

Japanese Americans' Care Fund

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Estate Planning Concepts

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Introduction

Most people give little thought to how their things will pass to others upon their death. Similarly, few consider giving medical directions to others if they were unable to speak because of an unexpected illness like a stroke. Every society has laws or customs that determine how things owned by deceased people pass to others. Originally, who got what was probably determined by strength or speed (or both). Whoever got to the cave first got it all or the strongest among those present prevailed.

There are, however, still disagreements among survivors. If these tiffs cannot be resolved amicably, there is a legal system to sort things out. The system is called probate. Today we will cover some of the basics of that system and talk about ways to avoid that system should you want to do so.

In Japan, and most of the world, I suspect, few focus on estate planning the way Americans do. The U.S. is an odd combination of cultures, with many elements of British law, that has evolved into a morass of state and federal laws which many find confusing. Whether you like the U.S. system or not, ultimately someone will receive the U.S. assets of a decedent. What the beneficiaries (recipients) receive will in nearly all cases be decided by state intestacy laws (explained later) if there is no Will or Trust.

In the last seminar we gave to this group, on November 1, 2003, we spent considerable time comparing the Japanese probate system to the U.S. system and on how U.S. estate taxes could be reduced or avoided. This time, the effort will be on more basic explanations of the U.S. system.

The topics we will discuss today are:

- I. How things pass
- II. Deeds
- III. Contractual Control

- IV. Probate (No Will = intestate; Will = testate)
- V. Wills
- VI. Trusts
- VII. Marital Deduction – Non-citizen Spouse
- VIII. Some Particular U.S. Laws for Non-Citizens
- IX. Medical Directive

I. How things pass

There are three broad ways assets pass to others. These are:

- A. Deed or Contract – Examples: Deed to land, Retirement Benefits, IRAs, Insurance Policies, Annuities, etc.
- B. Probate – A legal-judicial system created to facilitate choices made in Wills or monitor distributions if there is no Will.
- C. Trusts – A British-U.S. system permitting the creation of a new entity, a Trust, which has powers and a life of its own.

II. Deeds

- A. What is a Deed? A dictionary type definition is, “ a signed and usually notarized document conveying some transfer of title, rights or bargain. Title to land (real estate) is usually conveyed (made) by a deed. Basically, a Deed, is a piece of paper (document) stating Mr. Era sold (or conveyed) property to Mrs. Ito. The paper must be signed by Mr. Era and his signature notarized. Please refer to the sample Deed.
- B. Notarization of Era’s signature is required for a Deed to be valid and recorded. A document is notarized when a “Notary Public” witnesses the signature of Era and signs a declaration (statement) indicating that the Notary knows who Era is and that he signed the document willingly.
- C. There can be many kinds of Deeds and unusual Deed provisions. The most common type of deed is the one used to transfer title to a house.
- D. Since Deeds can be a substitute for a Will and/or estate planning we need to first consider how Deeds can be structured.
- E. In Virginia, Deeds are recorded in the Office of Land Records, which is in the Circuit Court. In other states, Deeds are recorded in an equivalent office which may have a different name. There is a recording fee. You can order a copy of a Deed from the same office when you need one. Often times, a nominal fee is charged for such an order.
- F. Types of Ownership obtained by Deeds: Let’s begin by exploring the four ways in which real property is generally held.
 - 1. Sole Ownership – one individual owns the real estate;

2. Tenants in Common – is a form of ownership in which two or more individuals own an undivided interest in property. Example: A and B each have a 50% interest as tenants in common, should one of the two die, her 50% undivided interest in the property would pass to her heirs as an asset of her estate.
 3. Joint Tenants with Rights of Survivorship – In joint tenancies with rights of survivorship ownership, the survivor “takes all.” Assume X, Y and Z, “Zurvivor,” own a property. If X dies, then Y and Z own it all. When Y dies, then Zurvivor, “Z” has sole ownership. The estates of X and Y (and their children) have no claim to the property because of the rights of survivorship. In other words, the Zurvivor, “Z,” takes all.
 4. Tenants by the Entirety – is a special form of joint ownership, that is only available to married couples in Virginia (and most other states). This type of ownership provides special protection of marital assets against the claims of creditors of one spouse, often described as the husband who drinks and gambles too much.
- G. Some people use Deeds with survivorship provisions (creating joint ownership among the parents and their children) as a substitute for a Will or Trust. For example Era could create a deed with him, his wife and his two children jointly owning the family home in the U.S. The wording of such a deed controls (even if there is a Will or Trust) and the home passes to the survivors upon the death of each co-owner. After both Mr. & Mrs. Era die the two children own the property jointly. When the one of the children dies the surviving child will become the sole owner of the property. The first child to die (and the children of that child, grandchildren of the Era’s) receive no interest in the family home.
- H. Reasons why joint ownership may not be good planning.
1. A child may predecease a parent. In such a case not only does the child not get joint ownership of the house, the children of that child (grandchildren of Mr. Era) get no interest in the house.
 2. If only Mr. and Mrs Era are joint owners and Mr. Era dies, Mrs. Era may remarry and retitle the house in the name of her and the new husband, Mr. Warui. When the former Mrs. Era dies the house passes to the new husband, Warui, and the children of the first marriage get no interest in the house. This happened in my family. It’s “totemo warui.”
 3. Another problem with any form of joint ownership is the need to get the signatures of all of the owners if the property is to be sold. Family relationships may change over time. So when it is desired to sell the property, it may not be easy or even possible to get the consent and

signature of other co-owners. Often children disagree with each other after the death of the second parent (see our newsletter, 'Don't Assume Your Children Will "Get Along",' July/August 1998).

III. Contractual Controls

- A. Insurance policies, bank accounts, and retirement benefits are forms of contracts between you and an institution or company. You, as the owner of an insurance policy, have the right to name (and change) the beneficiary. The "contract," in this example, is your insurance policy.
- B. Here are some samples of arrangements where survivorship rights are controlled by agreement rather than a Will, Trust, or Probate.
 - 1. Insurance and Annuity Policies
 - 2. Bank Accounts
 - 3. Retirement Benefits

IV. Probate

- A. Probate is a system of laws for distributing the assets of a decedent. Designated officials, called "Commissioners" in Virginia approve and control the process. It is a protracted process that usually takes one and a half years or more before it is concluded.

No Will

- B. Intestate or intestacy means dying without a Will. In that case the probate system allows an individual, called an "Administrator," not named by you, to administer your estate. Who gets what is determined by state law. These patterns of distribution are called by some the "rules of intestacy" or "intestate distribution."
- C. Stated differently for those things not controlled by a Deed or Contract, the State, in effect, makes a Will for you.
- D. If you are living with a "friend" or "pal" that person may receive nothing under the laws of intestacy. Similarly if you want an errant child to receive less than other children that will not happen without a Will. If you wanted cash to be given to a distant relative that relative probably will not receive such cash if you die intestate.

V. Wills

A Will allows you to make choices. With a Will you can:

1. Decide who will administer your estate. That person or entity (Trust Company) is called a Personal Representative, "PR," (my preferred term) or Executor (Male) or Executrix (Female). The PR can be one or more individuals or entities. There can also be a succession of choices, say, "Taro" first, if no "Taro" then "Kenji," etc.
2. Determine who gets what and in what proportions.

Example 1: Since Yukiko received \$300,000 for her business, which failed, then Hajime should get a larger share of the family wealth than Yukiko.

Example 2: You may want a relative in Japan to receive a family heirloom like a rare kimono.

3. Appoint guardians for minor children. If the guardian cannot manage money a Will can establish a Trustee to manage the money.
4. Establish a Trust in a Will. Such Trusts are called "Testamentary Trusts." Example, you may want your children to wait until they are 25 to receive one-half of their share. The balance will be distributed when they reach age 30. These particular distribution ages are used here only for illustration purposes and you may choose any age(s) within reason.
5. Continue business activities for a limited period of time, usually during probate, and direct that a certain child will get the business.
6. Take advantage of tax choices that could reduce or eliminate estate taxes.

VI. Trusts

- A. Trusts, like corporations, partnerships, charities, and religions, exist because societies recognize them as such. In the British-American system Trusts can be created like corporations. Such Trust entities can own property, exist beyond the life of the creator, and make distributions for the benefit of the survivors of the Trust creator.
- B. Trusts not created in a Will are sometimes called "Living Trusts." "Living" in this context means created while the Grantor (the creator, of the Trust) is alive.

- C. Changeable Living Trusts are called "Revocable." The most common type of Trust used for estate planning is called a Revocable (changeable) Living Trust, sometimes abbreviated "RLT."
- D. Unchangeable Living Trusts are called "Irrevocable." Irrevocable Trusts are commonly used with gifts of insurance policies, usually with families having substantial wealth. A gift to an Irrevocable Trust defers receipt until some event happens, example the death of the creator of the Trust.
- E. The Three Players in all Trusts are:
 - 1. the Grantor (Creator);
 - 2. the "do-er" (the Trustee who has duties to perform); and
 - 3. the Beneficiary (the one who receives benefits from the Trust).

Of course, there can be more than one trustee or beneficiary in any Trust.

At the beginning of most Revocable Living Trusts, the Grantor (who creates the Trust) usually plays all three roles — Grantor, Trustee, and Beneficiary. When the Grantor becomes incapacitated or dies, the Successor Trustees take over for the Grantor and, of course, the initial Beneficiary (the Grantor) must change if the Grantor is deceased.

F. It's Not in Stone

A Revocable Living Trust is referred to as "revocable" because, as the name implies, it can be revoked in whole or in part during the creator's ("Grantor's") life. Of course, the beneficiaries can be changed during the Grantor's life, although few Grantors make such changes. The term "living" means the Trust was created during the life of the Grantor, as opposed to "at death," as happens with Trust provisions in a Will, which is called a Testamentary Trust. While the Trust does become irrevocable (unchangeable) at the death of the Grantor, there are usually broad grants of power given to the Successor Trustees (the ones who take over after the Grantor's death) to make discretionary distributions to family members for a variety of purposes.

G. Lack of Maturity

While many of us wonder if we have truly obtained maturity, we readily agree that often our children and grandchildren are suspect when it comes to handling large sums of money. Many Trusts contain built-in flexibility that allows the Trust to continue until children or grandchildren reach a designated age, say 25, when they may be more mature than an 18-year-old.

H. Highlight of RLT Advantages

Let's look at a brief summary of some of the advantages of using an estate planning-oriented revocable living trust.

TAXES SAVED - Federal and State estate taxes are usually substantially reduced or eliminated by the planning alternatives presented by these Trusts.

PROBATE REDUCED - Probate complications and related costs are reduced. Because the Trust does not terminate at the death of the creator, there is no probate of the assets put into the Trust.

FLEXIBLE FUNDING - The creator can alter, amend, or revoke the Trust prior to death and watch its growth and asset mix to see if it has been properly funded.

IMMEDIATE DISTRIBUTIONS - The successor trustee or co-trustees (often the surviving spouse, assisted by a trust company, adult child, or a business associate) can disburse money to the children immediately after the death of the first spouse without the need for the consent of a probate court.

ASSETS CONSOLIDATED - The decedent's assets allocated to the family portion can remain in the Trust and be available for use by the family members during the life of the surviving spouse. This means all of the funds are available for the surviving spouse's and the children's health, support, and maintenance without incurring estate tax at the second death. To the extent the family assets are not used during the life of the surviving spouse, such assets can be passed on, free of further estate tax and probate, to the children at the death of the second spouse. Differently stated, and perhaps of greatest importance to many families, even though the estate is taxed at different times, essentially all of the family's assets (the nest egg) can be kept in the revocable living Trust and available to any family member until the death of the second spouse.

SUCCESSOR TRUSTEES - Since there are provisions for successor trustees in the event of the death or disability of the creator and the creator's spouse, there is continuity of administration after the death or disability of either spouse. Thus, in the event of the disability of the creator, there is no need to begin a legal proceeding to appoint a guardian for the assets in the Trust. Similarly, if both spouses die, there is financial management of the estate assets by the successor trustee until the children have attained the age or ages specified in the Trust and are able to manage money.

DELAYED DISTRIBUTIONS FOR CHILDREN - A Trust can provide for planned percentage distributions of money to children so they do not receive one large sum of money at their majority (usually age 18).

GRANDCHILDREN - Provisions can be, and usually are, placed in such Trusts for delayed distributions to grandchildren in the event the creator outlives a child who dies leaving minor grandchildren of the creator.

INCOME TAX FLEXIBILITY - After the creator's death, the trustee can distribute income among the beneficiaries based upon their needs. This flexibility automatically allocates the income tax on such income to the recipient rather than taxing all the trust income to the spouse.

AMENDMENTS - Trust amendments are easier to accomplish than amendments to lengthy wills with testamentary trust provisions. Since the order of death is not known, if testamentary trusts are used, there will normally be two very long wills even for rather modest estates.

ESTATE PLANNING APPROACHES COMPARED

<u>Question</u>	<u>No Will or Trust</u>	<u>Will Only w/o Trust</u>	<u>Living Trust</u>
Can I avoid Probate?	No	No	Yes
Can I reduce or avoid federal estate taxes?	No	No (Usually)	Yes
Will my estate stay private when I die?	No	No	Yes
Can I keep inheritance from my heirs until they reach age 30 or older?	No	No	Yes
Can I arrange to have funds managed for the benefit of an heir who is handicapped or otherwise unable to handle funds?	No	No	Yes
Can I make sure my grandchildren will receive my estate after my children die, excluding spouses of my children?	No	No	Yes
Can I leave assets to children from an earlier marriage, cutting out my present spouse?	No	No	Depends on the state
Can I retain control over my assets while I'm alive?	Yes	Yes	Yes
Can I change/revoke the plan?	N/A	Yes	Yes
Does the document provide for someone to handle my finances if I become disabled?	No	No	Yes

VII. Marital Deduction – Non-citizen Spouse

- A. In the case of a Japanese citizen married to a U.S. citizen, a Trust with certain special provisions (also called a “Qualified Domestic Trust,” “QDOT”) may be necessary in order to take maximum advantage of U.S. tax law provisions allowing unlimited amounts of property to pass to a spouse tax-free if the U.S. citizen spouse dies first. Gifts between citizen spouses, without incurring transfer tax, are unlimited.
- B. Gifts to a non-citizen spouse are not unlimited. This year, 2004, the annual limit is \$114,000. Gifts of more than \$114,000 may incur gift (transfer) taxes.

VIII. Some Particular U.S. Laws for Non-Citizens

- A. None Resident Aliens, “NRA” – means a non-citizen not living in the U.S. Example, someone who is a citizen of a country other than the U.S. who does not reside in the U.S. An NRA may own assets in the U.S. and be subject to certain U.S. laws, discussed below.
- B. FIRPTA – An NRA not residing in the U.S., but owning U.S. real estate is subject to some special income tax and reporting rules (Foreign Investment in Real Property Tax Act, “FIRPTA”). Special tax planning is usually required with such sales on U.S. real estate.
- C. Taxes sometimes on NRAs – Nonresident Aliens, “NRAs,” are subject to U.S. estate tax only on U.S. assets. Broadly defined such U.S. assets are: (1) real estate, (2) stock issued by U.S. corporations, and (3) cash and valuables physically in the U.S. Surprisingly, U.S. bank accounts and certain governmental securities and bonds (U.S. bonds) are not subject to U.S. estate tax. For a listing of what assets are subject to U.S. estate tax, see BNA Portfolio 837-1, “Aliens - - Estate, Gift, and Generation-Skipping Taxation” Worksheet 29 entitled “Comparison of Transfer Tax of U.S. Citizens, Resident Aliens, and Nonresident Aliens.”
- D. Lifetime Exemption of NRAs – The Lifetime Exemption for a NRA is \$13,000. This is equal to the estate tax on only \$60,000. The rate of estate taxation is 26% to 55% on NRA assets in excess of \$60,000. The Lifetime Exemption for a U.S. citizen is \$1.5 million in 2004 and 2005.

IX. Medical Directives

Please refer to the handouts.

END