

## *Introduction to Estate Planning*<sup>1</sup>

Estate planning involves not only decisions as to who should receive your property at death, but an understanding of how such property will pass at death. Estate planning also involves the management of your property during a period of lifetime disability and the authority to make health care decisions on your behalf. This memorandum discusses ownership of property, elementary estate tax planning, and the principal decisions which need to be made in the estate planning process.

### *Ownership of Property*

A common misconception in estate planning is that your last will and testament solely determines who will receive all of your property at death. A last will and testament will control the distribution of property titled in your sole name, property made payable to your estate, and property held by you as a tenant in common. However, your last will and testament *will have no effect* on determining who receives property held by you in joint tenancy with the right of survivorship, your spouse's interest in community property, property held by a trustee of a trust, or property payable to a beneficiary other than your estate (such as life insurance proceeds) under a beneficiary designation. Because of this, an important part of estate planning is a review of the ownership of your assets and beneficiary designations. The various types of ownership are discussed below in more detail.

*Last Will and Testament ("Probate Property"):* Your last will and testament will control the distribution of your real estate and personal property which is held in your sole name, assets made payable to your estate (such as life insurance proceeds or other company benefits) and interests held by you as a tenant in common. These properties are referred to as "probate property" and estate administration proceedings must be conducted after your death for this property to be distributed to the persons entitled to it under the provisions of your last will and testament. Estate administration proceedings are court supervised proceedings and can last from a few months to several years, depending on the size of the estate and its complexity.

*Revocable Living Trust ("Non-probate Property"):* A revocable living trust is similar to a last will and testament in that it normally contains provisions distributing your property at death. It differs from a last will and testament because the revocable living trust is a *lifetime* document and can hold title to your property during your life. All property transferred to the trustee of the trust during your lifetime will be distributed to the beneficiaries under the trust and are not subject to estate administration proceedings. Therefore, this property is referred to as "non-probate property." If you transfer *all of your assets* to the trust and designate the trustee of the trust as the beneficiary of your life insurance policies and other benefits, then none of your assets will be subject to probate.

---

Another aspect of the revocable living trust is that it can serve as a management vehicle in the event of your incapacity. If you have transferred property to the trust prior to the incapacity, then the trustee can continue to manage the trust property. If you have not transferred your property to the trust prior to the incapacity but have executed a durable power of attorney, your agent appointed under the power of attorney can transfer your assets to the trust for management purposes. Such transfers may also be made in the event of a terminal illness in order to avoid probate. If you decide on a revocable living trust as the primary document of your estate plan, we recommend that we also prepare a "pour-over" will, which distributes all of your probate property, if any, to your trust at death.

*Joint Tenancy Property ("Non-probate property"):* All real estate and personal property held by you in joint tenancy with the right of survivorship will pass at death to the surviving joint tenant regardless of the provisions of your last will and testament or revocable living trust. Often married persons will hold title to their home and bank accounts in joint tenancy with the right of survivorship. This property also is not subject to probate and is referred to as "non-probate property."

*By Contract ("Non-probate Property"):* The designated beneficiary of your life insurance policies, company benefits, individual retirement accounts and other property which requires designation of a beneficiary, will receive the benefits at death. Again, this property is not subject to probate and is not controlled by the provisions of your last will and testament or a revocable living trust.

*Community Property:* Community property is property acquired by a husband or wife during marriage other than as a gift or inheritance. Property may be community property if acquired during the marriage even if formal title to the property appears in some other form. For example, property owned in the sole name of the husband may nevertheless be community property if acquired during the marriage while living in a state, such as Arizona, New Mexico, Nevada or Texas, which recognize community property. Although each spouse owns an undivided one-half interest, community property differs from joint property since it does not have the automatic survivorship feature and may be disposed of separately by each spouse. A married couple living in a community property state may change property to or from community property by agreement between themselves. Community property may or may not be probate property depending on how it is held. For example, community property might be owned through a trust and not be subject to probate.

## *Basics of Estate Planning*

*Who Should Inherit Your Property:* Of course, the most basic decision in estate planning is who should inherit your property at your death. You must consider whether you want to leave a sum of money or certain items of tangible personal property to designated beneficiaries. You need to decide who should receive the rest of your tangible personal property (such as household items and personal effects) and the balance of your estate (cash, bonds, real estate and all other assets). You should provide for alternate beneficiaries in the event the primary beneficiary or beneficiaries

predecease you. In addition, you should consider whether you want the gift to a beneficiary to be an outright gift or placed in a trust for management purposes. Trusts are appropriate for marital gifts and gifts to the elderly or a disabled person. Trusts are also used for gifts to minors. Trusts may be designed to protect the property from future creditors of the beneficiary or from loss of property through divorce. All of these trusts can be created at death under the terms of either your last will and testament or in a revocable living trust.

*What Documents Should Comprise Your Estate Plan:* The basic documents in an estate plan are either (i) a last will and testament or (ii) the combination of a revocable living trust with a "pour-over" will. The attorney fees for the preparation of a revocable living trust with the "pour-over" will combination will cost more than a last will and testament, but the revocable living trust has the advantage of lifetime management of your assets in the event of an incapacity and, if fully funded, the advantage of avoiding probate at death. The revocable living trust also provides more privacy since, unlike a last will and testament, it is not normally part of any public record.

In addition to one of the above types of estate plans, you should consider a durable power of attorney. A durable power of attorney is one which will continue to be effective even in the event of a lifetime disability. The person holding such a power could manage the property of the disabled person during such person's lifetime. When a person has a revocable living trust, the principal purpose of the durable power of attorney is to provide a designated person the ability to put the disabled person's assets into the trust for more flexible asset management and to shelter those assets from probate.

*Whether Estate Tax Savings Trusts for Married Persons are Appropriate:* If you are married and your combined net estates exceed \$1 million, you should consider including an estate tax savings trust in your estate plan.<sup>2</sup> To determine the value of your combined net assets for estate tax planning purposes, you must add the fair market value of all of your assets (bank accounts, real estate, household items, company benefits, joint tenancy property). You must also include the proceeds of life insurance policies payable at your death (the proceeds, not cash value). Include the full value of any retirement plans or individual retirement plans. This will give you your gross estate. Now, subtract all debts to arrive at your combined net estates. To assist you in the process, we have a form we call a Fact Sheet which you can use to assemble the family and financial information we will need.

If your combined net estates exceed \$1 million or because of their nature are likely to do so within a few years, we may recommend that you include an estate tax savings trust in your estate. This means that your basic estate planning document (last will and testament or revocable living

---

<sup>2</sup> The current level of exclusion from federal estate tax is \$1 million. This exclusion is scheduled to increase to \$1.5 million in 2004 with further increases to occur in future years. Under present law, the estate tax is to be repealed in 2010 but reinstated in 2011. We expect the law relating to repeal and reinstatement to be modified before repeal occurs but it is impossible to predict what the modifications might be.

trust) would provide for your estate to be divided into two parts at your death: a marital part and an estate tax savings part. The estate tax savings part would be a trust funded with the amount of assets you can give at death estate tax free to persons other than your spouse, which is currently \$1 million. The beneficiaries of the trust can be your spouse and your children. The savings in estate taxes comes at the death of the surviving spouse because the assets in the trust will not be part of the surviving spouse's estate for estate tax purposes and will therefore escape estate taxes at the surviving spouse's death. The second part of your estate, the marital part, will consist of the balance of your estate (assets in excess of \$1 million). The marital part is not taxable for estate tax purposes because of an estate tax marital deduction. However, the marital part will be included in the surviving spouse's estate for estate tax purposes at his or her death.

If you do not divide your estate into two parts, but give all of your assets to your spouse, there would be no federal estate tax at the first death because of the marital deduction, but *all* of your combined assets will be included as part of the surviving spouse's estate for estate tax purposes at his or her later death. The benefit of the \$1 million exemption for the first spouse to die would be unused and lost. If the size of your combined net estates is appropriate for this type of estate plan, we will discuss this aspect of your estate plan in more detail during the estate planning process.

There are reasons other than tax planning which cause many people to create a trust for some part of the estate at the death of the first spouse. For example, a trust can be used to help shelter property from creditors of the surviving spouse and from marital claims in the event of remarriage of the surviving spouse. A trust can also ensure property is available for children and grandchildren while providing lifetime security for the surviving spouse.

*Provisions for Minor Children:* Children under 18 years old are minors and should generally not own valuable property directly in their own name. Therefore a trust is normally created to manage the property. Trusts are frequently created for children to continue well beyond age 18 for various reasons which we will discuss. If you have more than one child, there are two types of trusts for minors for you to consider: (i) the "pot trust"; and (ii) the "separate share" trust.

A "pot trust" is one trust fund which receives all of the assets for the benefit of more than one child. The trustee of the trust is instructed to distribute the income and principal from the single fund to the children according to their needs, and the trustee has no obligation to distribute equal amounts of income or principal to any one child during the trust term. However, at the termination of the trust the assets are normally distributed equally among the children.

"Separate share" trusts differ from "pot trusts" in that a separate trust is created for each child and that child's separate trust is used solely for that particular child. If one child has a greater need than another child, the trustee cannot use the trust funds set aside for the other children but is limited to that particular child's trust funds. Unless there is a need to anticipate that one child might require more than an equal share, separate trusts are generally preferred. It is possible to combine these two concepts and use a pot trust until your youngest has reached a minimum age (such as 23 or 25) after which the pot trust divides into separate share trusts.

*Fiduciary Relations:* In all estate plans, you must decide who should be the personal representative of your estate. This is the person, bank or trust company who manages your estate during the estate administration proceedings and has the duty to see that all income and estate tax returns are properly filed. In addition, if your estate plan includes one or more trusts, you must decide who should act as trustee or successor trustee and if you have minor children, who should act as guardian and alternate guardian. Further, if your estate plan includes a durable power of attorney, you must designate a person to act as your agent.

### *Health Care Decisions*

During a period of disability, the trustee of your revocable living trust and your agent under a durable power of attorney are relied on for management of your property. You should also appoint someone with the authority to make health care decisions on your behalf. Thus, decisions such as long term care, choice of physician, medication or treatment facility, and more dramatic decisions such as continuation of life support, can be made by your health care agent. The agent you appoint to manage your property can also be given the authority to make health care decisions or you may appoint a different agent for this purpose.

### *Basic Decisions in Estate Planning*

There are numerous decisions to be made in the estate planning process. These decisions may be easier to make if you review this outline prior to our initial meeting. These are only basic steps in the estate planning process and we will discuss them and others in more detail during our conference.

#### *Types of documents to use in your estate plan:*

1. Think about whether your estate plan should consist of a last will and testament or a combination of a revocable living trust with a pour-over will;
2. You should also consider whether a durable power of attorney would be appropriate as part of your estate plan and who you would want to be designated as your agent with authority to manage your property..
3. Who would you want to make health care decisions on your behalf?

#### *Ownership of assets:*

1. Review the ownership of all of your assets and beneficiary designations and bring this information with you to the estate planning conference;
2. For married persons, determine the approximate size of your combined net estates. For combined net estates in excess of \$1 million, you should consider the use of an estate tax savings trust in a last will and testament or revocable living trust.

*If you have minor children or wish to make gifts to minors, you should consider:*

1. A trust for the management of the assets for your children and whether you would prefer a "pot trust" or "separate share" trusts;
2. At what age or ages do you feel your children should receive their share of your estate free of trust;
3. Who you would want to serve as trustee and successor trustee of a trust created for your minor children; and
4. Who you would want to serve as guardian and alternate guardian of your minor children.
5. Trusts can also be designed to protect children from their creditors, bad business decisions and failed marriages. Such trusts may provide the child a "nest egg" but may limit the child's control over the property in return for the protection. You should think about your general philosophy concerning gifts to your children and, for older or married children, whether there is a need to provide the child with financial protection.

*You must also consider:*

1. Who you would want to serve as primary and alternate personal representative of your will (the person, bank or trust company who will see to the administration of your estate);
2. If your estate plan includes a revocable living trust or a management trust for an adult, who you would want to serve as trustee and successor trustee of such trust;
3. Whether a parent or other person than your children may require your support in the future;
4. Whether any person who is or may become dependent on you, such as a disabled child, may have special needs which should be addressed; and
5. If you own a closely-held business, what arrangements should be made for continuation of the business or its disposition.