ESTATE PLANNING WHAT CAN I DO FOR MY PETS?

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Introduction

Your dog is your passion. He, she or them, as in my house, are treated as an important part of your family. Or your dog is part of a sophisticated business venture with multiple owners and different interests. Sometimes the two intertwine. When you sit down with your attorney to discuss your estate planning it is sometimes awkward to reveal your passion or concerns about what will happen to your dog when you die or the complexity of the business relationships you may have with other individuals which have not been properly documented in writing.

Estate Planning covers a myriad of topics. Most clients who meet with an attorney about estate planning want to discuss three main issues. Their goals are to 1) avoid the probate court, 2) lower their estate taxes and 3) discuss distribution planning. Distribution planning is the who gets what and when of any estate plan. No matter the amount of wealth that you have this is the main issue which needs to be resolved. Estate taxes and probate, while concerns in many situations, are put on the back burner by the distribution planning issues.

We are going to cover various estate planning issues regarding your dogs. However, it is important to understand the basics of estate taxes, what is probate and what the differences are between wills and trusts. Some of the nuances will

change from state to state depending upon where you live. Each state has different probate laws and procedures and there may be an state level estate tax in your state while in another state there is no such tax. The basic concepts will provide you with a good understanding of the issues which you should raise with your estate planning attorney.

Estate Taxes

Congress has provided for a tax upon your death called an estate tax. The value of your assets less your liabilities is subject to the estate tax. While this may seem unfair, Congress has provided two items which counteract the effect of the estate tax. First, at your death there is a step up in basis to fair market value for your after tax investments. This means that if you have a highly appreciated asset the cost basis is increased at your death to fair market value removing the realized gain for your beneficiaries. For example, you bought a dog for $1000.00. He turns out to be the national champion for three straight years and you can sell him for $30,000.00. Your cost basis is $1,000 and if you sold him for $30,000 you would have gain of $29,000 and have to report the $29,000 on your income tax return for the year of sale. If you die owning the dog the cost basis is increased to $30,000.00 (fair market value as of date of death)[1] Whoever inherited the dog if

[1]Fair market value is determined by appraisal, market value (stocks and mutual funds) or other approved methods. Appraisals need to be in writing.

he turned around and sold him would have no gain or loss on the sale. The cost basis would be $30,000.00 therefore having no taxable income. The sale would still need to be reported on the seller's income tax return.

Second, Congress provides for an federal estate tax exclusion amount. The current value of the exclusion is $2,000,000.00 per person. The exclusion amount is scheduled to increase in 2009 to $3,5000,000.00 but return to $1,000,000.00 in 2011. There are no federal estate taxes in 2010. The reason for the fluctuation is the 2001 tax law changes are temporary not permanent and are set to expire on December 31, 2010. The crystal ball is cloudy for those who predict the future estate tax changes. As we approach the December 2010 sunset date it is looking more and more likely that the estate tax repeal is only for one year. In fact, depending upon the 2008 election it is possible that the repeal may never take place for 2010 depending upon Congress's mood as it approaches its budget issues in 2009.

The benefit to you is that a portion of your estate will pass federal estate tax free to your family. Assets that pass between spouses pass estate tax free with certain exceptions.[2] For most individuals the estate tax exclusion will eliminate any estate tax. However, if your gross estate is in excess or approaching

[2]If the surviving spouse is a non U.S. citizen there can be an estate tax at the first death. Non U.S. citizens require specialized documents to meet their estate planning goals

$1,000,000.00 then you should consider sitting down with an estate planning attorney to walk through the various tax issues along with the distribution issues. Proper use of your federal exclusion amount can save your heirs hundreds of thousands of dollars. How do you compute your gross estate? It's the fair market value of all of your assets including the death benefit from any life insurance policies which you control. This includes your house, stocks, mutual funds, IRA and other retirement accounts and business investments. When you include the death benefit from life insurance it is not difficult to have a gross estate near $1,000,000.

Probate

The word probate conjures up many thoughts for people. The probate process is the legal method of how your assets which are solely owned by you and not being transferred at your death because of joint ownership with rights of survivorship, beneficiary designation or by a revocable living trust are transferred at your death. Assets that are solely in your own name at your death will need to be transferred either through probate or alternative means if provided for by your state probate statutes. There are alternative methods to transfer assets other than through the probate court system. However, each method may have benefits or negatives which should be discussed before you proceed with them.

If you have a Last Will and Testament ("Will") it strictly provides guidance and direction to the probate court. Having a will does not help you avoid the

probate system. A will nominates your personal representative or executor of your estate who is then approved by the probate court. Real estate, homes, vacant land and some types of time shares will need to be probated in the state where the property is located. A will should also describe who are the beneficiaries of your estate. Typically a will does not provide any estate tax planning or well thought out distribution planning.

The local probate court where you resided at your death has jurisdiction over your probate estate. Each state's system is different. Some states have simplified the probate process when the probate estate's value is under a statutory dollar amount. Other state's have simplified their probate system for all estates. The probate system can be time consuming and costly in situations where there are family disagreements, complications and minor children or special needs. Also, some states still have attorney fees based upon the size of the estate rather than upon the time spent working through the probate system. Most probate estates are opened and closed within one year. However, the process does vary from state to state.

Revocable Trusts

Revocable Living Trusts ("RLT") are estate planning documents which can provide for probate avoidance, estate tax planning, privacy and most importantly distribution planning. RLT's became more popular in the last 25 years as the

middle class's wealth has increased due to the growth of stock market and increased home values. RLT's have been used by wealthy families for years. The federal estate tax laws began to effect more upper middle class and middle class families when the federal estate tax exclusion amount was fixed at $600,000.00 for ten years (1987-1997) while the stock market and home prices increasing. RLT's have become the primary estate planning tools for many people no matter their wealth. Due to their flexibility the benefits of a RLT outweigh the costs for many people. Privacy and distribution planning are worth the extra cost for many people.

A RLT is a written agreement which sets forth who gets what and when (beneficiaries and distribution provisions). If funded during lifetime or upon death, except through the probate court, there is no public disclosure of the trust assets or the distribution provisions. Funding the trust requires changing the ownership or beneficiary designation of assets into the RLT's name.

A RLT can also provide estate tax planning for a married couple through use of the federal exclusion amount at the first death. Estate tax planning through a RLT is beneficial for married couples whose estates exceed $1,000,000. Basic planning with a RLT could save hundreds of thousands in estate taxes.

For most people the distribution benefits are the primary reason for a RLT. A will is controlled through the probate court. If there is a situation where children

or other relatives need to be provided for or just should not receive their inheritance outright in a lump sum a trust can describe when the beneficiary should receive the funds and who should be in charge. Distribution terms are outlined in the RLT. For example, if you have children your trust may state that upon my death the assets are held in trust with principal and income distributions in the trustees discretion until my child reaches age 25. Once the child reaches age 25 the child receives 1/3 of the principal and ½ of the remainder at age 30 and the remainder at age 35. The trustee becomes the financial parent determining how and when the trust assets are distributed. The Pet Trust concepts described below have grown out of RLT distribution provisions.

Planning For My Pets

On a regular basis clients ask what will happen to my beloved dog upon my death or disability. For some people the discussion is a simple as one of the kids will take the dog. The next level is "I want to provide financial support for my dog and my sister who will take her once I am gone". At this level, the client is looking to gift the dog and a dollar amount directly to the care giver without any controls or checks and balances. For example, their estate planning documents will indicate that my dog and $10,000.00 to my sister Sarah. There is a good faith belief that Sarah will take care of the pet and the financial gift will help compensate for the annual costs. There are no checks and balances with this type of planning. It is

important to ask the caregiver that they are willing and able to take care of your pets in the event of a lifetime issue or death.

Pets are considered personal property under most probate codes. Personal property which is not specifically provided for will be distributed to under the probate codes distribution provisions. Typically, first to the surviving spouse and then to your children. The problem lies in the short term issues. Who should have immediate control over your pet? This should be planned for in writing to cover not only death but illness or other untimely emergencies. Estate planning can help you not only work through potential solutions to these questions but help provide you with peace of mind.

As Americans have been spending billions of dollars on their pets, the increased use of sophisticated estate planning documents by more people the concept of a Pet Trust was developed. Many states have enacted statutes providing for Pet Trust language. There are currently over 30 states with statutory provisions for your pet.

A Pet Trust is a written agreement which provides for a care giver, the person who the pets live with, and a trustee, who controls the money, for the benefit of a pet. The trust can provide detailed instructions for care and provides a check and balance that the pet is actually being taken care of by the care giver.

A Pet Trust is a written agreement where the grantor/settlor, the person setting up the trust, outlines what should happen to their pet. Key items to consider:

-The name and address of the Trustee and a Successor Trustee

-The name and address of the care giver and Successor care giver

-Detailed information about your pet so they can be identified such as microchip or DNA information

-Guidelines on how often the Trustee should inspect the situation

-How funds should be distributed to the care giver.

-Details of your pet's needs including food, vet, health issues and other day to day matters can be attached as an exhibit

-Final disposition of your pet's remains

-What should happen to the remaining assets after the death of your pet

Typically, the Pet Trust will not be "funded" until the owner has died. The owner through a beneficiary designation or their other estate planning documents will designate financial assets[3] to be turned over to the Pet Trust and the Trustee. How much is enough to leave? This answer depends upon the age, health, life span, number of pets and your financial resources. If you provide too little, will the care giver be able to provide for your pet out of their own funds? If you provide too much it can be challenged by your other heirs. Some states provide by statute that

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[3]Not everyone is Leona Helmsley providing $12 million dollars for her dog's Pet Trust

the local probate court can reduce the amount if its deemed excessive. You may want to counter act the family by providing that the excessive distribution is distributed to charity rather than the family. You need to be realistic in the long term costs of maintaining your pet. Various factors including longevity, current health issues and the number of pets must be considered.

Pet Trusts will follow normal trust taxation other then distributions are not a deduction to the trust. Trust income is subject to federal and state income taxes. The trustee will be responsible for preparing, filing and payment of the trust taxes.

Powers of Attorney

What happens to your dog when you end up in a nursing home or retirement facility? Individuals who have planned ahead may not have any pets in their lives as the get older. However, we never know when a health issue will strike. Strokes, car accidents or unforeseen incidents can immediately create a stressful situation when you are unable to take care of your dog. When you are unable to act on your own behalf to make business decisions there are two distinct avenues which you may be forced to walk down.

As part of your estate plan you should have your state's version of a General Durable Power of Attorney ("POA"). A POA is a written agreement whereby you

appoint someone to be your attorney in fact or agent when you are unable to act on your own behalf. If you don't have a POA then some one will be appointed as your guardian/conservator of your assets. This second method requires the probate courts involvement. This logistics of having a person appointed your guardian may take weeks.

It may be prudent to address your pets in a POA. The POA can also indicate what should happen to your pets such as placement in a rescue program or their custody given to a relative or friend. Most POA's do not specifically provide for pets but would be covered under the general provisions dealing with your personal property. You should consider specific provisions including the transferring of ownership to the ultimate care giver if its not your agent named in the POA.

Am I Running A Business?

How many dogs do you own or co-own? Do you have a written contract between yourself and the other co-owners? Have I or should I consider incorporating my kennel operations? How does this effect my estate planning? If you are here at the National Specialty show you probably own more than one Berner. In fact, you may own your Berner with other people listed a co-owner due to your breeding agreements and friendships. What happens when you die? Who owns your dogs? Is your ownership interest passed on to your estate or does the other co-owner own the dog outright? Do you have any of this in writing?

The business side of being a breeder needs to be explored with your legal counsel particularly in the tax and estate planning areas. Detailed written agreements between co-owners is an important legal document for your heirs. A co-ownership agreement should in great detail indicate the financial relationship between the co-owners. Co-Owners need to agree on who pays or the percentage for each owner to contribute for health care issues; travel and show expenses and rights to puppies or breeding stock. Without an agreement, there can be disagreements over common issues which arise in a co-ownership situation.

A co-ownership agreement can tie into your estate planning. If you are a co-owner of a dog, not with your spouse, and you die what happens to your ownership interest? Typically, your ownership interest would become a probate asset. The ownership does not pass directly to the co-owner. Now your spouse or children will become co-owners after your interests pass through the terms of your will or by intestate through the appropriate probate court. They may not see eye to eye with your surviving co-owner. A written agreement between co-owners can bind your estate to ownership issues including ultimate ownership of your prized dog.

Conclusion

When doing your estate planning you need to consider what happens to your pets. Most people leave this issue to chance. Raising the issue with your estate

planning attorney will allow you to proactively think through the various options that are available. In the more sophisticated situations of kennels and joint ownership with non family members it can provide a detailed road map to allow a smooth transition for your loved pets during a difficult time period.