

Introduction to Estate Planning for Married Couples

The primary purposes of an estate plan are to specify the ultimate recipients of your property, to designate the persons necessary to carry out your dispositive wishes and to nominate the persons to act as guardians of any minor children. In carrying out these purposes, an estate plan also is designed to reduce the impact of state and federal estate taxes. Typically, two instruments are used to achieve both dispositive and tax goals: a will and a revocable trust. This Memorandum will focus on the key provisions of these two instruments for clients who are married.

Tax-saving strategies should support but not distort your personal dispositive objectives. Therefore, we suggest that your estate plan be shaped primarily by your personal objectives and secondarily by tax considerations. A typical plan for a married individual will take advantage of the tax-saving opportunities summarized in this Memorandum. More sophisticated tax planning opportunities -- described at the end of this Memorandum -- are employed where circumstances warrant.

No estate plan can carry out your wishes unless the form of ownership of your assets is carefully coordinated with the plan. You should bear in mind that many assets do not pass by will: jointly held property, including real estate, securities, and bank accounts, pass directly to the surviving joint owner; and assets such as life insurance and retirement plans pass directly to the designated beneficiary. Only those assets which are held in your own name, made payable to your estate, or in which you have an interest as a "tenant-in-common," pass in accordance with the terms of your will.

Your Will

Dispositive Provisions

Tangible Personal Property. Tangible personal property includes household furnishings, jewelry, artwork, automobiles, boats and the like. Many individuals choose simply to leave all of their tangible personal property to their spouse or children. Others desire to specify the items and the persons or organizations to whom they wish to leave their tangible property. If you do not wish to include specific bequests in your will, you may instruct your executor in a separate memorandum to distribute certain items to certain individuals or organizations. While such a memorandum is not legally binding on the beneficiaries of your estate, most people will honor such an expression of your wishes.

Pecuniary Bequests. Your will may provide for gifts (bequests) of cash to individuals or organizations. Bequests left to qualified charities will be deductible for estate tax purposes.

Real Property. Your will may also make a specific disposition of real property, such as a second home. Even if your real estate is owned jointly so that it automatically passes to the surviving spouse, you may want to provide for the disposition of the property in the

event that your spouse does not survive you. A devise of real estate may be to one or more individuals or to a special trust created in order to ensure continued enjoyment of the property by family members.

Remainder of Your Property. The “residuary clause” of your will disposes of all of your property that is not otherwise disposed of and which is not used for payment of estate taxes and expenses. This “remainder” may be left to your spouse or, if he or she is not then living, to your children. The remainder need not be left to one person, but may be divided among a group or class. If your estate plan includes a revocable trust, the trust will be named in your will as either the primary or contingent remainder beneficiary, and your dispositive plan will be carried out by the trustees as specified in the trust instrument.

Executor. Your will may nominate the person or persons whom you wish to serve as the executor or executors of your will. You may name as executor your spouse, a child, a friend, an attorney, an accountant, or a corporate fiduciary. (Depending upon the terms of your estate plan and personal circumstances, it may be advisable to name at least one independent co-executor -- a person who has no interest in your estate.) You should also nominate successor executors in case one or more of the named executors cannot serve. The duties of an executor include filing the will for probate, marshaling and preserving the assets of the estate, paying the debts and expenses of administration, preparing the appropriate Federal and state tax returns and, ultimately, distributing the remainder of the estate in accordance with the terms of the will.

Guardians. Your will may nominate a guardian for your minor children to serve if your spouse does not survive. Selection of a guardian is often the most difficult question faced in estate planning. Although there is rarely a struggle over the guardianship of children, it is wise to nominate a guardian as well as a successor in case your first choice cannot serve. Common choices are grandparents (if they are not too elderly), siblings or close friends. If you are considering naming a married couple, you should be explicit as to whether you want either of them to serve in the event of a divorce or death during your children’s minority.

Funeral and Burial Arrangements. Your will should not include instructions for your funeral or burial, since the will is often not consulted until after the funeral. Rather, you should inform your family of these wishes during your lifetime. Anatomical gifts should also be dealt with during your lifetime.

Your Trust

A revocable living trust is an integral part of most estate plans. Established during your lifetime to receive your property upon your death, it is commonly the primary vehicle for carrying out your dispositive plan. The remainder of your assets which were not disposed of by your will pass to the trust, as well as the proceeds of insurance policies or pension benefits made payable directly to the trustees.

Generally, if you are survived by your spouse, the assets received by your trust will be divided into two separate shares according to a formula designed (a) to minimize the impact of federal and Massachusetts estate taxes, and (b) to defer any such taxes until your spouse's death (the "optimum marital deduction formula"). Generally, there will be one share for the sole benefit of your spouse (the "marital deduction trust") and one share for the benefit of your spouse and issue (the "family trust"). The share for the sole benefit of your spouse may be divided into two separate trusts, for optimal estate tax results (see attached "flowcharts"). If you are not survived by your spouse, all of the trust assets are distributed or held in trust under the terms of the family trust.

Under the optimum marital deduction formula, the portion of your estate allocated to each trust depends upon estate tax credits and deductions described below.

Estate Tax Rates and Credits. Currently, Federal gift and estate taxes share a common rate schedule. The unified credit against estate and gift taxes allows a total of \$1,000,000¹ to pass free of federal tax, during your lifetime and/or at death, in addition to any lifetime "annual exclusion" gifts of up to \$11,000 per donee per year (this amount may be indexed for inflation, annually). For amounts in excess of the estate tax exemption amount, the rates of federal estate and gift taxes are graduated, currently starting at 41%, and with a top bracket of 49% on estates in excess of \$3 million. (Each year beginning in 2004, the top bracket will be reduced by 1%, until 2007, when it will remain at 45%.)

Under new Massachusetts tax legislation, Massachusetts now has an estate tax of its own, separate and apart from any federal estate tax which an estate may owe. In 2003, there is no Massachusetts estate tax due if an estate's assets plus taxable gifts made by the decedent during lifetime do not exceed \$700,000.² As referred to above and illustrated by the attached flowcharts, by appropriate division into family and marital trusts, any federal or Massachusetts estate tax that the estate of a first-spouse-to-die would otherwise owe may be deferred until the surviving spouse's death. There is no Massachusetts gift tax.

Use of Federal Marital Deductions. The federal estate tax laws provide for an unlimited "marital deduction" permitting property to pass to your spouse free of tax. To qualify for the marital deduction, the property must be left to your spouse either outright or in one of the following special forms of trust:

¹ Under the 2001 EGTRRA, in 2003, the estate tax exemption equivalent will be \$1,000,000; it will increase to \$1.5 million in 2004-2005; to \$2 million in 2006-2008, and to \$3.5 million in 2009.

² The Massachusetts estate tax exemption, or "filing threshold", will increase to \$850,000 2004; to \$950,000 in 2005; and to \$1 million thereafter.

A. Testamentary Power of Appointment Trust

This form of marital trust which provides that income must be paid to your surviving spouse periodically, with principal payable to your spouse only in the discretion of the trustees. The surviving spouse must have a general power of appointment (an unrestricted right to direct the ultimate disposition of the remaining marital trust property by his or her will) over the trust. The surviving spouse may also be given the right to withdraw principal upon request.

B. Qualified Terminable Interest Trust

This type of marital trust provides that income must be paid to your surviving spouse periodically, with principal payable to your spouse only in the discretion of the trustee. You may direct to whom the remaining trust principal shall be distributed upon your spouse's death or your spouse may be given a limited power to appoint the property. (This form of trust is often referred to as a "QTIP" trust.)

Which form (or forms) of marital bequest you select depends upon both personal and tax planning goals. A type "A" trust gives the surviving spouse maximum access to the trust assets, but does not assure that the trust property will remain in the family line. A type "B" trust, or QTIP trust, limits the surviving spouse's control over the trust assets, thus ensuring that the assets ultimately remain in the family line. A common variation of the QTIP trust gives the surviving spouse more control over the ultimate disposition of the trust property by permitting him or her to direct by will the distribution of the property upon his or her death among a defined class of persons, such as descendants but not a second spouse. Either form of marital trust provides a structure for management of assets in case the surviving spouse subsequently becomes incapacitated.

(Note that due to the new Massachusetts estate tax, in order to defer any Massachusetts estate tax until the death of the surviving spouse while also making full use of both spouse's federal estate tax exemptions, type "B" trusts should now be used.)

Most couples choose to establish trusts rather than leaving the property outright to their spouses. Outright bequests may be desirable in some cases but do not allow for optimum generation-skipping transfer ("GST") tax planning and do not provide a structure for asset management.

Family Trust. The property set aside to take advantage of both the Massachusetts estate tax exemption (\$700,000 in 2003) and a portion of the federal "unified credit", after payment of expenses of administration, is held in the family trust for the benefit of the specified beneficiaries, typically the surviving spouse and issue. If there are several beneficiaries, the trustee may be given discretion to distribute income and/or principal as necessary or appropriate among them.

A wide variety of arrangements are available for disposition of the family trust upon the death of the surviving spouse. Typically, the trust (which may be augmented by the assets of one or more marital trusts) is divided into as many equal shares as there are living children of yours (or deceased children with surviving issue) and each trust share is

then either distributed to the child or grandchild for whom it is established, or continued in further trust for the beneficiaries. Your trust should include a provision for alternate disposition of your property in the event that the primary trust beneficiaries do not survive you or die during the continuation of the trust.

Example. The attached chart illustrates how the optimum marital deduction formula operates in a hypothetical estate plan where there is a surviving spouse and children. The desirability of this type of plan depends upon the size of the spouse's estate and other non-tax factors.

Administrative Provisions. You may select the persons you wish to serve as trustee or trustees of the trusts. The selection of trustees is an important decision especially if the trustees are to be given broad discretion in making distributions. The person or persons nominated as executor(s) of your will may also serve as trustees, and your surviving spouse may serve as a co-trustee. For tax reasons, it may be advisable to name at least one person who has no interest in the trust to act as an independent trustee. For administrative reasons, it is advisable to name someone with experience in investments and fiduciary accounting and with whom you have a professional and personal rapport. Under appropriate circumstances, the surviving spouse may be a co-trustee or sole trustee.

Supplemental Estate Planning Documents

You may wish to consider signing a health care proxy and/or durable power of attorney. These documents provide for health care decision-making and management of your property in the event that you become incapacitated. We can provide you with additional information about these documents when we meet.

Related Planning Areas

In addition, if any of the following matters are of concern to you, please let us know:

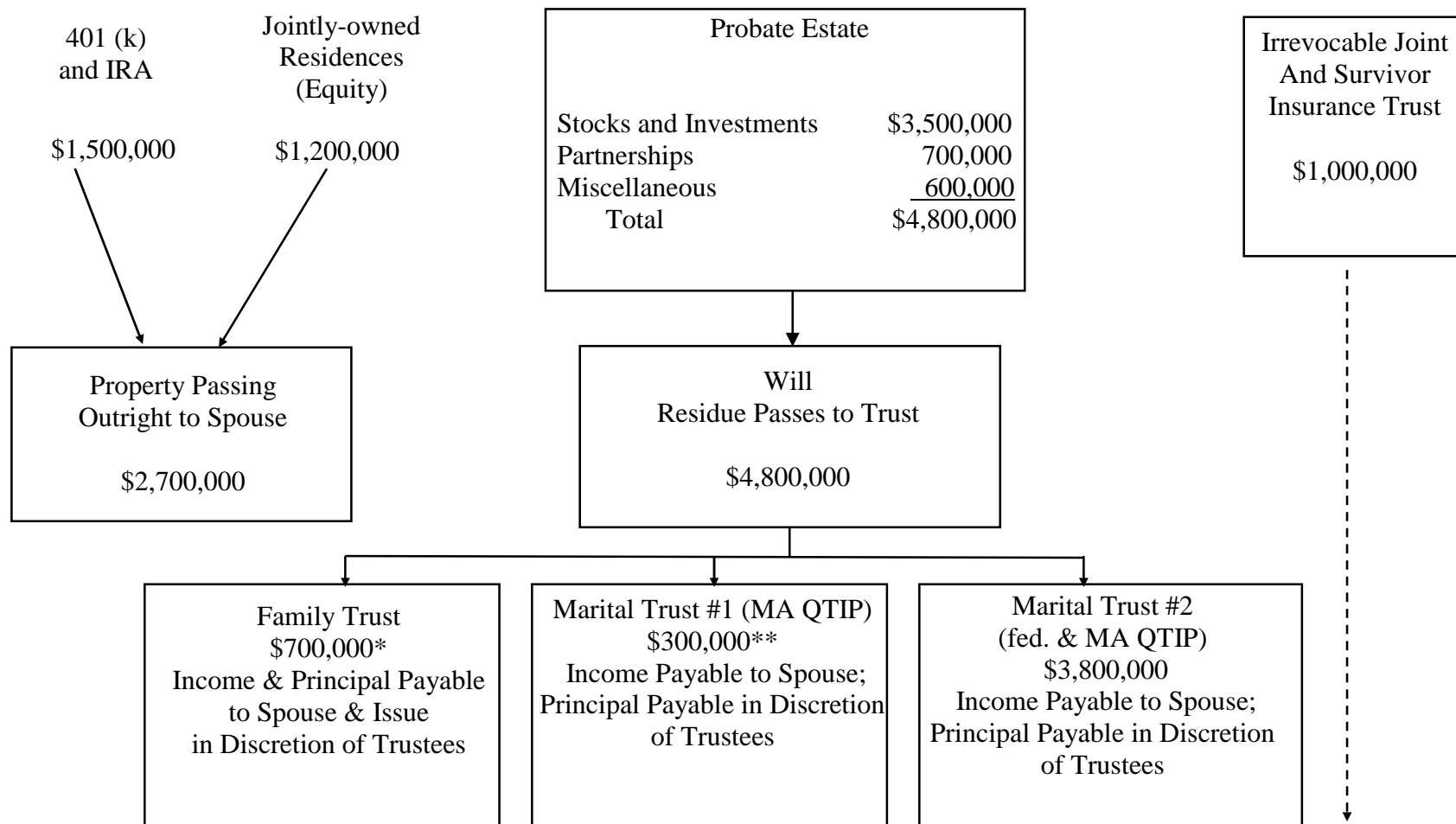
- § Planning for disability by funding revocable trusts.
- § Protecting assets from claims of spouses and creditors by transferring assets and/or filing a homestead exemption.
- § Making lifetime gifts to children and/or grandchildren by establishing minors' trusts and using available generation-skipping transfer tax exemptions.
- § Coordinating charitable giving with estate planning by establishing a charitable trust or foundation.
- § Arranging for optimal disposition of life insurance proceeds, pension and profit sharing plans and IRAs.
- § Planning for the transfer of a closely held business by creating partnerships and/or buy-sell agreements.
- § Planning for non-citizen spouses and/or foreign property to take advantage of available deductions, exemptions, credits, and treaties.

§ Planning for the exercise of powers of appointment.

Conclusion

We hope this memorandum will be helpful to you in developing your thoughts about your estate plan and related matters so that our first meeting will be as productive as possible. At that time, we will be happy to answer your questions about estate planning in general and your estate plan in particular.

The following flowchart illustrates a hypothetical tax-efficient estate plan for a married couple (assuming deaths in 2003).



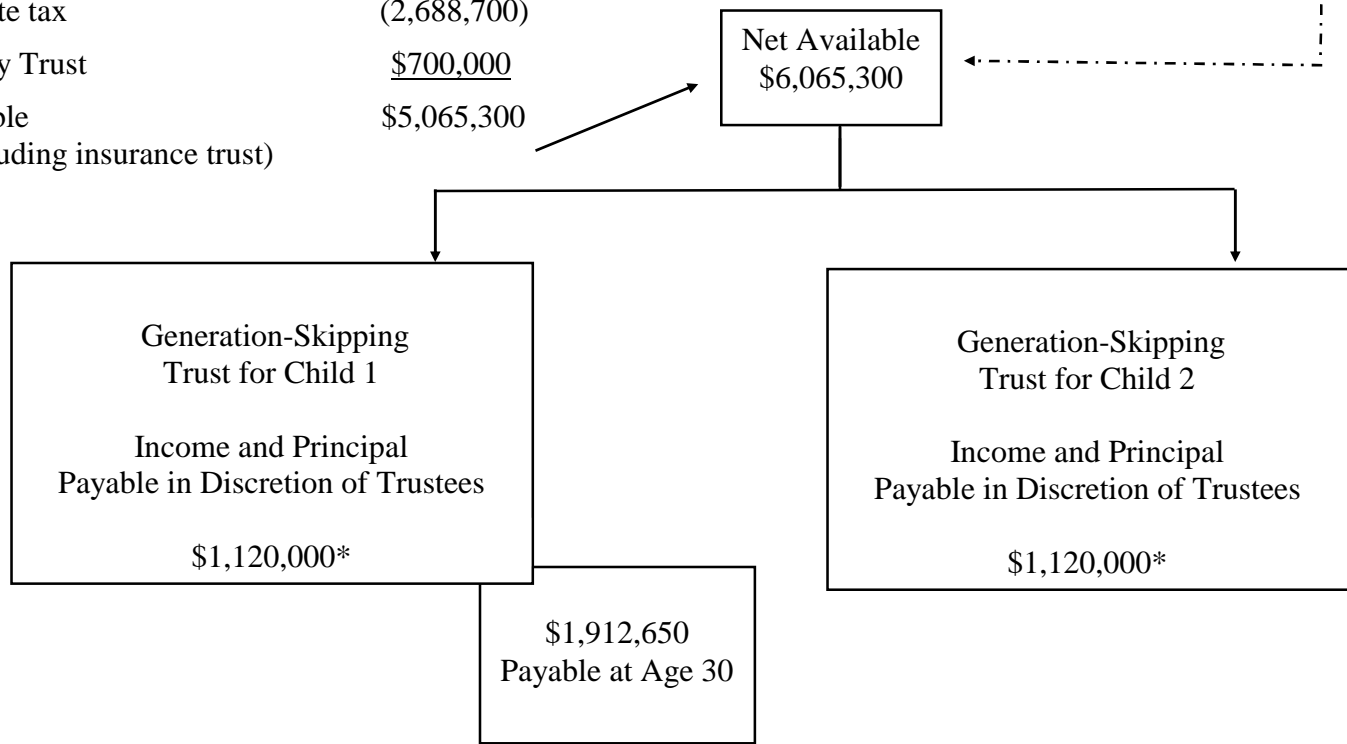
* This amount -- the Massachusetts estate tax exemption amount in 2003 -- will increase substantially over the next several years. (See footnote #2 of the attached Memorandum for the applicable schedule.)

** This amount -- the difference between the federal and Massachusetts estate tax exemption amounts in 2003 -- will increase substantially over the next several years. (See footnote #1 of the attached Memorandum for the applicable schedule for the federal exemption amount.)

After Spouse's Death (assume in 2003)

Spouse's Assets:	
Retirement Benefits and Home	\$2,700,000
Miscellaneous Investments	1,000,000
Marital Trust #1	300,000
Marital Trust #2	<u>3,800,000</u>
Taxable estate for MA tax purposes	\$7,800,000
MA estate tax	(746,000)
Taxable estate for fed. tax purposes	\$7,500,000
federal estate tax	(2,688,700)
plus: Family Trust	<u>\$700,000</u>
Net Available (excluding insurance trust)	\$5,065,300

\$1,000,000 tax-free
from Insurance Trust



* In 2003, each person's generation-skipping transfer ("GST") tax exemption is \$1,120,000. The GST exemption will equal the federal estate tax exemption, after 2003.