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Wills and Trusts

There are several topics people should consider prior to meeting with the attorney who will draft a will or a trust.

Wills and Trusts

As you consider the preparation of wills and trusts, remember to ask your attorney about

- Wills
- Trusts for Married Couples
- Credit Shelter Trusts
- Durable Powers of Attorney
- Advanced Health Care Directives
- Livings Wills, Healthcare Proxys
- Beneficiary Designations
- Taxes

You should bring a list of your assets and liabilities to your interview with your attorney. It should specify

- Name of asset
- How owned
- Current Value
- Mortgages or Liens Against the Property
- Personal Liabilities (credit card, student loan debt. It should be noted that these kinds of debts are not eradicated on your death.)
- Specific beneficiary designations such as life insurance and retirement plan accounts

Remember, naming beneficiaries is extremely important. Before you fill in your spouse's name, or put your child's social security number on the dotted line, make sure you're avoiding these typical mistakes.

- Assuming your will is going to take care of the details
- Subjecting your heirs to an avoidable tax bill
- Forgetting to update forms when life happens
- Not having a Plan B
- Naming minor children as beneficiaries

There are several topics people should consider prior to meeting with the attorney who will draft a will or a trust.

Items to Discuss Before Meeting with An Attorney

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 ages of proposed guardians and their children, ages of your children and number of them still minors, and 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 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 approximate values, along with your list of mortgages on any proper ty. 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 as backups.

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. Discuss 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.
- Investment expertise, tax and accounting abilities, and computer capabilities. Studies show that they save many dollars in the average estate.
- Refuse loans to hard-up friends of the trustee.
- Keep current with 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., a third at age 21, a third at age 25 and a third at age 30; or half at age 30 and half at age 35, etc.

Your preference:

__________________at age ________________

__________________at age ________________

__________________at age ________________

Final Heirs

Executors and trustees are referred to as fiduciaries because of the higher standard of care 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 half to the husband's side of the family (e.g., parents, brothers, sisters, etc.) and half to the wife's side.

Charitable Bequests

Would you be interested in making any charitable bequests, especially if it reduced your income and death taxes?[1]

Other Questions

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

Is reducing your death tax important to you?

1. Under the current tax law, for each individual the first $5,450,000 is exempted from Federal Estate taxes. It's $10,900,000 per married couple. This amount is adjusted annually for inflation. Any amount above this exemption is taxed at a 40% rate. Source: IRS.gov, Form 706

Advantages of a Will

Avoids Distribution Under the Law of Intestacy

The state intestacy law will pass property to certain relatives of the decedent. These laws have been drafted to be fair in the average situation, but most persons would like to choose who will receive their estate when they die.

Permits the Nomination of Guardians for Minor Children

Without a nomination in a will, the court will appoint a guardian of the person for minor children. Relatives are not always the best choice for a guardian and consideration must be given to the financial situation of the potential guardian, as well as his or her health, age, willingness and ability to care for your children.

Waiver of the Probate Bond

In the absence of a will, the court will require a fiduciary bond to be posted by the administrator (executor) of the estate to guarantee the replacement of any funds embezzled or diverted by him. Since this additional cost must be borne by the estate, the estate owner may want to waive the bond requirement in the will. Great care should be used in selecting an executor.

Choosing the Executor

The duties of and estate executor can be very time consuming and frustrating, especially to a spouse who has just lost a mate. In the will, a chosen qualified individual and/or a corporate trust company can handle these responsibilities.

Making Specific Bequests to Individuals

You may bequeath specific items of jewelry, heirlooms and furniture, or make cash bequests, and be certain that they will pass to the proper persons. Without a will, written or oral instructions may not be followed.

Sale of Assets During the Administration of Probate

Additional expense to the estate can generally be avoided by permitting the sale of assets without the executor having to publish a notice of sale in the newspaper. A sale of assets may be necessary in order to pay death taxes and expenses of probate.

Authorizes Continuation of a Business

Unless the will authorizes the continuation of a business, the executor must operate it at his or her own risk. Many executors may elect not to administer the estate unless this risk is borne by the estate.

Deferring Distributions to Minors

When parents die leaving minor children, each child's share of the estate must be held in a guardianship account until he or she attains the age of 18 (or 21), at which time the entire remaining share is distributed outright. Trust provisions can be placed in the will to defer these distributions until a more mature age.

There are several topics people should consider prior to meeting with the attorney who will draft a will or a trust.

Tax Savings

Certain substantial tax savings are possible through the use of trusts. The will can be used to create trusts after death. Such trusts are known as testamentary credit shelter trusts. Similar tax savings, as well as probate savings, can be achieved through the use of trusts established during life, known as living credit shelter trusts.[1]

Reduces Emotional Stress

Although this advantage cannot be measured in dollars and cents, when the estate is in order an emotional load is lifted from the person who is concerned for his or her family's well being.

At least two copies of a will should be made and stored in safe places that are known and accessible to the maker's attorney and the executor.

A safe deposit box may not be a good place to store a will, as its contents are often frozen upon the box owner's death.

1 Under the current tax law, for each individual the first $5,450,000 is exempted from Federal Estate taxes. It's $10,900,000 per married couple. This amount is adjusted annually for inflation. Any amount above this exemption is taxed at a 40% rate. Source: IRS.gov, Form 706

Irrevocable Life Insurance Trust for a Married Couple

Since estate taxes are imposed upon all of the assets in the estate, many people prefer to pay the taxes by rearranging some of these assets instead of relying on their current income.

One method of achieving this goal is the irrevocable life insurance trust. However, to prevent inclusion in the estate, an irrevocable trust cannot be revoked or amended by the grantor.

Funded irrevocable insurance trusts:
This trust has income-producing assets transferred into it which will pay the premiums on the insurance policy from the income earned. Irrevocable life insurance trusts are typically not funded because the gift taxes on the assets transferred are the same as the federal estate taxes on assets remaining in the estate. Also, the income earned on the assets would still be included on the income tax return of the insured grantor. See IRC Sec.677(a)(3).

Unfunded irrevocable insurance trusts:
Although this trust is not totally unfunded, it usually just owns an insurance policy and the grantor makes annual gifts to the trust with which the trustee can pay the premiums.

Additional Considerations

Trust is irrevocable:
This means the grantor cannot get anything out once it is put into the trust. Some suggest that a special power of appointment in the hands of the insured's child would permit that child to appoint the trust assets back out to the insured or others. The trustee would need to be authorized to reappoint trust assets without liability to the trust beneficiaries.

Annual gift tax exclusion may be lost:
Contributions to the trust are future interests instead of present interests. Future interests typically do not qualify for the current $14,000 annual gift tax exclusion.[1] This concern can be overcome by granting to the beneficiaries a limited power to withdraw certain sums from the trust for a short time after the grantor makes the contribution. This is sometimes referred to as a Crummey provision after the case which decided the validity of this technique (Crummey vs. U.S., 397 F.2d 82 (CA-9, 1968)). The rules set forth in this case and subsequent rulings must be carefully followed. Crummey power holders should be actual trust beneficiaries; however, the tax court allowed annual gift tax exclusions for the contingent beneficiaries (e.g., children, grandchildren, etc.) who were given withdrawal rights (*Est. of Maria Cristofani vs. Comm.*, 97 T.C. 74(1991).

Non-exercise of withdrawal powers:
The failure of a beneficiary to withdraw the amounts permitted under the Crummey provision will cause a lapse of that power. Lapsed amounts in excess of the specified limit[2] are generally considered to be taxable gifts from the beneficiary. However, if the beneficiary is given a limited power to appoint the amount in excess of these limits (e.g., in his or her will), the power is deemed not to lapse and therefore no gift tax is due.

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Since estate taxes are imposed upon all of the assets in the estate, many people prefer to pay the taxes by rearranging some of these assets instead of relying on their current income.

Another strategy used to deal with this problem is referred to as a hanging power. It limits the amount which lapses each year to the larger of $5,000 or 5% of trust assets. Any amount in excess of this limit hangs or carries over to later years. The IRS has, in one situation stated its opposition to this method. See TAM 8901004.

Three-year rule:
If an existing life policy is transferred by the insured to an irrevocable life insurance trust and the insured dies within three years of the transfer, the policy proceeds will be included in the insured's estate. IRC Sec. 2035. On the other hand, if the trustee uses the cash in a trust to purchase a new policy on the insured's life and the insured dies within the three-year period, the proceeds will generally be excluded from his or her estate. Care should be taken to make certain that the insured has no incidents of ownership in the policy or control over the trustee.

Second-to-die policies:
Second-to-die or survivor life policies do not pay the proceeds until both insureds are deceased, which is when death taxes generally become due.

Premiums on a single second-to-die policy are generally lower than the combined premiums on two individual policies, allowing a couple to obtain a larger face amount of insurance. If the surviving spouse will need policy proceeds to live on, however, this type of policy should generally not be used.

An irrevocable trust can be drafted giving an independent trustee the discretionary power to distribute trust income and principal to the grantor's spouse or children during the grantor's lifetime. This means, if the only asset in the trust is a whole life insurance policy, the trustee could borrow or surrender cash value to make distributions to the grantor's spouse or children.

1. The annual gift tax exclusion ($14,000 in 2016) is indexed for inflation in increments of $1,000. This amount is adjusted annually for inflation. Source: IRS.gov, Form 706
2. The limit is the greater of $5,000 or 5% of the value of the assets subject to the power.

Types of Wills and Trusts

Some More Common Documents, Listed Below.

Basic will: A basic or simple will generally gives everything outright to a surviving spouse, children or other heirs. Sometimes called an "I Love You" will.

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 will generally be subject to probate administration, however.

Tax-saving will: A will may be used to create a testamentary credit shelter 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.

Living credit shelter trust: This type of trust avoids probate and also makes certain that both spouses use their applicable credit amount Estates of $5,450,000 [1] can be passed to children or other heirs, without probate expense or death tax, by a married couple using this type of trust.

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. At the death of the second spouse, the value of the QTIP trust is subject to estate taxes. 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 at least annually 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. The QTIP trust is often used in tandem with a living credit shelter 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.

1. Under the current tax law, for each individual the first $5,450,000 is exempted from Federal Estate taxes. It's $10,900,000 per married couple. This amount is adjusted annually for inflation. Any amount above this exemption is taxed at a 40% rate. Source: IRS.gov, Form 706

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 are generally at the center of a person's estate plan.

Credit Shelters and Irrevocable Insurance Trusts

ASSETS OF HUSBAND AND WIFE WHEN FIRST SPOUSE DIES

IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

Contains the life insurance policy

First Spouse Dies

No Tax

No Tax

No Tax[1]

TRUST A
SURVIVOR'S TRUST

This Trust could contain the survivor's assets and the assets of the decedent in excess of the $5,450,000 applicable exclusion amount.[2]

TRUST B
CREDIT SHELTER TRUST

Funded with the $5,450,000 applicable exclusion amount[2]

Second Spouse Dies

Taxable

No Tax

ASSETS PASS TO CHILDREN OR OTHER HEIRS

Assets from the survivor's trust are taxable if they exceed $5,450,000 or the applicable exclusion amount at that time.[2]
Assets from the credit shelter trust should not be taxable. Life insurance in the irrevocable life insurance trust is outside of the taxable estate.

1 Under the current tax law, for each individual the first $5,450,000 is exempted from Federal Estate taxes. It's $10,900,000 per married couple. This amount is adjusted annually for inflation. Any amount above this exemption is taxed at a 40% rate. Source: IRS.gov, Form 706

2 The applicable exclusion amount ($5,450,000 in 2016) is the dollar value of assets protected from federal estate tax by an individual's applicable credit amount. The amount is indexed for inflation annually.

A power of attorney is a written document which one person (the principal) uses to empower another person (the attorney-in-fact or holder of the power) to act on his or her behalf.

Durable Powers of Attorney

PRINCIPAL (COMPETENT ADULT)

DURABLE POWER OF ATTORNEY →

HOLDER OF POWER (ATTORNEY IN FACT)

Powers Which May Be Included

NON-TAX POWERS

To buy, sell or lease assets

To sue on the principal's behalf

To collect from creditors

To change provisions in a living trust

To operate the principal's business

TAX-RELATED POWERS

The power to make gifts to the spouse (to equalize the estates) and to children, grandchildren, etc. (to utilize the annual gift tax exclusions)

The power to make disclaimers

The power to create living trusts to benefit the principal, spouse and heirs

The power to complete transfers to a living trust if the principal becomes incompetent

The power to join the competent spouse in signing income and gift tax returns

The power to exercise special powers of appointment

Additional Considerations

Powers of attorney are usually notarized and those affecting real property may need to be recorded.

A power can be a general power of attorney, giving the holder all of powers possessed by the principal. On the other hand, a special power of attorney limits the powers only to those specifically set forth in the document.

Document can be drafted to empower the holder currently or to become effective only in the event the principal becomes incompetent (sometimes called a springing power).

Note: Significant powers may be granted under a power of attorney. Before using a preprinted form, legal advice should be obtained.

The condition that may be included is subject to the law of the state where the document was executed.

The Advanced Health Care Directives[1] (AHCD) is the document that contains health care directives and now replaces legal documents commonly known as durable health care powers of attorney and living wills.

Advanced Health Care Directive

When an adult loses his or her ability to make personal health care decisions, the law in most states allows that person to designate another person, called a surrogate, to make those decisions, including the power to make end-of-life decisions.

AHCD may also include the following.

- Directions as to pain medication
- Directions to provide, withhold or withdraw artificial nutrition, hydration, and all other forms of health care, including cardiopulmonary resuscitation
- A physician designated by the patient or the patient's agent, conservator or surrogate to have primary responsibility for the patient's health care
- Postmortem powers to dispose of the remains, to authorize an autopsy and to donate all or part of the principal's body for transplant, education or research purposes

Surrogates

In the event an individual revokes his AHCD, he or she may designate a surrogate to make health care decisions in keeping with the instructions or values of that individual. If orally made, the designation must be entered into the patient's medical chart.

In the event that no AHCD exists or that a designated agent is not reasonably available, adult, statutory surrogates exist. They are: (1) the spouse (unless legally separated), (2) a domestic partner, 2 (3) a child, (4) a parent, (5) a brother or sister, (6) a grandchild and (7) a close friend.

Preprinted forms are usually available and those interested in an AHCD should contact their attorney or physician and discuss all options. A card can also be kept in the wallet indicating that the individual has an AHCD.

1 This document is the result of legislation in many states over the last 15 years, enactment of the Federal Patient Self Determination Act of 1990 and promulgation of a new Uniform Health Care Decision Act passed in 1993.

2 Defined as an adult in a long-term relationship of indefinite duration with the patient in which the individual has demonstrated a commitment similar to that of a spouse.

Remember, the best thing you can leave your family is a plan. Have a plan for any of these you may own.

- Annuities
- Bank Accounts
- Bonds
- Business Interests
- Cash
- CDs
- Inherited Valuables
- Life Insurance
- Mutual Funds
- Notes Receivable
- Personal Property
- Real Estate
- Retirement Plan Assets
- Stocks

Also note, the disposition of the following assets, which may not be subject to will and living trust provisions.

Jointly owned property, such as

- Real estate
- Bank accounts
- Brokerage accounts

Beneficiary designated assets

- Life insurance
- Tax qualified retirement plans
    - Pension plans
    - Profit sharing accounts
    - 401(k) plans
    - 403(b) plans
    - IRA (both individual and spousal rollover
    - Roth IRA plans

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