SchiffHardin LLP
Summer 2008
update

Private Clients, Trusts and Estates

www.schiffhardin.com

One Atlantic Center
Suite 2300
1201 West Peachtree Street
Atlanta, GA 30309
t 404.437.7000
f 404.437.7100

225 Franklin Street
Suite 2600
Boston, MA 02110
t 617.848.5750
f 617.848.5784

6600 Sears Tower
Chicago, IL 60606
t 312.258.5500
f 312.258.5600

One Westminster Place
Lake Forest, IL 60045
t 847.295.9200
f 847.295.7810

900 Third Avenue
New York, NY 10022
t 212.753.5000
f 212.753.5044

One Market
Spear Street Tower
32nd Floor
San Francisco, CA 94105
t 415.901.8700
f 415.901.8701

1666 K Street, N.W.
Suite 300
Washington, DC 20006
t 202.778.6400
f 202.778.6460

1000 Skokie Blvd.
Suite 215
Wilmette, IL 60091
t 847.920.9327
f 847.920.9329

Young adults in their 20s and 30s confront many new responsibilities. They take on full-time employment, select and pursue a career, become financially self-sufficient, acquire homes and start families. As part of this process, many young adults begin to focus on budgeting and financial planning. As they negotiate life's challenges and opportunities, however, they often spend little or no time thinking about estate planning. This Update answers the common questions that many young adults (and older adults too) ask about estate planning and explains why everyone, young or old, needs an estate plan. It also discusses the equally important issue of disability planning. Most people will be disabled and unable to act for themselves at least once during their life. This Update describes some of the steps that you can take to protect yourself in the event that you become temporarily or permanently disabled. Finally, this update briefly summarizes how protected your bank and brokerage accounts are during these difficult economic times and the latest proposal for estate tax reform.

ESTATE PLANNING

Why do I need an estate plan? Won't my property just go to my family if I don't have a Will?

The most obvious reason for having an estate plan, which may mean either a Will alone or in combination with a Living Trust, is that it allows you to control who receives your property in ways that other alternatives cannot. A Will is a legal document that facilitates the transfer of ownership of property after your death. It entitles the individual you name in the Will to act as executor to administer your estate. After your death, the executor will petition the court for the authority to take control of your property, pay taxes and debts, and distribute your property as provided in the Will.

A Will gives you the following benefits. You, not the state laws where you reside, control who will receive your property, when they will receive your property and the purposes for which they can use it. You also can designate who you want to administer your affairs after your death and who you want to act as guardian for any minor children that you leave behind In addition, you can waive any surety bond requirement that might otherwise apply to the person administering your estate. Finally, a Will allows you to do tax or other planning for the special needs of family members.

If you fail to make any arrangements for the transfer of your property, it will be transferred pursuant to guidelines adopted by the "intestacy" statutes of your home state. In general, intestacy statutes allocate your property to one or more relatives. state intestacy statutes do not take into account any special needs that your relatives may have or any tax planning considerations. Some of the problems that can result from dying without an estate plan are: (1) half siblings inherit equally with full siblings even if you never knew them; (2) children inherit equally even if they have vastly different needs; (3) children or spouses receiving public aid disability or Medicaid benefits lose their benefits when they receive property outright; (4) beneficiaries who have problems properly managing money receive property outright and squander it; (5) beneficiaries with creditor problems receive money outright and lose it to creditors' claims; (6) unnecessary estate tax is paid and future tax benefits are lost; and (7) family disputes arise over who should be guardian for the decedent's minor children.

I hear about Living Trusts all the time. What are they and why do I need one?

A Living Trust (also often referred to as a Revocable Trust or a Declaration of Trust) is a revocable trust in which you place your property, and over which you or someone you designate acts as trustee. During your life and while you are not disabled, you retain complete control over any property transferred to your Living Trust, including the right to use the trust property (income and principal) without restriction for whatever purposes you wish. The Trust is fully amendable and revocable so you can change the trust provisions at any time.

Privacy concerns are one reason to have a Living Trust. Generally, if a person has a Living Trust, the bulk of that person's estate plan is set forth in the Living Trust rather than the person's Will. In most states (although not in New York), a Living Trust is a private document. It is not filed in court and the assets owned by it upon the creator's death are not reported in a court proceeding.

A Living Trust also can provide for the lifetime management of your property in the event that you become disabled because of poor health, accident or age. This is discussed in more detail in the Disability Planning section below.

Finally, many people use Living Trusts in order to avoid probate. Whether this is a sufficient reason by itself to have a Living Trust depends upon the state in which you reside. Some states, such as Illinois, have streamlined probate procedures which are neither complicated nor expensive. Other states, such as New York, have far more complicated procedures. However, regardless of where you reside, if you own real estate in a state other than your own, you should consider holding that real estate in a Living Trust so that it is not subject to a separate probate proceeding in that other state at your death. It is important to remember that only property that is actually registered in the trust's name before your death avoids probate. Also, avoiding probate just means that certain court procedures are avoided. It does not avoid all the tax reporting that applies equally with or without a Living Trust.

What decisions will I need to make in order to implement an estate plan?

The initial decisions to be made when designing an estate plan are pretty simple. You need to decide who you want to be your executor and administer your property after your death, who you want to receive your property and whether you want them to receive it outright or in trust, who you want to manage any amounts going to a

beneficiary in trust, and who you want to take care of any minor children who survive both parents.

What responsibilities do executors and trustees have? How should I select an executor or trustee?

At the most basic level, executors and trustees have the duty of managing property for other people. An executor has the responsibility of taking control of a deceased person's property, paying his or her debts, winding up his or her financial affairs, filing income and death tax returns on behalf of the estate, and making sure that the balance of the decedent's property is distributed according to the decedent's estate plan, or if the decedent had no estate plan, then according to state intestacy law. The attorney for the estate will guide the executor through much of the estate administration process.

A trustee's primary duty is to hold the trust assets, to administer them solely in the interest of the trust beneficiaries and to carry out the terms of the trust. Once an individual or corporation has accepted the position of trustee, the trustee becomes bound to administer the trust by its terms in accordance with the desires and intentions of the person who created the trust. As a result, a trustee has a duty to exercise reasonable effort and diligence in making and monitoring investments for the trust (with attention to the trust's objectives), to preserve and protect trust property, to treat beneficiaries impartially (within the terms of the trust instrument), to account for trust property, to distribute the trust property in accordance with the terms of the trust instrument, and to terminate the trust at the appropriate time.

You can name family members, friends, advisers or a bank or trust company as your executor or trustee. Whether you name one or more individuals, a bank or trust company, or an individual together with a bank or trust company will depend upon your personal preferences and circumstances. Many people prefer to name their spouse and/or one or more adult children or siblings as their fiduciaries. Other people, especially those with children from a previous marriage, no adult family members, or a very large estate, prefer to involve a bank or trust company either alone or in conjunction with an individual. Two advantages to naming a bank as co- or sole trustee are that the bank can be given the primary responsibility for managing and investing the trust assets, and it can act as an impartial arbitrator between family members.

Will my property be subject to a tax at my death?

Whether your death will trigger an estate tax depends upon the total value of your property and the beneficiaries of your estate plan. Transfers of property to charity or to a spouse (whether outright or in a qualifying trust of which the spouse is the sole beneficiary) do not trigger estate tax. Transfers of property to other recipients will trigger estate tax to the extent they exceed, in the aggregate, your exclusion from estate tax. In 2008, the federal estate tax exclusion is $2 million and the federal estate tax rate is 45%. The federal exclusion is scheduled to increase to $3.5 million in 2009, become unlimited in 2010, and then revert to $1 million in 2011. (At this point, most estate planning professionals anticipate that Congress will repeal the planned changes for 2010 and 2011 and make the $3.5 million exclusion permanent.)

A majority of states no longer have an estate or inheritance tax. This includes California, Georgia, Arizona, Florida and Michigan. Of the states that have retained an estate tax, most tie the amount of their estate tax exclusion to current federal law, although some use prior (lower) exclusion amounts. Illinois and New York both have a state estate tax. As a general rule, if a person dies in a state that has an estate tax, the top combined federal and state rate will be about 53%.

If I am married, can I avoid triggering any estate tax by leaving all of my property to my spouse?

Yes, you can leave all of your property to your spouse without triggering any estate tax. However, such a disposition often is not the best plan because it does not take advantage of your exclusion from estate tax. The primary way to take full advantage of your estate tax exclusion is to use an "A/B Plan." Such a plan involves leaving the maximum amount of property sheltered by that exclusion to a so-called "B" or "family" trust for the benefit of your spouse or your spouse and children. The trust is drafted to limit your spouse's interest to prevent its inclusion in your spouse's estate at death. The remainder of your property is then left to your spouse outright or to an "A" or "marital" trust that benefits only your spouse.

> Example: Assume that both Husband and Wife die in 2008. Each of Husband and Wife have $2 million of property and have a $2 million exclusion from estate tax. Wife dies first and leaves all of her property to Husband, so that his total assets are $4 million. While there will be no estate tax at Wife's death because she has left all of her property to a spouse, there will be federal estate tax of 45% (or $900,000) at Husband's subsequent death because his property now exceeds his federal estate tax exclusion by $2 million (45% x $2 million = $900,000). If, however, Wife leaves her $2 million to Husband in a family trust, then at Husband's subsequent death, no federal estate tax will be due because the value of Husband's property ($2 million) does not exceed his exclusion from estate tax ($2 million). This means that no federal estate tax will be due at either death and the $900,000 that would have been paid to the IRS if Wife had left all of her property outright to Husband will instead go to the couple's beneficiaries.

Should I leave my children or other beneficiaries their inheritance in trust?

There are many reasons to use trusts for your children, grandchildren and other beneficiaries. Trusts allow for maximum tax planning flexibility and permit property to pass to successive beneficiaries with a minimum of transfer tax. A trust also can protect assets from the claims of creditors, such as someone suing the beneficiary over a car accident, the plaintiff with a malpractice claim or a spouse in a divorce action. Using a trust also will allow you to provide such other protections to your beneficiaries as you feel appropriate. For example, you may want your children to act as co-trustee with a relative, bank or trust company for a term of years before assuming sole responsibility for his or her own trust property. You also may want to provide specific directions to the trustee as to when and under what circumstances a beneficiary can access his or her trust property.

Can My Parents Act for My Children If I Am Out of Town?

If you are going out of town and leaving your children with friends or relatives, then you should leave written authorization with your designated caregivers that will allow them to act for your children in emergency situations. Many states have laws that permit parents to name a temporary guardian — called a "short-term guardian" — to act on behalf of minor children for a specified period of time. In most cases, you can name such a guardian using a simple statutory form.

Should I be doing anything special if a beneficiary of mine is disabled?

If a beneficiary named in your estate plan is disabled, then it is possible that a certain type of trust called a "special needs trust" should be used to receive that beneficiary's inheritance. A special needs trust allows property to be given to a beneficiary who is receiving (or may in the future receive) needs-based government benefits without disqualifying the beneficiary for those benefits.

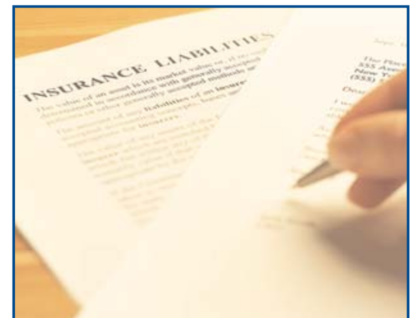
Do I need any additional documents or planning if I own a business?

Business owners often need special planning to preserve the business for the next generation or owner. There are two primary estate planning concerns that arise with respect to closely held businesses. One concern is planning for the disposition of the business. The other is planning for how to pay any estate taxes that might be triggered by the value of the business at the owner's death. There are a number of techniques that a business owner may use to facilitate the transfer of a business to a business partner or family member. These techniques include (i) using a buy-sell agreement, (ii) purchasing additional life insurance, (iii) creating a non-voting class of stock, and (iv) using voting and other types of trusts. Life insurance also can provide liquidity to pay for estate taxes that are generated by the business interests.

Do I Need Insurance?

There are many types of insurance and most people need at least some of them. Estate and disability planning are forms of insurance. As discussed above, they protect you and your family both personally (think health care agents and guardians) and financially (think property agents and trustees). Other types of insurance are: (i) life insurance; (ii) disability insurance; (iii) homeowners insurance; (iv) car insurance; and (v) health insurance.

The latter three provide financial protection in the event that you suffer a property loss due to theft, fire, storm damage, accident, injury or other unexpected calamity. Disability insurance provides replacement income in the event that disability interferes with your ability to work. Life insurance can serve several different purposes — replacement income for your family in the event that die during your income earning years, cash liquidity for estate taxes, and an alternative type of asset to hold in your investment portfolio.



Are Your Assets Safe?

With the collapse of Bear Stearns and the failure of IndyMac, and the nearly constant stream of bad financial news in the press, you may be wondering exactly how safe are your assets being held at your bank or brokerage firm. Here is a short primer on the rules related to your assets and the creditors of a failed financial institution.

Assets held in deposit accounts at a bank (such as cash and certificates of deposit) are insured up to $100,000 per account owner (not account) by the Federal Deposit Insurance Corporation ("FDIC"). If you have more than $100,000 in deposit accounts at any given bank, that excess amount is not covered in the event of the bank's failure. However, if an account has more than one individual owner (a typical joint account), each owner is deemed to own a proportionate amount of the account, which is counted towards that individual's $100,000 limit. Other assets purchased through a bank, such as mutual funds and annuities, are not covered by the FDIC. Self-directed retirement accounts, such as IRAs, are insured up to $250,000 per account owner. Dividing your assets among banks can increase the amount of assets that are protected.

Calculating FDIC coverage for trust accounts is very complex and may not always be easily determined. Some situations are pretty straightforward. For example, if an individual has a revocable trust account at a bank and the trust provides that at the individual's death, the remaining trust property is distributed equally among the grantor's three children, there will be $300,000 of FDIC coverage—$100,000 for each of the beneficiaries. However, certain beneficiaries are not considered "qualified" for these purposes. So, for example, if the trust is divided equally among three children and a niece, the niece is not a qualified beneficiary and no additional FDIC coverage would apply to her share. If the beneficiaries do not receive equal amounts, it also affects the amount of FDIC coverage. For example, if one child receives 60% of the trust and a second child receives 40%, the maximum amount that can be deposited with full FDIC coverage is not $200,000 but $166,667 ($100,000/60%). Bequests that are made to others, such as charities or friends, may also change the calculation. Further issues arise if assets are left in trust rather than left outright to a beneficiary. Given that the typical estate plan often utilizes trusts, the more generous limit of $100,000 per qualified beneficiary may not always be available.

Brokerage firms are covered by a different agency—the Securities Investor Protection Corporation ("SIPC"). SIPC covers assets that are stolen by a broker or that are lost when a brokerage firm fails. Cash and securities (such as stocks and bonds) are covered, while such things as unregistered investment contracts (such as limited partnerships), currency and commodities futures contracts are not. SIPC provides coverage up to $500,000 per customer (with a maximum of $100,000 for cash claims). Banks and brokerage firms often carry insurance in excess of these limits, but the amount varies from institution to institution. An express trust is considered a separate customer from the grantor, trustee or any beneficiary of the trust unless the trust was created simply to obtain or increase SIPC protection. If a brokerage firm fails, there can be a delay before the SIPC trustee releases the property in an insured account.

Assets held by an institution as trustee are not considered that institution's assets and are not subject to the claims of its creditors if it fails. Assets held in custodial accounts are generally thought to have the same protection. Assets in margin accounts and

even fully-paid securities that the brokerage firm can lend to its other customers (pursuant to its agreement with you) do not have the same protection, though. Accordingly, if you have a margin account but do not actually use the margin feature or if your brokerage agreement allows your broker to lend your securities to others, you may want to consider closing it.

Estate Planning Reform Update

Ever since the estate tax laws were last significantly amended in 2001, we have been hearing that Congress was going to act either to repeal permanently the estate tax or "reform" it. Seven years later, nothing has happened, but because the law currently provides for a one-year repeal of the tax in 2010, most observers feel that change (but not repeal) will come by the end of 2009. The latest salvo is the so-called "Sensible Estate Tax Act of 2008" ("the Act") introduced in the House of Representatives on July 15. The Act would make permanent the current $2 million estate tax exemption. Other bills introduced in the recent past have called for larger exemptions of up to $5 million. This exemption would be increased for inflation, with increases being made in $10,000 increments.

The Sensible Estate Tax Act would also bring back higher estate tax rates. Currently, there is a flat estate tax rate of 45% on amounts in excess of $2 million. The Act would enact a 50% rate for amounts between $5 and $10 million and a 55% rate for amounts in excess of $10 million.

The Sensible Estate Tax Act would make other changes as well. For example, it would reunify the gift and estate tax exemptions that were uncoupled in 2001. Although the current estate tax exemption is $2 million, the lifetime gift tax exemption was frozen at $1 million. The Act would increase the gift tax exemption up to the estate tax exemption amount. The Act would also introduce "portability," allowing a surviving spouse to use any of his or her deceased spouse's estate tax exemption that went unused at the deceased spouse's death.

Clearly, the Sensible Estate Tax Act is not the last word on the transfer tax front. Most commentators continue to believe that a permanent exemption at or close to $3.5 million is more likely. We will keep you informed of further developments as they occur.

Thomas W. Abendroth
312.258.5501
tabendroth@schiffhardin.com

Barry S. Alberts
312.258.5611
balberts@schiffhardin.com
Trust and Estate Litigation

Scott Bieber
312.258.5636
sbieber@schiffhardin.com

David C. Blickenstaff
312.258.5637
dblickenstaff@schiffhardin.com
Trust and Estate Litigation

Harmon A. Brown
312.258.5690
hbrown@schiffhardin.com

Reetu Chauhan
312.258.5732
rchauhan@schiffhardin.com

Lisa M. Chessare
312.258.5693
lchessare@schiffhardin.com

John D. Dadakis
212.745.0860
jdadakis@schiffhardin.com

Louise M. Fitzsimons
212.745.0822
lfitzsimons@schiffhardin.com

Andrew M. Grumet
212.745.9543
agrumet@schiffhardin.com

P. Gregory Hess
212.745.0812
ghess@schiffhardin.com

David R. Hodgman
312.258.5714
dhodgman@schiffhardin.com

Michael J. Huft
312.258.5627
mhuft@schiffhardin.com

Kim A. Kamin
312.258.5621
kkamin@schiffhardin.com

Robert E. Kolek
312.258.5755
rkolek@schiffhardin.com

Katherine J. Levy
847.295.4305
klevy@schiffhardin.com

Theresa M. H. Marx
312.258.5562
thellmann@schiffhardin.com

David A. Milberg
312.258.4579
dmilberg@schiffhardin.com

Margaret A. Nagela
312.258.5518
mnagela@schiffhardin.com

Robert R. Pluth, Jr.
312.258.5535
rpluth@schiffhardin.com

Christine R.W. Quigley
312.258.5761
cquigley@schiffhardin.com

Debra L. Stetter
312.258.5741
dstetter@schiffhardin.com

Thomas R. Wechter
312.258.5756
twechter@schiffhardin.com

This publication is for the general information of clients and friends of our firm. It does not provide legal advice for any specific matter. Readers should consult a lawyer directly for such advice. This publication, or parts of it, may be considered advertising material under professional conduct rules applicable to lawyers.

© 2008 Schiff Hardin LLP
All rights reserved.

6600 Sears Tower
Chicago, Illinois 60606