

# DYING IS NOT A PREREQUISITE TO HAVING AN ESTATE

*An Explanation of Estate Planning: What, Why, and How*

*Including a Special Supplement  
on  
Living Trusts*

**McTexLaw.Com**  
**McPherson & Associates, P.C.**

600 North Dallas Bank Tower  
12900 Preston Road @ LBJ  
Dallas, Texas 75230  
**Office • 972 • 385-9947**  
Facsimile • 972 • 385-9948

*Written by J. Mark McPherson, Esq.*  
*mark@mctexlaw.com*

This booklet contains general legal information designed to help clients and potential clients develop an understanding of the topics discussed in this booklet. Legal information is not legal advice. The general information contained in this book should only be applied to particular facts by qualified legal counsel in the context of a formal attorney-client relationship. A competent, experienced attorney should always be consulted before utilizing any of the information contained in this book.

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## WHAT IS AN ESTATE?

Most people tend to think that an “Estate” is created upon death and is comprised of all assets owned by the person who passed away as of the date of death. However, dying is not a prerequisite to having an Estate; we all have an Estate from the minute we are born. Our respective Estates are comprised of all of our assets, such as:

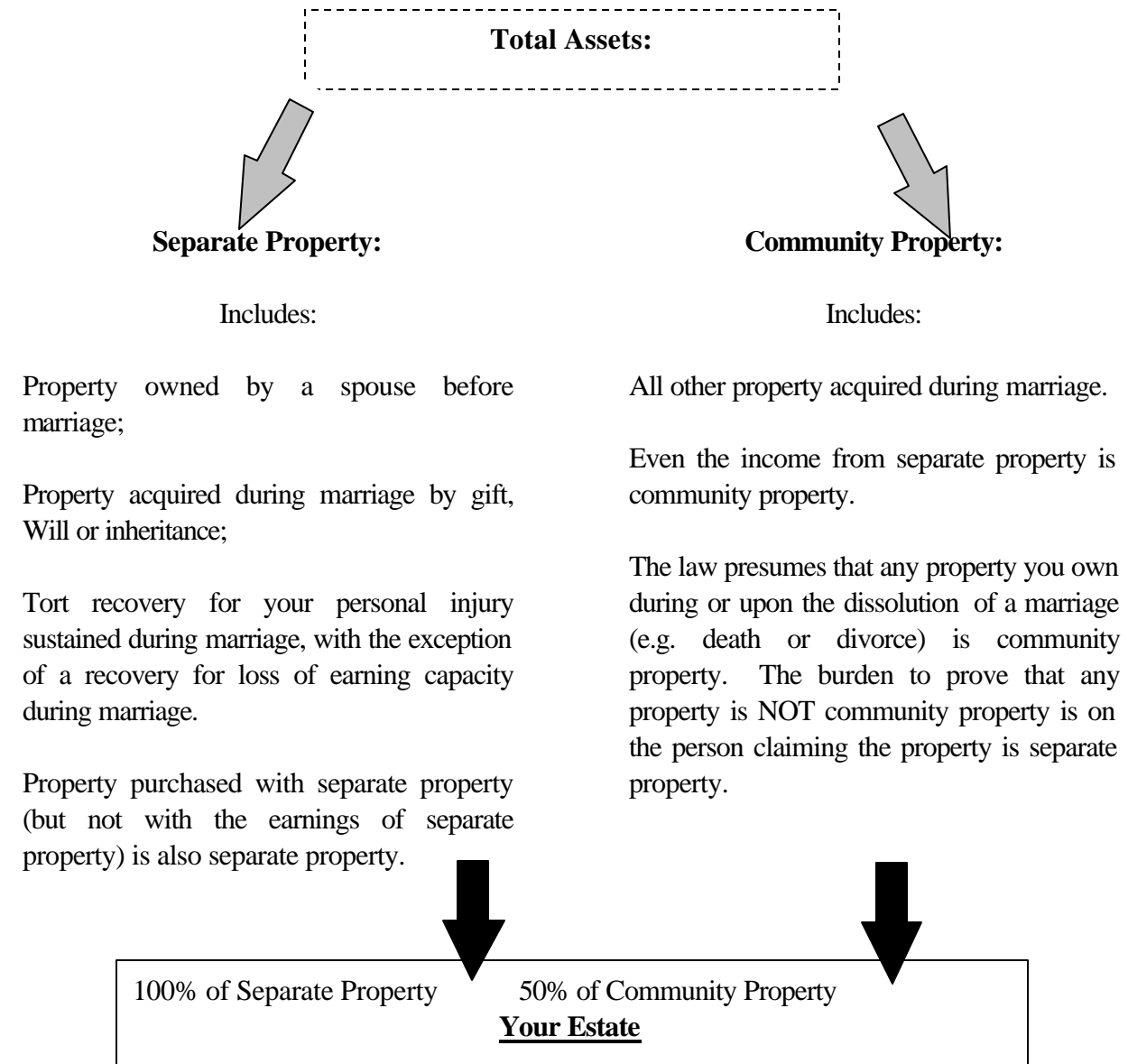


For estate planning purposes, we are concerned with the fair market value of these assets at any point in time, and the death benefit of life insurance policies. Your task is to identify every asset, keep a written record of those assets in whatever form you choose, organize this written record so that others may understand them, and keep them where your designees can find them.

Once you have identified all your assets, it is important to categorize those assets in the following categories:

**Community Property vs. Separate Property.** If you are currently married and live in Texas, your estate most likely includes assets that are both “separate property,” and “community property,” because Texas is a “community property” state (out of 9 in America currently). Texas law regards the assets acquired during marriage, philosophically, as belonging to the community of the marriage. You own all of your separate property, and half of the community property of your marriage. Since your estate plan can only affect one-half of the Community Property and all of your Separate Property, it is important to know which of your assets are community and which are separate.

The definitions of separate property and community property are very technical in application. However, their general definitions are:



You and your spouse may change separate property to community property, and community property to separate property, by signing a written agreement identifying the property and its new characterization. However, income tax consequences should be considered with a knowledgeable Certified Public Accountant.

*A General Durable Power of Attorney will give your designated agent the ability to control these assets in your estate during your lifetime upon the happening of certain events, such as your incapacitation.*

## WHAT IS AN ESTATE PLAN?

An “Estate Plan” is a plan that you write which controls your person and your property, allowing you to choose who you want to fulfill various positions of responsibility. It instructs, directs and controls your family members and loved ones, your medical attendants, and the legal system, about what you want done with your person and your property when you are unable to make those decisions in person or when you are incapacitated for any reason. It is much more than just a will.

Among other things, an Estate Plan allows you to:

1. Control your assets both during your lifetime and upon your death;
2. Choose the people who will inherit the assets of your Estate;
3. Leave property to minors in trust until they become mature enough to wisely assume responsibility for that property so they don't receive “too much too soon”;
4. Save your loved ones estate administration expenses;
5. Control your medical treatment and end of life decisions;
6. Protect the assets of your Estate from creditors of intended beneficiaries; and
7. Reduce any Estate taxes which may be due at death.

In order to accomplish these and other important goals, estate planning asks basically three questions:

1. What Happens to Your Assets at Death?
2. What Happens to Your Assets During Your Life?
3. What Happens to Your Body During Life?

## TRANSFERRING THE ASSETS IN YOUR ESTATE AT DEATH

When you pass away, all of your assets must be transferred to someone else, because you can't take them with you. There are 3 general ways property is transferred at death:

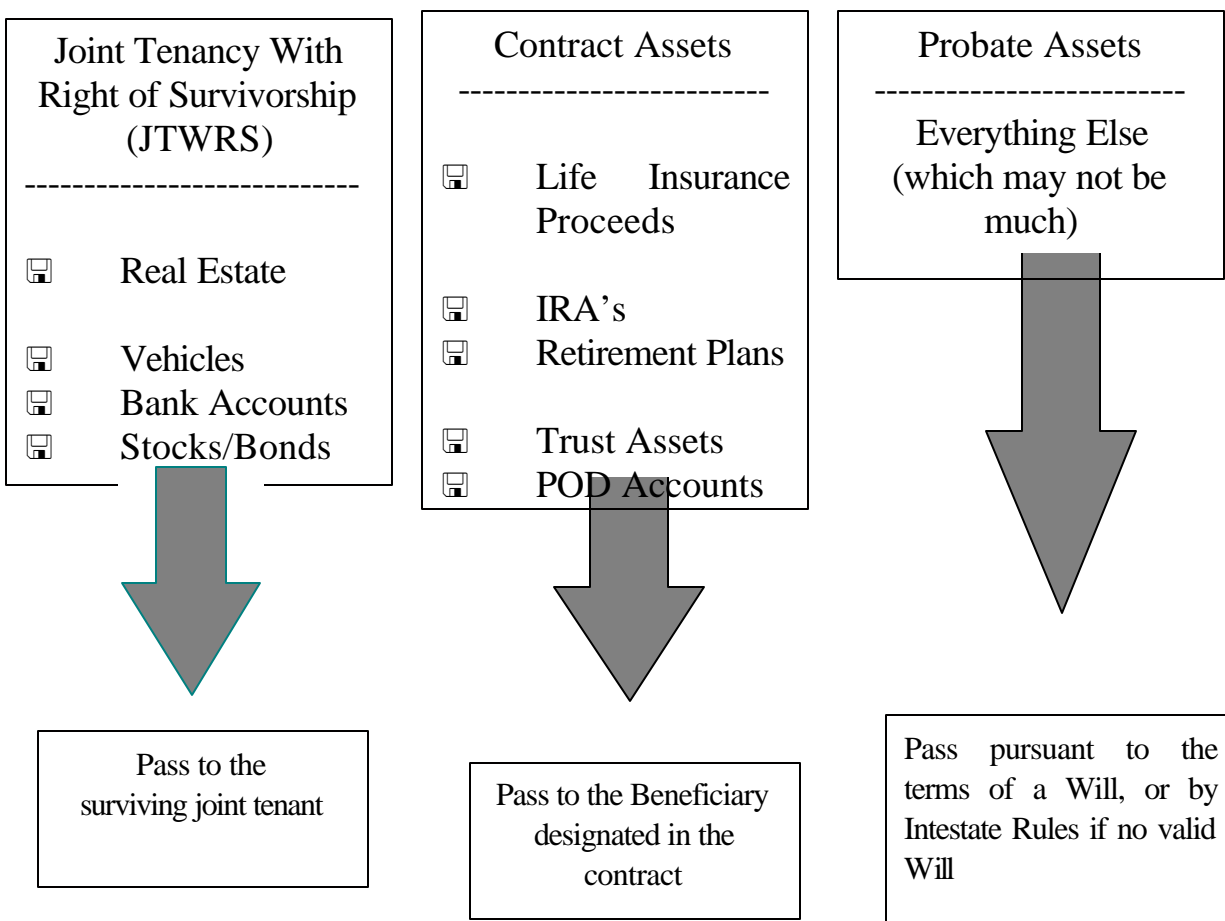
**(1) Joint Tenancy Assets (with right of survivorship).** We often hold property in joint tenancy with other people, and this is a very convenient way to hold and transfer property. For example, a bank account in the name of both a husband and wife is usually an asset held in joint tenancy. During the lives of both joint tenants, each has undivided complete control over those assets. The ownership rights of the first joint tenant to pass away are terminated automatically by law upon death; the surviving tenant then obtains complete ownership rights. Because of this, joint tenancy assets do not pass to the deceased tenant's heirs by Will. The surviving joint

tenant receives the entire property, the heirs of the deceased joint tenant receive NONE of these assets, and they will later pass to the surviving tenant's designee(s) in accordance with the surviving tenant's estate plan.

(2) **Contract Assets (e.g. life insurance and retirement accounts).** We often enter into contracts with others to distribute property to certain designated beneficiaries upon our death. Contract assets include life insurance policies, IRA's, retirement plans, "pay on death" financial accounts, and trusts. These contracts specifically provide for the distribution of the asset to certain named individuals or entities, which are usually called beneficiaries. These assets pass to the beneficiaries by the terms of the contract, and not by the provisions of a will.

(3) **Probate Assets.** Probate Assets are basically the assets left in your estate after removing the joint tenancy assets and contract assets. Depending on how your assets are titled and the types and values of assets in your estate, this may be a significant amount, or it may be very little.

Graphically, then, assets are transferred as follows:



**How Not to Plan: Consider the Whole Plan.** Estate planning must be a comprehensive

process. The story is told of a gentleman who remarried in his 70s and re-titled all of his assets in joint tenancy with right of survivorship with his new wife. He had one daughter, and on his deathbed he called his daughter in and explained to her that he loved her and wanted to make sure she was taken care of. In order to do this, he had rewritten his will a few weeks prior to this conversation, and it gave 2/3rds of his estate to his daughter, with 1/3rd to his new wife. Upon his death, the daughter was very distraught to learn that she actually received only 1/3 of one small certificate of deposit, comprising less than 5% of his estate, while the new wife, who was about the daughter's age, received over 95% of the estate.

In this instance and countless others very similar, the person writing the will forgot, or did not know, that property which passes by joint tenancy does not pass by a will. More times than not, the effect of a will that provides for someone to receive x% will actually give that beneficiary less than x% of the estate because a will only affects "probate assets."

Joint tenancy has the following advantages and disadvantages:

- Advantages:
1. Property is quickly, easily and automatically transferred to the co-owner.
  2. Avoids Probate at death of the first joint tenant.
  3. Use of a surviving parent's bank account by one co-owner, such as a child, is a simple and convenient way for the child to pay the parent's bills and otherwise manage the parent's money.
  4. For some, holding property in joint tenancy with family members provides a psychological sense of family unity and security.
- Disadvantages:
1. The first joint tenant to pass away loses all control as to the property's use and management.
  2. Property cannot be disposed of by a will or trust.
  3. It may needlessly subject property to taxation and probate at the surviving owner's death.
  4. It does not avoid probate in the event of simultaneous death of joint owners.

**How Not to Plan: Consider the Gift Tax.** It is not uncommon for someone to title all of their assets in joint tenancy with their most trusted child, with instructions to the child as to how to distribute those assets to the ultimate beneficiaries upon the parent's death. This may work for small estates, but it imposes gift tax on each and every transfer of assets from the trusted child to the ultimate beneficiary that is over \$10,000. With proper planning, in most instances the same result can be achieved with no gift taxes whatsoever.

## **YOUR WILL BY DEFAULT (Intestacy)**

Every resident of the State of Texas has a will. If you did not write your own will, the State has supplied one for you. If you die without having written your own will, you are said to have died "intestate" and your probate assets will pass pursuant to the "laws of intestacy" or "intestate succession." While the laws of intestate succession are very technical in application, the following table

provides a general idea of how Texas intestate laws distribute probate assets:

	<i>Separate Personal Property Inherited by:</i>	<i>Separate Real Property Inherited by:</i>	<i>Community Property Inherited by:</i>
<i>Survived by One or More Children, No Surviving Spouse</i>	Divided Equally Among the Surviving Child(ren)	Divided Equally Among the Surviving Child(ren)	None to Inherit
<i>No Surviving Children or Spouse; Survived by Both Parents</i>	½ to Father; ½ to Mother	½ to Father; ½ to Mother	None to Inherit
<i>No Surviving Children or Spouse; Survived by Only One Parent</i>	½ to Surviving Parent; ½ Divided Equally Among Brothers and Sisters	½ to Surviving Parent; ½ Divided Equally Among Brothers and Sisters	None to Inherit
<i>No Surviving Children, Spouse or Parents</i>	Divided Equally Among Brothers and Sisters	Divided Equally Among Brothers and Sisters	None to Inherit
<i>Surviving Spouse; No Surviving Children</i>	Surviving Spouse	½ to Surviving Spouse; 1/4 to Father of Decedent; 1/4 to Mother of Decedent; if not survived by Father and Mother, then to the Brothers and Sisters of the Decedent	Surviving Spouse
<i>Surviving Spouse; Surviving Child(ren)</i>	2/3 Divided Equally Among the Decedent's Children; 1/3 to Surviving Spouse	2/3 Divided Equally Among the Decedent's Children; 1/3 to Surviving Spouse for Life, then to the Decedent's Children upon Death of Surviving Spouse	All of Decedent's Interest in ½ of all Community Property is Equally Divided Among the Decedent's Children

**Shortcomings of Intestacy Distribution.** Leaving the distribution of your probate assets to the Texas laws of intestate succession can create many problems, including the following:

1. They do not determine distribution of specific assets, and so in many cases, a failure to plan may cause quarrels and conflicts among your family members over who gets which particular assets.
2. Children who have demonstrated the wise use of money and assets may wonder why other children received the same value of assets out of your estate.
3. Your spouse's standard of living may be jeopardized as well as their ability to keep your home. The chance for arguments and misunderstandings increases greatly in cases of prior marriages and children by prior marriages.

All of these complications may add emotional hardships to your surviving family members in addition to the bereavement they must deal with at your passing. It is almost physically impossible for emotional people to make rational decisions. Without a plan in place, your family members may wind up in this challenging situation.

## **WRITING YOUR OWN PERSONAL WILL**

A personal Last Will and Testament is a written instrument which provides for the distribution of your "probate assets" which do not fall into one of the other two categories above in any manner you choose. Wills can be of varying degrees of complexity and may be used to achieve a wide range of family and tax objectives. Some typical Wills are:

- ③ **Simple Will:** provides for the outright distribution of assets to identified beneficiaries, such as "all to my spouse if they survive me, and if not, in equal shares to my children." These Wills are generally acceptable if the Estate is not subject to estate tax, and neither spouse has children by prior marriages or out of wedlock.
- ③ **Testamentary Will:** establishes one or more trusts upon death, such as for minor beneficiaries, governmental aid recipients, to protect assets from the creditors of beneficiaries, and for estate tax planning by including "unified credit trusts".
- ③ **Pour-over Will:** leaves all property to a previously existing "inter vivos" trust, such as a revocable living trust.

There are several other important objectives you may accomplish in your Will:

- ☞ **Independent Administration:** Choosing independent administration instead of dependent administration allows your designated executor to act independently of the court in settling your estate according to your Will.
- ☞ **Guardian:** You may appoint a guardian for your person in the event of incapacity as well as for any minor children.
- ☞ **Successor Custodian:** If you are acting as custodian for the assets of a child or grandchild under the Uniform Gift (or Transfers) to Minors Act, you may designate your successor custodian and avoid the expense of a court-ordered appointment.
- ☞ **Bond:** You may waive the requirement that your executor obtain a bond or surety to guarantee the accuracy of their acts.
- ☞ **List Succession of Executors:** You may designate a series of executors in the event one of your executors cannot serve.
- ☞ **Protect the Family Home:** Your home is one of the most important assets in your estate, both financially and emotionally. Often it is a community property asset. In order to protect and preserve your home for the benefit of your family, your Will should state who is to receive your interest in your home.

**How Not to Plan: Do Not Disinherit Yourself.** Planning alone is not enough. The plan must be well thought out. The story is told of a husband who, in order to save estate taxes, did not draw up a Will but instead put most of his property into his wife's name, assuming that she would survive him. She died before him and without a Will. Her parents and sister had predeceased her, but she had a niece whom they hadn't seen in 20 years. Her husband received only the first \$10,000 of his wife's property and shared the balance of what had once been his property with her long lost niece. An Estate Plan would have easily and readily corrected this situation by achieving the desired outcome.

**How Not to Plan: Do Not Do it Yourself.** Estate planning is a fact-intensive undertaking from the legal perspective. There is no "one size fits all" available. An attorney experienced in estate planning should be retained to help you with your estate plan. The family of the top lawyer in the country, the former Chief Justice of the United States Supreme Court, Warren Burger, learned this lesson the hard way. Chief Justice Burger drafted his own will in 1994 after the death of his wife. His Will left 1/3 of his estate to his daughter, and 2/3 to his son. When the Chief Justice passed away in June of 1995, his heirs discovered the following problems:

1. His estate, valued at \$1.8 million, had to pay estate taxes of approximately \$450,000;
2. He misspelled the word "executor" twice, causing unnecessary uncertainty;
3. The people who witnesses him sign his will must testify in Court to prove the Will, requiring additional attorneys fees and time for a Court decision;

4. His executor must obtain a surety bond because the Will did not waive that requirement;
5. The Will did not provide the executor with any power to sell real estate, and so the executor must go to Court every time he wishes to sell any of Justice Burger's real estate, again requiring additional attorneys fees and time; and
6. The Chief Justice, for obvious reasons, had zealously guarded his privacy. However, the probate record of his estate is now open to public scrutiny at the Arlington County, Virginia, Courthouse, in Deed Book 196, page 96.

According to the estate's attorney, the right Estate Plan would have resolved all of these problems and saved several hundred thousand dollars, time and privacy.

## **IS A WILL ALL I NEED?**

Many people think that a Will is all that is needed for their Estate Plan. However, as shown above, in most cases a Will only determines who inherits some of the assets of your Estate upon death. In addition to a Will, your Estate Plan should also include written documents stating your wishes for medical treatment in the event you are disabled during your life. Statistically, it is more probable that a person will suffer some sort of disabling injury in any given year as opposed to death. If that injury incapacitates you mentally, such as a stroke or coma, you will not have any control over your own person, your medical treatment or your assets without a written Estate Plan that includes a General Durable Power of Attorney, a Durable Power of Attorney for Health Care, and a Directive to Physicians.

## **CONTROLLING YOUR ASSETS DURING LIFE**

### **General Durable Power of Attorney**

A General Durable Power Of Attorney is a written instrument that appoints an individual or entity to act on your behalf with respect to your property. You are the "principal" and they are your "agent." Many people appoint their spouse, children, or another trusted family member to serve as their agent. The appointment can be specific and limited to a certain task or transaction, or it may be broad and general to allow the power holder to do almost anything in your best interest. These may be effective during your disability or incapacity. They can be used to give someone control over a bank account, such as to help pay bills and manage finances, without naming the agent as a joint tenant and creating the problems inherent in joint tenancies.

A general durable power of attorney may be effective from the moment you sign it, or it may become effective only upon your disability. Most married couples make the power of attorney effective immediately and continuously. A power of attorney automatically ceases upon death.

An agent owes the principal a fiduciary duty, meaning the agent must act with utmost honesty in carrying out the wishes of the principal. Third parties are entitled to rely upon information and instructions they receive from your agent. As is evident, naming someone to serve as your agent gives

that person substantial power over your assets. As a result, careful thought should be given to the person or persons you select to serve as your agent.

## CONTROLLING YOUR PERSON DURING LIFE

A Durable Power of Attorney for Health Care is a written instrument that appoints an individual to make health care decisions for you during time periods when you are incapacitated, and places whatever limitations you want on that person's decision-making discretion.

### Durable Power of Attorney for Health Care

Many people appoint their spouse or another trusted family member as their agent. One or more alternative agents are usually named to ensure someone is available to act.

### Directive to Physicians

A Directive to Physicians or "Living Will" is a written instrument that directs your physicians as to what treatments to give you, and what treatments not to give you, during the time periods in which you are incapacitated. In particular, it evidences your intentions whether to withhold or continue life sustaining treatment in the event you have an irreversible or terminable condition.

These two documents apply only in the event you are incapacitated and unable to make medical treatment decisions on your own behalf. Even after signing these documents, you have the right to make health care decisions for yourself as long as you are able to do so, and treatment cannot be given to you or stopped over your objection. Either document may be revoked by you at any time unless you are incapacitated.

## WHAT OTHER OPTIONS ARE AVAILABLE?

**Irrevocable Life Insurance Trusts.** In many instances it is important to keep insurance policies out of your estate, because policy proceeds are included in your estate and taxed by the estate tax. An Irrevocable Life Insurance Trust (ILIT) is designed to do just that. The ILIT owns and holds the insurance policy, and the death benefits are paid to the ILIT, not the person's estate. This reduces estate taxes and passes more of your estate's value to your children. Often, in the case of married couples, ILITs are funded with a "second to die" life insurance policy on both spouses. Estate tax is not triggered until the death of the second spouse, and a second to die policy does not pay death benefits until the second to die of the insured spouses. This may substantially reduce premiums and allow a family to obtain a larger death benefit. Many of

ILIT

these same benefits can also be achieved with a life insurance limited partnership (a "LILIP").

## Family Limited Partnerships

**Family Limited Partnerships.** The family limited partnership uses a limited partnership to achieve a myriad of estate planning goals. It is perhaps the most flexible, dynamic, sophisticated estate planning tool available today, and is particularly useful for owners of closely held businesses who need to transfer the business to succeeding generations or one or more key employees. Family limited partnerships may provide a superior level of asset protection, estate tax reduction, and can provide much more privacy and flexibility than can a trust. McPherson &

Associates, P.C., has an entirely separate book that deals solely with Family Limited Partnerships. Please call the office (972-385-9947) and request one if you are interested in learning about Family Limited Partnerships, or print off a booklet from our website, [www.mctexlaw.com](http://www.mctexlaw.com)

## Life Insurance

**Life Insurance.** Life insurance may be used to help ensure your heirs a certain standard of living after your death. In some instances it may be required in order to prevent the sale of your assets, either to pay estate taxes and administrative fees, or to pay for your heirs' living expenses. If you do not have sufficient probate assets to fully fund a trust included in your estate plan to reduce estate taxes, you may want to add an insurance policy payable to your estate. Also depending on the makeup of your estate, it may be more advantageous to place the insurance policies and their resulting proceeds in

an irrevocable life insurance trust or family limited partnership, instead of owning the policies in your name.

**Disability Insurance.** Disability insurance helps ensure a steady stream of income in the event you are physically or mentally incapacitated. Since statistics show that one is more likely to suffer a physical or mental incapacity than death, this type of insurance may be more important than life insurance.

## Disability Insurance

## Buy-Sell Agreements

**Buy-Sell Agreements.** Buy-Sell Agreements are used for owners of small businesses to ensure smooth continuation of the business upon the death of one of the principals. They often require the sale of the interest by the deceased principal's estate, provide the method for determining the value of the interest in the closely held business owned by the deceased principal, and contain a provision establishing the manner in which the owners' estate will be paid the determined amount. These agreements are as much for the protection

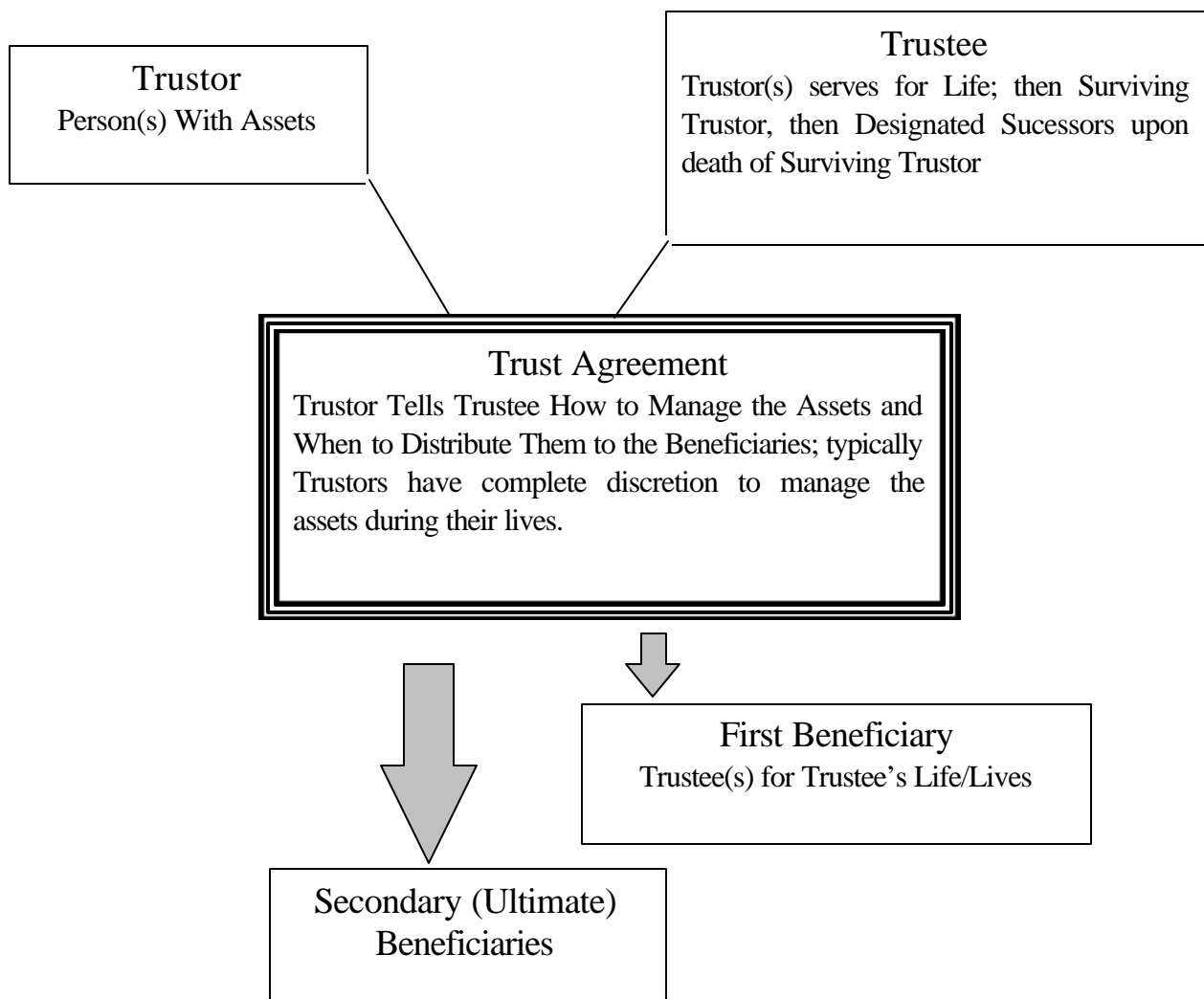
and benefit of the surviving principals as it is the deceased principal's estate. If you are a principal in a small business with other people, you should consider having a buy-sell agreement executed by your fellow principals for your protection. McPherson & Associates, P.C., has a separate booklet

specifically on Buy-Sell Agreements, explaining how they work, how they may be funded, and providing other important information on these valuable tools.

## **Special Supplement–Living Trusts**

The term “trust” describes the holding of property by a trustee (which may be one or more persons or a corporate trust company or bank), in accordance with the provision of a trust agreement, for the benefit of one or more persons called beneficiaries. The person delivering property to the trust is called a “trustor” or “settlor.” In a living trust scenario, the Trustor is the same person as the Trustee and Beneficiary during the Trustor’s lifetime. For married couples, both spouses are Trustors and Trustees. A living trust is also known as an “inter vivos” trust because it is created during the life of the trustor; it does not come into existence only upon the death of the trustor.

The trust is “revocable” in that the trustors can revoke, modify, or amend the trust agreement at any time during their lives. Upon the death of the first spouse, that part of the revocable living trust that applies to the deceased spouse’s assets becomes irrevocable and unchangeable by the surviving spouse.



**IN THE NEWS.** Living Trusts are a hot topic in Texas and they have been so for quite some time. Unfortunately, there is as much misinformation about them as there is correct information, and living trust sales by non-lawyers are a growing area of consumer fraud. Here is a comparison of certain characteristics of each:

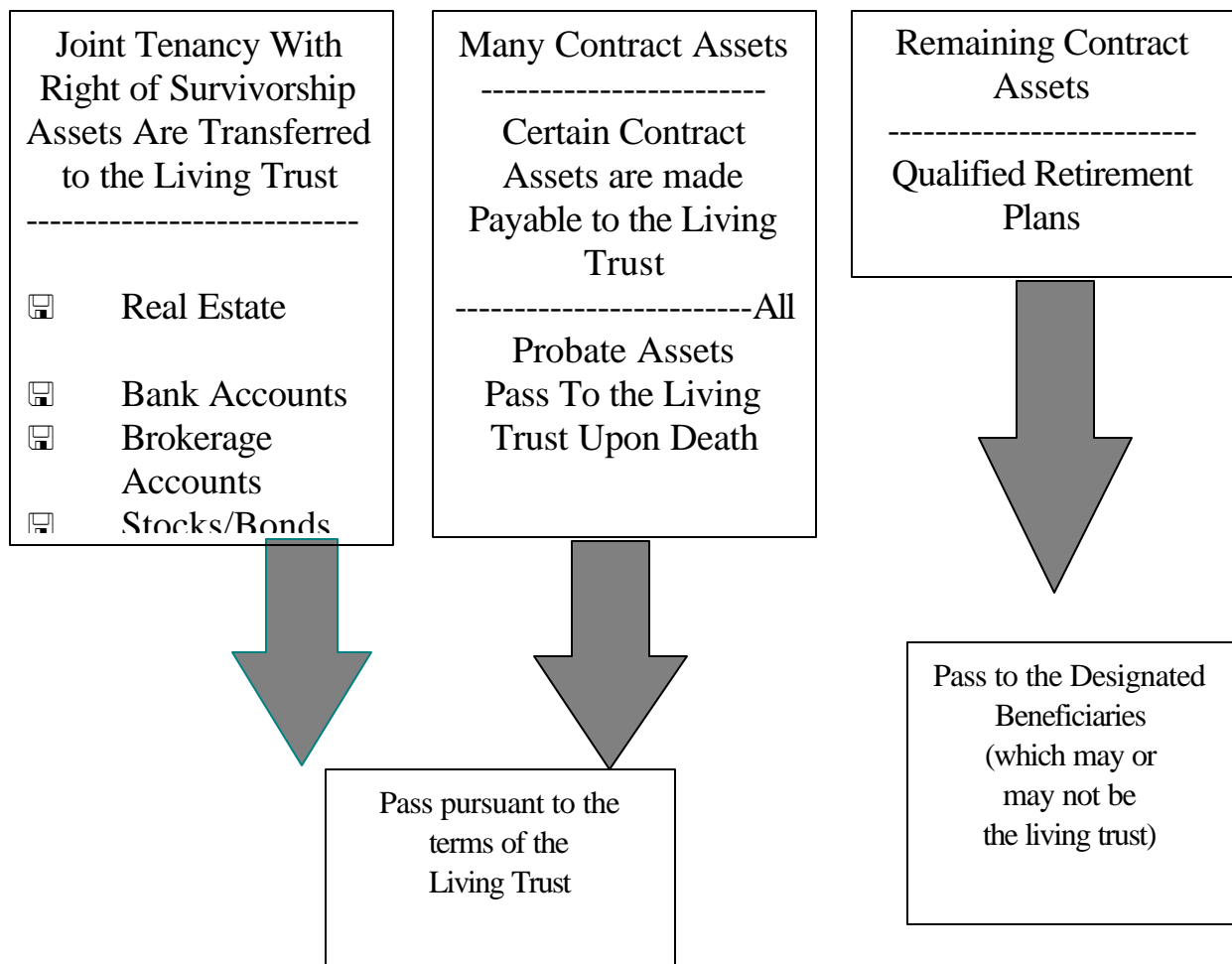
## A BRIEF COMPARISON OF WILLS To LIVING TRUSTS

<i>Wills</i>	<i>Living Trusts</i>
Requires Probate, which is a process briefly described below. It may or may not be advantageous to “skip” probate.	Avoids Probate for assets owned by the Trust ( <i>all other assets must pass through probate</i> ).
Non-taxable probate estates generally only take a year or less to complete. Many of the “horror stories” about how long it took to settle an estate have more to do with negotiating and paying estate taxes, not probate itself.	In most cases, the administration of a living trust is no more time efficient than the administration of a will in probate.
Not So Easy to Revise. Revision requires a “codicil”, which has to be executed in the same fashion as a will, namely the person signing the will plus two witnesses.	Easy to Revise. Revision requires the notarized signature(s) of the trustor(s) and trustee(s).
Public.	Private.
In some circumstances, a durable power of attorney is a simpler and less costly way to achieve the same goal	A living trust is helpful to avoid the expense of a guardianship in case of your future incapacity.
If You Own Real Property in More Than One State, You Must File Dual Probate Proceedings, i.e. a separate probate case in each state you own real property.	Eliminates Needs for Dual Probates.
Assets May be Left In Trust for Minor and Other Beneficiaries.	Same.

<i>Wills</i>	<i>Living Trusts</i>
Allows You to Maximize Estate Tax Savings IF your estate is subject to the federal estate tax (please see below to determine if your estate may be taxable). Since the estate tax laws were amended in 2001, fewer estates should be subject to estate taxes each year for the next 10 years.	Same.
Conservatorships, or living probates, will be ordered or denied by the Court after a hearing to determine your need. However, documents such as a durable power of attorney may be drafted to allow others to manage your property without the necessity of a court hearing.	If you require a conservatorship or living probate during your life, a co-trustee or successor trustee may automatically manage your property with no court supervision, and your person with minimal court supervision.
No Centralization of assets until death.	Centralized Management of Assets.
May be attacked and challenged on the basis of lack of capacity, undue influence, and fraud.	Trusts do not necessarily help you avoid contested wills. Trusts, just like wills, are subject to attack on the basis of lack of capacity, undue influence, and fraud.
No Alternative Dispute Resolution Opportunities Unless and Until Trusts Come Into Existence Upon Death.	Allows you to Institutionalize Family Disputes in Alternative Dispute Resolution Proceedings.

This author, however, sees one primary benefit to living trusts over wills that may apply to some families, and that is that living trusts can take joint tenancy assets, and probate assets, and even some contract assets, and combine them all into one living trust contract asset, and then distribute those assets according to the terms of that one trust agreement, as shown on the next page.

With a Living Trust, assets are transferred as follows (compare to the diagram on [Page 6](#)):



The fact of the matter is, many people think of their estate as one pile of assets. We all like to use joint tenancy, especially for our bank accounts and other liquid assets, for convenience. But as shown previously, joint tenancy can cause an estate to be distributed differently than intended.

A living trust allows joint tenancy assets to be combined with probate assets, and even certain contract assets, so that they all pass by the common terms of the living trust. By moving joint tenancy assets into a living trust most, if not all, of the negative ramifications of joint tenancy discussed on [Page 6](#) and [Page 24](#) can be avoided, and more overall integrity of estate planning can be achieved, while those assets may still be dealt with by all trustees as conveniently though they were joint tenancy assets.

## WHAT IS PROBATE?

Since much of the information, and misinformation, about living trusts makes such an issue over probate, it is important to know what probate is, and what it is not, if probate is a consideration involved in deciding whether or not to implement a living trust as your estate plan. An Independent Administration follows this path:

1. Death (the decedent). Every probate begins with a death.
2. Within 4 Years After Death, the Executor files Application for Letters Testamentary (or Administration) that include:
  - A. Name, Age and Address of Decedent;
  - B. Date and Place of Death of Decedent;
  - C. Describe Will and Attach Original Will;
  - D. Description and Value of Decedent's Real and Personal Property.
3. The Probate Clerk "posts" Notice of the Probate Case.
4. At Least 10 Days After Posting, the Court Holds a Hearing to Either:
  - A. Hear Challenges to the Will; or
  - B. Issue Letters Testamentary or Administration.
5. The Executor Notifies Creditors, Files an Inventory, Appraisal and List of Claims.
6. The Executor Classifies, Pays or Rejects Claims Against the Estate. Claimants must follow a procedure in order to have an allowed claim. This process may be used to reduce an estate's debts.
7. After All Claims Have Been Paid and/or All Property of Decedent Distributed, the Independent Executor Files an Affidavit With the Court with Supporting Documentation Showing Proper Distribution of Assets According to the Terms of the Will.

*Probate is the formal process of transferring title to assets at death.*

## ESTATE TAX PLANNING

In addition to the other planning that goes into your Estate, if your estate is large enough to be subject to estate tax, you must also plan to either reduce the anticipated estate tax or pay the anticipated estate tax.

### The Four Foundations of Basic Estate Tax Planning:

1. Unlimited Marital Deduction.: A person can give unlimited assets to a spouse at death, estate tax free.

This works great at the death of the first spouse to completely eliminate estate taxes, but a simple will giving all assets to a surviving spouse ensures maximum estate tax upon the death of surviving spouse.

2. Estate Taxes Apply to All Gifts to Persons other than Surviving Spouse.

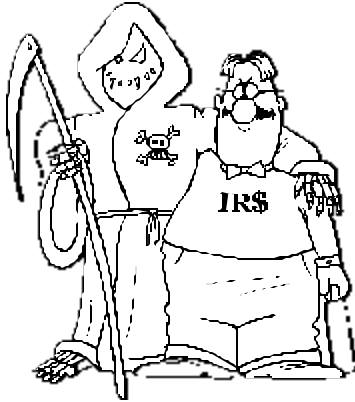
The definition of “persons” includes natural people as well as trusts, corporations, partnerships, companies, and entities.

3. A person can give up to a certain amount of assets to a non-spouse, estate tax free. The amount changes each calendar year. This is the “Exempt Amount.”

Under the new estate tax law, this is the ultimate lottery. How much one can exempt depends completely on when one dies. It is possible to plan the timing of one’s death to completely avoid estate taxes. However, most estate tax professionals expect additional changes to this law within the next few years.

4. A spouse can give assets to a trust for the benefit of the surviving spouse, up to the Exempt Amount, estate tax free. This is called a “Unified Credit Trust.”

A unified credit trust is typically put in a Will or Living Trust in combination with the unlimited marital deduction as follows: “I give up to the Exempt Amount to a Unified Credit Trust, with the remainder to my surviving spouse.”



**The Taxable Value of Your Estate.** The next step is to estimate the taxable value of your estate. In order to do this, you should add up the value of all of the assets of your estate (**NOTE: REMEMBER TO INCLUDE HALF OF THE VALUE OF YOUR COMMUNITY PROPERTY AND ALL OF THE VALUE OF YOUR SEPARATE PROPERTY as explained earlier in this booklet**), and include the death benefit of every life insurance policy you own, control, pay premiums on, or that will pay proceeds to your estate. Deduct from that amount all of your debts, administrative expenses, and you basically have a rough estimate of the taxable value of your Estate.

Because of our community property laws, Husbands and wives often have Estates with different values, particularly where one spouse has more separate property than the other spouse, and so in determining whether your estate is subject to estate tax, each spouse should go through the following exercise separately. Please enter the amount you believe represents the fair market value of your Estate and use the tax rate chart to estimate your Estate Taxes:

You: \_\_\_\_\_ Your Spouse (if applicable): \_\_\_\_\_

In 2001, Congress changed our estate tax laws by implementing a gradual phase-out of the estate tax over 10 years<sup>1</sup>. So, for each of the next ten years, the estate tax calculation will change. For **calendar year 2002**, Section 2001(c) (1) of the Internal Revenue Code of 1986, as amended (most recently by Section 511(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001), imposes the following tax rates on estates:

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000 but not over \$2,000,000	\$555,800 plus 45% of the excess over \$1,500,000
Over \$2,000,000 but not over \$2,500,000	\$780,800 plus 49% of the excess over \$2,000,000
Over \$2,500,000	\$1,025,800 plus 50% of the excess over \$2,500,000

Enter the Amount of Tentative Tax from the table on the prior page:

You: \_\_\_\_\_ Your Spouse (if applicable): \_\_\_\_\_

Next, deduct from that number the amount allowed by the Internal Revenue Code as determined from this chart (use the deduction amount based on the current calendar year):

<i>Calendar Year of Death:</i>	<i>Amount to Deduct:</i>	<i>Estate Value:</i>
1997 and prior:	\$192,800	\$600,000
1998:	\$202,050	\$625,000
1999:	\$211,300	\$650,000
2000 and 2001	\$220,550	\$675,000
<b>2002 and 2003</b>	<b>\$345,800</b>	<b>\$1,000,000</b>
2004 and 2005	\$555,800	\$1,500,000
2006, 2007 and 2008	\$780,800	\$2,000,000
2009	\$1,525,800	\$3,500,000
2010	All	Unlimited

Enter the applicable amount to deduct:

You: \_\_\_\_\_ Your Spouse (if applicable): \_\_\_\_\_

\_\_\_\_\_  
Tax Due

\_\_\_\_\_  
Tax Due

If these numbers are zero or less than zero, then depending upon the accuracy of your estimate of the value of your estate, your estate would owe no estate tax if you passed away today. If this number is more than zero, you probably need to immediately do some financial planning to reduce these estimated Estate Taxes, acquire the life insurance needed to pay the tax, or otherwise determine how

the estate tax will be paid. You also need to make sure your Wills or living trust includes unified credit trusts. Typically, any married couple's combined estate that is near the threshold of owing estate tax should seriously consider unified credit trusts. So, for example, for 2002, any married couple whose combined estate value is nearing \$1 million may benefit from unified credit trusts.

For 2002, the maximum amount one person can give to non-spouses without paying estate taxes is \$1 million. For a couple, an estate valued at up to \$2 million, with proper planning, will pay no estate tax. The following page compares how an estate with a fair market value of \$2,000,000.00 would be taxed under a simple will scenario, with a unified credit trust that is fully funded.

Under present law, each year from now until 2010 or the next change in the law, the amount allowed to be funded into the Unified Credit Trust will gradually increase. See Appendix 2 for the yearly changes. This allows more estates to escape estate taxation, until 2010, when there is no estate tax. Unfortunately, in 2011 the estate tax scheme will revert back to the estate tax scheme of 2001, unless Congress amends the law again. But, in the interim, some estates that would pay estate taxes in 2002 will not be subject to estate taxes in later years. This sets up a form of lottery because whether estate taxes will be due, and if so how much, may depend on the date of your death.

## **HOW TO PLAN TODAY FOR ESTATE TAX CHANGES TOMORROW**

Many estate planning professionals fully expect Congress to change the estate tax laws again in the next several years. While trying to predict Congress is a dangerous proposition, many believe Congress will at some point freeze the estate tax scheme, leaving us at some point with a system that does not change from year to year.

But the probability of changes in the law opens up the question of what to do in the meantime. This author believes planning should be kept at its most flexible during this period of time, and that implementing an estate plan now, and keeping that plan up to date, is more critical now than ever. Your estate plan should fit your family, your goals, and be prepared to pay estate taxes, as though the plan would be tested tomorrow. Looking into the future and only planning for that expected future is far too risky a proposition.

## THE UNIFIED TAX CREDIT: 2002

Estate With Taxable Value of \$2,000,000.00 (combined Husband and Wife)



Simple Will

Death of 1 <sup>st</sup> Spouse
“All to My Surviving Spouse”
Estate: \$2,000,000
Unlimited Marital Deduction
Tax Due: \$0.00
Estate Remaining: \$2,000,000
Surv. Spouse Dies
Tentative Tax: \$780,800 Unified Tax Credit: \$345,800
↓
Tax Due: \$435,000

Estate to Heirs:  
\$1,565,000



Unified Credit Trust  
(A-B)

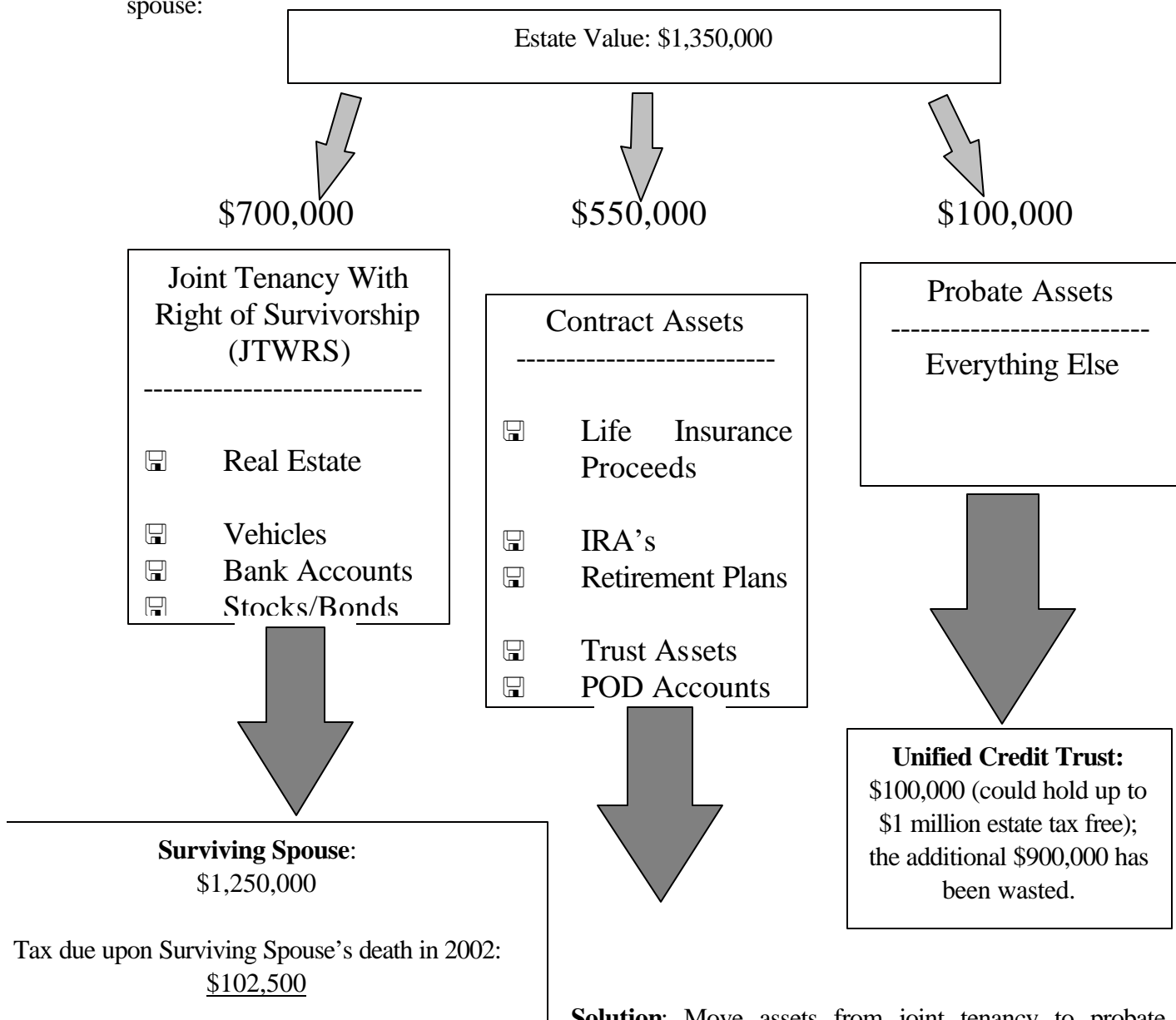
Death of 1 <sup>st</sup> Spouse
→ =
“Give Up to Exempt Amount to Trust; and the Remainder to Surviving Spouse”
Exempt Amount to Trust: \$1,000,000
Tent. Tax: \$345,800 Unified Credit: \$345,800 Tax Due: \$0.00
Estate Remaining: \$1,000,000
Surv. Spouse Dies
No Tax Due (it's not in the surviving spouse's estate)
↓
Tax Due: \$0.00

Estate to Heirs:  
\$2,000,000

Remainder to Wife: \$1,000,000
Unlimited Marital Deduction
Tax Due: \$0.00
Estate Remaining: \$1,000,000
Surv. Spouse Dies
Tentative Tax: \$345,800 Unified Tax Credit: \$345,800
Tax Due: \$0.00



**How Not to Plan: Too Much Joint Tenancy.** Sometimes, an estate that would pay no estate tax with a unified credit trust may end up paying estate taxes because there is not enough value to fund the unified credit trust. For example, an Estate like this where all non-probate assets go to the surviving spouse:



**Solution:** Move assets from joint tenancy to probate category or make some insurance policies payable to the estate. See [Page 17](#) for a diagram of this solution.

## **WHEN SHOULD I PREPARE MY ESTATE PLAN?**

If you have no Estate Plan in writing and validly signed, you should formulate and implement an Estate Plan **immediately**. Since the documents comprising your Estate Plan are not valid unless you are mentally competent when you sign them, it is important to execute the written documents at a time when there is no basis for someone to challenge your mental capacity. In other words, it is very dangerous to wait until you need an Estate Plan for medical reasons before you implement an Estate Plan. Also, we never know what day may be our last.

If your plan includes the transfer of assets to a trust, family limited partnership or other person or entity, the applicable federal and state fraudulent transfer laws allow a creditor to challenge those transfers for up to six years after the date of the transfer; therefore, the Estate Plan should be implemented immediately to so that this time period may expire as soon as possible.

## **WHEN SHOULD I REVIEW MY ESTATE PLAN?**

Any time your estate is affected, you should review your Estate Plan to make sure that your wishes are the same, and to make sure your written plan takes into account the changes in your Estate. Specifically, you should review your Estate Plan immediately when any of the following events happen:

- \*Every Increase in Personal Wealth;
- \*Every Decrease in Personal Wealth;
- \*Every Change in the Amount of Your Debt (such as is usually connected with the purchase of a vehicle or home);
- \*Divorce of a family member;
- \*Birth of a Child or Grandchild;
- \*Adoption of a Child or a Grandchild;
- \*Death of a Spouse;
- \*Receiving an Inheritance or Relatively Substantial Gift;
- \*Move to Another State;
- \*Special Circumstances Relating to a Child, for example, special needs such as education, health or business;
- \*Purchase or Sale of Real Property (including mineral interests);
- \*Purchase of Life Insurance Policies;

- \*Setting Up an IRA Account, 401(k) Account, or employee benefit plan;
- \*Minor Child or Grandchild Becomes an Adult;
- \*Change Desired in Executor, Guardian and/or Trustee;
- \*Prolonged Sickness or Terminal Illness;
- \*Sickness, Bad Health or Incapacity of Spouse, Child or Grandchild;
- \*Admittance of Spouse, Child or Grandchild in Nursing Home or Other Residential Facility.

In any event, your Estate Plan should be reviewed every three (3) years if it is non-estate taxable, whether or not any of these events happen during that time period, and if it is subject to estate taxes, it should be reviewed in November or December of every calendar year as long as the laws continue to change yearly, so that there will be time to make any necessary changes by January 1 of the next year.

## **HOW DO I GET STARTED?**

In order to begin developing and implementing your Estate Plan, please contact our office at **(972) 385-9947** or by Email at [mark@mctexlaw.com](mailto:mark@mctexlaw.com) for an Estate Planning Organizer. After completing the Organizer, please call the office to schedule an appointment. We ask that you also bring a financial statement listing all of your assets and debts, which may as informal as a handwritten list to statements formally prepared by a CPA.

We can then review the Organizer, along with any of your prior Wills and other Estate Planning documents. During the meeting we will map out your Estate and then custom design an Estate Plan that fits your particular needs and achieves your desired goals. I look forward to hearing from you and helping you with this sensitive and important matter.

## ABOUT THE AUTHOR

Mr. J. Mark McPherson is an attorney licensed by the State Bar of Texas in 1990. He began his career as an associate with the Dallas law firm of Mankoff, Hill, Held & Goldberg upon graduation from law school that same year. In March of 1995, he opened his own private practice in Plano, Texas, moving it to Dallas in 2001.

Mr. McPherson's practice includes estate planning for mid-sized to larger estates, business succession planning, and other business transactional matters including commercial real estate. According to McPherson:

*In 2001 we saw substantial changes both in federal estate tax matters as well as state probate laws. More change is expected over the next few years. It is critical for our clients and potential clients to understand how these changes affect their estates, and how changes in their estate affect their beneficiaries. This booklet was written to help educate you about additional estate planning options that benefit you and your loved ones.*

Mr. McPherson earned his law degree from Washington & Lee University in Virginia, where he won numerous Moot Court awards, including both Best Brief and Best Oralist in the John W. Davis Moot Court Competition for second and third year students. Mr. McPherson received his undergraduate degree from Belmont University in Nashville, Tennessee, where he graduated *cum laude*.

Mr. McPherson is admitted to practice before the Supreme Court of the State of Texas and all other Texas state, county and local courts, the United States District Court for the Northern District of Texas, the United States District Court for the Southern District of Texas, the United States District Court for the Eastern District of Texas, and the United States District Court for the Western District of Texas.

Mr. McPherson is or has been a member of the following professional and community organizations:

- ✕ American Bar Association
- ✕ Texas Bar Association
- ✕ Dallas Bar Association
- ✕ Attorneys for Family-Held Enterprises
- ✕ The Estate Planning Council of Dallas
- ✕ The Estate Planning Council of North Texas

*Disclaimer Pursuant to Texas State Bar Rules:*

*J. Mark McPherson is Not Certified by the Texas Board of Legal Specialization in any area of law.*

**Appendix 1:**

**GLOSSARY OF TERMS COMMONLY USED IN ESTATE PLANNING**

**Administrator:**

Person appointed by the Court, in cases where the testator dies without a will, to do the same functions as an executor.

**Beneficiary:** The person(s) who receive the property placed into the trust.

**Claims:** include liabilities of a decedent which survive, including taxes, whether arising in contract or in tort or otherwise, funeral expenses, the expense of a tombstone, expenses of administration, estate and inheritance taxes, and debts due such estates.

**Community Property:**

all property acquired during marriage is community property. Even the income from separate property is community property. All property owned during or held at the dissolution of a marriage is presumed by Texas law to be community property.

**Corporate fiduciary:**

a trust company or bank having trust powers, existing or doing business under the laws of the State of Texas or the United States, which is authorized by law to act under the order or appointment of any court of record, without giving bond, as receiver, trustee, executor, administrator, or, although without general depository powers, depository for any moneys paid into court, or to become sole guarantor or surety in or upon any bond required to be given under the laws of Texas.

**Decedent:** a legal term used to refer to a person who has passed away.

**Devise:** when used as a noun includes a testamentary disposition of real or personal property, or of both. When used as a verb, “devise” means to dispose of real or personal property, or both, by Will.

**Devisee:** includes legatee.

**Distributee:** denotes a person entitled to the estate of a decedent under a lawful Will, or under the statutes of descent and distribution.

**Estate:** a person’s entire property, more particularly property left at death; an estate is said to be closed when the decedent’s will has been carried out, or when, if no will is left, the estate has been divided in accordance with state laws.

**Exempt property:**

refers to that property of a decedent's estate which is exempt from execution or forced sale by the Constitution or laws of the State of Texas, and to the allowance in lieu thereof.

**Executor:**

Person you designate in your will that collects the assets of the estate, protects the property against loss or harm, asserts any claims against third parties which the deceased or the estate may have, values and inventories the property, liquidates assets, pays all debts and expenses, prepares and files estate and income tax returns. The duties end when the beneficiaries are accounted to and the property is distributed to the beneficiaries. The executor is a fiduciary. If he acts recklessly or imprudently, then he will be held responsible and personally liable for any consequent loss.

**Heirs:**

denote those persons, including the surviving spouse, who are entitled under the statutes of descent and distribution to the estate of a decedent who dies intestate.

**Incapacitated:**

(1) a minor; (2) an adult individual who, because of a physical or mental condition, is substantially unable to provide food, clothing, or shelter for himself or herself, to care for the individual's own physical health, or to manage the individual's own financial affairs; (iii) a missing person; (iv) a person who must have a guardian appointed to receive funds due the person from any governmental source.

**Independent executor:**

the personal representative of an estate under independent administration. The term is the same as "independent administrator."

**Inter Vivos**

**Trusts:**

trusts created during the settlor's lifetime. These may be revocable or irrevocable. A revocable trust is one that the settlor may revoke at any time; nothing is given away or signed over to someone else for management. It is simply a way for a property owner to manage his affairs efficiently while avoiding problems associated with inheritance and estate taxes. An irrevocable trust is permanent; it cannot be revoked by the settlor. Property placed into an irrevocable trust is put into the hands of the trustee with no strings attached.

**Interested persons:**

heirs, devisees, spouses, creditors, or any other s having a property right in, or claim against, the estate being administered; and anyone interested in the welfare of a minor or incompetent ward.

**Legacy:** includes any gift or devise by Will, whether of personal or real property. “Legatee” includes any person entitled to a legacy under a Will.

**Minors:** all persons under eighteen years of age who have never been married or who have not had disabilities of minority removed for general purposes.

**Next of kin:** includes an adopted child or his or her descendants and the adoptive parent of the adopted child.

**Personal property:**  
includes interests in goods, money, choses in action, evidence of debts, and chattels real.

**Personal representative:**  
includes executor, independent executor, administrator, independent administrator, temporary administrator, together with their successors.

**Real property:**  
includes estates and interests in lands, corporeal or incorporeal, legal or equitable, other than chattels real.

**Separate Property:**  
property owned by a spouse before marriage, property acquired during marriage by gift, Will or inheritance, and a tort recovery for your personal injury sustained during marriage, with the exception of a recovery for loss of earning capacity during marriage. Property purchased with separate property is also separate property.

**Settlor:** the individual who owns property and takes the legal steps to place it into the trust.

### **Testamentary**

**Trusts:** trusts created by a will.

**Trust:** a form of property that a person, group of persons, or company holds and manages for the benefit of another. When a trust is created, title to the Trust Property and the responsibility for managing it is vested in the Trustee.

**TrustInstrument:**the written document that establishes the Trust, appoints the Trustee, designates the Beneficiaries, and includes other terms and conditions relating to the operation of the Trust.

**Trust**

**Property:** the property placed in the trust. It may include real estate, stocks, bonds, insurance policies, government securities, bank accounts, mortgages, and other forms of property.

**Trustee:** the person to whom management of the Trust Property is legally entrusted. This may be an individual such as a relative, friend or business associate whom the settlor believes will deal responsibly with his affairs. Or the trustee may be assigned to a corporation such as a bank or trust company. A trustee has several significant duties. A trustee must: carefully manage the property in the trust as though it were his or her own; act loyally toward all of the beneficiaries in all trust administration matters; defend the trust against attack; protect the property in all reasonable ways; make an inventory of all assets and keeping records of all transactions; pay operating expenses of the trust from trust property; pay out trust income and capital to the beneficiaries when required to do so by the terms of the Trust Instrument. If a trustee violates his obligation by making unlawful investments, failing to pay beneficiaries, making outrageous charges for services, conveying trust property to those unauthorized to receive it, or other wrongful action, he may be held liable by the beneficiaries for any loss.

**Will:** (1) a legal document assigning property to survivors upon the death of the property owner; (2) the legal transaction by which an owner of property transfers assets in the event of death. A will does not take effect until the testator's death, and it can be revoked or altered until then. A will is not considered valid if, when it is made, the testator is mentally incompetent, acting under coercion, or trying to perpetuate a fraud. Witnessed wills can fail if the witnesses signed out of the testator's line of sight or for other minor reasons. Drafting a will can be complicated by a diversity of state laws on inheritance and by varying tax problems. Because of the legal complexities, it is prudent for a testator to draft a will with expert legal assistance and to appoint as executor someone who will see that the provisions of the will are carried out properly.

**Appendix 2:**

**ESTATE TAX RATES FOR 2003-2010**

**2003:**

**(Estate Tax Credit: \$345,800)**

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000 but not over \$2,000,000	\$555,800 plus 45% of the excess over \$1,500,000
Over \$2,000,000	\$780,800 plus 49% of the excess over \$2,000,000

**2004:**

**(Estate Tax Credit: \$555,800)**

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000 but not over \$2,000,000	\$555,800 plus 45% of the excess over \$1,500,000
Over \$2,000,000	\$780,800 plus 48% of the excess over \$2,000,000

**2005:**

**(Estate Tax Credit: \$555,800)**

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000 but not over \$2,000,000	\$555,800 plus 45% of the excess over \$1,500,000
Over \$2,000,000	\$780,800 plus 47% of the excess over \$2,000,000

**2006:**  
**(Estate Tax Credit: \$780,000)**

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000 but not over \$2,000,000	\$555,800 plus 45% of the excess over \$1,500,000
Over \$2,000,000	\$780,800 plus 46% of the excess over \$2,000,000

**2007 and 2008:**  
**(Estate Tax Credit: \$780,800)**

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000	\$555,800 plus 45% of the excess over \$1,500,000

**2009:**  
**(Estate Tax Credit: \$1,525,800)**

<i>If the Fair Market Value of the Estate is:</i>	<i>The Tentative Tax is:</i>
Over \$1,000,000 but not over \$1,250,000	\$345,800 plus 41% of the excess over \$1,000,000
Over \$1,250,000 but not over \$1,500,000	\$448,300 plus 43% of the excess over \$1,250,000
Over \$1,500,000	\$555,800 plus 45% of the excess over \$1,500,000

**2010:**  
**Complete Repeal of the Estate Tax And**  
**Implementation of Very Complex Rules**  
**For Allocation of Limited Stepped Up Basis to Assets**

**2011:**  
**Reinstatement of the Estate Tax**

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## **Using Pre-2002 Rates and Unified Credits**