the estate settlement process, having a Revocable Trust in and of itself does not reduce estate taxes. Accordingly, while our analysis of estate taxation is phrased in terms of provisions found in wills, it is equally applicable to those clients who create Revocable Trusts.

[5] Although a Disclaimer Will can be an attractive solution for those who require its additional flexibility, there are certain limitations involved with its structure. As a result, Disclaimer Wills are not frequently implemented by couples whose combined estates clearly exceed the applicable estate tax exemption amount.

[6] For residents of Connecticut or any other state making gifts of property located in Connecticut, such gifts may also trigger Connecticut state gift taxes if they exceed $2,000,000 in the aggregate over your lifetime.