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PRIVATE WEALTH MANAGEMENT

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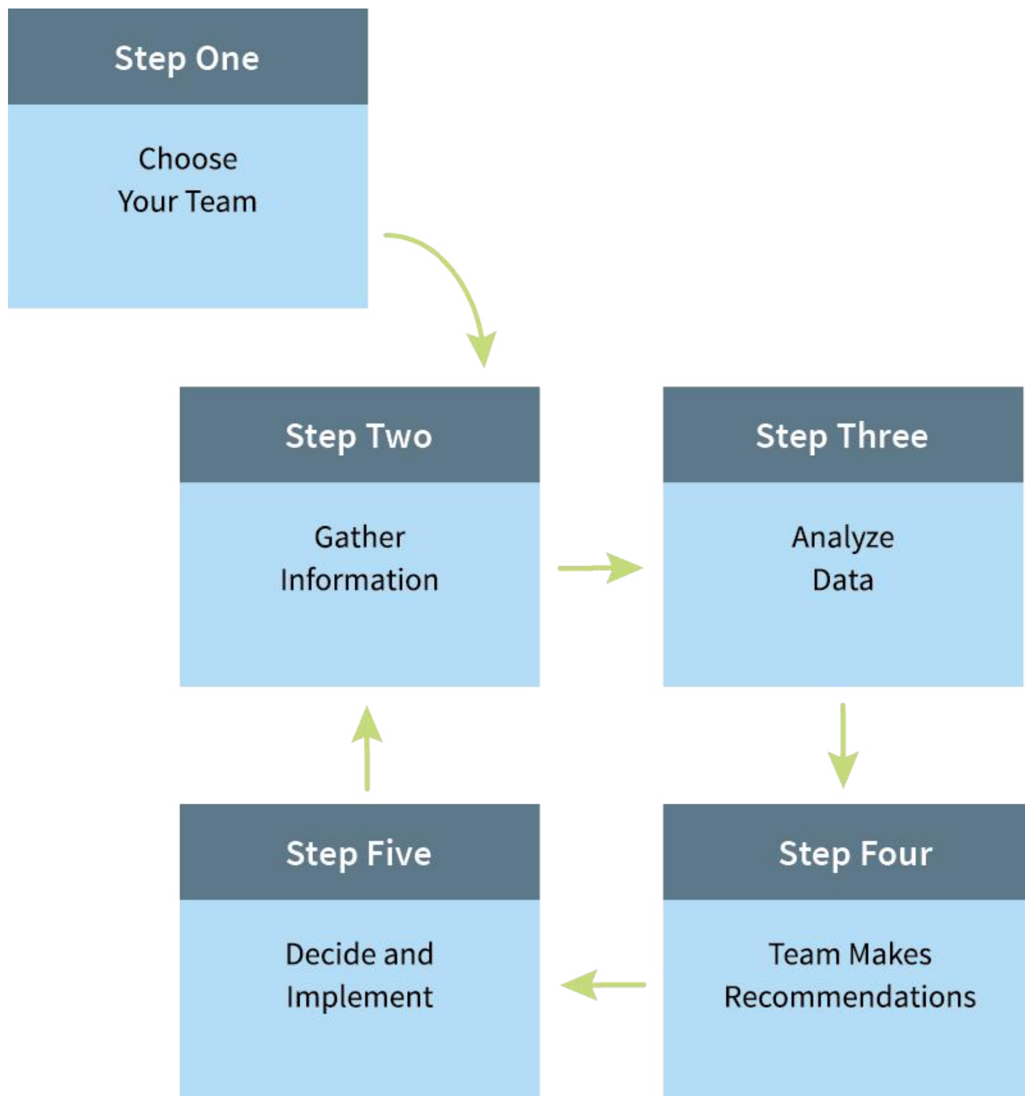
Basic Steps in the Estate Planning Process

There are basic steps to take in planning your estate. A typical program would be as follows:



Basic Steps in the Estate Planning Process

The Basic Steps

- **Choose your team:** Choose, as needed, your attorney, tax professional, insurance professional, trust officer, planned-giving specialist or financial professional.
- **Gather information:** A completed fact finder serves to list your goals and objectives, shows names, ages, assets and liabilities, and desired heirs.
- **Analyze data:** Pretend death occurred yesterday. What happens to your estate, your business, and your family? What if you die 10 years from now? Your team analyzes the data to provide you with the results.
- **Team makes recommendations:** Review the suggestions made by your team to overcome current plan shortcomings.
- **Decide and implement:** Select the plan that best fits your needs and goals. Sign essential documents (e.g. wills and trusts), transfer title to assets into trust names, purchase needed insurance, and change investments as necessary.
- **Periodic review:** Starting the cycle over. Because the world – and your situation – are constantly subject to change, many advisors recommend an annual planning review.

Choose the Estate Planning Team

Estate planning is a complex field that covers many areas including wills, trusts, insurance, accounting, business continuation, and estate, gift, and income taxes. It would be difficult to find one person who is a trained and licensed expert in all of these areas. Most often, the needed skills and knowledge are available only by bringing together an Estate Planning Team. The various members of the team can then work closely to preserve the estate and pass it on to the heirs with the least amount of expense and aggravation. Potential members of the team may include the following.

Estate Planning Attorney

Most attorneys can draft a basic will. However, one who specializes in estate planning law will be more familiar with the various tools and techniques available to save you and your heirs thousands of dollars in taxes, probate and administration expenses.

Tax Professional

Federal and state laws require that a number of income and estate tax returns be filed shortly after your demise. Even in the simplest of situations, properly completing these tax returns can be a complex and confusing process. These returns will be even more involved if you own a business or rental real estate.

Insurance Professional

Life insurance is often utilized in estate planning solutions. Contracts differ greatly and are issued by companies with varying degrees of financial strength.

A life insurance professional will help you choose a financially strong company, the correct type of policy for your situation, and the correct amount of insurance. Determining who will be the owner of a life insurance policy is a key question. The answer can add or avoid hundreds of thousands of dollars in estate taxes.

Choose the Estate Planning Team

Trust Administrator

If you select a corporate fiduciary (a bank or trust company) as executor of your will or trustee of your trust, you should consider involving them in the development of your estate plan.

Sometimes they have important provisions which should be added to the will or trust document to help them administer the estate.

Planned-Giving Specialist

Charitable organizations often have planned-giving specialists who are well versed in methods of making lifetime gifts or bequests at the time of death, which can benefit you, your heirs, and your favorite charities.

Financial Professional

Sometimes the life insurance professional, accountant, or other member of the estate planning team may have special training in financial planning. Other times, a person who specializes in financial planning may be part of your team. If so, he or she will often take a very active part in directing the formation of the overall estate plan.

The Captain of the Team

You are the captain of the team. The final decisions must be made by you after carefully reviewing the recommendations of the other members of your estate planning team.

Key Estate Planning Considerations

Although Congressional action has effectively eliminated federal estate and gift taxes for all but the wealthiest Americans, there is still a vital need to do estate planning.

Why? There are several key reasons: (1) to be sure that all of your wishes are followed after death; (2) to plan for *state* inheritance or estate taxes, if you live (or own property) in a state which levies such a tax; and (3) to plan in advance how to pay for any estate settlement costs. Federal estate tax law may have changed, but estate planning *still* matters.

Transfer of Assets

A primary objective is to insure that your assets go to those you want to receive them.

Method	Description
Will	Considered a key element in any estate plan, a will is a legal document, prepared under state law, which names those who should receive your property. An "executor" is generally named in the will to carry out your wishes. After death, "probate" will be required, a process in which the property listed in the will is distributed to the named heirs under court supervision. Unfortunately, the probate process is frequently expensive and time-consuming, and generally makes the contents of a will a public record. If you die without a will (termed "intestate"), your property will be distributed according to state law, which may result in your assets being distributed in a manner *not* in accordance with your wishes.
Revocable Trust	Also known as a "living" trust, a revocable trust can be changed or revoked during the lifetime of the trust creator (the "grantor," "settlor," or "trustor"). Such a trust is often used as a will substitute, when the grantor transfers assets into the trust during life or at death through a "pour-over" will. A revocable trust can make settling a decedent's estate easier and less expensive than probating a will and can also provide privacy not available in probate.
Irrevocable Trust	An irrevocable trust – as the name implies – cannot be changed once it is set up. These trusts are often used in estate planning for wealthy individuals. An irrevocable trust which holds life insurance can provide the funds needed to pay death taxes and other estate settlement expenses, while keeping the life insurance proceeds outside of the taxable estate.

Method	Description
Joint Tenancy	Assets held in joint tenancy pass automatically at the time of death to the surviving joint owner, if living. In community property states, community property with right of survivorship has the same result. How ownership of an asset is "titled" can be important.
Beneficiary Designations	Some assets, such as life insurance policies, qualified retirement plans, and IRAs allow the owner to name a "beneficiary." At death, the policy death benefit or title to the asset automatically passes to the named beneficiary or beneficiaries. In some states, "Transfer-on-Death," (TOD) and "Pay-on-Death" (POD) allow certain types of property to automatically pass to named beneficiaries upon the death of the owner. Proper beneficiary designations are essential to make sure the assets pass according to your wishes.

Planning for Estate Transfer Costs

If proper prior planning is not done, estate and inheritance taxes, legal fees, and other estate settlement expenses can significantly reduce the legacy passing to your intended heirs.

Planning for estate settlement costs: Making maximum use of non-probate transfer methods such as revocable trusts, joint tenancy, community property with right of survivorship, or named beneficiaries, can help limit estate settlement costs and avoid the delay of probate.

Planning for estate taxes:[1] If the dollar value of an estate is large enough to be subject to estate and/or inheritance taxes, these taxes can add appreciably to transfer costs. In 2020, an estate with a net value of $11,580,000[2] or less is exempt from federal estate tax. This federal estate tax threshold is also known as the "applicable exclusion amount." However, most states with an estate or inheritance tax have estate tax thresholds which are considerably lower. Thus, an estate which has no federal estate tax liability could easily be subject to state death taxes.

Under federal estate tax law there are a number of ways to shrink the taxable estate:

- **Lifetime gifts:** each individual has an annual gift tax exclusion, currently $15,000[2] per person per year, generally allowing for tax-free gifts to others.

[1] The discussion here primarily concerns federal law; state or local law may differ.

[2] Source: Internal Revenue Service (IRS). 2020 value. This amount is subject to adjustment for inflation in future years.

- **Marital deduction:** spouses who are both U.S. citizens can gift any amount to each other, generally with no estate or gift tax consequences. The survivor's now larger estate could face a greater estate tax problem when he or she later dies.

- **Charitable giving:** gifts to charities, during life or at death, reduce the estate size.
- **Bypass trust:** A type of trust known as a "bypass" trust allows the first-to-die of a married couple to set aside a portion of his or her assets. In years before 2011, such trusts were used in an effort not to "waste" the first-to-die's applicable exclusion amount. With the applicable exclusion amount currently set at a very high level, plus the introduction in 2011 of the "Deceased Spousal Unused Exclusion" (see below), for *federal estate tax* purposes at least, the bypass trust is less useful than before. When planning for *state death taxes*, however, often with much lower taxability thresholds, the bypass trust remains a useful estate planning tool.[1]

- **Deceased spouse unused exclusion (DSUE):** Beginning in 2011, a change in federal estate tax law provided that any portion of the applicable exclusion amount that remained unused at the death of a spouse could be held over and made available for use by the surviving spouse, in addition to the surviving spouse's own applicable exclusion amount. This "portability" opened up new planning opportunities that did not exist under prior law.

Paying estate settlement costs: While careful planning can help reduce estate settlement expenses, the planning process also needs to consider how to pay for the costs that do remain. There may be a need for funds to sustain the family until the estate is settled, to pay off debt or otherwise provide for the surviving spouse or children. An estate will often need to sell assets to raise the needed cash. While some assets are relatively liquid, others may take months or even years to be sold. Working with your investment advisor, you may need to rearrange some of your assets to provide increased liquidity to your estate. If there are currently not enough liquid assets in the estate, consider life insurance as a way to provide the needed funds.

Caring for Survivors

Your survivors – a spouse, minor children, or a disabled child of any age – must also be considered in the estate plan.

[1] There may also be other, *non-tax* reasons, for including a bypass trust in an estate plan.

A guardian for dependents: In case both parents are deceased, a guardian (and one or more alternates) should be named to care for minor children or other dependents.

Asset management: Professional asset management may be necessary to insure that financial resources are not squandered.

Who Makes Medical Decisions When I Cannot?

Modern medicine can now keep someone "alive" in situations that formerly would have resulted in death. Those who do not wish to have their lives artificially prolonged by such techniques must plan ahead and put their wishes in writing:

"Living Will": Also known as a "Directive to Physicians", this document provides guidance as to the type of medical treatment to be provided or withheld and the general circumstances under which the directive applies.

Durable power of attorney for health care: Many states have laws allowing a person to appoint someone to make health care decisions for them if they become unable to do so for themselves.

Durable power of attorney for financial affairs: Allows another individual to act on your behalf with regard to financial matters in the event of your incapacity.

Outside the Legal Framework

Most of the documents involved in an estate plan are legal in nature and should be prepared by an attorney. However, not all documents involved in an estate plan are legal ones:

Letter of Instructions: A "Letter of Instructions" is an informal document that can include information such as your wishes regarding disposition of your remains, contact information for key advisors and family members, the location of important documents, the description and location of assets, user names and passwords for online accounts, or notes on family history. It is used to provide, in a private manner, direction and guidance to your family or executor in settling your estate.

Ethical Will: While a legal will or a trust is used to distribute assets, an "Ethical Will" serves to transfer values and beliefs. It is a very personal expression of the writer's life and values as

well as the people, events, and experiences that influenced that life. In a very real sense, an ethical will is a spiritual legacy to future generations.

Seek Professional Guidance

Although an estate plan can be as simple as a set of hand-written instructions, there are a number of situations where legal guidance is considered vital:

To create a will or trust: An experienced attorney, familiar with local law, can prepare the legal documents required to meet the needs of your individual situation.

Estate taxes: If your estate is large enough to be subject to estate tax, your attorney can suggest ways to lighten the tax burden.

Squabbling heirs: Planning may be needed to minimize potential conflicts between your heirs or beneficiaries. Such disputes can occur when siblings don’t get along or there are children from more than one marriage.

Property elsewhere: If you own property in more than one state or country, there may be a need for an ancillary probate. Living trusts are often used to transfer these assets and avoid the additional probate.

In addition to your attorney, your estate planning “team” will likely include experts from other disciplines such as income tax, life insurance, trust administration, charitable giving, and investment management. The professional guidance provided by such advisors is a key part of creating and implementing a successful estate plan.

Periodic Review

Because tax law and personal lives are never static, don’t just put your estate plan in a drawer and forget about it. Many financial professionals recommend a periodic estate plan review.

Federal Estate Tax Tables

Recent Federal Estate Tax Changes

The past few years have seen a parade of changes to the federal estate tax. Under the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), the federal estate tax underwent a number of scheduled changes during the years 2002-2010. During this period, the top federal estate tax rate decreased, while the dollar amount of assets that could be transferred at death free of estate tax gradually increased. Under EGTRRA, the federal estate tax even completely disappeared for one year, 2010.

The 2010 Tax Relief Act temporarily extended many of the tax provisions of EGTRRA. Under this legislation, in 2012, a top marginal rate of 35% applied to taxable transfers in excess of $500,000, with an "applicable exclusion amount" of $5,120,000. The applicable exclusion amount is the dollar amount of assets protected from estate tax by an individual's "applicable credit amount."

The American Taxpayer Relief Act of 2012 (ATRA 2012), effective in 2013, provided for a top marginal estate tax rate of 40%, on taxable transfers in excess of $1,000,000.

Finally, the Tax Cuts and Jobs Act of 2017, (TCJA), for 2018-2025, doubled the applicable exclusion amount from $5,000,000 under prior law, to $10,000,000. Adjusted for inflation, the applicable exclusion amount for 2020 is $11,580,000, equal to an applicable credit amount of $4,577,800. Both of these values are subject to adjustment for inflation in future years. Under the TCJA, the applicable exclusion amount (and the equivalent applicable credit amount) will return to the $5,000,000 level, adjusted for inflation, in 2026.

Federal Estate Tax Table

The following table applies to the taxable estates of individuals dying in 2020. In simple terms, the "taxable" estate is a decedent's gross estate (everything he or she owned on the date of death) less transfers to a spouse, gifts to charity, and taxes and other allowable estate expenses.

Under current law, this tax rate table is not scheduled to change in future years.

Federal Estate Tax Tables

If Taxable Estate…		Tentative Tax Is…		
Is Over…	But Not Over…	Tax	Plus %	Of Excess Over…
$0	$10,000	$0	18.00%	$0
10,000	20,000	1,800	20.00%	10,000
20,000	40,000	3,800	22.00%	20,000
40,000	60,000	8,200	24.00%	40,000
60,000	80,000	13,000	26.00%	60,000
80,000	100,000	18,200	28.00%	80,000
100,000	150,000	23,800	30.00%	100,000
150,000	250,000	38,800	32.00%	150,000
250,000	500,000	70,800	34.00%	250,000
500,000	750,000	155,800	37.00%	500,000
750,000	1,000,000	248,300	39.00%	750,000
1,000,000	and up	345,800	40.00%	1,000,000

Avoiding Probate

The probating of a will permits a court of law to supervise the transfer of assets from the decedent to his or her heirs. A typical probate lasts about one year, with six months generally being a minimum time if everything proceeds according to schedule.

Because of high attorney's fees, executor's commissions and court costs, and the often-unwanted publicity and the time delay involved in probating an estate, many people attempt to avoid probate administration. Some of the methods of avoidance are listed below.

Joint Tenancy

Joint tenancy is a form of title arrangement, usually between spouses. The joint tenancy is dissolved after one tenant dies, with title passing automatically to the surviving joint tenant. There may be income tax disadvantages to this arrangement. Creditors of either joint tenant can attach the asset. It may also frustrate estate tax savings which are anticipated from carefully drafted wills and trusts.

Community Property with Rights of Survivorship

Title passes automatically to the surviving spouse with no income tax disadvantages as with joint tenancy.

Totten Trust

A Totten trust is a vehicle for passing savings accounts to heirs. Passbook accounts are held in trust for another. Typical wording would be: "John Doe, in trust for Johnny Doe."

Life Insurance

The proceeds of life insurance are rarely subject to probate administration, unless the insured's estate is the beneficiary or all of the named beneficiaries pre-decease the insured.

Lifetime Gifts

Even gifts made shortly prior to death will avoid probate. However, they may be brought back into the estate for death tax purposes. Also, gifts carry the donor's basis to the donee, whereas appreciated assets in the decedent's estate will generally get a new or stepped-up basis.

Revocable Living Trust

The revocable living trust is an effective method of avoiding probate. It has the additional advantage of providing management of the funds for the heirs for some time after the decedent's demise. Also, in the event the person setting up the living trust (also called an inter-vivos trust) becomes mentally incompetent or otherwise incapacitated, a successor trustee can take over management of the estate. Generally, this type of trust will not produce any estate tax savings.

Transfer on Death (TOD)

Many states have adopted the provisions of the Uniform TOD Security Registration Act, which permits securities and securities accounts to be registered so that ownership automatically passes to named beneficiaries at the death of the owner(s).

Holding Title

Separate Property

Property owned by either a husband or wife that is not owned by the other spouse is called separate property. This generally includes property acquired by either spouse prior to marriage, by gift, will or inheritance, or as money damages for personal injury, and all of the rents, issues and profits thereof.

Community Property

Both real and personal property earned or accumulated during marriage through the efforts of either spouse living together in a community property state.[1] Deceased spouse's will has control over one-half of the community property.

Community Property With Right of Survivorship

Both real and personal property earned or accumulated during marriage through the efforts of either spouse living together in a community property state. At the first death, title automatically passes to the surviving spouse by operation of law.

Joint Tenancy

Joint ownership of equal shares by two or more persons with right of survivorship. A person's last will has no effect upon such joint tenancy assets.

Tenancy by the Entirety

Joint ownership of an asset between spouses (with right of survivorship) that generally cannot be terminated without the consent of both parties.

Tenancy in Common

Ownership by two or more persons who hold undivided interests without right of survivorship. Interests need not be equal and will pass under the terms of the owner's will.

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[1] The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. In Alaska, spouses may opt-in to a community property arrangement.

Holding Title

Severalty

Ownership held by one person only. This can be a natural person or a legal person, such as a corporation.

Tenancy-in-Partnership

Method by which property is owned by a partnership. Specific interest in the property cannot be conveyed by one partner alone.

Custodian for a Minor

Under the Uniform Gifts to Minors Act or Uniform Transfers to Minors Act, an adult person can hold title to property for the benefit of a minor.

Trustee

The trustee of a living or testamentary trust holds legal title to property for beneficiaries, who have equitable title.

Life Estate

A use of ownership in real property that terminates upon the death of the life tenant.

Note: Advice as to how to hold title to specific assets is the practice of law. These laws vary from state to state.

Transfer on Death

Many states have adopted a version of the Uniform TOD Security Registration Act. TOD is an acronym that stands for “transfer on death”. The provisions of the Act permit securities and securities accounts to be registered so that ownership automatically passes to named beneficiaries upon the death of the owner or the last-to-die of multiple owners. In general, the result is a simplified, nonprobate transfer similar to pay-on-death (POD) transfers of bank accounts or Totten trusts. Assets transferred via TOD registration generally receive a full step-up in cost basis.

In the case of multiple owners, the property must be titled so that ownership will vest in the survivor of them before the asset passes to the named beneficiary. Thus, the owners may hold the property as joint tenants, as tenants by the entireties, or as “owners of community property held in survivorship form." A disadvantage of multiple ownership is that all parties must sign for any future account changes.

Beneficiary Designations

Beneficiary designations determine who receives the assets at death. The Act allows naming a contingent beneficiary to receive the assets if the beneficiary fails to survive. It also provides that “lineal descendants per stirpes[1]” may be substitute beneficiaries.

Acronyms Approved in Statute	Example of Use
TOD = transfer on death	John S. Doe TOD John S. Doe, Jr.
POD = pay on death	John S. Doe POD John S. Doe, Jr.
JT TEN = joint tenants	John S. Doe Mary B. Doe JT TEN TOD John S. Doe, Jr.
SUB BENE = substitute beneficiary	John S. Doe TOD John S. Doe, Jr. SUB BENE Peter Doe
LDPS = lineal descendants per stirpes	John S. Doe Mary B. Doe TOD John S. Doe, Jr. LDPS

Creditor and Third-Party Claims

Generally, the Act does not provide any protection against the claims of third parties such as creditors, or individuals with other interests, such as a spouse’s community property interest. A creditor or other party asserting a conflicting interest can do so simply by giving notice to the registering entity (the broker-dealer). As a practical matter, this will usually block transfer of the asset until the conflict is resolved.

[1] “Per stirpes” is a Latin term which can be translated variously as “per branch” or “by the roots.” In estate planning it refers to a common method of dividing an estate among the heirs of an estate owner.

Seek Professional Guidance

As a general rule, TOD registration as an estate planning tool is most useful in smaller estates, those without estate tax problems, or in situations involving a single estate owner with a single beneficiary. Estate owners are advised to seek the advice and counsel of a competent estate planning attorney in their state of residence before making any decisions regarding the use of TOD registration.

Types of Wills and Trusts

There are many varieties of wills and trusts to fit the needs of each individual. Only a qualified attorney should draft these documents.

A few of the more common documents are listed below.

- **Basic will:** A basic or simple will generally gives everything outright to a surviving spouse, children or other heirs.
- **Will with contingent trust:** Frequently, married couples with minor children will pass everything to their spouse, if living, and if not, to a trust for their minor children until they become more mature.
- **Pour-over will:** The so-called "pour-over" will is generally used in conjunction with a living trust. It picks up any assets that were not transferred to the trust during the person's lifetime and pours them into the trust upon death. The assets may be subject to probate administration, however.
- **Tax-saving will:** A will may be used to create a testamentary bypass trust. This trust provides lifetime benefits to the surviving spouse, without having those trust assets included in the survivor's estate at his or her subsequent death.
- **Living trust without tax planning:** Generally, the surviving spouse has full control of the principal and income of this type of trust. Its main purpose is to avoid probate. If required, the trust can also be used to manage the assets for beneficiaries who are not yet ready to inherit the assets outright, because they lack experience in financial and investment matters.
- **Bypass trust:** This type of trust allows the first spouse to die of a married couple to set aside up to $11,580,000[1] in assets for specific heirs while providing income and flexibility to the surviving spouse. The appreciation on assets in the trust can avoid estate tax.

[1] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. For 2020, the applicable exclusion amount is $11,580,000. In 2019, the applicable exclusion amount was $11,400,000.

- **QTIP trust:** A type of trust known as a QTIP trust allows the first spouse to die to specify who will receive his or her assets after the surviving spouse dies. Use of a QTIP also permits the deferral of death taxes on the assets until the death of the surviving spouse.

  QTIP means "qualified terminable interest property." The income earned on assets in a QTIP trust must be given to the surviving spouse for his or her lifetime. After the death of the surviving spouse, however, the assets then pass to beneficiaries chosen by the first spouse to die, frequently children of a prior marriage.

  Even if there are no children of a prior marriage, some estate owners use this type of trust to prevent a subsequent spouse of the survivor from diverting or wasting estate assets. A QTIP trust can only hold certain qualifying property. For this reason, it is often used in tandem with a bypass trust.

- **Qualified domestic trust:** Transfers at death to a noncitizen spouse will not qualify for the marital deduction unless the assets pass to a qualified domestic trust (QDOT). The QDOT rules require a U.S. Trustee (unless waived by the IRS) and other measures that help ensure collection of a death tax at the surviving noncitizen spouse's later demise.

Note: Additional trusts may be used for current income tax savings or to remove life insurance from the taxable estate, but the above-described documents should generally be considered for a person's estate plan.

Various Estate Planning Arrangements

A Summary of Benefits

Benefits	No Will	Basic Will	Trust Will	Basic Living Trust	Bypass with Living Trust	Bypass, QTIP,[1] & Living Trust
1. Allows you to select:						
a. Beneficiaries of estate,	No	Yes	Yes	Yes	Yes	Yes
b. Executor of will,	No	Yes	Yes	Yes[2]	Yes[2]	Yes[2]
c. Guardians for children, and	No	Yes	Yes	Yes[2]	Yes[2]	Yes[2]
d. Trustees of trust.	No	No	Yes	Yes	Yes	Yes
2. Avoids probate costs.[3]	No	No	No	Yes	Yes	Yes
3. Provides asset management for children over age 18.	No	No	Yes	Yes	Yes	Yes
4. Protects estate owner from a conservatorship.	No	No	No	Yes	Yes	Yes
5. Designed to save death taxes for couples.	No	No	Maybe[4]	No	Yes	Yes
6. Allows the first spouse to die to determine the ultimate beneficiaries of the estate in excess of $11,580,000[5], while still deferring the death taxes.	No	No	Yes	No	No	Yes

[1] QTIP stands for qualified terminable interest property trust.

[2] Each living trust is generally accompanied by a "pour over" type of will which picks up assets not put into the trust during lifetime and transfers them after death. Executors/guardians are named in a will.

[3] If all of the assets are in the living trust, and such trust is properly structured, probate is not necessary. However, there will usually be some expense for legal advice or the transfer of assets not in the trust. Without a trust, probate costs may exceed 5% of the total estate.

[4] Some trust wills contain bypass trusts designed to save death taxes, while others merely manage assets.

[5] The applicable exclusion amount is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. For 2020, the applicable exclusion amount is $11,580,000. In 2019, the applicable exclusion amount was $11,400,000. Source: Internal Revenue Service (IRS).

Various Estate Planning Arrangements

Brief Description of Arrangement

- **No will:** Your estate passes to heirs picked by the legislature.
- **Basic will:** Generally passes everything to your spouse, if living, otherwise to your children when they reach age 18.
- **Trust will:** May contain bypass and QTIP trusts or may pass everything to your spouse, if living, otherwise for children.
- **Basic living trust:** Designed to avoid probate and provide asset management. Used for smaller estates and single persons.
- **Bypass with living trust:** Designed to set aside assets for specific heirs while giving the surviving spouse income and flexibility. Appreciation on assets inside the trust can avoid estate tax.
- **Bypass and QTIP with living trust:** Same as the bypass with living trust, plus it gives the first spouse to die more control over who will eventually receive his or her assets after the surviving spouse dies. Also called a QTIP trust.

Revocable Living Trust

Inter-vivos Trusts

A trust is created when one person (the trustor or grantor) transfers to another person or a corporation (the trustee) a property interest to be held for the benefit of himself or others (the beneficiaries).

If the trust is created during the trustor's lifetime, rather than in his will, it is an inter-vivos or living trust. When the trustor retains the right to dissolve the trust arrangement, it is a revocable living trust.

What Are Some of the Advantages?

- Assets in the trust are not subject to probate administration. This usually saves executor's and attorney's fees. It also grants more privacy as to who gets the trust assets, when they receive them and how much they get.
- Professional management is available if the trustor becomes incompetent, disabled or wants to be free of the worries of management.
- Should the trustor (also usually the original trustee) die, or be unable to serve, a successor trustee can step in and manage the trust assets without delay or red tape.
- Annual court accountings, with their legal fees, are not required, although some states do not require annual accountings for testamentary trusts (will trusts), either.
- The trustee can collect life insurance proceeds immediately after the trustor dies and can (if permitted under the trust document) use the proceeds to care for family members without any need for court approval.

What Are Some of the Disadvantages?

- Creditors may not be cut off as quickly as they are in probated estates, e.g., four months in some states.
- A little more effort is required to transfer assets into the trust and records should be kept of transactions by the trustee.
- The attorney usually charges a higher fee to establish a living trust, as opposed to a will with a testamentary trust. There may also be ongoing administrative charges.

Note: Assets in a revocable living trust are included in one's gross estate for federal estate tax purposes.

Items to Discuss Before Meeting with an Attorney

There are several topics that should be considered prior to meeting with the attorney who will draft a will or a trust.

Guardians for Minor Children

Who is best able to cope with the raising of your minor children? A brother, sister, or a close friend may be a better choice than a grandparent.

Factors to consider would include the ages of the proposed guardians and their children, the ages of your children and the number of them who are still minors, and the health and financial situation of all parties. Decide on alternative choices, in the event your first choice is unwilling or unable to serve. If you name a couple as guardians and one of them dies, would you want the surviving co-guardian to act as sole guardian? What if they divorce?

Executor of the Estate

If all or part of your estate passes through probate, whom do you want to handle the details of paying your debts and death taxes and distributing the remaining assets to the beneficiaries named in your will?

Living Trust

Is it important to you to avoid probate? Make a list of your assets and their approximate values, along with a list of mortgages or other debt on any property. Your attorney can give you an estimate of what it will cost your heirs to pass your estate through probate.

The living trust is frequently used to avoid or reduce probate expenses. Ask your attorney to explain the advantages and disadvantages of this type of trust.

Trustee

If you have a trust, either in your will or a separate living trust, you will need to name a trustee to manage investments, pay taxes, make distributions, etc. In the event he or she dies, you will want to provide for one or more successor trustees.

Items to Discuss Before Meeting with an Attorney

A Corporate or Individual Fiduciary

Executors and trustees are referred to as "fiduciaries" because of the higher standard of care which is required of them in managing the assets of another person. Consider the facts of your own estate relative to the list of advantages shown below.

- **Advantages of a corporate fiduciary:**
  - Don't die or become disabled – permanence.
  - Financially accountable for their mistakes.
  - Impartial as to the children. This may prevent the children from becoming bitter towards an individual trustee who happens to be a friend or relative and who doesn't make distributions every time the children ask for something.
  - Have investment expertise as well as tax and accounting abilities.
  - Refuse loans to hard-up friends of the trustee.
  - Keep current with the constant changes in the law.
- **Advantages of an individual fiduciary:**
  - A relative or friend may not charge a fee.
  - A relative or friend may have a more personal interest.
  - An individual may have special expertise (i.e., running the family business).

Suggestion: Some people prefer the use of an individual and a corporate trustee, as co-trustees, to obtain the advantages of each.

Distributions to Children

If you do not want your assets distributed outright to your children in the event of your demise, they should probably be held in a trust. The trustee will take care of their needs as instructed in the trust. However, at some future time you will probably want to distribute the assets to them.

Many people like to distribute a portion of the estate at several different times, e.g., 1/3 at age 21, 1/3 at age 25 and 1/3 at age 30; or l/2 at age 30 and l/2 at age 35, etc. Your preference: ___ at age ___; ___ at age ___; ___ at age ___.

Final Heirs

In the event your children pass away prior to inheriting your estate, to whom would you want your estate to pass? For example, one could pass ½ to each spouse's side of the family (e.g., parents, brothers, sisters, etc.).

Healthcare Decisions

Who makes healthcare decisions if you are unable to do so? Consider alternative choices if your first choice is unwilling or unable to serve.

Charitable Bequests

Would you be interested in making a charitable bequest, especially if it reduced your income and death taxes?

Other Questions

Would you want your children to remain in the present house?

Is it important to reduce your death tax obligation?

Is it important that your assets pass to your heirs without the expense and delay of probate?

Duties of an Executor

The executor of an estate is named in one's will and has many duties and responsibilities. Some of the more important tasks include:

- Find the latest will and read it.
- File a petition with the court to probate the will.
- Assemble all of the decedent's assets.
    - Take possession of safe deposit box contents.
    - Consult with banks and savings and loans in the area to find all accounts of the deceased. Also check for cash and other valuables hidden around the home.
    - Transfer all securities to his or her name (as executor) and continue to collect dividends and interest on behalf of the heirs of the deceased.
    - Find, inventory and protect household and personal effects and other personal property.
    - Collect all life insurance proceeds payable to the estate.
    - Find and inventory all real estate deeds, mortgages, leases and tax information. Provide immediate management for rental properties.
    - Arrange ancillary administration for out-of-state property.
    - Collect monies owed the deceased and check interests in estates of other deceased persons.
- Find and safeguard business interests, valuables, personal property, important papers, the residence, etc.
- Inventory all assets and arrange for appraisal of those for which it is appropriate.
- Determine liquidity needs. Assemble bookkeeping records. Review investment portfolio. Sell appropriate assets.
- Pay valid claims against the estate. Reject improper claims and defend the estate, if necessary.

- Pay state and federal taxes due.
    - File income tax returns for the decedent and the estate.
    - Determine whether the estate qualifies for special use valuation under IRC Sec. 2032A or the deferral of estate taxes under IRC Secs. 6161 or 6166.
    - If the surviving spouse is not a U.S. citizen, consider a qualified domestic trust to defer the payment of federal estate taxes.
    - File federal estate tax return and state death and/or inheritance tax return.
- Prepare statement of all receipts and disbursements. Pay attorney's fees and executor's commissions. Assist the attorney in defending the estate, if necessary.
- Distribute specific bequests and the residue; obtain tax releases and receipts as directed by the court. Establish a testamentary trust (or pour over into a living trust), where appropriate.

The Importance of Beneficiary Designations

Some types of assets allow the owner of the asset to name a "beneficiary." If the original owner later dies, ownership of the asset passes automatically to the named beneficiary. Because beneficiary designations are easy to use, they can be a key estate planning tool. However, significant negative tax, financial, and even personal problems can arise if the "wrong" individual or entity is named as the beneficiary.

Common Named Beneficiaries

A number of individuals, entities, or organizations are commonly named as a designated beneficiary:

- **Spouse:** A married individual's spouse is perhaps the most common beneficiary designation. Assets passing to a surviving spouse generally escape federal estate tax because of the unlimited marital deduction.[1]
- **Children:** Children, as adults or minors,[2] are often named as beneficiaries. Step-children or other children adopted informally generally need to be specifically identified.
- **Other family members:** Brothers and sisters, aunts and uncles, and nieces and nephews are frequently encountered beneficiaries.
- **Estate:** In some situations, the asset owner will name his or her estate as the beneficiary.
- **Trust:** As a part of a more complex estate plan, a trust may be named as a beneficiary. The trust must exist at the time of death for the beneficiary designation to be valid.
- **Charity:** A charity may be a designated beneficiary, which can reduce the owner's taxable estate.
- **Corporation or partnership:** Buy-sell agreements, key man insurance, stock redemption, split-dollar arrangements, and salary continuation plans are all valid business reasons why a corporation or partnership may be named as a beneficiary.

[1] The discussion here concerns federal income and estate tax law. State or local law may vary.

[2] In many states, 18 is the "age of majority" when an individual is considered, for legal purposes, to be an "adult." In some states the age of majority is 21.

The Importance of Beneficiary Designations

General Considerations in Making Beneficiary Designations

There are a number of general issues to consider when using beneficiary designations:

- **Keep beneficiary designations current:** Divorce, the birth of a child, the death of a beneficiary, or any number of other life changes can result in the need to update a beneficiary designation. Lack of planning can result in an ex-spouse receiving retirement benefits intended to provide for others or for assets to inadvertently be paid to the estate when a named beneficiary has predeceased the owner.
- **Your estate or executor as the beneficiary:** In these situations, the transferred assets must generally go through a costly and time-consuming court-supervised process known as "probate." During probate the proceeds can be subject to the claims of creditors. In some situations there may be valid estate planning reasons for naming the estate as a beneficiary.
- **A minor as beneficiary:** In most states, a minor generally cannot legally enter into contracts or own property. If a minor is named as the beneficiary of an asset, the end result is frequently an expensive court-appointed guardianship with court supervision of the use of these funds. Once reaching his or her majority, the individual then takes control of the assets.
- **Per Capita vs. Per Stirpes:** A beneficiary designation form will generally use one of these two terms to specify how an asset will be distributed if a named beneficiary predeceases the asset owner. In a "Per Capita" distribution, generally, each survivor (a living beneficiary or a deceased beneficiary's heirs) receives an equal share. In a "Per Stirpes" distribution, generally, a deceased beneficiary's heirs divide his or her share into equal portions. Many states have modified these rules.
- **Spousal rights:** In some states, a surviving spouse may have the right to claim a portion of a decedent's estate, including part of assets that can be transferred by a beneficiary designation. In Community Property[1] states, a surviving spouse may have rights that need to be considered.

[1] The Community Property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. In Alaska, spouses may opt-in to a community property arrangement.

- **Common disaster:** What provision has been made for a situation in which both the asset owner and a designated beneficiary (think of spouses who travel together) die in a common disaster? This contingency is frequently addressed in an individual's will.
- **Impact on the beneficiary:** Consider how receiving an asset will impact the beneficiary's life:
  - Is the beneficiary capable of using the inheritance as the donor might wish, or will it be wasted? Is the beneficiary capable of managing the inheritance?
  - Are there income tax considerations? Assets such as deferred annuities, or retirement plans such as IRAs or 401(k) plans, have varying distribution requirements, depending on who inherits the assets. Will one beneficiary pay less income tax than another?
  - Does the intended beneficiary need the money?
  - Are there other ways, such as via a will or trust, to transfer assets to the intended beneficiary that might ultimately benefit the beneficiary more than an outright gift?
- **Conflict with other estate planning documents:** In some cases, an individual will leave contradictory instructions with regard to how his or her assets should be distributed. For example, a will may indicate that an individual's retirement plan assets are to pass to a child, while the beneficiary designation form for the retirement plan shows that the ex-wife is to receive the funds. As a general rule, the instructions contained in the beneficiary designation form will trump those contained in a will or trust.

Seek Professional Guidance

While beneficiary designations are easy to use, they should be considered to be only one part of an overall, coordinated estate plan. The guidance of experienced, trained estate, income tax, and other financial professionals is strongly recommended.

Powers of Appointment

A power of appointment may allow an estate owner to transfer to another person, e.g., spouse, child, etc., the power to decide at some future time the ultimate beneficiary of his or her estate.

This may be important when the beneficiaries are minors and the donor is not certain as to their spending habits, wealth from other sources, future needs, undesirable personal habits, etc.

The creation and exercise or non-exercise of these powers may incur certain tax liabilities and must, therefore, be carefully planned and drafted.

General Powers of Appointment

A general power of appointment is a power that permits the holder to appoint the assets to himself or herself, his or her creditors, his or her estate, or the creditors of his or her estate. Assets subject to a general power of appointment are included in the estate of the person who possesses it. If the power is released during lifetime, it may subject the assets to gift taxation. General powers of appointment created after October 21, 1942 are included in the gross estate whether exercised or permitted to lapse. See IRC Sec. 2041(a)(2). The value of the property which can be appointed is includable in the gross estate of the holder of the power.

Exception to the Rule Regarding General Powers

A person can die owning a power of appointment and not have it included in his or her estate if its use is limited by an ascertainable standard relating to the person's health, education, support or maintenance. In drafting an ascertainable standard provision, the cautious estate planner will follow the provisions set forth in the IRC Sec. 2041(b)(1)(A). Do not use words like comfort, welfare, or happiness. See Treas. Reg. Sec. 20.2041-1(c)(2).

These limited powers are sometimes called special powers of appointment and, since they are generally not subject to estate or gift taxation, can be very flexible estate planning tools.

This type of power is often used with the AB-type bypass trust (also sometimes called an exemption or credit shelter trust). A special power of appointment is any power to appoint to persons other than the donee of the power or his or her creditors, or the donee's estate or its creditors.

Lapse of a General Power and the 5-and-5 Rule

Usually the non-exercise (or lapse) of a general power of appointment is considered to be a release of the power and hence a taxable gift. However, to the extent that the property which could have been appointed does not exceed the greater of $5,000 or 5% of the total value of the assets subject to the power, the lapse will not be a taxable transfer. See IRC Secs. 2041(b)(2) and 2514(e).

Disclaimer of a General Power of Appointment

A person who properly disclaims a power of appointment will not have the power included in his or her gross estate.

Seek Professional Guidance

Creating and using a power of appointment is a complex area of law. Care must be taken to avoid unintentionally creating or exercising a general power of appointment. Both federal and state or local law must be considered. In this effort, the advice and guidance of trained legal and tax professionals is highly recommended.

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