ESTATE PLANNING TOOLS

The basics of common wills and trusts.

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There are many variations of estate planning tools, but some are more common than others. The following provides a brief description of the common basic tools and some of the advantages and disadvantages of each. You should always consult with an attorney to determine your appropriate estate planning strategy.

NON TAX PLANNING TOOLS:

THE SIMPLE WILL: A will is a revocable instrument that provides for the transfer of property and assets that takes effect upon death. The simple will is the most important, basic and inexpensive estate planning tool to create. A will can take many different forms; however, there are seven requirements for a will to be valid:

- Legal age. You must be of legal age, which in most states, including Oregon, is 18 years old.
- Sound mind. You must be of sound mind, meaning you are aware you are executing a will, you know the general nature of your property, you know the manner in which your will disposes of your property and the relatives who would ordinarily be expected to share in your estate, such as a spouse and descendants.
- Intent to transfer property. A will must have a provision disposing of your property and that the document is intended to be the final word regarding such disposition.
- Written. Although few states may accept oral wills, Oregon is not one of them and a will must be written along with the other requirements.
- Signed. You must sign your will voluntarily. In some circumstances such as illness, accident, or illiteracy, where you cannot sign for yourself, you may direct an agent such as your lawyer or a witness to sign for you.
- Witnessed. In Oregon, and in most states, a will must be witnessed by two adults who understand what they are witnessing and are competent to testify. Although in most states the witnesses must be disinterested, or not receiving any part of the estate, in Oregon a person who receives a gift under the will may also be a witness.
- Execution. The will should have a statement at the end attesting that it is your will, with the date and place of signing, and the fact that you signed before witnesses who then also signed in your presence.

In addition to the above, today's accepted practice is to include an affidavit of attesting witnesses at the time of witnessing (signing the will). Having this done and kept with the will avoids the need for the witnesses to testify in court after death to prove the validity of the will.

When a person dies without a validly executed will, it is known as having died intestate. The laws of the state then control the disposition of the person's estate, which often times is not what the decedent would have chosen. Executing a will allows you, the testator, to:

- devise your property to specific persons or entities of your own choosing in the amount you choose;
- name a personal representative (PR) or executor, which is the person who will be in charge of the estate during the probate process;
- provide overall better efficiency during the probate process by giving specific directions to your PR for things such as funeral expenses, taxes, distributing property, etc.; and
- designate a guardian for minor children.

Executing a will does not avoid the probate process, which is the court supervised process of administering the estate of a deceased person. The probate process commonly lasts up to a year and can often take longer depending on the size and complications of the estate. It involves quite a bit of work on the part of the personal representative and the estate will pay fiduciary, attorney and court fees. However, sometimes having court supervision over the estate is helpful and can avoid fraud. Families with strained relations may benefit from court supervision. Additionally, while there is a four month waiting period for creditors to make claims against the estate, this also provides a definite end date for which claims may be made.

No matter what your station in life or how much or how little you own, if you want control over who will act as guardian of your children, what happens to your belongings, money or anything else you own, you should have a will. Anyone with children, money in the bank, real property or items they would like specifically devised to someone should have at least a will in their estate plan. Other documents typically included with the will are a Power of Attorney and Advance Directive. These are two other very important documents to have in place to establish who will make financial and medical decisions for you if you were to become incapacitated.

TESTAMENTARY TRUST (WILL BASED TRUST): This type of will and trust takes estate planning one step further than the simple will. While a simple will allows you to devise both specific and general gifts to beneficiaries of your choosing, those gifts come in the form of a lump sum with no strings attached. That may be your desired effect, but what if the beneficiary is a minor child, or a child with a disability, or an adult child who may not have financial intelligence? These are some of the circumstances that a trust of some form should be considered.

A testamentary trust is drafted within the will and takes effect only upon the death of the testator, as opposed to a living trust which takes effect upon funding after execution. However, just as with a living trust, a testamentary trust can distribute gifts over time and under certain qualifications. This allows you to better ensure that your gift is put to good use as opposed to being spent frivolously. Qualifications often refer to education, medical needs, and support at the discretion of the trustee. Distributions can also be made upon reaching certain ages. For example, the beneficiary receives 1/3 of the gift at age 25, 1/3 at age 30 and the remainder at age 35. A testamentary trust allows more control over gifting without the added cost and maintenance of creating a living trust. However, there will be costs at the time of death in order to get the trust funded and administered. *Unlike a living trust, a testamentary trust does not avoid probate*. The trustee is appointed in the will and non-probate transfers (e.g. assets with beneficiary or P.O.D. designations) to the trust take place as soon as the will is admitted to probate. Transfers of property required to go through probate will be transferred to the trust at the distribution phase of probate. After these transfers are made the estate will be closed, probate ends, and the trust continues outside of court supervision, absent objections or ongoing litigation over the estate.

Advantages of a testamentary trust:

- all advantages of a will;
- provides a way to devise assets to beneficiaries over time and according to certain achievements or ages;
- lower *upfront* costs and maintenance during your lifetime than a living trust.

Disadvantages of a testamentary trust:

- does not avoid the probate process, or the cost, fees and time associated with probate;
- in addition to cost of probate, expense of trust administration will incur;
- does not provide added protection for incapacity;
- delay in disbursements to beneficiaries.

Persons with more modest means, minor children or young adult children who may not be financially mature are primary candidates for a testamentary trust. This is a suitable plan for persons who believe it is important to provide guidance in how their gift is disbursed and used, but don't want the maintenance and upfront cost of a living trust.

SIMPLE REVOCABLE LIVING TRUST: A "simple" revocable living trust (RLT) acts much like a testamentary trust with a couple major differences. First, it is created and funded during your life time as opposed to operating only upon your death. This means that any assets you wish to be in the trust should be transferred over to the trust at the time of execution or as they are acquired. Assets such as your house, bank account, investments, a business, vacation home, etc. would be re-titled to name the trust as the owner or beneficiary. You then sign as trustee for anything to do with those things. Second, the revocable living trust is created separate from your will, whereas the testamentary trust is created inside the will.

Among the several benefits of a trust, there are three primary ones. First, having a trust avoids the probate process for anything that is owned by the trust at the time of death. This feature of a RLT is often the selling point; many people wish to avoid the court involvement, cost and process of a probate. However, keep in mind that anything that was not transferred into the trust and does not otherwise pass outside probate must still go through probate, which means a trust does not avoid the need for a will and requires some care to ensure assets are kept in trust. While a trust is often more efficient in terms of distribution and administration compared to a probate, they typically still require the assistance of an attorney, and will have some administration costs.

Second, when a person acts as your trustee during your lifetime but while incapacitated, it can often times hold more weight than a power of attorney. Banks and financial institutions can be finicky about dealing with a power of attorney; acting as trustee instead can grease the wheels a bit. This feature becomes crucial if you were to become incapacitated and need your successor trustee to step in and manage your assets for you while you are alive.

The third chief benefit of a RLT is the ability to span gifts out over time and overall flexibility in gifting. Just as with the testamentary trust, you can design a disbursement plan for your beneficiaries so that they do not receive a lump sum of money to spend on a whim. Disbursement plans can be as general or as specific as you like and often include parameters such as age, education, support, medical needs, etc. The benefit of the RLT over the testamentary trust, in addition to acting as your trustee during a period of incapacity, is the efficiency with which the successor trustee can take control and begin to manage after your death since the RLT will avoid probate.

One common misconception about a RLT is that it avoids taxes. In order to avoid estate tax implications via a trust, a tax planning trust is required, which is more involved than a non-tax planning RLT. Tax-avoidance provisions may also be included in a tax-planning will. Currently, many people’s estates will fall under the estate tax exemptions provided by the state and federal government. Additionally, unlike an irrevocable trust, a basic revocable trust does not remove assets from being included in your estate and therefore does not avoid income tax liability, protect from creditor liability or avoid estate taxes. If you are interested in discussing tax avoidance or asset protection strategies you should always consult with an attorney, certified public accountant and a financial professional. *This does not constitute tax advice*.

There are several benefits to a RLT, some of the primary benefits are as follows:

Advantages of a revocable living trust:

- Avoids the probate process if correctly maintained;
- More empowerment as a trustee acting on your behalf as compared to a Power of Attorney should you become incapacitated;
- Avoids the need of a court-ordered conservatorship upon incapacity;
- Allows for quicker disbursement of assets if necessary;
- Better privacy since no court filing or public record required;
- Helps to avoid ancillary probates of properties owned in different states;
- Allows you to disburse gifts over time and under certain circumstances– just as in a testamentary trust, you are given more options and more control over the gifts you leave your loved ones than in a simple will.

Disadvantages of a revocable living trust:

- As the grantor it is important to stay diligent about proper titling of assets;
- Less court supervision may allow for more abuse of power;
- More expensive to create.

Nearly everyone can benefit from a revocable living trust. The flexibility, efficiency and probate cost savings can be reason enough to spend a little more up front. Those with minor or spendthrift children, properties in more than one state, who have concern of incapacity in later years, want to span gifts out over time, are concerned about privacy or have an aversion to the probate process, are primary candidates for a revocable living trust. Other specific situations appropriate for a revocable living trust exist as well; it is best discussed with your attorney to determine the right estate plan for you.

This covers the most common <u>non-tax</u> planning tools, the next section will discuss the common <u>tax</u> planning tools.

TAX PLANNING TOOLS:

Both Oregon and the federal government impose an estate tax upon death. However, this tax is only assessed on the assets exceeding the applicable exemption. In Oregon, the current estate tax exemption is $1 million. Under the 2010 tax law, the federal exemption was a little more than $5 million and was set to revert back to $1 million at the end of 2012 unless Congress made new law. In January of 2013, Congress made that new legislation and the exemption will remain at just over $5 million, increasing each year for inflation, for the foreseeable future.

In addition to the individual estate tax exemptions, there is also a marital deduction that allows spouses to pass any amount of property to each other tax free. On the surface this is great news, but what happens when the first spouse dies, leaving everything to the surviving spouse using the marital deduction? The surviving spouse now has the entire estate in his or her name and only his or her individual estate tax exemption to use. The 2010 federal tax law gave a significant tax break to spouses on this issue as well, called portability. Portability enables a surviving spouse to add any unused individual federal exemption of their deceased spouse to their own exemption. This means that together, a couple can transfer just over $10 million tax free without having to do any prior tax planning to preserve the first spouses exemption. The 2013 laws make portability permanent (unless new law is passed in the future to say otherwise). The catch is the surviving spouse must file an estate tax return for the deceased spouse within nine (9) months after death, regardless of whether any tax is owed, to preserve the right to portability. Portability is not available for the Oregon estate tax exemption, thus, if the first spouse to die does not use his or her Oregon exemption, it is wasted.

The previous section did not contemplate tax planning. For those with estates valued under the state and federal exemptions, tax planning is not of concern unless the estate is expected to grow and exceed the exemption later on in life. When thinking about valuation of your estate, it's likely a much bigger net than one might expect. The government will include assets like the fair market value of real property at the time of death (less mortgages), life insurance, retirement accounts, investment accounts, stocks, bonds, checking/savings accounts, personal property, money owed to you, business interests and so on. The following are examples of basic estate tax planning tools. As with any estate or tax planning, you should always consult an attorney and/or tax accountant to discuss the particulars of your situation.

The following does not constitute tax or legal advice.

CREDIT SHELTER TRUST- GENERALLY: A typical credit shelter trust becomes irrevocable and is automatically funded, with an amount set out in the terms of the trust, upon the death of the first spouse. However, this type of trust can also be structured as a *disclaimer* trust, which is basically a subset of the credit shelter trust and only differs in the way the trust is funded. A disclaimer trust is only funded if the surviving spouse "disclaims" part of the estate, *giving the surviving spouse a choice*. In either scenario the trust is funded with enough assets to utilize the tax exemptions. Finally, some more complex estate plans may provide for mandatory funding of the credit shelter trust and include a disclaimer funded trust in addition to that. This kind of estate planning can be done either within a will or within a revocable living trust. The more common planning strategy utilizes the disclaimer provision, thus that will be the focus below.

DISCLAIMER TRUST: Whether you have a disclaimer trust within a will or in a living trust, it operates in a similar fashion. When it is created within a living trust, the general trust is funded upon creation, during your lifetime, by re-titling assets into the name of the trust. The disclaimer (or credit shelter) trust portion of the general trust is not funded until the death of the first spouse. In the case of investments or life insurance, the general trust is named as a beneficiary.

Upon the death of the first spouse, the surviving spouse has nine months to decide whether it makes sense to utilize the disclaimer trust to avoid tax liability. If it is, the trust is created and assets are moved into the trust. It is important to note that the surviving spouse must not be in receipt of the assets owned by the deceased spouse at any point before disclaiming. Any assets received by the surviving spouse after death of the first are no longer eligible for disclaiming into the trust.

If the surviving spouse chooses to disclaim, assets in an amount up to the tax exemption (either state or federal) are moved into the disclaimer trust, which is then irrevocable. The surviving spouse receives income (basically interest earned on the assets, dividends, rents, etc.) from the trust and can access the principal of the trust for specified things such as health, education, support and maintenance. This typically includes maintaining a similar lifestyle as he or she had before the first spouse died. It is important that the surviving spouse has only restricted access to the principal of the trust to avoid it being included in his or her estate. However, the spouse may serve as trustee of the disclaimer trust. Upon the death of the surviving spouse the remaining assets in the disclaimer trust pass estate tax free to the beneficiaries named by the first spouse to die. The assets that are not transferred into the disclaimer trust typically pass directly to the surviving spouse using the tax free marital exemption and are then part of his or her estate. Upon the surviving spouse's death, those assets pass according to his or her estate plan and anything over his or her exemptions is subject to tax. See Diagram A.

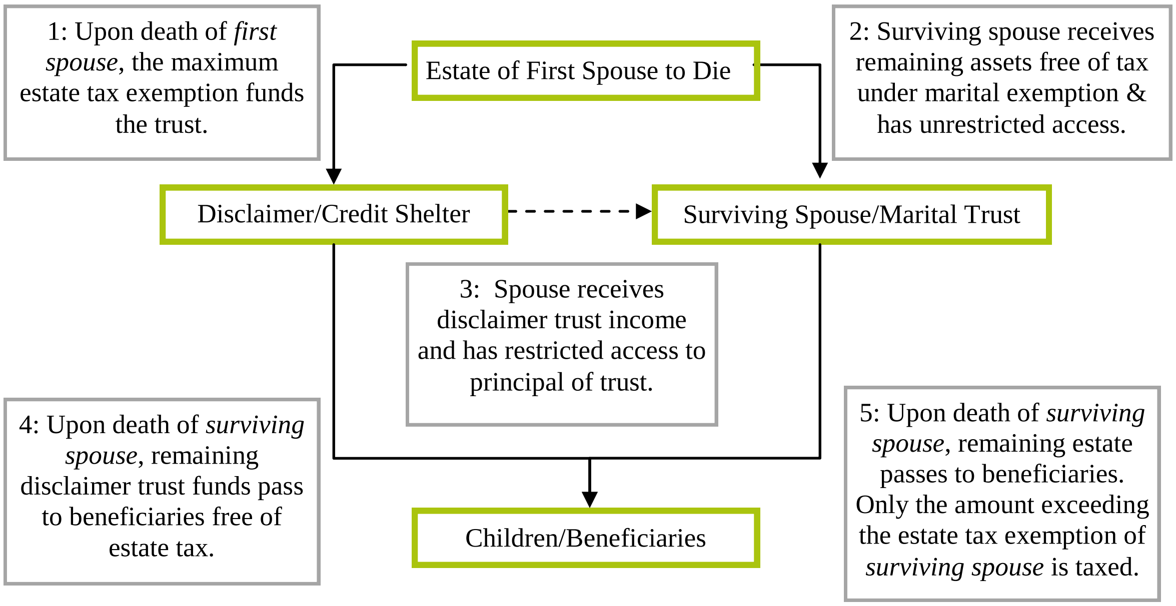
Living trusts are created as a separate document than the will. A will that accompanies a living trust is called a pour over will. It includes a provision that all assets that might have been left out of the trust should be "poured" into the trust so that upon death, if the grantor mistakenly left out an asset it can be included. Whether you have a basic non tax planning living trust, or a tax planning living trust, it is important to keep properties and assets updated in the name of the trust because a living trust that is not funded, is not working.

This kind of estate plan is useful for couples who currently have, or expect to have assets in excess of the state and/or federal tax exemptions. The reasons for creating a credit shelter/disclaimer trust within a living trust, as opposed to in a will, are the same as creating a non tax planning revocable living trust, only you have the added purpose of tax shelter.

TAX PLANNING WILL: Put simply, the tax planning will is one that incorporates a credit shelter or disclaimer trust. In all other respects it has the same advantages and disadvantages as described above under TESTAMENTARY TRUST. The trust will first go through the probate court process to get established. Once established, the disclaimer trust within an estate tax planning will works just as it does when created in a living trust, as shown in Diagram A.

Diagram A.

CREDIT SHELTER/DISCLAIMER TRUST



Every family is unique, that is why it is important to look at various options when designing your estate plan and decide what is most important to you. Many of these tools can be combined and tailored to your needs. If you have children or family members with disabilities, there is yet another tool called the special needs trust, or supplemental needs trust. Briefly, this trust provides supplemental benefits to a disabled or special needs person without interfering with their government benefits. This trust can be used along with any of the tools described here.

The key is the planning. No matter how you choose to design your estate plan, you and your loved ones will greatly benefit from you taking the time to get it in place. You will have the peace of mind knowing that they will be taken care of and that your wishes will be carried out.

When you are ready to plan your legacy, contact attorney Patricia A. Clements to schedule your free initial consultation. She provides affordable, friendly, and professional estate planning services. You can visit her on the web at www.essentialep.com or email her at pclements.law@gmail.com.

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