FROM MEZA TALBOTT LAW

# Creating Your
# ESTATE PLAN

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# About the Genoveva Meza Talbott

Genoveva has been a practicing attorney in Southern California since 2003.

In 2018, Genoveva founded Meza Talbott Law, a family law mediation and estate planning firm. She is also the founder of www.TheLawUnbundled.com, an online platform for delivery of unbundle family law legal services.

She began her legal career working with primarily low-income clients, and then spent a number of years working for a well-respected Southern California law firm known for representing celebrities and high net worth individuals in family law matter.

Genoveva has spoken on matters relating to family law, as well as diversity in the legal profession. She continues to volunteer her time to pro bono legal clinics, as well as non-profit organizations whose mission is to support underrepresented individuals in legal and non-legal matters. She was honored by California State Senator, Anthony J. Portantino of the 25th District, for her dedication to serving the community through legal and non-legal efforts.

Genoveva serves on the Board of Shoes That fit, a California nonprofit organization that has been recognized nationwide for its efforts in helping school children receive new athletic shoes. She also serves on the Board of Orange County Conservations Corps, Sisters of Strength, and is an appointment member of the Fullerton College Paralegal Studies Advisory Board. Genoveva maintains membership and involvement in multiple legal organizations such as the Orange County Hispanic Bar Association, Los Angeles County Bar Association, the Latina Lawyers Bar Association, and in 2011 served as President of the Orange County Hispanic Bar Association after having served on its Executive Board for seven years.

Genoveva received her J.D. from University of Southern California Gould School of Law, earning a full-tuition scholarship for all three years of study, and her B.A. from the University of California, Los Angeles, where she majored in Political Science and minored in French.

Ms. Talbott is admitted to the State Bar of California and the United States District Court, Central District of California. She is fluent in Spanish and conversational in French. She lives in Claremont with her husband and two young children.

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CHAPTER 1

# Preparing to Create Your Estate Plan


I. Why Have an Estate Plan
II. Trusts in Estate Planning
III. The Estate Planning Document Package
IV. Leaving Gifts to Your Beneficiaries on Your Death
V. Preparing to Meet Your Estate Planning Attorney


## I. WHY HAVE AN ESTATE PLAN

### §1:01 Five Things You Can Accomplish with Your Estate Plan

Estate planning is for everyone. You don't have to be wealthy to create a plan that ensures your property is passed on to your loved ones as quickly and inexpensively as possible. You'll want to make sure your wishes regarding end of life medical care are followed regardless of how much money you have.

Estate planning has five major purposes. With a good estate plan you can:

1. Designate how your assets are to be distributed among beneficiaries after you die.
2. Avoid or minimize the delays and expense of probate.
3. Appoint a guardian for your minor children and a person to manage the children's assets.
4. Provide for your incapacity.
5. Minimize estate taxes.

## §1:02 Distribution of Your Property

If you die without an estate plan, the state will provide a plan for you. Every state has an intestacy statute that specifies who gets your property if you die without a will or other documents for passing your property. The statute is a "one size fits all" plan that attempts to predict how most people would like their property distributed. Typically, your property would go partly to your spouse with the rest to your children in equal shares. If you don't have a spouse or children, your property would go to other relatives such as parents or siblings.

This plan may not be suitable in many instances. For example, you may want to:

- Leave unequal shares to your children because they have different needs or you have already provided more help to one during your life.
- Ensure that property left to a spouse will go to your children from a different marriage on the spouse's death, rather than to the spouse's children or relatives.
- Disinherit a child.
- Leave your estate to a life partner to whom you are not married.
- Leave a gift to a grandchild, more distant relative, or friend.
- Leave a contribution to charity.

All of these goals require estate planning.

## §1:03 Avoiding Probate

Probate, the court-supervised process of distributing your estate, can be time-consuming and expensive. You can minimize the assets that need to pass through probate or eliminate probate by using certain devices such as:

- Revocable living trusts.
- Joint tenancies with right of survivorship for real estate and other types of property.
- Transfer on death deeds and pay on death bank accounts.

- Beneficiary designations for life insurance and retirement plans making them payable to a beneficiary other than your estate or executor.

Revocable living trusts are discussed in Ch. 6. Probate and probate avoidance are covered in Ch. 2.

## §1:04 Providing for Your Minor Children

If you have minor children you will want to name a guardian to care for them in the event of your death. Although a court will need to appoint the guardian, most courts will follow your wishes in the absence of a compelling reason not to. Minors can't be given property outright. You will need to designate someone to manage your children's property until they are adults and able to manage it themselves or you can leave property for minor children in a trust.

For more information on providing for minors, see Ch.5.

## §1:05 Preparing for Your Incapacity

In your estate planning documents, you can designate someone to manage your financial affairs should you become unable to do so. You can also specify how your incapacity is to be established. With the proper documents in place, you will save your family the expense and stress of having to go to court to get a guardianship. See Ch. 7 regarding durable powers of attorney for financial management.

You can designate a person to make medical decisions for you when you no longer can. And you can provide written guidelines for that person as to what type of end of life treatment you want. See Ch. 8 for information on advance medical directives.

## §1:06 Reducing Estate Taxes

Most people will not owe federal estate tax due to the very large estate tax exemption. Approximately 99.9 percent of all

estates are not subject to the federal estate tax. But if you expect your estate to be worth more than around $11 million, you will want to meet with an estate planning attorney to discuss strategies for eliminating or minimizing your estate taxes. For discussion of the estate and gift tax and tax-saving strategies, see Ch. 6.

## II. TRUSTS IN ESTATE PLANNING

### §1:07 What Is a Trust?

A trust is a legal relationship in which one person, the trustee, holds legal title to property for the benefit of another person, the beneficiary.

Many kinds of trusts exist, and each state has different rules outlining the specific requirements for trusts.

Trusts are used to accomplish a variety of estate planning goals. A trust may supplement a will or replace a will. A trust may allow your estate to avoid probate. A trust may be created to manage a person's property or protect it from creditors. Some trusts provide tax benefits or reduce tax liabilities.

### §1:08 Creating a Trust

The settlor is the person who creates the trust and funds it with property that he or she owns. A trust must have at least one settlor because a trust cannot exist without property.

To create a trust, the settlor transfers legal ownership of his or her property to a person or institution, the trustee. The trustee can then manage the property for the benefit of another, the beneficiary. Often the trustee receives compensation for serving as trustee. A trustee has a fiduciary duty to act in the best interests of the beneficiary.

A settlor may name himself or herself a trustee or a beneficiary. For example, a settlor is typically the trustee and beneficiary of a revocable living trust. However, the settlor should not be the

trustee or beneficiary of an irrevocable trust created for estate tax saving purposes.

If the only trustee is also the only beneficiary, the trust will terminate under the doctrine of merger. Regardless of what kind of trust a person establishes, the trust will only become effective after the trust maker has funded it, i.e., transferred assets to it.

Only the settlor needs to sign the trust document. However, because a trustee is not responsible for the trust unless he has accepted it, it is customary to have the trustee sign to evidence acceptance.

## §1:09 Revocable and Irrevocable Trusts

A trust may be either revocable or irrevocable. A revocable trust is a trust that the settlor can change, amend, or revoke during his or her lifetime. The settlor still has complete control over the assets that he or she has transferred into the trust. Revocable trusts may include a provision that makes the trust irrevocable on the settlor's death.

On the other hand, an irrevocable trust is a trust that the settlor cannot modify or revoke. The settlor of an irrevocable trust permanently relinquishes any right to make changes to the trust.

## §1:10 Living (Inter Vivos) Trusts and Testamentary Trusts

A testamentary trust is a trust that is funded and comes into existence only after the settlor has died. The term is usually applied to trusts that are created by a will. But a trust that takes effect on the settlor's death can also be created by a revocable living trust. A testamentary trust becomes irrevocable on the settlor's death.

A testamentary trust, as opposed to an outright gift, allows the settlor to have more control over the management and distribution of his or her property after death. For example, parents often establish a testamentary trust for the benefit of their minor children through which the trustee manages the assets and

disbursement of money to the children until the children reach a certain age or attain certain milestones.

A living or inter vivos trust is a trust that is established and funded during the settlor's lifetime. It may terminate after a specified period or on the settlor's death or it may continue after the settlor's death. A living trust may be revocable or irrevocable. One type of living trust, the revocable living trust, may allow a person's estate to avoid probate if his or her assets were transferred into the trust before his or her death.

Irrevocable living trusts are often used for protecting property from creditors or for certain tax benefits.

## §1:11 Why Include a Trust in Your Estate Plan

Some of the most important reasons for including one or more trusts in your estate plan are:

- To provide property management for minor or incapacitated beneficiaries.
- To avoid probate.
- To avoid a guardianship if you become incapacitated.
- To protect beneficiaries from creditors or a court-ordered property division on divorce.
- To save on taxes.

## §1:12 Property Management for Minor or Incapacitated Beneficiaries

Because minors cannot enter binding contracts, property owned by a minor directly can be managed only through a court-supervised guardianship proceeding. However, by creating a trust in your will or revocable living trust to hold property until the minor turns 18 (or older), you can avoid the cost and inconvenience of the guardianship. A trust allows you to select a trustee to handle the child's inheritance until the child reaches an age at which you think he or she is mature enough to receive the inheritance without restrictions. For more on trusts for minors, see Ch. 5.

Similarly, trusts can be used to protect legally incapacitated adults. A mentally disabled person may lack the legal capacity or the wisdom to handle his or her affairs, so an inheritance can be held in trust for the person's lifetime. If a disabled person is receiving government benefits because of the disability, a supplemental needs trust can enable the beneficiary to enjoy the benefits of the trust estate without becoming ineligible for government aid programs.

## §1:13 Probate Avoidance

Another common use of trusts is probate avoidance. Probate avoidance is typically accomplished with a revocable living trust to which you transfer title to all of your assets; if no assets are in your name when you die, no state court probate proceeding will be needed to transfer title to your heirs. For more on revocable living trusts, see Ch. 4.

A living trust is useful in other circumstances as well. For example, if you own real estate in multiple states, a revocable living trust can avoid multiple probate proceedings, which may save time and money. Also, a revocable trust can provide greater privacy than the probate process in certain circumstances. Finally, for a disabled person, a revocable trust can provide a mechanism for allowing someone else to manage the person's affairs.

Because some states have a relatively simple probate process, avoiding probate is not a good plan for everyone. In some cases, the hassle and expense of probating a will are not much greater than the hassle and expense of creating a trust, given that probate does not need to be paid for until death, but a trust must be paid for upfront, and then must be maintained until death. For more on probate, see Ch. 2.

## §1:14 Guardianship Avoidance

Without a revocable living trust, if you become incapacitated, then it is likely that your property will be managed through a

court-supervised guardianship. However, if you transfer all of your assets to a revocable trust, the person designated as the successor trustee can manage your properties for as long as you are incapacitated. Instead of using a fully funded revocable trust to avoid a court-supervised guardianship, you could execute a durable power of attorney. Your agent under the durable power of attorney could manage your property until you are no longer incapacitated. However, many financial institutions are reluctant to allow the individual designated as an agent under a durable power of attorney to gain access to a principal's bank and other financial accounts and are generally more comfortable with allowing a successor trustee under a revocable trust instrument to manage these same assets. See Ch.7.

## §1:15 Creditor and Divorce Protection for Beneficiaries

A trust established for a child, grandchild or other beneficiary is generally better protected from the beneficiary's creditors and from a divorce court-ordered property distribution to an ex-spouse of any such beneficiary, than would be the case if such property were to be inherited outright by the beneficiary; provided that the trust contains a spendthrift trust clause or is a discretionary trust.

A spendthrift clause is a provision in a trust that prohibits beneficiaries from spending or borrowing against the trust funds and creditors from accessing funds still in the trust to pay a debt a beneficiary owes them. The beneficiary can spend funds that are distributed to him or her and creditors can also go after such funds. In a discretionary trust, the trustee is given full discretion as to when and what funds are given to the beneficiaries.

## §1:16 Tax Planning

The federal estate tax system provides a complex set of rules for the taxation of trusts. Many of these rules allow individuals and couples with substantial estates to defer or minimize estate taxes.

For example, trusts that meet certain requirements under IRC §2056(b) qualify for the unlimited marital deduction, allowing couples to defer all estate tax until the death of both spouses. At the same time, an individual can create a bypass trust that will not be included in the surviving spouse's estate, allowing the most efficient use of both spouses' lifetime gift and estate tax exemptions.

Irrevocable life insurance trusts can effectively remove the proceeds of life insurance from an insured's estate, and other irrevocable trusts can be used to transfer wealth out of a parent's estate without giving the beneficiary immediate control over assets. For more on these types of trusts, see Ch. 6.

## III. THE ESTATE PLANNING DOCUMENT PACKAGE

Every estate plan, regardless of the value of the estate, should include these essential documents.

### §1:17 A Will or Revocable Living Trust with a Back-Up or Pour-Over Will

These are the foundation documents of the estate plan. For probate avoidance, you may prefer a living trust in combination with a will to dispose of property that doesn't pass through the trust. If probate avoidance is not a goal (or is accomplished through other devices), then a will may be sufficient. These documents will allow you to designate how your property is to be distributed on your death. In a will, you can name a guardian for your minor children and an executor to oversee your estate. In a trust, you can name a trustee to oversee the distribution of trust property on your death and to manage the trust property should you become incapacitated.

### §1:18 A Durable Power of Attorney (DPOA)

This document allows you to name a person to manage your financial affairs if you become unable to do so. The purpose of

a DPOA is to avoid the need for a guardianship proceeding. In some states, you can also execute a declaration naming a preneed guardian. This document helps ensure that the court appoints as guardian the same person you have decided to entrust with your affairs under your DPOA in the unlikely event that a court decides that you need a guardianship.

## §1:19 Advance Medical Directives

Advance medical directives include a medical durable power of attorney (MDPOA) and a living will. With an MDPOA, you appoint a person to make health care decisions for you if you become unable to make them for yourself. In a living will, you can explain what type of care you would like at the end of your life. Your living will provides a guide for the person appointed to make health care decisions in your MDPOA.

## §1:20 Additional Documents for More Complex Estates

Additional documents may be necessary depending on the complexity of your estate and your estate planning goals. For example, wealthy individuals and couples may want to establish and fund certain types of irrevocable trusts while they are alive to minimize or eliminate estate and gift taxes while benefitting their children, grandchildren, or charities.

## §1:21 Keeping Your Estate Plan Up to Date

Remember that estate planning is not a one-time event. Once you have your initial plan and documents in place, you and your estate planning attorney will need to review them periodically and revise them as necessary for changes in your financial or family circumstances or the law. See Ch. 9.

### §1:22 Remember Beneficiary Designations

You should be certain to complete beneficiary designations for any assets that pass in this manner, such as life insurance and retirement accounts.

When you create and update your estate plan, discuss your beneficiary designations with your estate planning attorney. He or she can look at the big picture including all your assets, those that pass by beneficiary designation and those that don't, when helping you to design a plan that meets your goals. Then he or she can advise you on the best way to complete your designations to be consistent with the rest of your estate plan.

## IV. LEAVING GIFTS TO YOUR BENEFICIARIES ON YOUR DEATH

### §1:23 Types of Gifts You Can Make in Your Will or Revocable Living Trust

You have a number of options for specifying who will get your property on your death, whether you use a will or a revocable living trust as your principal document.

- You can give one or more specific items of property to one or more specified persons or organizations.
- You can give specific sums of money to specified persons or organizations.
- You can give property to two or more people jointly or you can specify that property be liquidated and the proceeds divided between two or more beneficiaries. They can share the property or proceeds equally or in whatever percentages you specify.
- You can leave property in one or more trusts that go into effect on your death for the benefit of whomever you choose as beneficiaries.
- You can leave property to one beneficiary for life and then to a different beneficiary on the first beneficiary's death.

- You can give a gift to be shared among a class of beneficiaries, such as your children.
- You can give broad categories of property (e.g., all my household furnishings and personal effects) to one or more specific persons or organizations or to a class of beneficiaries.
- You can pass all or part of your estate through a residuary clause, a provision that specifies what happens to any property that you have not already disposed of through some other provision in your will or trust.

## §1:24 Specific Bequests

A specific bequest is a gift of a particular item that is described in your will or living trust so that it is clear that you intended for the beneficiary to receive that particular item, rather than cash or other property from your estate. A gift of "my diamond engagement ring" is a specific bequest, as is a gift of a business or a particular piece of real estate. You don't need to name a beneficiary for every item of personal property you own. Typically, specific gifts are limited to items of significant monetary or sentimental value.

**When the item is no longer in your estate.** If you plan to make specific gifts, you should think about what you want to do if the item isn't in your estate when you die. Even though you leave a specific gift in your will or trust, you are still free to sell the property or give it away during your lifetime. If you no longer own the specific item when you die, the gift will fail (the legal term is "adeem") and your beneficiary will not receive an alternative gift unless you explicitly provide one.

**When the beneficiary predeceases you.** Similarly, you should consider what you want to do if the recipient of the gift dies before you. You may want to name an alternate beneficiary who will receive the item. You can even name a series of alternates.

If you do not name alternates and your beneficiary predeceases you, as a general rule, the gift will lapse and pass to your residuary beneficiaries (see §1:26). However, state anti-lapse

statutes may change this result if your beneficiary is a relative. All states have anti-lapse statutes that presume that if you make a specific gift to a relative who does not survive you, you would want the gift to go to his or her heirs.

**Anti-lapse statutes.** States take different approaches to who qualifies as a relative. In some states, the beneficiary may have to be your descendant, in other words, a child, grandchild, etc. In other states, the beneficiary may be a descendant of your parents, who would then include your siblings and nieces and nephews. So, if you leave your diamond engagement ring to your daughter and she predeceases you, the ring will go to her heirs, but if you leave the ring to your best friend and she predeceases you, the ring will go to your residuary beneficiaries.

**Sample provision.** Here is a sample will provision for a specific gift naming alternative beneficiaries:

> I give my telescope and all of my jewelry to Jane Doe or to Alice Doe if Jane Doe does not survive me, If neither Jane Doe nor Alice Doe survives me, these items shall pass to my children as part of my gift to them of my personal and household effects.

Here, Jane Doe is the primary beneficiary. Alice Doe and the testator's children are alternate beneficiaries. A revocable living trust provision would be similar, except that it would direct the trustee to make the gift.

You are not obligated to name an alternate beneficiary. If your primary beneficiary predeceases you, you can always amend your will or trust if you want to leave the item to someone else.

**Personal property memorandum.** In some states, instead of setting out specific gifts in your will, you can specify to whom you want to leave items of tangible personal property in a separate statement or letter so long as the letter is referred to in your will. See Ch. 3.

**Gifts of categories of property.** As an alternative to specific gifts, you can make gifts of general categories of property, for example, "all my jewelry," or "all my tangible personal property and household furnishings." Use of broad categories to describe gifts reduces the likelihood that the gift will fail because a specific item is not in your estate when you die.

## §1:25 General and Demonstrative Bequests

A gift of a sum of money to be paid from the general assets of the estate is known as a general bequest. A demonstrative bequest is a gift of a sum of money to be paid out of the proceeds of a specific piece of property.

**Sample provisions.** Here is a typical general bequest from a will:

> I give $10,000 to my brother, Sam Smith, or to Sam Smith's descendants if Sam Smith does not survive me. If neither Sam Smith nor any of his descendants survive me, this gift shall lapse and pass as part of my residuary estate.

Here is a demonstrative bequest:

> I give $10,000 to my brother, Sam Smith, or to Sam Smith's descendants if Sam Smith does not survive me, to be paid from the proceeds of the sale of my Microsoft stock. If neither Sam Smith nor any of his descendants survive me, this gift shall lapse and pass as part of my residuary estate.

## §1:26 Residuary Bequests

A residuary bequest is a gift that is made in the residuary clause of a will or living trust. A residuary clause is an essential

provision of every will or revocable living trust that takes care of who inherits your property in three situations:

- You own assets that you did not dispose of in some other provision in your will or trust.
- A beneficiary to whom you gave a specific gift dies before you or refuses the gift and you have named no alternate beneficiary or your alternate also predeceases you or disclaims the gift.
- You own an asset like life insurance that passes by beneficiary designation and you have named no beneficiary or have named your estate or the trustee of your trust.

Without a residuary clause, these assets would pass by state intestacy law rather than in accordance with your wishes.

The bulk of your estate or even the entire estate can be passed through the residuary clause if there are few or no specific, general, or demonstrative bequests. Many people leave their entire estates to their spouses or children to be shared equally or in specified percentages.

**Sample provision.** Here is a typical residuary clause from a will:

**Residuary Estate.** I give all the reminder of my estate ("my residuary estate"):

(a) To my wife.
(b) If my wife does not survive me, to my descendants.
(c) If none of my descendants survive me, to The Very Generous Charitable Foundation for Solving World Wide Problems, federal taxpayer Id number [____________].

## §1:27 Class Gifts

You can leave a gift to be divided among a group of persons, such as "my children" or "my descendants," or "my nieces and nephews." This is called a class gift. It will include members of the class who are born after you execute your will or trust.

**When a class member predeceases you.** A class gift will be shared equally among all members of the class. You'll want to specify what happens if a member of the class predeceases you. Do you want a deceased member's share to be divided among the surviving class members or do you want the deceased member's share to go to his or her descendants?

Most people want to provide that if a child predeceases them, that child's share should be divided equally among his or her children.

**Defining the class.** If you leave a class gift, you should define who is to be in the class. Whom do you consider to be your "children," "siblings," or "nieces and nephews?" For example, does a gift to "my children" include adopted children or step-children? Most people want to include adopted children (and the law usually includes them as well), but often don't want to include people adopted as adults. People who have raised their stepchildren from an early age may want them to be treated the same as biological or adopted children.

**Sample provision.** Your will or trust could say something like this, which also makes clear that "children" include those born or adopted after the will is executed:

> The term "children" includes my two stepchildren and any children hereafter born to or adopted by me. "Descendants" means the children of the person designated and the lineal descendants of such children, and includes any person adopted before attaining age 18 and the adopted person's lineal descendants. My "descendants" include my stepchildren and their descendants. A posthumous child shall be considered as living at the death of his or her parent.

## §1:28 Shared Gifts

You can leave a specific item to be owned jointly by two or more beneficiaries. For example, perhaps you want to leave your

hunting cabin to your son and your brother, both of whom have enjoyed using it in the past. If you decide to give a shared gift, you'll want to specify the percentage ownership of each beneficiary. Otherwise, it will likely be presumed that you intended for them to share it equally. Shared gifts can present a problem for your beneficiaries if they don't get along or agree on how to use the gift. So you may want to make sure the gift will not cause conflict among the beneficiaries.

Alternatively, you can specify that property be sold and the proceeds divided among named beneficiaries. Again, you'll want to state each beneficiary's share of the proceeds in percentages.

## §1:29 Gifts in Trust

You can make a gift to one or more beneficiaries to be held in a trust created on your death by your will or revocable living trust. These trusts may serve a number of different purposes. They may provide property management for minor or young adult beneficiaries; protect the trust property from creditors of the beneficiaries; minimize estate taxes; or allow you to maintain some control over the property after your death.

**Sample provision.** Here is a will provision making a gift from the testator's residuary estate to a trust for the testator's children if any of them are under 25.

**Residuary Estate.** I give all of the remainder of my estate ("my residuary estate"):

(a) If I am survived by any children of mine who are under age 25 at my death, to the trustee of a trust for the primary benefit of my children. This trust shall be known as the Jones Family Trust.

(b) If I am not survived by any children of mine who are under age 25 at my death, to my descendants.

(c) If none of my descendants survives me, to my Contingent Beneficiaries.

## §1:30 Life Estates

You can make a gift to a person for his or her lifetime, known as a life estate, and on that person's death, provide that the property is to go to other beneficiaries. This type of gift is most often made in a trust.

**Sample provision.** For example, here is a will provision making a gift to the testator's wife for her lifetime and then to the testator's descendants.

**Jones Family Trust.** The gift to the trustee of the Jones Family Trust shall constitute the initial trust estate of a trust for the benefit of my wife during her lifetime, and for the primary benefit of my children after my wife's death.

- (a) **Distributions During Wife's Lifetime.** During my wife's lifetime, the trustee shall distribute to my wife:
  - (1) All of the net income from the trust, in convenient installments at least annually; and
  - (2) So much of the trust principal as is necessary to provide for my wife's health, education, maintenance, and support in the standard of living to which she was accustomed at my death.
- (b) **Termination of Trust Upon Wife's Death.** Upon my wife's death, or if my wife does not survive me, the trustee shall distribute the trust estate to my descendants. If at my wife's death none of my descendants is then living, the trustee shall distribute the trust estate to my Contingent Beneficiaries.

## §1:31 Expressions of Your Wishes and Explanations of Your Gifts

You may want to indicate how you would like to see a beneficiary use a gift (e.g., to buy a home or pay off debts), but these expressions are not binding on the beneficiary if the gift is given

outright. If you want to place restrictions on a gift, you can leave it in trust and authorize the trustee to distribute it to the beneficiary once the beneficiary meets your requirements.

You may also want to explain why you have made or not made certain gifts. Alternatively, you may prefer to put these thoughts into a letter that can be kept private and delivered to your beneficiaries and other appropriate parties. Exercise caution when providing an explanation of why you have chosen to disinherit an heir.

## §1:32 Disinheriting Spouses and Children

Your will or revocable living trust can contain provisions disinheriting a child or spouse, although it may not be possible to completely disinherit a spouse without the spouse's consent.

**Inheritance rights for surviving spouses.** A surviving spouse has inheritance rights under state law. The specific rights vary by state, but they typically allow the surviving spouse to claim a certain percentage of the deceased spouse's estate despite what the will or trust provides (or doesn't provide) for him or her. A surviving spouse may also be able to claim a right to remain in the marital home for a period of years or life, even if the home is entirely the deceased spouse's property and is left to someone else. A surviving spouse may also be entitled to an allowance from the estate for a period after the other spouse's death.

Probably the most common situation of spousal disinheritance is the second marriage. One or both spouses have children from prior relationships and no children in common and want to leave their entire estates to their children. The solution is a premarital or marital agreement. Most states allow spouses to waive state inheritance rights in these agreements. If you and your spouse do not wish to leave the bulk of your estates to each other, you should consider hiring separate counsel to prepare a marital agreement (or premarital agreement if you are not yet married) to make your joint estate plan binding on both of you.

**Disinheriting children.** Unlike a spouse, you are allowed to disinherit a child. Your will or trust should explicitly state that you have disinherited the child. That way, your intention is clear. Otherwise, state law may give the child a right to claim some of your estate on the basis that the omission was an oversight or error.

You may feel the need to describe the reason in your will or trust because you want the family to understand and respect your motives. However, the law does not require you to provide a reason. Many estate planners advise their clients to avoid providing an explanation to foreclose any possible grounds the child may have for challenging your decision.

If you do decide to provide an explanation, it should be phrased carefully and in general terms to avoid mistakes of fact. The explanation should not contain strong or emotional language that could be characterized as irrational. Otherwise, the explanation could open the door for the disinherited child to claim you were under an "insane delusion" which could invalidate your will or trust.

## V. PREPARING TO MEET YOUR ESTATE PLANNING ATTORNEY

### §1:33 Questions to Consider as You Determine Your Estate Planning Needs and Goals

Below is an Estate Planning Questionnaire that you may find helpful to complete before meeting with your estate planning attorney for the first time. Jot down your answers and bring them (along with an inventory of your estate) to your meeting. Your attorney will need this information to help you develop the best plan to achieve your goals.

## Estate Planning Questionnaire

**Planning for Disposition of Your Property**

1. Do you want each of your children to inherit equal shares or do you want to leave them unequal amounts?
2. Do you want to leave gifts to family members other than your spouse or children?
3. Do you want to leave gifts to friends or other nonrelatives?
4. Do you want to leave gifts to charity?
5. Do you want to leave specific items or cash to specific people?
6. Do you have children from a prior marriage whom you want to provide for?
7. Do you want to disinherit a child or spouse?
8. Do you want to leave funds to care for a pet?
9. Do you want to limit the uses to which a beneficiary can put his or her inheritance (e.g., for college expenses)?
10. Do you want to restrict a beneficiary's access to his or her inheritance?
11. Do you want to allow someone else to decide what happens to some or all of your property after your death?

**Planning for Your Minor or Disabled Children**

12. Whom do you want to act as guardian and as alternate or successor guardian of your minor children?
13. Whom do you want to manage your minor children's property?
14. Do you have dependents with special needs or disabilities who will need lifetime assistance and will not ever be able to manage their inheritances?

**Planning for Your Incapacity**

15. Whom do you want to manage your financial affairs if you are unable to do it?
16. Whom do you want to make medical decisions for you if you can't make them for yourself?
17. What type of care do you want at the end of your life or if you are seriously ill and cannot make the decision yourself?

**Tax Planning**

18. Do you know your net worth? If not, consider making an inventory of your estate to get an approximate figure.
19. Is it approaching the estate tax exemption so that you need tax planning advice?
20. Are your spouse, children, or parents not U.S. citizens?

**Planning for Estate and Trust Administration**

21. Whom do you want to serve as your executor and alternate or successor executor?
22. Do you want to avoid probate?
23. Whom do you want to serve as the successor trustee of your living trust?
24. Whom do you want to serve as the trustee and successor trustees of any other trusts that are part of your estate plan?

## §1:34 Making an Inventory of Your Estate

As you begin to think about developing your estate plan, you may find it helpful to make an inventory of your assets and debts. The inventory will get you thinking about what you own and to whom you want to leave it. You'll have the inventory ready to show your estate planning attorney who will need it to give you the best advice and to draft your documents. Finally, it will give you an idea of the value of your estate and whether you will need to employ tax planning strategies.

You can use the form below to get started. Add extra pages as necessary.

# Estate Planning Inventory of Assets

## I. Assets

### A. Real Estate

| Address/ location | Value | Mortgage balance | % ownership | Net value of your interest |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |

### B. Bank and Brokerage Accounts (including savings, checking, CD, money market, mutual funds, stock, and securities)

| Account type | Financial institution | Value or balance | % ownership | Net value of your interest |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

### C. Vested retirement plan interests (including IRAs, employee benefit plans, annuities)

| Institution/ Custodian | Balance/value | % ownership | Net value of your interest |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |

### D. Life insurance

| Institution | Amount | % ownership | Net value of your interest |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |

### E. Vehicles (including automobiles, trucks, boats, planes, RVs)

| Make & year | Value | Loan amount | % ownership | Net value of your interest |
|---|---|---|---|---|
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

### F. Other assets (including electronics, jewelry, art & collectibles, household goods, clothing & tools)

| Description | Value | % ownership | Net value of your interest |
|---|---|---|---|
| | | | |
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| | | | |
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### G. Business interests (LLCs, corporations, partnerships)

| Name and Type of entity | Value | % ownership | Net value of your interest |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |

### H. Intellectual property (patents, copyrights, royalties)

| Description | Value | % ownership | Net value of your interest |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |

### I. Money owed to you (debts, receivables)

| Description | Value | % ownership | Net value of your interest |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |

Total net value $________

**II. Liabilities (excluding mortgages and vehicle loans listed above)**

**A. Consumer/personal debts (personal loans, credit cards, medical bills, back child support, etc.)**

| Description | Amount owed |
|---|---|
| | |
| | |
| | |
| | |
| | |

**B. Business debts**

| Description | Amount owed |
|---|---|
| | |
| | |
| | |
| | |

**C. Taxes (past and currently due)**

| Description | Amount owed |
|---|---|
| | |
| | |
| | |
| | |

Total liabilities $________

Net worth $________

## §1:35 Conflicts of Interest Disclosure for Couples

Couples often make their estate plans together and want to have the same attorney advise them and prepare their documents. If this is your situation, you should be aware of the possibility that a conflict of interest could arise between you.

A conflict could arise if the decisions of one of you regarding your estate plan become adverse to or inconsistent with the decisions of the other. A conflict could also arise if you cannot agree on the disposition of property you jointly own. A conflict of interest between partners with the same attorney creates an ethical dilemma for the attorney. An attorney is obligated to refuse to jointly represent two clients with conflicting interests.

Some conflicts can be adequately addressed by having the attorney withdraw from representing either partner.

**Example:**

Harley and Devon, a married couple, own property jointly. Harley wants to leave his share to his mother but Devon expects to inherit the entire asset. Their attorney faces a conflict of interest if she attempts to represent both spouses. If Harley and Devon cannot reach an agreement on this issue, the attorney would probably have to withdraw from representing both of them.

However, some conflicts cannot be resolved by withdrawal after they have arisen.

**Example:**

An attorney prepares wills for Pierre and Virginia, a couple in a second marriage who have decided to leave everything to each other, even though they both have children from previous marriages. Two years later, Virginia asks the attorney to prepare a codicil amending her will to leave part of her estate to her children. Virginia tells the attorney that she doesn't want Pierre to find out about the codicil. The attorney now has a conflict of interest because ethical rules require him to keep Virginia's confidence. But the attorney has a duty to give Pierre all the information he

needs to make informed decisions about his estate plan. Because Pierre is likely to want to change his will if he learns that Virginia has changed hers, this information is relevant and Pierre could be disadvantaged if he is not told.

Even if the attorney formally withdraws from representing the couple, he is still compromising Virginia's confidence because Pierre will suspect that something is up. There is no solution to this problem. No matter what the attorney does, either Virginia or Pierre (or both) will not get the treatment that he or she wants and is entitled to receive from the attorney.

Therefore, if you and your spouse choose the same attorney to prepare your estate plans, the attorney is likely to require you to sign a conflict of interest disclosure and waiver of confidentiality in which you acknowledge that you understand that the attorney has to stop representing you if a conflict arises and you agree that the attorney will not keep communication from one of you secret from the other. The attorney is still obligated to keep communications from both of you secret from third parties.

CHAPTER 2

# Probate and Probate Avoidance

I. Probate
II. Deciding Whether to Avoid Probate
III. How to Avoid Probate
IV. Joint Tenancy with Right of Survivorship
V. Transfer on Death Deeds (TODD) and Vehicle Registrations
VI. Pay on Death Bank Accounts and Securities Registrations
VII. Beneficiary Designations
VIII. Lifetime Gifts

## I. PROBATE

### A. Overview

#### §2:01 What Is Probate?

Probate is the legal process for settling an estate after someone (the decedent) has died. It is also known as estate administration.

During probate, the decedent's personal representative (also called the executor if the decedent left a will or the administrator if the decedent did not have a will) locates the decedent's assets, pays his or her debts, and distributes the remainder of the estate to the inheritors. If the decedent left a will, the inheritors are the beneficiaries named in the will. If the decedent died without a will (intestate), the inheritors are the heirs specified by state law.

## §2:02 Purposes of Probate

Probate serves many important purposes.

- **Probate prevents fraud and protects the last wishes of the decedent.** The probate court determines the authenticity of the will by closely scrutinizing the document and signatures. This scrutiny prevents a fraudulent will from being admitted to probate and ensures that the true wishes of the decedent are carried out.
- **Probate protects heirs.** The personal representative is required to mail a notice of probate to all known heirs and interested parties making them aware of the process and whom to contact with any questions or objections.
- **Probate protects creditors while also protecting estate assets.** The personal representative is required to publish a notice of probate in a newspaper for several weeks in a row and to mail a notice of probate to any known creditors. This allows creditors to make claims against the estate for debts the deceased owed to them. It also allows the representative to verify that the claims are for legitimate debts. Creditors are barred from bringing claims against the estate after a specific period.
- **Probate ensures accountability.** During probate process, the personal representative is required to gather assets, create inventories, appraise property, and make periodic reports to the court and all heirs. The personal representative is required to keep the heirs informed about what goes on during each step of the process. Probate records are public, allowing them to be viewed by anyone. There is no room for nefarious actions by the personal representative or any other party in probate.
- **Probate provides a forum to resolve issues.** Interested parties may disagree with the appointment of the personal representative, distributions to beneficiaries, amounts paid to creditors, or other issues. Probate provides a forum in which interested parties can bring disputes for a neutral third party to decide.

## §2:03 Formal and Informal Probate

In many states, a probate procedure can be either formal (also known as supervised or dependent administration) or informal (also known as unsupervised or independent administration). In a formal probate, the probate court assumes a greater role. The decedent's personal representative must get court approval before conducting financial transactions or making major decisions regarding the estate. For example, the personal representative may need to get the court's approval before selling the decedent's home.

An informal probate allows the representative to make decisions about the estate and distributions without having to report to the court. However, the executor still must follow the decedent's wishes as outlined in the will. In general, informal probate tends to be faster than formal probate because the court does not need to be as involved.

You can specify which type of probate you want in your will if both types are permitted in your state. Your beneficiaries may be able to elect an informal probate if they all agree.

If you die without a will, or if you don't specify your preference, whether probate of your estate will be formal or informal may be determined by its value. For example, in many states, estates valued under $50,000 in total assets are automatically designated for informal probate.

A dispute among interested parties will turn informal probate into formal probate.

# B. Steps in the Typical Probate

## §2:04 What Probate Is Designed to Accomplish

The functions of probate are to:

- Validate the will, if the decedent left one, and appoint a personal representative to settle the estate.
- Identify, inventory, and value all probate property included in the estate.

- Enforce the estate's rights to income and property to which the decedent was entitled.
- Handle any matters involving the decedent's business interests.
- Pay the decedent's debts and taxes, including estate taxes if any are due.
- Resolve any disputes among the potential inheritors or between the estate and potential inheritors, creditors, or other parties.
- Distribute property to beneficiaries of a will or heirs as provided by law if the decedent did not leave a will.

Probate administration is almost entirely a matter of state law. Each state has its own rules governing the process. Regardless of the state, the following steps are generally required.

## §2:05 Initiating Probate

To open probate, a petition asking the court to admit the will to probate and to appoint a personal representative to administer the estate is filed with the probate court. The death certificate and the will are filed along with the petition.

Typically, the person named in the decedent's will as the executor files the paperwork. But any person who potentially has an interest in the estate can file. An interested person is someone who has or might have some claim to estate assets, like a beneficiary named in the will, a relative, or a creditor. If no executor is named, the person who petitions is usually the spouse or an adult child of the decedent.

The original will must be filed. When the original will cannot be found, it may be possible to probate a copy. State requirements vary for when a copy may be probated instead of an original. Typically, a copy can be probated only after a thorough and diligent search is made for the original will. It may also be necessary to know what happened to the original. For example, it may have been destroyed in a fire or flood at the decedent's home. The court wants to be sure the decedent didn't destroy the will himself or

herself with the intention of revoking it. If neither an original nor a copy of the will can be found, the decedent is said to have died intestate and the estate will be distributed according to the state laws of intestate succession.

The initial filing should specify which type of proceeding, formal or informal, is being requested.

## §2:06 Notification of All Interested Persons

After the initial filing, the person who submitted the court documents must give written notice to interested parties that an application to open probate was submitted. The notice typically requires copies of the filed papers. If an interested party cannot be located, notice must be given by publication in a newspaper.

Notice provides interested parties with the opportunity to object to the probate application. For example, they may raise questions about the validity of the will, or they may object to the appointment of a particular person as executor or administrator.

Notice should also be provided to the decedent's known creditors. A notice should be published in the local newspaper to provide notice to unknown creditors. Notice to creditors provides them with the opportunity to file claims against the decedent's estate.

All probate assets are subject to creditors' claims. However, if the decedent is survived by a spouse or children, or children of deceased children, certain probate assets may be exempt from creditors' claims. Any creditor who wishes to make a claim on assets of the estate must do so within a limited period or the claim will be barred.

## §2:07 Authentication of Will and Appointment of Personal Representative

Once a petition or application for probate has been filed and notice given, the court will appoint the personal representative by issuing an order or "Letters Testamentary." This document enables the personal representative to open a checking account

for the estate, access the decedent's accounts, collect money due the estate, and otherwise manage estate property.

If informal probate is requested in the petition and is appropriate, an officer of the court will look over the application documents and decide whether all legal requirements have been met to probate the will. If all legal requirements have been met, the will is admitted to probate, testamentary letters are issued to the appointed personal representative, bond is posted if required, and probate begins.

If the process is formal, a hearing will be held before a probate judge to authenticate the will and appoint a personal representative. The court may hear from witnesses and interested parties regarding both issues. If the court determines the will is authentic, a personal representative will be appointed and testamentary letters will be issued. If the court has any questions about the authenticity of the will, or whom to appoint as a personal representative, or other issues need clarification, interested parties will be given the opportunity to submit evidence and another hearing will be set for a later date.

Once appointed, the personal representative must pay any required bond and give notice to all interested parties and creditors that testamentary letters have been issued. The notice should contain a copy of the letters along with contact information for the personal representative. If another hearing has been scheduled, the date, time, and place of the hearing are included. The court will require notice by publication for any unknown interested parties or creditors.

## §2:08 Representative Locates the Assets and Creates an Inventory

The personal representative identifies the decedent's probate assets and makes an inventory of them. The inventory is a listing of each asset and its value. Assets may include real property, investments, business interests, and personal property. Personal and household effects can usually be lumped together. However,

unique assets or those of substantial value need to be separately listed and may need to be professionally appraised. Some well-organized decedents leave a list, which greatly speeds up the work. Otherwise, the personal representative may have some detective work to do.

(A decedent may own assets that do not need to go through probate. These assets, which are discussed in §§2:18-2:37, are not included in the inventory.)

## §2:09 Representative Opens a Bank Account for the Estate

The personal representative must transfer the deceased's existing accounts and also deposit proceeds from the sale of the deceased's assets into an estate bank account. This functions just like a routine bank account, with a few distinctions. For example, to open an estate account, the representative must establish an Employer Identification Number ("EIN") with the Internal Revenue Service ("IRS"). This EIN will serve as the unique identifier for estate financial transactions and tax reporting.

Additionally, the representative should keep estate finances separate from personal finances. The estate bank account also helps with record-keeping, which will help the representative demonstrate the value of the estate to creditors and beneficiaries.

## §2:10 Representative Pays Debts and Taxes

The personal representative must review each creditor's claim to make sure it is legitimate and accurate before paying it from the estate checking account. Estate debts may include medical bills and funeral expenses, credit card debt or loans, and other routine bills. Expenses of administering the estate also need to be paid, such as court fees, fees for attorneys and any other professionals whose services were required such as appraisers, accountants, realtors, investment advisors, and tax preparers. The personal representative may also be entitled to a fee. Any outstanding debts or liabilities should be paid before distributions are made.

The personal representative is responsible for filing the decedent's final income tax returns and collecting any refund that is owned or paying any taxes that are due. The personal representative is also responsible for filing the estate tax return and paying any estate taxes that are due. Few estates owe estate taxes, however. See Ch. 6.

If the estate does not have enough cash to pay debts and taxes, the representative may need to sell property. With a formal probate, the representative typically must get the court's permission first.

## §2:11 Representative Prepares Periodic Progress Reports

As part of its supervision of the process, the court requires the personal representative to prepare periodic progress reports. The format will vary from state to state, but generally, the report will give the court an update as to the status of the probate property. Usually, the personal representative is required to present these reports to heirs and other interested parties also.

## §2:12 Representative Prepares a Final Accounting

Once debts and taxes are paid, the personal representative prepares a final accounting that looks like a balance sheet showing the value of the estate's assets and debts, taxes, and expenses. A copy is sent to the beneficiaries or heirs, who may challenge it if they disagree with the numbers.

## §2:13 Representative Distributes the Assets

The personal representative distributes the remaining estate assets in accordance with the decedent's will. If the decedent left no will, state intestacy statutes determine who is entitled to estate property and in what shares.

If the estate has mostly been converted to cash, this may be as easy as writing a distribution check. The representative will find it

helpful to accompany each distribution check with an accounting of expenses and also the inventory to corroborate the amount.

In estates with significant non-cash assets, other distribution methods may be necessary. For example, if the estate consists primarily of real estate, the representative should sign a deed to convey the deceased's real estate to the proper beneficiaries. This should resolve any lingering ownership issues and make it easier for the beneficiaries to sell the real estate if they so desire.

## §2:14 The Estate Is Closed

Closing the probate estate includes completing all administrative matters, distributing estate assets, closing the probate court's file, and discharging the personal representative.

Depending on the number and type of the decedent's assets and other property, the probate process may be straightforward or more complex. Probating an estate may take many hours of work and can last from a few months to a year or more.

## §2:15 Contested Probate

Occasionally disputes can arise among beneficiaries, heirs, and the personal representative that complicate the probate process. These include:

**Will contests.** A will contest arises when someone disputes a purported will's validity. The contestant may attack the will on a variety of theories, including fraud, forgery, and lack of testamentary capacity. If the contestant wins the will contest, and no other will is produced, the estate will be distributed to the lawful heirs.

**Representative appointment lawsuit.** Perhaps the nominated executor has developed a drug addiction, gambling habit, or health problem, and an interested party believes the nominated executor is no longer fit to manage the estate. He or she might

file a lawsuit to block the formal appointment of the nominated executor. If the court agrees, the court may appoint someone else.

**Fiduciary litigation.** If the personal representative mismanages the estate, interested parties may sue the representative directly for breach of fiduciary duty. Every personal representative owes a fiduciary duty to the estate beneficiaries, which means that the executor must loyally act for their best interest and not exploit the estate for selfish purposes. In addition to the routine notices and filings that a personal representative must make, the potential threat of fiduciary litigation provides a persuasive incentive for the representative to serve honorably.

# II. DECIDING WHETHER TO AVOID PROBATE

## §2:16 Why You Might Choose to Avoid Probate

People choose to avoid probate for one or more of the following three reasons:

**1. Cost.** Most personal representatives decide to hire an attorney to guide them through probate. It can be difficult for a non-attorney to figure out the procedures, forms, and deadlines. Courts do not always have clear instructions available for non-lawyers or staff available to help. Some states require the personal representative to hire an attorney. Attorneys' fees can be expensive. In some states, they are based on the value of the estate. In others, on the amount of time the attorney spends and what the judge thinks is reasonable. It is not unusual for them to run into the tens of thousands of dollars depending on the complexity and size of the estate and whether the estate is contested.

Additionally, there can be fees for executors, court filings, appraisers, and other expenses, such as real estate taxes, insurance, utilities, and property maintenance. These fees are all deducted from the estate and can take a big bite out of it. For

smaller probated estates, fees can greatly diminish the distributions the heirs receive.

**2. Delay.** A minimum of six months is usually required to complete probate. Even routine uncontested probates can take more than a year to complete. If probate is contested, it can take many years to settle the case. While the probate drags on, the beneficiaries and heirs wait to get their distributions. By contrast, when probate-avoidance methods are used, property transfers can usually be completed in weeks.

**3. Lack of privacy.** Many court probate filings are a matter of public record. Probate could open up information to the public that you would prefer to keep confidential.

## §2:17 Why You Might Choose Not to Avoid Probate

Probate avoidance isn't the right solution for everyone. Some reasons why you may decide you want your estate to be probated include:

**1. Avoiding probate won't save much money or time in your state.** In some states, probate is less complicated and expensive than in others. Unsupervised or informal administration may be available. Unsupervised administration requires less court involvement and consequently, attorney fees are lower. In these states, the costs of probate avoidance may exceed the costs of probate. The principal vehicle for avoiding probate is the revocable living trust. A revocable living trust is more expensive to have prepared than a will and it must be maintained. See Ch.3. If you bring your estate planning attorney an inventory of your assets and liabilities, he or she can advise you whether avoiding probate will save money in the long run.

**2. Avoiding probate will involve unwanted hassle or other undesirable consequences.** If you choose a revocable living trust as your method of probate avoidance, you must keep the trust

funded. Other methods of probate avoidance, which are discussed below, can have significant disadvantages.

**3. You have a small estate.** Virtually all states have some type of expedited or simplified probate procedure for "small estates." One such procedure allows the inheritor to claim an asset with an affidavit. The inheritor simply signs an affidavit stating under oath that he or she is entitled to the asset under a will or state law and presents the affidavit with a death certificate to the person or institution (a bank, for example) holding the asset. What constitutes a "small estate" varies widely from state to state from ten or fifteen thousand to several hundred thousand dollars. If your most valuable assets are held as non-probate assets, any remaining assets that must pass through probate may qualify for simplified procedures.

**4. You have significant or disputed debts.** The probate process generally affords a greater degree of protection to beneficiaries and provides for a set of rules to appropriately deal with the claims of a decedent's creditors.

**5. You expect challenges to your estate plan.** If you expect your estate plan to be challenged by disgruntled relatives, friends, or associates who are likely to be unhappy with your choices, probate offers an efficient forum in which to resolve the conflict.

## III. HOW TO AVOID PROBATE

### §2:18 Six Methods for Avoiding Probate

The principal probate-avoidance methods are:

- The revocable living trust.
- Joint tenancy with right of survivorship.
- Transfer on death deeds (TODDs) and vehicle registrations.
- Transfer on death/pay on death (TOD/POD) accounts and securities registrations.

- Beneficiary designations.
- Lifetime gifts.

Notice that a will is not included in this list. Disposing of probate assets in a will does not avoid probate.

In some cases, you may need more than one of these options to fully avoid probate. Your estate planning attorney can help you choose and implement the most appropriate methods for your property and estate planning goals if you decide to avoid probate.

## §2:19 Revocable Living Trusts

A revocable living trust is the most versatile probate avoidance mechanism, but also the most expensive to create and complex to maintain. A revocable living trust is a trust that you create to hold your property while you are alive and to distribute it among your beneficiaries on your death.

The typical living trust:

- Names you as the trustee with the power to manage and access trust assets as you deem necessary.
- Names a successor trustee to take over management of the trust property for your benefit on your incapacity and to turn the trust property over to the beneficiaries after your death.
- Names the beneficiaries who are to receive the trust property on your death and specifies what specific assets or shares of the trust property they get.
- Provides that you can revoke or amend the trust at any time until your death, at which time the trust becomes irrevocable.

At your death, the successor trustee pays your taxes and debts and distributes the trust property to the beneficiaries according to the terms of the trust. With a properly drafted and funded living trust, your estate will not need to go through probate. If no assets are in your name when you die, no probate will be needed to transfer title to your heirs.

As the settlor (creator) of the trust, you can manage, revoke, and change your trust based on your circumstances or wishes. You can also access assets placed in the trust during your lifetime. An asset must be in or owned by the trust at the time of your death to avoid probate.

Even if you establish a living trust, you should still have a will to dispose of any property you own that is not transferred to the trust.

With a properly drafted and funded living trust, your estate will not need to go through probate. Revocable living trusts are discussed in detail in Ch. 4. The other probate-avoidance methods are explained below.

## IV. JOINT TENANCY WITH RIGHT OF SURVIVORSHIP

### §2:20 What Is Joint Tenancy with Right of Survivorship (JTWROS)?

Joint tenancy with right of survivorship is one way that people can co-own property. When one joint tenant dies, his or her share of the property passes to the other joint tenant(s) “by operation of law” without any need for probate.

The right of survivorship is built-in to the form of ownership. A joint tenant cannot leave his or her interest in the property to anyone other than the other joint tenant(s). If a joint tenant tries to do so in a will, the bequest is void.

**Examples:**

Ben and Riana, a married couple, own their home as joint tenants with a right of survivorship. Riana dies and her one-half interest passes to Ben automatically, without any need for probate.

Three siblings, Zach, Ellen, and Alexis, own a home in joint tenancy with right of survivorship. Ellen dies and her one-third interest passes automatically to Zach and Alexis. They now own the home 50/50.

In comparison, if two or more people own property as tenants in common, when one dies, his or her share does not pass to the surviving owner or owners automatically. The deceased owner can pass his or her interest in the property to a beneficiary. If the transfer is accomplished with a will or if the deceased owner does not leave a will, the property will need to be probated.

JTWROS is a common way to own real estate, but any type of property can be owned this way including vehicles and bank accounts.

## §2:21 Community Property with Right of Survivorship

There are seven community property states in the United States- Alaska, Arizona, California, Idaho, Nevada, Texas, and Wisconsin. In these states, you can co-own your community property with your spouse with a right of survivorship. When one spouse dies, the other will automatically own the community property. No probate is necessary to transfer title and the process of transferring title to the surviving spouse is simple. Usually, you only need to present a death certificate.

## §2:22 Tenancy by the Entirety

Tenancy by the entirety is similar to joint tenancy but is generally limited to married couples and is allowed only in some states. Like joint tenancy, when one of the spouses dies, his or her interest in the property passes to the other without probate. Tenancy by the entirety offers better protection to one spouse from the creditors of the other. When the debt is owed by one spouse, in most states, the creditor cannot seize and sell the property.

## §2:23 Advantages of Using JTWROS to Avoid Probate

- JTWROS is easy and inexpensive to create. For real estate, it usually requires executing a deed with the particular language required by the state where the property is located. Typically, the deed must state that title is held in joint tenancy

with right of survivorship. A few states require some additional paperwork. The procedure is similar for other types of property. The title documents simply have to include the wording required by your state to create a joint tenancy with right of survivorship. Your state's motor vehicle department and the financial institutions where you have accounts will have standard forms for creating a joint tenancy.

- Title can be easily transferred to the survivor. To get title in the surviving owner's name, little paperwork is usually needed. The surviving owner files a certified copy of the death certificate and perhaps an additional form required by the state or local recorder's office.

## §2:24 Disadvantages of Using JTWROS to Avoid Probate

JTWROS often works well as a probate avoidance mechanism for married couples, people with stable long term relationships, and people who contribute to the purchase and maintenance of the property. It is most risky when created by gift as a way to leave an inheritance with the sole purpose of avoiding probate. Before transferring property into a joint tenancy, you want to be sure that you trust the other person.

- JTWROS gives co-owners equal rights and it cannot be revoked. Unlike a revocable living trust or transfer on death deed, a joint tenancy takes effect immediately. It gives the recipient the same rights in the property as the owner making the gift. And once completed, it cannot be revoked.

  **Example:** Ed transfers his home into a joint tenancy with his nephew Hal intending for Hal to inherit the property when he dies. Ed later has a serious disagreement with Hal and wants sole ownership of the property back. Unless Hal agrees to transfer (or sell) his interest in the property to Ed, there's nothing Ed can do.

- As a general rule, any co-owner of a joint tenancy bank account can withdraw all of the funds in the account. A two-signature

requirement for withdrawals can prevent this result, but it can be inconvenient to get a second signature every time you want to make a withdrawal or write a check.

- JTWROS can be converted to a tenancy in common. In most states, as long as all joint tenants are alive, one joint tenant can terminate the joint tenancy and convert his or her share to a tenancy in common, which he or she can then sell or leave by will to anyone.

  **Example:** Don owns a family farm. He puts the farm in JTWROS with his son Dave intending for Dave to operate the farm after he dies. Dave instead converts his share into a tenancy in common and sells it to a neighboring farm owner. Don unexpectedly finds himself in partnership with his neighbor.

- All co-owners must agree on property management decisions. To sell, mortgage, or improve the property, all owners need to agree.

  **Example:** Louise transfers her home into JTWROS with her daughter. Later she decides she wants to sell it and use the proceeds to move to an assisted living facility. But her daughter refuses to agree to the sale. Even if Louise converts her share of the home into a tenancy in common, it may be impossible or difficult to sell and will not be worth as much as the entire home.

- Creditors of one joint tenant can reach the property. If a joint tenant has debts, goes bankrupt, owes taxes, or sued, the joint tenant's creditor may be able to place a lien against the property or even sell the property to satisfy the debt. The non-debtor joint tenant, however, is entitled to the value of his or her share from the sale proceeds.

- Children from prior relationships may lose out. Joint tenancy may not be the best option for spouses with children from prior relationships. When the first spouse dies, the property passes to the survivor. The children of the deceased spouse could be

deprived of an inheritance from the property when the second spouse, who is not their parent, dies.

**Example:** Fred and Ann take title to their home as JTWROS. Fred has a son from a previous marriage and Ann has a daughter. Fred dies and Ann inherits the property. When Ann dies, she leaves her entire estate to her daughter, including the home. Fred's son gets no share of it.

- A revocable living trust (or a will) may be preferable if you want to leave the property to more than one person. Although you can create a JTWROS with more than one other person, a trust or even probate may be a better choice. One person, the trustee or personal representative, can more efficiently manage and sell the property. Having one person in charge can minimize delays and disagreements. Also, in most states, you cannot give joint tenants unequal shares. All joint tenants own the property equally.
- A trust may be preferable if your beneficiary is a minor. Minors cannot own property worth more than a few thousand dollars outright. In most states, you can name a custodian under the Uniform Transfers to Minors Act to manage property given to a minor. The drawback is that the child gets full control of the property at the age specified by state law, which is usually 18 or 21. Property can remain in trust until the child is older. If you don't name a custodian (or leave the property in trust), a court will need to appoint a guardian to manage the property. See Ch. 5.
- Creation of a JTWROS can have gift tax consequences. If you create a joint tenancy by gift and the value of the interest is more than the annual gift tax exclusion, you will need to file a gift tax return. You will need to pay taxes only if the total value of taxable gifts and your taxable estate exceeds the estate tax exemption. See Ch. 6.

## V. TRANSFER ON DEATH DEEDS (TODD) AND VEHICLE REGISTRATIONS

### §2:25 What Is a TODD?

For many individuals, their home is their only asset of significant value that will be subject to probate on their death. In these instances, some states provide a relatively easy process to avoid probate of the home, a transfer on death deed (TODD). A TODD allows a homeowner to identify one or more beneficiaries who will receive the home on the homeowner's death.

For a TODD to be effective, the document must be signed and dated, usually before a notary, and recorded within a certain time frame at the local county records office where the property is located. There may also be restrictions on the type of property that can be transferred by a TODD. For example, TODDs may be restricted to residential real estate with a specified number of units or land of less than a certain acreage.

All payment obligations associated with the property after the owner's death remain. This includes mortgages and liens. The beneficiary will inherit these responsibilities along with the property.

### §2:26 States That Allow TODDs

The following states allow TODDs:

Alaska
Arizona
Arkansas
California
Colorado
Dist. of Columbia
Hawaii
Illinois
Indiana
Kansas
Minnesota
Missouri
Montana
Nebraska
Nevada
New Mexico
North Dakota
Ohio
Oklahoma
Oregon
South Dakota
Virginia
Washington
West Virginia
Wisconsin
Wyoming

A few states (e.g., Florida, Michigan, Texas) allow Lady Bird deeds (also called enhanced life estate deeds) that are similar to TODDs.

As time passes, additional states may permit TODDs.

## §2:27 Advantages of Using a TODD to Avoid Probate

- A TODD is easy and inexpensive to create. You need only sign and notarize a deed and have it recorded. The deed must say that it does not take effect until your death. Despite the ease of creation, it's a good idea to have a TODD prepared by an attorney to ensure the deed complies with the law of your state. You don't want to make an error with such a valuable asset.
- You retain full rights to your property during your lifetime. Unlike a JTWROS, the beneficiary has no right to your property while you're alive. If you own your home jointly, the transfer on death deed does not apply until all the owners have died. This means you can mortgage, sell, improve, etc. your home as you see fit. If you sell the home, the TODD ceases to be valid.
- You can revoke a TODD whenever you want so long as you are legally competent. Revocation is accomplished by filing a revocation statement or a new TODD naming a different beneficiary.
- The transfer of assets to the beneficiary on death is quick and easy. The beneficiary simply records a certified copy of your death certificate and maybe an additional form required by the state or local recorder's office.

## §2:28 Disadvantages of a TODD

- A TODD cannot be used in every state. If your property is in a state that does not recognize TODDs, you cannot use one to pass your property on your death. You will have to use a different method to keep the property out of probate.

- Formal execution and recording requirements must be met. If the TODD is not properly notarized or recorded by the deadline specified in state law, the TODD may not be effective.
- If the person named in the TODD dies before the property owner, the deed will have no effect. The property may end up in probate unless the owner makes other arrangements. If you name more than one beneficiary, the property will pass to the survivor.
- If the property is owned with a right of survivorship, it passes to the surviving joint owner on the death of the first joint owner, not to the TOD beneficiary. The TODD beneficiary receives the property only if the last surviving joint owner is the one who executed the TODD. In this case, both or all co-owners would need to execute a TODD naming the same beneficiary.
- A trust or even a will and probate may be preferable if you have multiple beneficiaries. One person, the trustee or personal representative, can more efficiently manage and sell the property. Having one person in charge can minimize delays and disagreements. Also, state law may restrict your ability to leave unequal shares to multiple beneficiaries.
- A trust may be preferable if your beneficiary is a minor. Minors cannot own property worth more than a few thousand dollars outright. You can name a custodian under the Uniform Transfers to Minors Act to manage property left to a minor. One drawback is that the child gets full control of the property at 18 or 21. With a trust, distribution can be deferred longer. If you don't name a custodian (or leave the property in trust), a court will need to appoint a guardian to manage the property.
- A TODD transfers only real estate. And the types of real estate that can be transferred may be limited. You will need to make other arrangements to avoid probate if you own other probate assets.

### §2:29 Transfer on Death Registration for Motor Vehicles

These work the same way as TODDs. During your life, the beneficiary has no rights to the vehicle. You can use it or sell it. And you can revoke the registration.

These states currently allow transfer on death registration for cars:

| | | |
|---|---|---|
| Arizona | Illinois | Nevada |
| Arkansas | Indiana | Ohio |
| California | Kansas | Oklahoma |
| Colorado | Maryland | Vermont |
| Connecticut | Missouri | Virginia |
| Delaware | Nebraska | |

As time passes, additional states are likely to be added. Check with the motor vehicle department in your state to see if TOD registrations or other simplified procedures for transferring ownership of a vehicle on death are allowed. If so, the department should be able to furnish you with instructions and the necessary forms.

## VI. PAY ON DEATH BANK ACCOUNTS AND SECURITIES REGISTRATIONS

### §2:30 What Is a TOD or POD Account?

Many states allow you to designate a pay on death beneficiary or beneficiaries on your bank account, brokerage accounts, and securities. These accounts are usually called payable-on-death (POD) or transfer-on-death (TOD) accounts. Until your death, you have complete control over the account. Your beneficiary has no right to or control over the money or securities. If you spend all the money or sell the securities before your death, the beneficiary receives nothing.

On your death, whatever is left in the POD or TOD account transfers immediately to the beneficiary without probate. As a practical tip, don't assume that your account is automatically a

TOD or POD account. Banks have specific formalities for setting up these accounts.

## §2:31 Advantages of Using TOD/POD Designations to Avoid Probate

- A TOD/POD designation is easy and inexpensive to create. There is typically no extra cost to set up the account or convert an existing account. The financial institution or broker provides the required form for you to sign.
- The beneficiary has no access to the account or security while you are alive. You won't need to worry about the beneficiary emptying your account, which he or she can do if you create a JTWROS.
- You can revoke a TOD/POD designation whenever you want so long as you are legally competent, unlike a JTWROS.
- You can name more than one beneficiary. In most, but not all states, you can leave them unequal shares.
- The transfer of assets to the beneficiary on death is quick and easy. The beneficiary simply presents identification and a certified copy of your death certificate to get access to the funds or securities. Early withdrawal penalties are usually waived.

## §2:32 Disadvantages of Using TOD/POD Designations to Avoid Probate

- You usually cannot name contingent beneficiaries. If the sole beneficiary dies before the account owner, the POD designation has no effect. The funds in the account could end up in probate.
- If the account has multiple beneficiaries and one dies before the account owner, his or her share passes to the other beneficiaries, not to his or her children.

## VII. BENEFICIARY DESIGNATIONS

### §2:33 Life Insurance and Retirement Accounts

Life insurance proceeds and retirement accounts such as IRAs, profit-sharing plans, and 401(k) plans can be passed outside of probate through beneficiary designations. Beneficiary designations for life insurance and retirement accounts are an important component of your estate plan. Your estate planning attorney can advise you on how to complete them so that they are consistent with your estate planning objectives.

So long as you complete a beneficiary designation and name someone other than your estate as the beneficiary, life insurance proceeds and the balance left in your retirement accounts when you die will pass to the beneficiary or beneficiaries outside of probate.

In community property states if a life insurance policy was purchased with community funds, your spouse is entitled to half the proceeds no matter whom you name as a beneficiary.

### §2:34 Minor Beneficiaries

If your intended beneficiary is a minor, you will want to make the benefits payable to a trust or name a custodian to manage the funds under the Uniform Transfers to Minors Act. Otherwise, a court will need to appoint a guardian. See Ch. 5.

### §2:35 Tax-Deferred Retirement Accounts

With retirement accounts on which you did not pay income taxes, you typically want to name "natural persons" (e.g., spouse or children) as beneficiaries. They will have to pay income tax on the money left in your accounts. But they will be able to spread the payments (and thus the tax) over their life expectancies, rather than take a lump sum. On some types of accounts (401(k) or 403(b) plans), you must name your spouse as the beneficiary

unless he or she signs a waiver. If you live in a community property state, your spouse will have a right to half of the balance in your retirement accounts that is community property.

## VIII. LIFETIME GIFTS

### §2:36 Gift Made Before Death Avoid Probate

Sometimes giving your property away during your lifetime can be an effective way to avoid probate. Assets you give away during your lifetime will not have to go through probate after your death. As a bonus, you get to see your loved ones enjoy and appreciate your gifts.

### §2:37 Gifts Made Before Death Can Reduce Estate Taxes

Making gifts while you are alive can also be an effective strategy for eliminating or minimizing estate taxes if your estate is so large that you could have estate tax liability. Each year you can gift up to a certain dollar amount tax-free to a beneficiary and a certain total amount during your lifetime. In 2019, the yearly annual gift exclusion is $15,000. The total estate and gift tax exemption is $11.4 million per individual. This means an individual can leave $11.4 million and pay no federal estate or gift tax. A married couple can leave up to $22.8 million. See Ch.6.

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# CHAPTER 3

# Wills

I. Choosing Between a Will-Based and a Trust-Based Estate Plan
II. The Property You Can Leave to Your Beneficiaries with a Will
III. Who Can Make a Will
IV. Making Your Will Legal
V. What to Do With Your Will After Executing It
VI. Your Executor
VII. What Goes in a Will: Common Will Provisions

## I. CHOOSING BETWEEN A WILL-BASED AND A TRUST-BASED ESTATE PLAN

### §3:01 Advantages of a Will-Based Estate Plan

One of the many decisions you will need to make in planning your estate is whether to choose a will or a revocable living trust as the principal device for passing your property.

People who choose a revocable living trust typically do so to avoid probate, plan for their incapacity, and keep their estate plans private. If these are not important goals for you at this time, a will may be more appropriate.

Probate is not an expensive and time-consuming process in every state. Avoiding it may not make economic sense if you live in a state with more streamlined procedures. A durable power of attorney (see Ch. 7) combined with health care directives (see Ch. 8) may be sufficient incapacity planning for you. Privacy may not be a major concern unless you are very wealthy or high profile individual.

Many people choose to make a will their primary method of making gifts when they die because:

- A will-based estate plan is less expensive to prepare and easier to implement. It's easier to understand so your attorney does not need to spend as much time explaining it to you. You don't need to deal with transferring the ownership of your assets to the trust, which saves on work for you and the possibility of mistakes.
- A will-based plan does not require the maintenance that a trust-based plan needs. A will passes all property that you own at death, including property you acquire after the execution of the will. With a trust, every time you acquire property, you need to make sure it is transferred to the trust which will involve time and possibly extra expense.
- A will is easier and cheaper to amend or replace than a trust if you change your mind or your circumstances change.
- A will-based plan saves you from the inconvenience of owning all or most of your assets through a trust. Every time you want to sell property that is in the trust, you may have to first transfer it to your name and then transfer it again to the buyer.

Even if you choose a revocable living trust, be aware that you will need a backup or pour-over will to handle any assets that are outside the trust when you die. For further discussion of the advantages and disadvantages of a revocable living trust and pour-over and backup wills, see Ch. 4.

## §3:02 When a Will-Based Plan May Be the Better Choice

A will-based estate plan may be the better choice for you if:

- The costs of probate in your state are unlikely to exceed the costs of preparing and maintaining a revocable living trust. Your estate planning attorney should be able to advise you on the relative costs of probate versus a revocable living trust.
- You prefer to have your estate probated because you want court supervision over the disposition of your estate. You may have disputed creditors' claims or anticipate that disgruntled relatives will challenge your plan. Probate provides a forum for resolving these disputes.

- You do not want the extra work of maintaining a revocable living trust or fear you will neglect to keep it up. If you don't keep your trust properly funded, the extra expense and effort of creating the trust may be wasted. Assets that are outside your trust when you die will need to go through probate.
- You do not want the inconvenience of owning property through a trust.
- You are young and in good health and want to put in place a simple starter estate plan. For example, your estate may consist of modest assets, (e.g., personal property and life insurance benefits) and you are primarily concerned with appointing a guardian for your minor children and ensuring they are provided for if you and their other parent should die. You can always implement a trust-based plan later when your holdings become more extensive or incapacity planning more urgent.

## II. THE PROPERTY YOU CAN LEAVE TO YOUR BENEFICIARIES WITH A WILL

### §3:03 Your Probate Estate

Your probate estate is defined as the property that you are entitled to pass by a will. Looked at another way, it is the property that would pass under state intestacy law if you were to die without a will.

Before you make your will, it's important to understand what property it will affect. A will may not control the disposition of every type of property that you own.

### §3:04 Property You Can Pass with Your Will

You can pass these assets with a will:

- Real property, unless you own the property with another person who has a right of survivorship or the property is subject to a valid transfer on death deed (TODD).

- Bank and brokerage accounts, CDs, stocks and bonds, unless you own them with a right of survivorship or subject to a pay on death (POD) designation.
- Your half of any community property you own.
- Motor vehicles unless you own them with another person who has a right of survivorship or subject to a TOD designation.
- Tangible personal property.
- Royalties generated by intellectual property.
- Money owed to you at the time of your death, such as personal loans, a final paycheck, a pending lawsuit, or refunds of insurance premiums.

## §3:05 Property You Cannot Pass with Your Will

You cannot pass these assets (your non-probate assets) with a will:

- Real property owned with another as joint tenants with right of survivorship, community property with right of survivorship, or tenants by the entireties. Or real property subject to a valid TODD.
- Bank accounts or investments owned with another as joint tenants with right of survivorship or subject to a POD designation.
- Motor vehicles owned with another person who has a right of survivorship or subject to a TOD designation.
- Life insurance proceeds unless your estate or executor is named as the beneficiary.
- The funds in an employer-provided retirement plan unless your estate or executor is named as the beneficiary and you are not married.
- The funds in your spouse's employer-provided retirement plan.
- IRAs that you own unless your estate or executor is named as the beneficiary.
- Property owned in a trust of which you are a beneficiary unless the trust by its terms is payable to your estate.
- Your spouse's half of any community property.

If you try to pass a non-probate asset in your will, the attempt will be unsuccessful. For example, if your will leaves your life insurance proceeds to a charity, but you have designated your son as the beneficiary, the beneficiary designation will control. The proceeds will go to your son, not to the charity.

## III. WHO CAN MAKE A WILL

### §3:06 The Three Requirements

To make a will you must:

- Be of age.
- Have testamentary intent.
- Have testamentary capacity.

### §3:07 Age

As a general rule, you must be at least 18 years old to make a will. However, married minors and minors in the armed forces are entitled to make wills. In some states, an emancipated minor may be able to make a will.

### §3:08 Testamentary Intent

You must sign your will with testamentary intent. This means that you must intend that the document dispose of your property on your death.

Testamentary intent is usually shown by the words of the will itself. For example, the following sentence conveys testamentary intent with reasonable clarity:

> I, [name of testator], of [city], [county] County, [State], declare that this is my last will.

## §3:09 Testamentary Capacity

You must be of sound mind or have "testamentary capacity," to execute a valid will. Testamentary capacity means that you:

- Understand you are making a will.
- Understand the effect of the will.
- Know the nature and extent of your property.
- Know the people who would be the "natural objects of your bounty" (i.e., your family members and other loved ones).

You do not lack testamentary capacity just because you are of advanced age. You need only possess capacity on the day the will is executed. Thus a person may have testamentary capacity on some days and lack it on others. This situation is common with people in the early stages of dementia.

## §3:10 Protecting Against Challenges to Testamentary Capacity

Sometimes a prospective testator (the person making a will) or his or her family suspect that the issue of capacity to make a will may come up. Attorneys also are on the lookout for this possibility. A testator's capacity to make a will is most likely to be challenged when the testator has an estate plan that benefits non-relatives or more distant relatives at the expense of more closely related family members and the testator is frail or sick at the time of execution. Perhaps she is in the early stages of Alzheimer's disease, or the will is executed in the hospital during the final illness.

In such cases, the attorney can take steps to preserve evidence to the contrary. The will of a testator whose capacity may someday be in question should, if possible, be witnessed by personal friends of the testator, or by attorneys rather than office staff, but not by beneficiaries of the will. Witnesses who have known the testator for some time will be able to provide more convincing testimony than strangers. They are also more likely to be able to

remember the specific circumstances of the execution since they probably do not regularly serve as witnesses to wills.

Because testamentary capacity is measured on the day the will is executed, a testator can decrease the likelihood of a successful challenge by executing the same will on multiple occasions. However, multiple original wills can be problematic. See §3:19.

The testator can execute an abbreviated version of the estate plan in his or her handwriting the day before executing the witnessed will. Rational statements in the testator's handwriting can be used as evidence of adequate capacity

If testamentary capacity is likely to be an issue, the will execution could be scheduled for a day on which the testator has other business to transact (such as an appointment with a financial planner, or simply the paying of bills). A testator who is disinheriting someone might consider making a small but significant gift to the disinherited person at the same time the will is executed — a will contestant who deposited a check dated the same day as the will was signed by the testator will have a difficult time arguing that the testator lacked capacity on that day.

## §3:11 Protecting Against Undue Influence Claims

Even if a testator has the mental capacity to make a will, the will could still be invalid if the testator was unduly influenced to make the will. Undue influence generally means that a beneficiary has pressured or persuaded the testator to make a will to the extent that the testator's independent decision-making ability has been overpowered. As a result, the testator makes a will favoring the beneficiary that he or she would not otherwise have made.

Some signs of undue influence include:

- The testator was in a weakened physical or mental state when he or she signed the will.
- The beneficiary hired or recommended the attorney who prepared the will.
- The beneficiary came to the testator's appointments with the attorney and was present at the will's execution.

- The beneficiary knew what was in the will before it was executed.
- The beneficiary instructed the attorney about what to put in the will.
- The beneficiary provided the witnesses.
- The beneficiary kept the will after its execution.

In your will, you may want to favor a loved one who has been especially close and helpful to you. If so, it's a good idea to exclude this person from the estate planning process. It is not uncommon for a favored son or daughter to drive an older parent to all appointments, sit in on meetings, and then help the parent follow through on instructions from the doctor, financial planner, and so forth. However, when it comes time to write a will, it may be best for such a beneficiary to stay out of the matter entirely, no matter how much he or she wants to help.

## IV. MAKING YOUR WILL LEGAL

### §3:12 The Minimum Requirements

To ensure that your will is legal and can be admitted to probate, your will should:

- Be typed or printed.
- Contain at least one provision disposing of your property.
- Appoint an executor.
- Be dated.
- Be executed according to your state's law.

Although some states recognize a holographic will (one that is handwritten and not witnessed), many do not. It's never a good idea to rely on one.

These are the minimum requirements. Additional provisions should be in any well-drafted will to ensure that your entire estate is disposed of as you wish and to minimize the likelihood of challenges and disputes. See §§3:26-3:38.

## §3:13 Executing a Will

A will must be executed (signed) with the proper formalities. Every state has a law that spells out how a will must be executed. Although details may differ from state to state, in all states a will must be signed by the testator and by two witnesses.

Why must a will be witnessed? Before a will can be admitted to probate, it must be authenticated. The testator is no longer available to verify that the document presented for probate is really his or her will. Unless a will is self-proved (see §3:14), at least one witness will need to testify that the will is genuine.

In some states, the testator and both witnesses need to be in each other's presence when signing. Typically, the testator signs the will while the witnesses watch. Then, with the testator and both witnesses still present in the room, each witness signs.

In other states, the witnesses don't have to be in the same room when they sign and in still others, they don't even have to watch the testator sign, so long as the testator tells them that he or she signed.

Some states require the testator to tell the witnesses that the document they are signing is his or her will. The witnesses do not need to read the will or know what is in it. In other states, the witnesses do not need to know that what they are signing is a will, as long as they know that the testator has signed it.

Although the formalities appear simple, complying with them can be surprisingly tricky. The witnesses should give their undivided attention to the will execution, and should not try to engage in another activity at the same time. Distracted witnesses may have faulty memories of what exactly happened if their testimony is needed to authenticate the will. Questions about whether proper formalities were observed can jeopardize the probate of the will. Wills have been denied probate because of seemingly minor mistakes in the execution process.

To avoid mistakes, the best policy is to execute your will under the supervision of your estate planning attorney.

## §3:14 Self-Proved Wills

Many states allow self-proved wills. If a will is self-proved, it can be probated without the testimony of the subscribing witnesses. Because making the will self-proved saves time and money when the time comes to probate the will, your will should be self-proved if that is an option in your state.

A self-proved will requires the addition of an affidavit that the testator and witnesses sign in front of a notary who then also signs. A typical affidavit might be as follows, although your state may require slightly different language:

> I, ........., the testator, sign my name to this instrument this ..... day of ........, ...., and being first duly sworn, do hereby declare to the undersigned authority that I sign and execute this instrument as my last will and that I sign it willingly (or willingly direct another to sign for me), that I execute it as my free and voluntary act for the purposes therein expressed, and that I am eighteen (18) years of age or older, of sound mind, and under no constraint or undue influence.
>
> ______________________________
>
> Testator
>
> We, ..........., ..........., the witnesses, sign our names to this instrument, being first duly sworn, and do hereby declare to the undersigned authority that the testator signs and executes this instrument as his last will and that he signs it willingly (or willingly directs another to sign for him), and that each of us, in the presence and hearing of the testator, hereby signs this will as witness to the testator's signing, and that to the best of his knowledge the testator is eighteen (18)

years of age or older, of sound mind, and under no constraint or undue influence.

______________________________

Witness

______________________________

Witness

The State of ..........
County of .............

Subscribed, sworn to and acknowledged before me by .........., the testator and subscribed and sworn to before me by .........., and .........., witnesses, this ..... day of ..........

(Seal)

With a self-proved will, it is even more important to have your signing ceremony under your lawyer's supervision. Most people will go to a bank to find a notary public. However, generally a notary in a bank knows very little about documents that will be submitted to a court, and the bank may not permit the notary to be away from other duties for the 15 to 20 minutes or so that are required for a proper will execution. Wills executed in this way frequently end up with errors that are visible on the face of the document (blanks not filled in correctly, witnesses signing in the wrong place, etc.). Even a will without obvious errors may contain hidden errors that will come to light if the will is contested.

## §3:15 Dating Your Will

Although a will may be legal even if not dated, the date of execution should be included. The date of the will can be a critical issue in certain circumstances. For example:

- If you were to leave multiple undated wills, a dispute may arise over which is the latest will.
- A date can be useful in determining whether you had testamentary capacity at the time the will was executed.

## §3:16 Signing Your Will

The best practice is to sign your full name at the end of the will the same way you would sign a contract or check. Non-standard signatures can call into question:

- Your identity.
- Testamentary intent.
- The possibility of forgery.

Your witnesses should do the same. If physical problems make it impossible for you to sign, another person may sign for you, as long as the other person signs in your presence and at your direction.

Your will may also provide a place at the bottom of each page for you to initial as well as a page number and the total number of pages in your will. For example:

Last Will of Jane Smith Page 1of 4 J.S. ________

These security measures are designed to make page substitution difficult, although they are not required by law.

If you and your spouse are signing wills at the same time, make sure you don't mix the documents up and sign each other's wills. This mistake has been known to happen and may cause your will to be denied probate.

## §3:17 Who Can Witness a Will

Although some states may allow minors to witness a will, the best practice is to have your will witnessed by two adults because it may be difficult to obtain the testimony of a minor should that become necessary. Also, since you are likely to be signing other

estate planning documents at the same time that may require adult witnesses, it is usually more convenient to use adult witnesses for everything.

Some states require disinterested witnesses. A disinterested witness is someone who does not benefit from the will. Even if your state does not require disinterested witnesses, to guard against an undue influence or similar challenge, it is rarely a good idea to have a will beneficiary act as a witness.

## V. WHAT TO DO WITH YOUR WILL AFTER EXECUTING IT

### §3:18 Storing Your Original Will

You should store your original will in a place where it will be easily found after your death. Many people choose to store their wills at their homes with their other important papers. A fireproof safe can be a good choice. If you intend to store your will in a bank safe deposit box, you should inform your executor and alternates of what bank the box is at and that the will is in it. You should also consider making arrangements with the bank so that your executor will have access to the box after your death since some banks will refuse to open the safe deposit box of a deceased holder without an order from the probate court. Resorting to this procedure may cause your estate to incur a delay of several weeks and additional legal fees and court costs, but this may be an acceptable outcome if your home is not a secure place for your will.

As extra security, you may wish to give copies of the will to your executor and the will beneficiaries. For example, if your house were to burn down with your will in it, it may be possible to probate the copy if evidence of the fire can be presented to the court. However, in the absence of clear evidence as to what happened to the original will, probating a copy can be difficult. So it is important that your executor be able to locate the original will after your death.

Incidents in which wills are lost to fire, water damage, or theft are rare. Far more common are cases in which the family cannot find the original will or find it only after tearing the house apart or incurring substantial legal expenses. So in choosing where to store your will, think through all of the scenarios. Your executor may predecease you, in which case your alternate executor will need to locate the will. Or your alternate may predecease you as well, in which case your beneficiaries will need to locate the will. By arranging your affairs such that everyone involved in your will can locate it after your death, you can save considerable hassle and expense for your beneficiaries.

## §3:19 Copies Are Ok, but Avoid Multiple Originals

The attorney who prepares your will should keep a copy, and you should have a copy for everyday reference so you won't need to remove the original from its safe storage place and risk misplacing it. You can also mark up the copy as a rough draft if you decide to make revisions to your will. You should never write on your original will. Depending on the law in your state, crossing portions of a will could have no effect, could revoke the crossed-out portions, or could revoke the entire will, while writing in a new provision may have no effect because it is not signed and witnessed.

If you have a copy, you can make additional copies from the existing copy, which can be unstapled and restapled without consequence. You do not want to unstaple your original will because the court may question whether all the pages are from the original or whether some have been added later.

It's not a good idea to have multiple originals of a will with the possible exception of the situation in which a challenge to testamentary capacity is anticipated. See §3:10. Since you can revoke a will by destroying it, multiple wills can lead to disputes about your intent to revoke. Suppose, for example, a testator burns one of two wills, but the other original is found after her death. Did she intend to revoke her will? Or was she merely trying to avoid the confusion of leaving two wills?

For amending or revoking your will, see Ch. 9

# VI. YOUR EXECUTOR

## §3:20 What Does an Executor Do?

Your executor is responsible for probating your will, collecting and preserving the assets of your estate, representing your estate before third parties, and carrying out the terms of the will.

Here are the principal duties your executor will be responsible for handling.

- Locating your will and filing it with the probate court.
- Ordering copies of your death certificate.
- Gathering the documents that will be necessary to manage your estate.
- Deciding whether probate is needed and, if so, what type of probate.
- Getting your will admitted to probate if probate is necessary.
- Figuring out who your heirs are and notifying them of the pending probate.
- Figuring out who your creditors are and notifying them of your death.
- Opening a bank account for your estate.
- Locating your assets and preparing an inventory and appraisal.
- Protecting your assets until they are sold or distributed to heirs.
- Identifying valid debts and paying them and other necessary interim expenses.
- Preparing your final tax returns and paying any tax that is due.
- Wrapping up your affairs.
- Distributing the remaining property to the people named in your will.

See Ch. 2 for more on the probate process.

## §3:21 Executor's Bond

As a general rule, an individual executor must post a bond to protect beneficiaries and creditors from misconduct by the executor. The amount of the bond, which is paid for from estate assets, depends on the value of the estate. If the executor is inheriting the entire estate, the bond need only be sufficient to protect the interests of creditors. If the estate has no debts and the executor is the only beneficiary, a bond will generally not be required.

Your will can waive the requirement that your executor post bond. In some states, if the testator does not waive the bond, the beneficiaries can agree to.

Generally, waiving bond is a good idea given the expense the estate will incur to post the bond. If your executor is also the sole beneficiary, then there should be no need to protect the beneficiary from executor misconduct. If you do not have a beneficiary or friend you trust to serve as the executor without bond, then you could consider a corporate executor who will be exempt from having to post a bond.

## §3:22 Executor's Liability

An executor has a fiduciary duty to the creditors and beneficiaries of the estate. Once the executor is appointed by the judge and takes the oath of executor, he or she is obligated to safeguard the assets of the estate and protect the interests of the estate's beneficiaries and creditors. This means that the executor must act with the highest level of honesty and good faith to ensure creditors are paid, estate assets are protected, and beneficiaries receive what they are entitled to. The executor can be held personally liable for breach of fiduciary duty. Some testators choose to add a provision to their wills limiting the executor's liability to intentional or reckless misconduct.

An executor is also individually liable to the federal government for payment of federal estate taxes owed by the estate if the executor pays any debts or makes any distributions to beneficiaries before

paying the estate taxes. This individual liability also applies to any deficiency assessed by the Internal Revenue Service after audit of the federal estate tax return. However, the executor can request a discharge from liability under 26 USC §2204 after filing the return and paying the tax out of estate assets. Few estates owe estate taxes because of the generous estate tax exemption. See Ch. 6.

## §3:23 Executor's Compensation

Executors are entitled to compensation for their work. The way the compensation is calculated varies from state to state. In some states, the executor is paid a percentage of the value of the estate. In others, the executor is paid an hourly rate. Some allow the judge to establish the fee. The executor's compensation comes from the assets of the estate. Executors often waive the fee, especially when they are the principal beneficiaries of the estate.

If you decide to appoint one of your children as executor, you may decide to explicitly prohibit compensation in your will to prevent any jealousy among the children and to preserve a perfectly equal distribution of your estate. Alternatively, you could allow only a nominal dollar amount as compensation.

Although preserving family harmony is one of the main goals of estate planning, limiting compensation may not be advisable in large estates, both because the duties of the executor may be significant, and because the executor's compensation is deductible for estate tax purposes (although it does add to the executor's taxable income).

## §3:24 Choosing an Executor

You are looking for three things in your executor. He or she must be someone (1) you trust; (2) who is capable of doing the job; and (3) who is willing to do the job. You want to choose a person who is intelligent, responsible, and well-organized.

The principal qualities that an executor should possess are honesty, organizational skills, and the ability to communicate

effectively. The executor has many responsibilities, some of which can be complex. Although some of the necessary tasks may be complicated (like preparing tax returns or making investment decisions), your executor can hire professionals (attorneys, accountants, investment advisors) for assistance.

One attractive quality in an executor is perseverance in handling bills, particularly those pertaining to hospitals, Medicare, ambulance, and doctors concerning a final illness. These frequently require much paperwork when communicating with and seeking reimbursement from insurance companies. The person you choose should have the time and be willing, to deal with bureaucracy and forms.

The location of the executor is another factor to consider. It's best to choose someone who lives in your state as some states have restrictions on out-of-state executors and someone local will find it easier to do the job. If the executor lives reasonably close to where most of the assets are situated, the executor can more easily make court appearances, check mail, and maintain estate properties.

If you have a revocable living trust, it's a good idea for the same person to serve as the executor of your pour-over or back up will and as successor trustee of the trust. See Ch. 4.

## §3:25 Likely Candidates for the Job

**Family members.** The most common executors are spouses, children, and siblings. A trusted child can be a good choice, although sometimes choosing one child over another can cause hurt feelings. In the interest of family harmony, you can name more than one executor, although that may not be the best idea if you think they can't work together.

Although your spouse may be the person you trust most, consider whether he or she will be up for the task. Your spouse may be incapable of fulfilling the requisite duties because of grief, sickness, or disability. In the role of executor, your spouse will have personal liability for any unpaid estate taxes and fines for

late filings, even if your spouse has assigned these responsibilities to an attorney.

Instead of choosing a child or your spouse, it may be better to select a trusted friend.

**Beneficiaries.** It can be sensible to choose an individual who will get a considerable inheritance under the will. A person who is in line for an inheritance will have an incentive to see that property in the estate is cared for and distributed in a timely fashion.

On the other hand, you want to make a selection that is unlikely to cause bickering among family members and will contests. Thus, exercise caution and think about the ramifications of your decision if you anticipate strife among your heirs. In this situation, a beneficiary may not be the best choice.

**Outsiders.** Another option is to select someone who has no potential conflict of interest, meaning someone who will not inherit under the will. In so doing, you minimize the likelihood of will contests brought by dissatisfied relatives who might hurl accusations of cheating against the executor. If you possess a sizeable estate, there are likely to be more conflicts, and thus, you should think about designating an outside executor.

**Institutions.** You could name a bank or financial institution, but many estate planners advise against this choice, unless you have no other options, because of the impersonal nature of the service and the fees the institution will charge.

## VII. WHAT GOES IN A WILL: COMMON WILL PROVISIONS

### §3:26 Purpose of Common Provisions

Other than satisfying the legal prerequisites so that it can be admitted to probate, a will doesn't have to be in any standard

form. However, a number of provisions are typically included wills to facilitate estate and trust administration, avoid ambiguity, discourage will contests, and ensure that all property is disposed of according to the testator's wishes. Here are some of these key provisions you should be aware of.

## §3:27 Introductory Provisions

"Last Will of [Name]" is the usual title of a will. Although wills were once commonly titled as "Last Will and Testament," the word "testament" is now often omitted as it has no meaning.

A will should begin with your name and a statement that the document is your will and that it revokes all prior wills and codicils. This statement shows your "testamentary intent" and makes clear that this will doesn't just amend a previous will. It completely supplants it.

Your domicile does not have to be recited in your will, but the reference is helpful if questions arise as to where the will is to be probated. Generally, a will is probated in the county of your domicile. The recital of domicile also provides evidence of what state the will was prepared and executed in. You could move to a state that has different execution requirements for validity. However, some states consider a will valid if it meets the execution requirements of the state in which it was executed.

Your marital status is also often included. The marital status of a testator determines who has standing to contest the will, what property is properly part of the estate, and who has priority to serve as administrator if all named executors are unavailable. Reciting the children's names can be useful if someone who is not named claims to be a child, or if a child's status as such is questioned.

## §3:28 Gifts

This is the part of the will where you state who is to get your property when you die. It is the most important part of a will for most testators.

You can give away specific items of property or specific amounts of money. You can give gifts of broad categories of property ("all my personal and household effects"); you can give gifts to be shared among two or more persons, or an entire class of persons, such as "my children." You can order that certain property be sold and the proceeds given to one or more beneficiaries. You can specify if beneficiaries of a shared gift are to share equally or in unequal percentages. You can leave gifts to charity and you can leave gifts in trust.

The various ways of leaving property in a will are explained further in Ch. 1.

## §3:29 Residuary Clause

Every will needs a residuary clause. A residuary clause disposes of any property you own that is not expressly disposed of by some other provision of your will. It specifies who is to take whatever is left after specific gifts. The purpose of a residuary clause is to prevent partial intestacy. Any probate assets you own that are not disposed of by your will pass to your heirs as determined by your state's intestacy laws.

Some people decide not to make any specific gifts of property or money and choose to dispose of their entire estate through the will's residuary clause.

## §3:30 Creation of Trusts

Your will can establish one or more testamentary trusts that will come into existence and be funded after your death. For example, your will may set up trusts for your spouse, children, grandchildren or others. If your estate is large, you can include trusts that will minimize your estate taxes. You will need to consider how long the trusts should last and when and under what circumstances the trusts should make distributions to the beneficiaries. For trusts in general, see Ch. 1. For leaving an inheritance in trusts for minors, see Ch. 5. For estate tax-saving trusts, see Ch. 6.

## §3:31 Appointment of Fiduciaries

These provisions name the persons you want to serve as the guardian of your minor children, custodian of your children's property, executor of your will, and the trustee of any trusts your will creates. You should also name successors in case the first-named fiduciaries are unable to serve. You can provide that your fiduciaries can serve without posting a bond and specify if and how they are to be compensated.

## §3:32 Powers of Fiduciaries

State law provides the basic powers that executors and trustees have. These are typically repeated or referenced in a will. Sometimes it's desirable to give the fiduciary expanded powers such as power to operate a business or to manage and sell real estate. Otherwise, the fiduciary may need to obtain court approval or consent of beneficiaries.

## §3:33 Payment of Taxes, Debts, and Expenses

Your will should provide that your executor must pay your taxes, debts, and expenses of administering your estate before distributing your estate. An allocation provision may be included that explains how these expenses are to be charged against your estate. You can provide that all taxes, debts, and expenses should come from your residuary estate so gifts of specific property and cash are not affected. Or you can provide that they are to be apportioned among all beneficiaries so that each bears a share.

## §3:34 Survivorship

This provision spells out for how long a beneficiary must survive you to get his or her inheritance. This is important because when a beneficiary dies at the same time or shortly after you, you may prefer that his or her inheritance go to an alternative

beneficiary of your choice, instead of to the deceased beneficiary's heirs. You can choose the required survival time. Thirty days to 60 days are common periods.

The outer limit should be six months. If a surviving spouse is required to survive longer than six months after his or her spouse to receive a bequest, the bequest will not qualify for the estate tax marital deduction, which will be important if you could owe estate taxes. See Ch. 6.

A practical rationale for a short survival requirement is that the beneficiaries may want to distribute the assets and move on. A surviving spouse who is subject to a six-month survival requirement has a limited ability to pay bills or fund trusts during those six months.

## §3:35 No-Contest Clause

A will contest is a possibility when someone who expected to be a beneficiary is disinherited or is given less than he or she expected. It is also a possibility when someone who was not expected to benefit receives a significant gift, especially if he or she is a distant relative or not related at all.

If the will was properly executed and the testator possessed testamentary capacity and was not unduly influenced, the contest should fail. In the meantime, however, the family's dirty laundry is aired in court, the testator's eccentricities and foibles are publicly analyzed (as evidence of lack of capacity), and the will beneficiaries may feel a need to settle the case merely to end the litigation. Thus, some testators feel that deterring a will contest from being filed is almost as important as ultimately winning it.

A no-contest clause offers one deterrent to a will contest. A no-contest clause (also referred to as a forfeiture clause or in terrorem clause) typically punishes contestants by depriving them of all benefits under the will. Some states will not enforce a no-contest clause.

A no-contest clause serves as a deterrent only if the will makes a meaningful gift to the aggrieved heir. An heir who has been completely disinherited has nothing to lose, but an heir who is

receiving an inheritance cannot contest the will unless he or she is willing to give up an assured amount to gamble on the possibility of receiving more.

## §3:36 Funeral and Burial Information

You may wish to leave specific instructions for your funeral and burial or cremation. Putting these instructions in writing can help settle family disputes, particularly if your wishes are unusual or likely to be opposed by family members. Even if the closest relatives can be trusted to carry out your wishes, having a written confirmation of those wishes can help fend off the criticism of other relatives or friends.

As a practical matter, funeral instructions cannot be carried out unless they are known. Because the family may not read your will until after the funeral, you should discuss your wishes with them in advance, and not rely on instructions in the will to convey the message.

## §3:37 Anatomical Gifts

If you want to donate your organs or body, the best policy is to make arrangements before you die, rather than in your will. Let your loved ones know of your wishes. If you want to be an organ donor, you can carry a card in your wallet, put a sticker on your driver's license, or indicate your choice in your health care directives. See Ch. 8. If you want to donate your body to a medical school or another research facility, it's best if you make advance arrangements to ensure that your gift will be accepted. Then provide your loved ones with the contact information for the institution you have chosen.

## §3:38 Gifts of Tangible Property in a Separate Letter

In some states, you can specify to whom you want to leave items of tangible property in a separate statement or letter so

long as the letter is referred to in your will. The letter must be in your handwriting or signed by you and must describe the items and who is to receive them. The advantage of using a separate letter for personal property, rather than spelling out the details in your will, is that the letter does not need to be executed with the formalities of a will. You can prepare it before or after executing your will and you can easily change it from time to time.

Even if the law in your state does not permit this method of making gifts of tangible personal property, a separate letter can still serve a useful purpose by providing non-binding guidance to your executor. For example, if your will leaves your personal and household effects in equal shares to your children, you may want to prepare a letter that suggests which of the children should receive which particular items. Even a non-binding letter can prevent disputes and simplify administration, by providing evidence of your intent.

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CHAPTER 4

# Revocable Living Trusts

I. Overview
II. Deciding Whether to Include a Revocable Living Trust in Your Estate Plan
III. Trustees of a Revocable Living Trust
IV. Creating a Revocable Living Trust
V. Funding a Revocable Living Trust
VI. A Will to Accompany your Revocable Living Trust

## I. OVERVIEW

### §4:01 What Is a Revocable Living Trust?

Like all trusts, a revocable living trust is created when a trust maker or settlor transfers property to a trustee for the benefit of one or more trust beneficiaries.

A revocable living trust has two defining characteristics:

- You create it while you are alive.
- You have the right to change it or terminate (revoke) it whenever you choose, so long as you are mentally competent.

### §4:02 How a Revocable Living Trust Works

The revocable living trust functions as an alternative to a traditional will. Initially, you are the settlor, the trustee (in most cases), and the beneficiary. You can name another person to serve as the initial trustee if you want another person to manage your property.

You create the trust by executing a document called a trust agreement or trust declaration. Then you transfer your assets to the trustee (to the trust itself in some states). As the beneficiary,

the trust assets are still considered yours to be used for your benefit throughout your lifetime. As the trustee, you have full authority to manage the assets as you see fit. As the settlor, you can change, modify, or terminate the trust.

Your trust document will name a successor trustee who will manage your trust when you die or if you become incapacitated. It will also describe who is to receive trust assets on your death. When you die, your successor trustee distributes the trust assets to your beneficiaries under the terms of your trust without needing to go through probate.

## §4:03 Selling Trust Property and Moving Property in and out of the Trust

If you are the trustee of your revocable living trust, you can sell the trust property just as if the title were still held in your name. Similarly, if your successor trustee is managing trust assets because you are no longer able to do so, he or she can sell or transfer the property out of the trust.

So long as you have your own, individual living trust, you may transfer property in and out of your trust as often as you wish. If you own a joint trust with a spouse or other person, you may need his or her consent when removing assets or at least when removing jointly owned assets. See §4:06.

## §4:04 Revoking or Amending the Trust

You can revoke or amend your individual living trust at any time. If you wish to make a minor change to your trust, you can create an amendment to the trust, which is a simple document outlining the changes. The document needs to be signed, dated, and kept with your original trust document. If you need to make substantial changes to your trust, you will need to create something called an amendment and restatement. An amendment and restatement avoids your having to transfer all your property into a new trust. Rather, the document serves to "restate" the terms

of the original trust combined with any new provisions. See Ch. 9 for more on amending or revoking a trust.

If you have a joint trust, you and your co-settlor may need to agree to amend or revoke the trust. See §4:06.

## §4:05 What Happens on Your Death

A revocable living trust becomes an irrevocable trust on your death, and changes can no longer be made to it. Your successor trustee takes on the role of managing the trust funds and distributing the trust assets to your beneficiaries. Your trust will remain in existence for as long as it takes the trustee to complete this process. Just like a will, your trust document can create sub-trusts that come into existence on your death. If you created a sub-trust for your spouse or children, the trustee will continue to manage the sub-trust until the beneficiary has satisfied all the conditions outlined in the trust to receive the full distribution of the trust property.

## §4:06 Joint Revocable Living Trust for Couples

If you and your spouse want to use revocable living trusts as part of your estate plan, you will need to decide whether to set up a separate trust for each of you or to create a joint trust. With a joint trust, you and your spouse transfer your property (jointly owned, community, and separate) to one trust. As joint settlors, each of you has complete authority to designate the beneficiaries to whom you want to leave your property on your death. While you are both alive, you can be co-trustees with each of you having control over the trust's assets. The trust may require you both to agree to revoke or amend it, but it may allow either of you to withdraw your separate property. Alternatively, it may allow either of you to revoke it but may require both of you to agree to amend it.

When the first spouse dies, the trust is split in two. The deceased spouse's estate (half of all jointly owned property and all of the deceased spouse's separate property) is distributed to

the deceased spouse's beneficiaries according to the terms of the trust. It may go to beneficiaries outright or some or all of it may be transferred to various types of trusts for property management and/or tax savings.

The surviving spouse's property remains in the trust. Often, each spouse leaves his or her estate entirely to the other spouse, in which case, it simply remains in the revocable living trust along with the surviving spouse's property. When the surviving spouse dies, the trust property is distributed to the surviving spouse's beneficiaries.

You and your spouse may be candidates for a joint trust if you own most of your property jointly or live in a community property state (i.e., Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington or Wisconsin). In a community property state, all property acquired during a marriage is considered to be jointly owned by both spouses.

If you have separate trusts, separating your jointly owned assets to transfer them to the trust can be a hassle. Also, with separate trusts, after the first spouse dies, property left to the surviving spouse will need to go first from the trust to the survivor, and then to the survivor's living trust. In a joint trust, that property would just stay in the trust on the first spouse's death.

You do not have to be married to create a joint revocable living trust. A joint trust may also be appropriate for unmarried partners who own most of their property jointly.

On the other hand, separate trusts may work better for you if:

- You and your spouse own mostly separate property (often the case with older couples or second marriages).
- You own separate property that you want to maintain sole control over (or your spouse does the same).
- You and your spouse have a prenuptial agreement keeping your earnings and property separate.

# II. DECIDING WHETHER TO INCLUDE A REVOCABLE LIVING TRUST IN YOUR ESTATE PLAN

## A. Advantages of Revocable Living Trusts

### §4:07 Estate Planning Goals that Can Be Accomplished with a Revocable Living Trust

You may choose to make a revocable living trust the centerpiece of your estate plan for one or more of the following reasons:

- To avoid probate.
- To avoid the need for a guardianship if you become incapable of managing your affairs.
- To provide for management of your property even if you are not incapacitated, but simply do not want the responsibility anymore.
- To keep your estate plan private.
- To avoid ancillary probate proceedings in other states if you own real property in more than one state.
- To protect your estate from will contests.

### §4:08 Probate Avoidance

When you die, the assets in your living trust do not need to go through probate. Your trustee can manage your estate and transfer your assets to your designated beneficiaries on your death with minimum delay and without payment of probate fees.

Although avoiding probate may be a legitimate goal for many, be sure it makes sense for you before deciding to use a revocable living trust. Probate procedures vary from state to state. In some states, probate is expensive and time-consuming because court involvement is significant and an attorney is usually required to guide your executor through it. In these states, a revocable living trust may offer an effective way to save time, money, and

aggravation so that your beneficiaries receive their inheritances promptly without reduction for probate fees.

Other states offer more streamlined informal probate procedures with little court involvement. If you live in one of these states, the costs of setting up a revocable living trust and maintaining it could equal or exceed the costs of probate.

Also, if most of your estate will pass outside of probate because it consists primarily of non-probate assets (e.g., retirement accounts, life insurance, property owned with rights of survivorship), a revocable living trust may not be necessary. For more on the probate process and assets that pass outside of probate, see Ch. 2.

If you bring your estate planning attorney an inventory of your assets, he or she can advise you on the relative costs of probate versus creating and maintaining a revocable living trust. For creating an inventory, see Ch. 1.

## §4:09 Incapacity Planning

A fully-funded revocable living trust can be useful should you become incapacitated. The trust can be drafted so that your successor trustee can easily take over the management of your finances if you become unable to manage them yourself.

Unlike the holder of a durable power of attorney (see Ch. 7), a successor trustee has legal title to the assets in the trust, so the trustee's authority to transfer real estate and write checks is more likely to be recognized by title companies and financial institutions.

A revocable living trust may well be worth the cost for someone who is expecting to become mentally incapacitated (such as an early-stage Alzheimer's patient) because it will ensure that the individual's family will be able to take action on his or her behalf without court involvement.

However, a living trust may not be cost-effective as a tool for incapacity planning if you have substantial assets in a qualified retirement plan or IRA. These cannot be transferred to a revocable trust without triggering income tax on the balance. The only ways

to manage such assets during the owner's incapacity are with a power of attorney or a guardianship. Although guardianships are expensive, they may not be as expensive as the tax bill on a large IRA distribution. So if the custodian or plan administrator will not accept a power of attorney, an incapacitated person with a large IRA may still be better off going through a guardianship rather than cashing out the IRA in advance. And if a guardianship is the plan for retirement assets, setting up a trust for other assets may not add enough value to justify the cost and inconvenience of the trust.

## §4:10 Delegation of Property Management

A revocable living trust can be very effective if you want a third-party trustee to manage your financial affairs. The trustee can operate more efficiently than an agent under a power of attorney because the trustee has legal title to the assets. Third parties are generally more willing to accept the authority of a trustee than of an agent under a power of attorney. See Ch. 7. At the same time, you can retake control at any time, so long as you are competent, by replacing the trustee or revoking the trust.

## §4:11 Privacy

Because a trust does not have to be filed with the probate court the way a will does, using a trust as a will substitute keeps your plan for the distribution of your assets private. If all your assets are in the trust when you die, your will need not be probated and your executor will not need to file an inventory of your assets with the court. If, however, some assets remain outside the trust and are passed by your will, your executor may still have to file an inventory with the probate court.

Even if you have a revocable living trust, a motivated person can find out a lot about your assets. So the privacy advantages of a living trust may be somewhat overstated.

Many assets are already a matter of public record. Deeds to real property are filed in the county deed records. Marriage

licenses, birth certificates, and other semi-public records contain information about a person's age and marital status. The title information for a car is available to many businesses and governmental agencies. Incorporation records, limited partnership filings, and assumed name filings are also public records, so the ownership of a business may also be publicly available. Finally, the typical credit report technically isn't a public record but is still available to many people (with few safeguards) and it contains a great deal of information about assets purchased on credit, employment history, marital status, and other things. Thus, for many people, probate doesn't reveal any information to the world that a good detective or scam artist can't already figure out.

Moreover, assets (such as life insurance and retirement plans) will not be included in a probate inventory because they pass by beneficiary designation instead of by will or trust.

## §4:12 Real Property in Multiple States

Typically, a probate proceeding must be initiated in each state where a decedent owns real property. If you own real property in more than one state, you may be able to avoid additional (ancillary) probate proceedings by transferring that real property to a living trust.

However, you (or your attorney) should investigate the laws of the other states where you own real estate before attempting to avoid probate in those states. Some states do not require probate in their state to pass title to real property owned by a non-domiciliary so long as a probate proceeding has been commenced in the state of the decedent's domicile.

## §4:13 Protection from Will Contests

If you are anticipating a will contest, a revocable living trust may bolster the strength of your estate plan. A living trust, like any other contract, can be challenged in court based on fraud, undue influence, or lack of capacity. These are also the same grounds on which a will is often challenged.

Trusts can be more difficult to contest because the law on challenging trusts is sometimes less clear and less well-developed than the law on contesting wills. Also, having set up your trust considerably before your death and managed your assets is strong evidence that you were competent.

A living trust may reduce the likelihood of a contest because it is not a public record. If your family members are unaware that another person is receiving more than they are, the likelihood of a contest is reduced. However, in many jurisdictions, the successor trustee is required to send all beneficiaries notice that the settlor has died along with a copy of the trust, which means that the trust provisions will be known to all beneficiaries and their confidants.

Courts may be reluctant to invalidate a trust that has been in operation for some years because each transaction involving the trust reinforces its validity, and unwinding all the transactions if the trust is found to be invalid creates a lot of legal problems.

You will benefit most from this reluctance if you fund your trust immediately (i.e., transfer your property into it) and keep it funded. Creating an empty trust or allowing assets to migrate back into your name reduces the value of the trust for this purpose.

Ultimately, it is not the existence of the trust that fends off the will contest so much as the fact that having the trust allows you to create and document a large volume of evidence confirming your mental capacity.

## B. Disadvantages of Revocable Living Trusts

### §4:14 Greater Cost

One disadvantage of having a revocable living trust is the upfront costs associated with it. Attorney fees will be higher for a living trust estate plan than a will-based estate plan because the attorney needs to spend more time preparing the documents and discussing the options and possibilities that are available under a trust-based plan. You may also need your attorney's help to ensure that your property is transferred to the trust correctly.

## §4:15 Burden of Maintaining the Trust

Using a revocable living trust as a will substitute creates administrative burdens. Unlike a will, which remains dormant until you die, a revocable living trust comes into existence when you execute it. It must then be funded and administered, both of which will cost you time and money. If you are the initial trustee, you must keep additional records because you owe a fiduciary duty to the beneficiaries who will receive trust assets when you die. You must also ensure that all newly-acquired assets are titled in the name of the trust. Every time you open a bank account or buy a new house, the trust adds one more requirement to those transactions.

If assets are left outside the trust, your successor trustee will not be able to manage them if you become incapacitated and your estate may need to be probated when you die.

## §4:16 Inconvenience of Owning Assets through a Trust

Owning assets through a trust can be burdensome. Title companies may refuse to title new real estate purchases in a trust. You may have to first purchase real estate in your name and then in a second transaction, transfer it to the trust. Or you may have to transfer an asset you want to sell from the trust to your name before selling it. Automobile loans may have to be paid off before the vehicle can be transferred to the trust. Insurers may not want to insure a vehicle that is held in trust.

## §4:17 Interaction with Medicaid Eligibility Rules

A revocable living trust can present an obstacle for someone who may someday apply for Medicaid nursing home benefits. An applicant for Medicaid nursing home benefits can own a home without it counting against him or her in the asset calculation. The home is only non-countable if it is owned outright; a home

owned in a trust is countable. Thus, the home will have to be moved out of the trust when the person applies for Medicaid, which means the trust will not help avoid probate.

A revocable trust could cause the Medicaid applicant to lose benefits. The Medicaid agency will allow an applicant to transfer his or her home out of the trust and then become immediately eligible, but the agency may not alert the applicant to the need to make this transfer until several months of eligibility have been lost. Even if the agency alerts the applicant immediately upon application, he or she may have already lost retroactive benefits. The Medicaid agency can award benefits for nursing home care received during the three months immediately before the applicant applies for benefits, but only if the applicant was financially eligible during those three months, and owning the home in a trust can prevent that.

Furthermore, the applicant's family would have to undergo the extra effort and stress of quickly getting the house out of the trust, at the same time as they are dealing with the Medicaid application and the stress of a medical crisis.

With careful drafting and planning, several types of irrevocable living trusts, such as a special purpose trust or Medicaid asset protection trust, may help you to qualify for Medicaid or other government benefits. The laws regarding transferring property into these types of trusts are complex; therefore it is in your best interest to seek the advice of an attorney who specializes in this area to assess whether you do qualify for these benefits and to properly draft a trust that would achieve these goals.

## §4:18 No Court Supervision after Your Death

Another possible downside of a living trust is that because a trust does not go through probate, the court cannot monitor the estate for fraud or abuse.

## C. What a Living Trust Does Not Do

### §4:19 Four Big Myths About Revocable Living Trusts

Many people mistakenly believe that a living trust will eliminate or reduce taxes, protect their assets from creditor's claims, make a will unnecessary, and make it easier to qualify for public assistance. None of these myths is true.

### §4:20 A Living Trust Does Not Save Taxes

People often think that a living trust provides some special tax benefits not available with a will. This is NOT TRUE. A living trust offers no special tax benefits. Any tax planning that can be done with a living trust can also be done with a will. Here is a summary of the tax consequences of establishing a revocable living trust:

**Income tax.** Because you have the right to revoke the trust, it is ignored for federal income tax purposes. Any income earned by trust assets is directly taxable to you, and you are entitled to take any deductions available to trust property (e.g., the home mortgage interest deduction for a home that is titled in the name of the trust or trustee).

**Estate tax.** When you die, the trust's assets are included in your estate for estate tax purposes at fair market value, as if they were owned in your name. A living trust can establish sub-trusts that can save on estate taxes, although these same tax-saving trusts can also be established with a will. See Ch. 6. Because the estate tax exemption is substantial, few people will need these trusts.

**Gift tax.** Transfers of assets to a revocable living trust are not subject to gift tax. They are not treated as gifts because you can revoke the trust.

## §4:21 A Living Trust Does Not Protect Your Assets from Creditors

You cannot shield your assets from creditors simply by placing them in a living trust. Creditors can reach the assets in a living trust both during your life and after your death. Probating a will often offers more protection from creditors. During probate, creditors must submit their claims in a certain format and by a certain deadline. If the creditors miss the deadline or otherwise fail to follow the rules, the debt can be eliminated. Legitimate claims must be paid before the assets are distributed, so the beneficiaries won't have to worry about creditors. If the assets pass to beneficiaries outside of probate, creditors can still come after them.

If your goal is to shield your assets, you should discuss with your estate planning attorney whether other more complex trusts are appropriate for your estate plan.

## §4:22 A Living Trust Does Not Make a Will Unnecessary

Even if you have a living trust, you still need a will. See §4:42, 4:43. The living trust affects only property that you have transferred to it. When you die, you could own property that you have not transferred to the trust. You might have acquired the property shortly before your death or simply overlooked it. Your estate could even acquire property after you die, such as a tax refund or payment of a debt.

You can have a "pour-over will" that provides that the property is transferred to your trust to be distributed according to its terms or a back up will that directly provides who is to get your property. If you have minor children, you may need a will to name a guardian for them. See Ch. 5.

### §4:23 A Living Trust Does Not Help You Qualify for Public Assistance

A revocable living trust will NOT help you qualify for Medicaid or government benefits. The reason is that you still can control your assets, either by managing their distribution or by revoking the trust and having the assets revert to you.

## III. TRUSTEES OF A REVOCABLE LIVING TRUST

### §4:24 Successor Trustee's Duties

The successor trustee's job is to manage the affairs of the trust and distribute its assets. In carrying out this role, a trustee must follow the settlor's wishes according to the instructions in the trust document.

The duties of a trustee differ, however, when a trustee is serving as a successor trustee for an incapacitated settlor, as opposed to when the successor trustee steps in when the settlor has died. A successor trustee for an incapacitated settlor is responsible for managing the trust assets as well as managing the settlor's care. When the settlor dies, the successor trustee's responsibilities focus on executing the terms of the trust, which may include inventorying the assets, taking an accounting of the assets, and settling the trust estate.

Often the trust continues after the estate has been settled, (for example in situations where a sub-trust is created for the benefit of a minor child). In these circumstances, the trustee is still responsible for managing the trust on a longer basis. In doing so, the trustee must make sure that he or she keeps the assets of the trust separate from his or her own assets. Also, a trustee must communicate with the beneficiaries and treat them equally (unless the trust provides otherwise).

When managing the trust assets, the trustee must make conservative investments for the trust, or invest trust funds in a manner to earn interest with minimal risk to the trust assets.

Finally, a trustee is responsible for maintaining accurate records, filing appropriate tax returns and reporting to the designated beneficiaries as outlined in the terms of the trust. See §4:26 for a list of common powers of the trustee of a revocable living trust.

### §4:25 Choosing a Trustee and Successor Trustees

Most people choose themselves as the initial trustee of their revocable living trusts. This enables them to manage their assets for as long as they are able to do so. Couples with a joint trust may choose to serve as co-trustees, which allows for the other to step in as sole trustee if one spouse dies or becomes incapacitated.

The duties and responsibilities of a successor trustee of a revocable living trust are similar to those of the executor of a will and an agent under a durable power of attorney. Consequently, many of the considerations that apply to choosing an executor and agent also apply to choosing a successor trustee. You want a person who is trustworthy, responsible, capable, and willing to serve. See Ch. 3 (executors) and Ch. 7 (agents under a DPOA) for further discussion of qualities to look for. It makes sense to choose the same person to serve in all three roles. Consider naming multiple alternate successor trustees to serve if the first person you name is unable to act.

Common choices are a spouse, adult child, relative, or close friend. Sometimes people choose a corporate trustee, rather than a family member or close friend. Corporate trustees may include bank trust departments, attorneys, or CPAs.

## IV. CREATING A REVOCABLE LIVING TRUST

### §4:26 The Trust Document

A revocable living trust is created when you execute a document called a trust agreement or trust declaration. The document will name the trust, for example, The Joe Doe Trust or the Smith Family Trust and provide that you as the settlor and you (or

another person) as the trustee agree to create the trust. Other provisions commonly included in a revocable living trust are:

**Purpose.** The purpose of the trust is usually stated to be to receive and manage assets for your benefit during your lifetime and to manage and distribute them on your death.

**Funding.** This provision typically allows you to move assets into the trust at any time by any reasonable method.

**Your home.** If your home is in the trust, this provision specifies that you have the right to live in it rent-free. The provision helps preserve any state homestead property tax exemptions and creditor protections you may qualify for.

**Distributions while you are alive.** This provision allows you to remove income and assets from the trust whenever you wish by directing the trustee (usually you) to make any distributions the settlor (also you) requests.

**Distributions if you are incapacitated.** This provision allows your successor trustee to distribute for your benefit as much of the trust estate as the trustee determines is necessary for your health, support, and maintenance.

**Distributions on your death.** On your death, the trust becomes irrevocable. Or, if you have a joint trust, the trust estate is divided into two and the part that holds your assets becomes irrevocable. Your trust can include provisions for the same types of gifts you can make by will. See Ch. 3. You can provide that your successor trustee distribute specific assets or specific amounts of money to named beneficiaries. You can name alternates to take if the primary beneficiary predeceases you. You can leave property in trust for the benefit of a spouse or minor children. You can leave a gift to be shared among members of a class, such as your children. You can leave a gift to charity. And you can name the beneficiaries

who will receive any trust property remaining after all other gifts are made. You can also explicitly disinherit an heir.

**Trustees/Successor Trustees.** Here you appoint your initial trustee (usually you) and a successor trustee who will take over if you are incapacitated or when you die. You can name a series of successors who can serve if the previously named successor is unable to do so. You can also allow the beneficiaries to agree on a trustee if there is a vacancy and no named successor. You may also want to allow the trustee to be paid a fee and be reimbursed for expenses. You can waive the requirement that a trustee post a bond and you can limit a trustee's liability to bad faith and intentional or reckless misconduct.

**Sub-trusts.** You can establish the same types of sub-trusts that take effect on your death that could be created in a will. For example, you may create a family pot trust or individual trusts for minor or young adult beneficiaries. See Ch. 5. If your estate is large enough to owe estate tax, you may include a bypass trust. You may want to leave property in trust for a spouse and then specify who is to take the property on his or her death. See Ch. 6 for bypass and marital deduction trusts.

**Trustee's powers.** Here you list the powers that you want to give your trustee. These could include, for example, the power to:

- Sell or borrow against trust property.
- Invest trust income and assets.
- Receive additional property into the trust.
- Purchase insurance to protect trust property.
- Prosecute or defend lawsuits on behalf of the trust.
- Vote stock held by the trust.
- Run your business.
- Execute documents necessary to administer the trust.
- Hire and pay professionals such as lawyers, accountants, and investment advisors.
- Perform any other acts required for the property management and distribution of trust property.

**Payment of debts, expenses, and taxes.** Before any assets can be distributed from your revocable living trust after your death, your debts, expenses, and taxes must be paid. This provision specifies from which assets payment is to be made. For example, to preserve any specific gifts, you may want taxes and expense paid from the residue of your probate estate, if you have one, or from the residue of your trust estate.

**Revocability.** The trust will provide that you can revoke or amend it at any time, so long as you are competent. If you have a joint trust, the trust may provide that you and your co-settlor have to agree to revoke or amend the trust.

**Definitions and other terms.** Your trust may contain additional provisions such as:

- A no-contest clause providing that if anyone unsuccessfully contests your trust, he or she forfeits any gifts provided by it.
- A survival provision stating that a beneficiary must live a certain amount of time after your death to inherit. Thirty to sixty days is typical.
- Definitions of terms used in the trust such as “children” and “descendants.”

While many forms and programs are available online that would allow you to create a living trust, a trust can be lengthy and complicated. A “form” may not cover your individual needs. An estate planning attorney can custom draft a trust document that ensures that your estate planning goals are met.

## §4:27 Schedule of Trust Property

A revocable living trust is typically accompanied by a schedule of assets that you are transferring into the trust. Simply listing an asset that has a title document (e.g., real estate, motor vehicles, securities) on the schedule, does NOT transfer it into the trust. The title document must be put in the trustee’s name.

For property without title documents (e.g., household furnishing, jewelry, and other personal possessions), listing them on the schedule may be sufficient in some states. Other states may require a separate document transferring the property to the trustee. The separate document may take the form of a bill of sale or an assignment. For funding your living trust, see §§4:31-4:41.

## §4:28 Executing the Trust Document

Typically, a revocable living trust document is signed before a notary but does not need to be witnessed. Only the settlor needs to sign. However, because a trustee is not responsible for the trust unless he or she has accepted it, it is customary to have the trustee sign to evidence acceptance. If, as customary, you are the initial trustee, you simply sign the document twice, once as the settlor and once as the trustee.

In some states, a revocable living trust must be executed with the same formalities as a will because it contains provisions distributing property on your death. Thus, it must be signed before two witnesses. For will execution requirements, see Ch. 3.

## §4:29 Trust Abstract or Certificate

When you or your successor trustee needs to transfer property in or out of the trust, banks and other financial institutions may ask to see a copy of your trust. They want to verify the trust exists and that you have the authority to manage the assets. Most states have laws that allow you to provide an abstract of trust or a certificate of trust (the name varies by state) instead. A trust abstract or certificate is an abbreviated version of your trust that does not reveal the identities of your beneficiaries or their shares in your estate. States-specific forms are available online. Generally, an abstract or certificate of trust requests:

- The name and execution date of the trust.
- The name of the settlor or settlors.
- The name and address of the current trustee or trustees.
- Whether co-trustees can act separately or must act jointly.

- A list of the trustee's powers.
- Whether the trust is revocable or irrevocable. If the trust is joint, whether each settlor has the power to revoke or whether both must consent.
- A statement that the trust has not been revoked, modified, or amended in any manner that would cause any statements in the trust certificate to be incorrect.
- How title to trust assets is to be taken.

The document needs to be signed before a notary, just like the original trust.

### §4:30 Storing Your Trust Documents

You should store your original trust documents along with your will. Follow the same guidelines for storing a will that are discussed in Ch. 3. Store the original in a secure place where it will be easily found after your death or on your incapacity. Make sure our successor trustee knows where your documents are. If they are in a safe deposit box, consider making arrangements with the bank so that your trustee will have access to the box after your death.

You may want to give copies to your successor trustee and beneficiaries. Keep a copy yourself so you can easily review the document in case you want to make changes. You can make notes on the copy, but never attempt to amend or revoke your trust by writing on the original or by unstapling it and inserting or removing pages. For making changes to your trust, see Ch. 9.

## V. FUNDING A REVOCABLE LIVING TRUST

### §4:31 Funding Depends on Purpose of Trust

You must fund your revocable living trust by transferring your assets to the trustee. On your death, your successor trustee has the authority to manage and distribute your property only if

it is in the trust. It's best to get an attorney's guidance on which assets should be transferred to your trust.

Which assets you transfer to a revocable living trust depends on what you hope to achieve with the trust:

**Avoiding probate.** If you plan to avoid probate, all your probate assets (see Ch. 3) should be transferred to the trust. These may include real estate, business interests, brokerage accounts, money market accounts, stocks, bonds, mutual funds, royalty contracts, patents or copyrights, antiques, jewelry, and artwork. Even if you jointly own real estate with another person or entity, you may want to still consider transferring your share into your trust so that it can be distributed with the rest of your trust estate. Alternatively, if you own most of your property with a spouse or partner, you can have a joint trust. See §4:06.

You may decide to keep non-titled, tangible personal property (e.g., furniture and clothing) outside the trust if your family will be able to divide it without argument.

Life insurance policies do not need to be transferred into your living trust because you can name your beneficiaries in your policy and the proceeds can be distributed directly according to the terms of your policy. Also, retirement accounts such as 401ks or IRAs by law are not allowed to be owned by a trust. Because you can also designate beneficiaries on those accounts, the proceeds can be distributed directly to your named beneficiaries rather than having to go through probate. However, you can name the trustee of your trust as the beneficiary of life insurance or retirement accounts to receive them on your death and distribute them according to the trust provisions.

**Disability planning.** If the trust is being used for disability planning only and not probate avoidance, you may prefer to leave the trust unfunded and let your successor trustee fund it using a power of attorney when you become incapacitated.

**Avoiding ancillary administration.** If the trust is created because you own real estate in multiple states and wish to avoid

ancillary administration, then you will need to transfer the out-of-state real estate to the trust, but all other assets will remain in your name.

## §4:32 How to Transfer Assets

Your trust document will typically specify that the trust property is described in an attached schedule, which then lists the property you intend to place in the trust. It's important to understand that listing an asset on the schedule does not transfer it to the trust. For assets with title documents, you will need to change the name of the owner on the title to the trustee or the trust.

These assets have title documents:

- Real estate.
- Motor vehicles.
- Bank accounts.
- Business interests.
- Investments, such as stocks, bonds, and mutual funds.
- Safe deposit boxes.

For assets without title documents, you can use a bill of sale or a document in which you describe the property and state that you are assigning it to the trust. In some states, the trust schedule of assets may suffice.

## §4:33 Special Concerns for Holding Real Estate in a Revocable Living Trust

To transfer real estate into your trust, you will need to execute a deed conveying the property to the trustee (who is usually you) or to the trust itself depending on the law in your state. Typical deed language might be Jane Smith, as trustee for the Jane Smith Trust.

Before transferring real estate to your trust, you will want to discuss the following issues with your estate planning attorney to ensure that the transfer is appropriate:

**Property taxes**. In some states, a change of ownership triggers a reassessment of real property and an increase in property taxes. Also, some states provide a property tax exemption that reduces taxes on owner-occupied homes. Usually, transfer of real estate to a revocable living trust is not treated as a change in ownership because you still have complete control over the property and so it does not trigger reassessment or loss of favorable property tax treatment.

**Homestead protection from creditors.** Most states exempt from creditors a certain amount of equity in a home. This protection is usually retained when the home is placed in a revocable living trust.

**Mortgage due on sale clauses.** Mortgages often contain a due on sales clause that allows the lender to call the mortgage when the property is sold. Federal law provides that a lender cannot call a mortgage when residential property with fewer than five units is transferred to a revocable living trust of which the borrower is a beneficiary. Thus, you can safely transfer your home or your vacation home to your revocable living trust.

If you own any other type of real estate, before transferring it into a revocable living trust have your attorney review your mortgage documents for a due on sale clause. You may need to seek the lender's permission before making the transfer.

**Homeowner's insurance.** The safest practice is to notify your insurance company or agent of the transfer and have your trust added to your homeowner's policy as an additional insured.

**Title insurance.** In some states, transferring real estate to a revocable living trust will void title insurance so you may need to purchase a supplemental policy.

**Approval of Condo or Homeowners Association.** Your condo or homeowners association rules may require you to get approval from the association before transferring the property to your trust.

## §4:34 Bank and Brokerage Accounts

Accounts at banks and brokerage firms are fairly simple to transfer to a trust. Major financial institutions have account registration forms designed for this purpose.

Some institutions allow the owner of the account to transfer the account online or over the phone; others require the owner to fill out a written request. The institution will typically require the following information:

- The name of the trust.
- The date the trust was created.
- The name of the current trustee and any successor trustees named in the trust instrument.
- The mailing address of the trustee.
- The taxpayer identification number of the trust, if it has one (otherwise, the settlor uses his or her TIN).

Most financial institutions will request a copy of the trust agreement for their files, or copies of the first and signature pages of the trust agreement. Alternatively, you can provide a certificate of trust. See §4:29.

Occasionally an employee of a financial institution decides to implement the account transfer by setting up a new account in the name of the trust and then transferring all the assets from the old account to the new account. This has the potential to be inconvenient, as you will have a new account number and may have to have checks reprinted. Furthermore, if the account contains mutual funds that carry a back-end load, the transfer to a different account may be treated as a sale that triggers a commission. To avoid this and any related problems, you or your attorney can request that the old account simply be reregistered in the name of the trust, without the creation of a new account.

## §4:35 Certificates of Deposit

Certificates of deposit typically carry penalties for early withdrawal. If you own a CD, you or your estate planning attorney

should first verify that the bank will not treat that transfer as a withdrawal subject to penalty.

If the bank will not reregister the CD without penalty, you may prefer to wait until the CD matures before transferring it. However, waiting does create a risk that you could die before the transfer is made, which means the CD may have to go through the probate process.

## §4:36 Stocks and Bonds

If you own securities in street name (i.e., through a brokerage firm), the securities will be transferred into the trust when the brokerage account is retitled in the name of the trust. If you own securities in certificate form, you will have to use a transfer agent to transfer the securities to the trust. A transfer agent is a financial institution that is authorized by a corporation to handle transactions in that corporation's securities.

A transfer agent typically requires that you mail the certificates and a letter of instructions to the transfer agent. You have to sign the assignment form on the back of the certificates. The letter of instructions usually contains the names of the trust and trustee, the TIN of the trust or your social security number, the address of the trustee, and a statement that a trust has been created and the transfer is requested.

You or your attorney should check with the particular transfer agent to find out if that agent has any special requirements concerning the letter of instructions.

## §4:37 Motor Vehicles

It may not be necessary to transfer your car to your revocable living trust. Your state department of motor vehicles may provide a simplified method of transferring title to your heirs. Alternatively, you can create rights of survivorship on the title itself.

Transferring a vehicle to a trust creates several issues that must be resolved. Some auto insurers will charge commercial rates for

cars that are not owned by individuals. So you may face extra hassle finding insurance at a reasonable price.

If the vehicle is subject to a lien, the lienholder may have retained possession of the original title to prevent you from transferring the vehicle without the lienholder's knowledge. In that situation, you must obtain the lienholder's cooperation to transfer the vehicle to the trust. Depending on how many years are left on the loan, it may be easier to wait until the loan is paid off before transferring the vehicle into the trust. However, this carries the risk that you could die in the meantime and your family will have to probate your will to transfer the vehicle.

## §4:38 Ordinary Personal Property

As a practical matter, an amicable group of beneficiaries can divide up your household furnishings and personal effects without permission from the court. If you own only ordinary personal property and do not expect disputes among the beneficiaries, it is usually undesirable to transfer the property to a revocable living trust. A successor trustee who has been entrusted with such items may feel a need to catalog them and supervise their distribution according to the terms of the trust, and this result may be contrary to your expectations.

## §4:39 Valuable Personal Property

If you own valuable items, such as artwork or jewelry, the property can be transferred to the trust using a bill of sale or assignment. A general bill of sale or assignment can transfer all your tangible personal property while a specific bill of sale or assignment can transfer specific items listed on a schedule.

In a dispute, the specific document is more likely to be respected. However, the general document is more likely to cover all relevant assets. If you want to make a global transfer, you may wish to execute one of each to cover all bases.

For global transfers, new transfer documents should be executed at regular intervals to cover all new assets that have been

acquired. Executed transfer documents should be stored with the trust documents.

## §4:40 Joint Tenancy with Right of Survivorship

Even though assets jointly owned with right of survivorship pass to the survivor outside of probate (see Ch. 2), you may still want to transfer them to the revocable trust.

Survivorship rights avoid probate only at the first death. At the second death, or if all owners die together, the asset will have to go through probate.

Real property and bank and brokerage accounts are typically owned with right of survivorship.

## §4:41 Retirement Plans and Life Insurance

Life insurance proceeds and retirement plans such as 401(k) plans, individual retirement accounts, or profit-sharing plans usually pass by beneficiary designation. See Ch. 2. Thus, typically you don't need to transfer these assets to your revocable living trust. Instead, they can be set to transfer on your death by designating your trust or trustee as the beneficiary. The proceeds or balance pass directly to the trust instead of going through the estate and thus avoid probate. Naming the trustee as the beneficiary causes the assets to pass according to the same dispositive plan as all the other assets that are owned through the trust.

Ownership of a retirement plan cannot be transferred without triggering income tax on the balance in the plan, and employer-provided plans typically will not allow transfers at all.

Instead of having these assets pass to your trust, you may prefer to name specific individuals as the beneficiaries. For example, if you want your life insurance proceeds to go to one person and your probate assets to another person, it may make sense to simply name the first person as the beneficiary of the policy. However, if you want the life insurance proceeds to be divided among several beneficiaries according to the overall scheme laid out in your trust, the trust should be the beneficiary of the policy.

# VI. A WILL TO ACCOMPANY YOUR REVOCABLE LIVING TRUST

## §4:42 Need for a Will

You need a will in conjunction with your living trust. A living trust deals exclusively with the assets that are in it. A will acts as a safety-net for everything else in your estate plan that your trust does not cover. If you have minor children, for example, a will contains provisions addressing the appointment of a guardian for them.

Even if you are diligent about titling all new assets in the name of the trust, there is always a risk that you will die owning assets in your name.

For example:

- You might inherit property and then die before acquiring the legal authority to transfer the inheritance to your trust.
- You might acquire new assets during a period of incapacity, and therefore be unable to transfer them into the trust.
- You might die in an accident that gives rise to a lawsuit on behalf of your estate.
- Your estate may become entitled to funds as a result of your death, such as refunds of unused insurance premiums that can be claimed only by an executor.
- Some property is better disposed of by a will than a living trust. For example, motor vehicles are not typically transferred to a living trust because insurance companies hesitate to insure such vehicles.
- If you've arranged to pass your big-ticket items through a trust or other probate-avoidance device, you may want to use a will to give away smaller value items, for example, grandpa's watch, or small cash gifts. These assets may not need to pass through probate or may qualify for simplified low-cost procedures.

## §4:43 Pour-Over Will vs. Back-Up Will

You may choose to have either a pour-over will or a back-up will to accompany your revocable living trust. With a pour-over will you leave any property you own outside of your revocable living trust to the trustee of your trust. On your death, the property is transferred to the trust and distributed to your beneficiaries according to the trust provisions.

With a back-up will, you leave any assets that remain outside your trust at your death directly to your beneficiaries.

Both back-up and pour-over wills need to be probated. A pour-over will does not escape probate just because the property passes through your trust. If the value of the property left outside the trust is small, expedited probate may be available.

The advantage of a backup will is that once probate is complete, the assets can be transferred to your beneficiaries. They will not need to first be transferred to the trust before your beneficiaries can receive them. This means your trustee can wrap up your revocable living trust and end it more quickly.

However, a pour-over will may be a better choice if your revocable living trust establishes sub-trusts that will continue for a while after your death. For example:

- Your revocable living trust may establish one or more trusts for minor or young adult beneficiaries. With a pour-over will, property can be transferred into these trusts. Otherwise, you may need to establish a second set of minors' trusts in your will.
- Your revocable living trust may create a bypass trust for minimizing estate taxes. You will want your property transferred to the revocable living trust so that this trust is fully funded to take advantage of your estate tax exemption. See Ch. 6.
- Your revocable living trust may create a QTIP trust that benefits your surviving spouse but allows you to name the ultimate beneficiaries on his or her death. See Ch. 6.

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CHAPTER 5

# Providing for Your Minor Children

I. Naming a Guardian to Care for Your Children
II. Naming a Person to Manage Your Children's Property

### §5:01 Introduction

If you have minor children, providing for them is probably one of your top estate planning goals. Even if you are young and healthy and likely to live many more years, you are understandably concerned about what will happen to your children should you (and your children's other parent) die unexpectedly. Because life is unpredictable, even though you do not expect to die with young children, planning carefully for the possibility is responsible and prudent.

In providing for your minor children in your estate plan, you must consider three separate issues:

- Who should raise your children if you and their other parent are both deceased.
- What assets will be available to support your children.
- Who should manage those assets.

## I. NAMING A GUARDIAN TO CARE FOR YOUR CHILDREN

### §5:02 Name a Guardian, Even if You Never Expect Your Children to Need One

The person who is appointed by the probate court to care for your children is known as a guardian of the person. A person

who is appointed by the probate court to manage your child's property is called a guardian of the estate. One person can be appointed as the guardian of the person, and a different person can be appointed as the guardian of the estate. Or one person may have both jobs.

If your children's other parent is still alive, he or she will usually be entitled to raise them on your death or disability. However, you should name a guardian for your children even if you expect their other parent to be able to care for them. There is always a possibility that your children's other parent will predecease you or be disabled or otherwise unable to care for them at the time of your death.

Although a court is not obligated to appoint the person you choose as a guardian, the court will likely agree with your choice in the absence of evidence that he or she is unsuitable. As a general rule, a court will appoint the person designated by the last surviving parent unless the court finds that person is disqualified, deceased, unwilling to serve, or would not serve the minor children's best interest.

If you don't name a guardian and one is needed, the court will appoint someone who may not be the person you would have preferred. The most likely candidates are grandparents followed by aunts, uncles, and then more distant relatives.

## §5:03 Who May Serve as a Guardian

All states have similar requirements for persons who may serve as guardians for minors. In general, the person you choose must be an adult and otherwise suitable to care for children. As you might expect, convictions of certain crimes, such as violent felonies, child abuse, child sexual abuse, and domestic violence may be disqualifying. Physical or mental incapacity is also disqualifying.

Usually, only one guardian is appointed at a time, but some parents decide to appoint a couple as co-guardians of the children. See §5:08 for thoughts on whether to name a married couple as co-guardians.

## §5:04 The Guardian's Duties and Responsibilities

A guardian of the person has the duty to provide your children with food, clothing, medical care, and shelter. To fulfill these duties, he or she has the authority to make parental-type decisions for your children, such as determining where they will live and go to school and what type of health care and medical treatments they will receive.

Of course, this description does not do the job justice. Your children's guardian will step into your shoes. He or she will be responsible for all the things you now do to ensure your children's welfare such as:

- Routine tasks like preparing meals, driving carpool, and helping with homework.
- Setting limits and imposing discipline.
- Providing love, comfort, emotional support, and moral guidance.

Make sure you choose a person is willing and able to do the job.

## §5:05 Qualities to Look for in a Guardian

**Shared Values.** In selecting a guardian, make sure that you choose someone with whom you have shared values, religious beliefs, goals and parenting styles.

**Emotional Support and Comfort.** Consider whether your choice loves or is at least fond of your children and capable of nurturing them. Try to choose someone your children know and feel comfortable with. The trauma of losing both parents can be diminished if the child's guardian is a person with whom the child is already comfortable. A family member or close family friend who already has a bond with the children can be a good choice. You may want to discuss your choice with an older child as many courts will consider the preferences of teenagers in appointing a guardian. It is also possible to name different guardians for different children. Although most parents probably want their children

raised in the same home, family dynamics, the children's ages, and sexes may make different guardians preferable. See §5:09.

**Financial Resources.** Unless you have provided substantial financial assets, your choice of guardian should also be financially capable of raising your children.

**Age and Health.** Select someone who is sufficiently young to fulfill the duties until your child becomes an adult. He or she should be in good health and have the stamina for raising children. Although physical disabilities do not prevent someone from being a good parent, it would be prudent to think about health considerations that may shorten an individual's life expectancy or capacity to be a parent. While you may be inclined to select your parents as guardians, they are more likely to predecease you than persons in your age group or younger.

**Location.** If possible, select a guardian who lives nearby or who is willing to relocate to where the children live. Additional trauma will be avoided if a child does not have to enroll in a new school or form friendships in an unfamiliar area.

**Character.** Be careful not to choose someone that a court would not approve as a guardian, such as a person who has abused drugs or alcohol, or who has a criminal record.

## §5:06 Speak with the Person You Have Chosen

Before finalizing your decision, talk with the person you've chosen to make sure he or she is willing to accept the appointment. Ask the person if he or she has an interest in looking after your children, and express your wishes as to how you would like your children to be raised as well as the duties that the role entails. The person you choose may have legitimate reasons for being unable or unwilling to assume the responsibilities of a guardian. Encourage him or her to be frank. It is better to discover in

advance that the person cannot honor your request while you have the time to choose someone else. Be sure to inform your candidate that you will not take offense if he or she cannot or does not want to take on this responsibility.

## §5:07 Select Alternate Guardians

You are wise to think about choosing an alternate guardian, and under what circumstances, if any, the alternate guardian would be favored over the initial guardian you named. The alternate guardian would be appointed if the first person you chose were dead, incapacitated, unable to accept the appointment, or disqualified by the court. However, you may also wish to name alternate guardians if you have named a married couple as the first guardians and they divorce. In such a scenario, it may not be feasible for them to be co-guardians.

## §5:08 Should You Choose a Couple as the Co-Guardians of Your Children?

As a general rule, it's best to choose only one person to serve as the guardian of your children. Choosing two or more co-guardians creates the possibility of conflict. They may disagree about education, religious training, medical treatment, and so forth. The one exception is for couples. The courts in some states do not permit co-guardians unless they are married.

A couple can be a good choice if both are willing and the relationship is stable. You know how demanding parenting is, especially if you are a single parent. A couple as co-guardians can share the work and responsibility of caring for your children. However, disagreements about how to parent your children can put a strain on their relationship and can end up in court.

If you are thinking about naming a couple, consider whether their parenting styles and values are similar and compatible with yours. Are they able to make decisions jointly and compromise when they don't agree? Do you admire the way they parent their

children? If you have reservations about one of the partners, it may be best to just name the other. It may even be preferable to name someone else if you think that having your children in the couple's household when only one of them has parental authority will cause strife.

You may be able to specify that one of them is to be the sole guardian should they divorce. If they do divorce while you are alive, the best course of action is to amend your documents to name one of them or a different person or couple.

## §5:09 Should You Choose Different Guardians for Different Children?

Most people want their children raised together in the same home and so choose the same guardian for all of their children. But it is possible to choose different guardians for different children and, in some circumstances, that makes sense. For example, the children are from different relationships or are widely spaced in age.

**Examples:**

Alexis has a 6-year-old daughter, Jade, from her second marriage and a 10-year-old son, Brad, from her first. Both fathers are deceased. Her second husband's sister is Jade's godmother and has been devoted to her. Her first husband's brother has been a good role model for Brad and has always welcomed the boy into his family's activities. Alexis decides to name her second husband's sister as Jade's guardian and her first husband's brother as Brad's.

Isabelle has two children, a 15-year-old daughter, Inez, and a 2-year-old son, Joaquin. She would like her brother, who lives in another state, to be Joaquin's guardian should anything happen to her and her husband. Inez is a popular and successful student at the local high school. Ava, a neighbor and close family friend, is willing to be Inez's guardian. Isabelle names her brother as Joaquin's guardian and Ava as Inez's guardian. Should Isabelle and her husband die, Inez will not need to give up her school, activities, and friends.

## §5:10 Naming Someone Other Than Your Children's Other Parent as Guardian

Normally, your children's other parent has the right to raise them if you die or become incapacitated even if you and the other parent are divorced or were never married. Parents are considered to be a child's "natural guardians."

You cannot bypass the surviving parent's right to serve as guardian by naming someone else in your will or guardianship designation. If your children's other parent survives you, the court will simply ignore your choice of a different guardian.

If you genuinely believe the other parent is unfit, but expect he or she will seek custody if you die, you can write a letter to the court explaining why the other parent should not get custody. Include with the letter any evidence you have of the parent's unfitness (e.g., police reports, criminal records) and leave it for the person you choose as guardian to present to the court. The court may consider the letter and other evidence, but the other parent will be entitled to rebut your claims. And the court will make the appointment it considers best for the children.

You may also want to consult with an experienced custody lawyer. He or she can advise you of any other steps you should take to minimize the likelihood of the other parent's success.

## §5:11 How to Designate a Guardian

Once you make your choice and obtain the candidates' consent, your lawyer will draft the requisite documents to ensure that your selections will be recognized by a court.

You may designate a guardian for your children in your will. In some states, you may appoint the guardian in a separate document. The advantage of making the appointment in a separate instrument is that it can take effect if you become incapacitated. A will is effective only on your death. The disadvantage of using a separate document is that it contributes to the stack of documents you must deal with, and may be at greater risk of being

misplaced. The separate document may need to be executed with the same formalities as a will (i.e., signed by the parent before two witnesses who also sign). See Ch. 3 for more on executing a will.

You can designate a guardian in both your will and a separate document, but if you ever want to change the designation, you'll need to remember to do it in both documents.

Here is some typical language for designating a guardian.

> *One Person as Guardian of Person and Estate*
>
> If my [husband or wife] does not survive me, or if [he or she] dies after my death without having made provision for the custody and care of my minor children, or for the management of such children's estate, I appoint [name] as guardian of the persons and estates of my minor children. If [he or she] fails or ceases to act as guardian for any reason, I appoint [name] as substitute or successor guardian.
>
> [Or]
>
> *Married Couple as Go-Guardians of Person and Estate*
>
> If my [husband or wife] does not survive me, or if [he or she] dies after my death without having made provision for the custody and care of my minor children, or for the management of such children's estate, I appoint [names of married couple] (or such one of them as shall serve or continue to serve) as co-guardians of the persons and estates of my minor children. If they both fail or cease to act as guardians for any reason, I appoint [name] as substitute or successor guardian.
>
> [Or]

*One Person as Guardian of Person and Another as Guardian of Estate*

If my [husband or wife] does not survive me, or if [he or she] dies after my death without having made provision for the custody and care of my minor children, or for the management of such children's estate, I appoint [name1] as guardian of the persons of my minor children, and [name2] as guardian of the estates of my minor children. If [name1] fails or ceases to act as guardian or their persons for any reason, I appoint [name1a] as substitute or successor guardian. If [name2] fails or ceases to act as guardian or their estates for any reason, I appoint [name2a] as substitute or successor guardian.

# II. NAMING A PERSON TO MANAGE YOUR CHILDREN'S PROPERTY

## A. An Overview of Your Options

### §5:12 The Need for a Property Manager

Minors do not have the capacity to contract, and they cannot sell real estate, buy securities, or generally manage their property. State law imposes limits on the value of property that a minor can own in his or her name. The amounts vary but are typically no more than a few thousand dollars. If a minor is named as a beneficiary of a life insurance policy, many insurance companies will not disburse the funds until a court appoints a guardian. Therefore, arrangements must be made for an adult to manage property left to a child.

## §5:13 Methods for Appointing a Property Manager

There are three ways to designate a person to manage property left to minor children:

1. A probate court guardianship, which is usually thought to be the least attractive alternative.
2. A custodianship under the Uniform Transfers to Minors Act (UTMA), which is easy to create, but best for relatively modest amounts.
3. A trust, which is the most flexible tool and is best for substantial gifts.

The advantages and disadvantages of each are discussed further below.

One other option often used by parents is to leave property to each other for their children's benefit. Typically a married couple with minor children will leave their estates to each other with the assumption that the surviving parent will use the funds to support the family. This method is the simplest way to leave an inheritance to children and works well if you trust the children's other parent to use the inheritance for their benefit. Even if you use this method, you need to make an alternate plan for the management of your children's property in case the other parent predeceases you or dies at the same time you do.

## §5:14 Choosing the Best Person to Act as Your Children's Property Manager

The person you choose to manage your children's property does not need to be a financial genius or a sophisticated investor. But he or she should be trustworthy, responsible with money, and willing to do the job. If you are leaving substantial assets to your children, the property manager can always hire a professional investment advisor and accountant to assist.

Parents often choose the same person to both raise their children and to manage their children's assets. This arrangement

makes sense. The person who is caring for your children on a day-to-day basis will know the children's needs first hand and will have direct access to the funds necessary to meet them.

If the person you feel will best care for the children is not the person you believe will best manage their property, you can choose different people. It will be important to choose people who you think will work well together and understand the boundaries of their different roles.

## B. Probate Court Property Guardianship

### §5:15 Name a Property Guardian Even if You Never Expect to Need One

A guardian of the estate is the person appointed by the probate court to manage your children's property if you and their other parent are deceased or incapacitated. Estate planners typically advise clients to plan their estates to avoid the need for a guardian of the estate by leaving property to children in trust or in an UTMA custodianship. A probate court guardianship is expensive and imposes a lot of administrative work on the guardian.

Even if you hope to avoid a property guardianship, you should name a property guardian in your will or guardian designation document just in case some property passes to your children outside of whatever trust or custodianship you have arranged. For example, they may receive a gift or inheritance from someone else or the proceeds of a lawsuit settlement after you die. Through oversight, some property may be left outside of a trust or custodianship.

### §5:16 Duties of the Property Guardian

The guardian of the estate possesses and manages the children's assets. The guardian of the estate serves under rules that are similar to those of the executor of a will. A guardian of the estate:

- Must prepare an inventory listing the children's assets and their values and file it with the court.

- Manage the assets prudently avoiding risky investments and taking whatever steps are necessary to conserve the children's property.
- Pay the children's expenses.
- File an annual accounting with the court that describes the income received by the children, the expenses paid by the guardian on the children's behalf, and how the children's assets are invested.

The guardian of the estate generally must post a bond and is entitled to compensation.

## §5:17 Disadvantages of a Probate Court Property Guardianship

A legal guardianship of the property of a minor is subject to extensive supervision by the court. However, this apparent advantage is frequently a disadvantage because it makes the proceedings expensive and unwieldy.

A property guardianship ends with the distribution of the remaining assets outright to the child at age 18. This is precisely the age at which many parents are the most fearful of the consequences of such a distribution. Because of these disadvantages, estate planning for minors focuses on avoiding legal guardianships if at all possible.

Most parents prefer to use an UTMA custodianship or create a trust for their minor children.

To ensure that a probate property guardianship is avoided, you will need to obtain change of beneficiary forms for all life insurance and retirement plans and revise them to either create an UTMA custodianship or name the trust or trustee as a beneficiary instead of the children. Furthermore, make sure you have not named your minor children as payable-on-death beneficiaries of any taxable bank or brokerage accounts. Although a payable on death account avoids probate when the beneficiary is an adult, when the beneficiary is a child, a property guardianship will be needed.

## C. Custodianship Under the Uniform Transfers to Minors Act (UTMA)

### §5:18 How UTMA Works

The Uniform Transfers to Minors Act, which nearly all states have adopted, provides a simple device for dealing with assets given to minors that would otherwise require a legal guardianship of the property. The device is referred to as a "custodianship." A custodianship is much like a trust, but no trust document needs to be prepared. Under UTMA, gifts of assets to minors may be made to a designated "custodian."

You can set up an UTMA custodianship for a gift you intend to make to a minor after your death in a will, revocable living trust, or beneficiary designation. You can also establish an UTMA custodianship for a gift you make to a minor while you are alive. Many people make gifts under UTMA without the assistance of a lawyer because banks and brokerage firms offer UTMA accounts as a financial product. Gifts made during your life under UTMA qualify for the gift tax annual exclusion. See Ch. 6.

A transfer made to an UTMA custodian is irrevocable.

UTMA custodianships are best for smaller gifts. Many estate planners suggest around $100,000 as the upper limit. For larger amounts, a trust is preferable.

### §5:19 Property That Can Be Subject to an UTMA Custodianship

Assets transferred to a custodian can include real or personal property of any type. UTMA allows a custodian to be designated as the beneficiary of life insurance policies, annuity contracts, retirement plan death benefits, and similar contract rights.

### §5:20 Creating the Custodianship

An UTMA custodial arrangement can be created simply by transferring property to a custodian using the words, "as

custodian for [name of minor] under the [State] Uniform Transfers to Minors Act."

### §5:21 One Custodian, One Minor per Custodianship

An UTMA custodianship may involve only one custodian and one minor. All custodial property held by a particular custodian for the same minor is considered part of the same custodianship. In this respect, an UTMA custodianship is not as flexible as a trust, which can be shared by all your children. See §5:28.

### §5:22 Naming a Custodian

The designated custodian must be an adult over 21 or a financial institution with trust powers. If you are making the gift to a minor in your will or revocable living trust, you can select the custodian or you can direct your executor or trustee to choose one.

You can appoint yourself the custodian of a gift to a minor that you make while you are alive. But, for wealthy individuals, this creates a risk of adverse estate tax consequences. See Ch. 6.

### §5:23 Substitute and Successor Custodians

You may designate one or more substitute custodians to serve if the first-named custodian dies before the transfer, declines to serve, or is ineligible or otherwise unable to serve.

Once a custodian begins serving (which means the custodial account has been established), the custodian may designate a successor custodian to serve in the event of the custodian's death, resignation, or incapacity. In the absence of a designated successor custodian, a minor over the age of 14 may choose someone to fill the vacancy, but the person must be an adult member of the minor's family, a conservator of the minor, or a trust company. Otherwise, a court proceeding may be necessary.

A court can remove a custodian for cause or can require the custodian to post a bond.

## §5:24 Custodian's Authority and Responsibility

A custodian functions much like a trustee. That is:

- A custodian has full authority to manage the property on behalf of the minor, acting as a "prudent investor."
- A custodian must keep the custodial property separate from his or her funds.
- A custodian has broad discretion to use the property for the minor's benefit.

A custodian, acting in a custodial capacity, has all the rights, powers, and authority over custodial property that unmarried adult owners have over their own property.

Generally, a custodian is not supervised by a court and does not have to post a bond. However, a court can order the custodian to provide an accounting on the request of the minor's guardian or another family member, including the minor herself if age 14 or older.

## §5:25 Termination of Custodianship

In most states, the custodianship ends when the minor turns 21 and the minor is entitled to receive the property outright. If the minor dies before reaching age 21, the property must be transferred to the minor's estate. If the minor left no will (which is likely since most persons under 18 cannot execute wills), the property will be subject to the rules of intestate distribution.

A termination age of 21 can be troubling for parents and family members if the balance in the UTMA account is beyond the amount that the young person is ready to handle. It is not uncommon for attorneys to receive calls regarding 20-year-old beneficiaries who are about to receive high six-figure sums that they lack the maturity to handle. While some states may allow the custodian to transfer the assets to a trust for the minor's benefit, the best policy is for the parents or other donors to begin with a trust if the amount of the gift is expected to be substantial by the time the child turns 21.

## §5:26 Advantages and Disadvantages of UTMA Custodianships

An UTMA custodianship can be very convenient for handling relatively small amounts of property.

Custodianships are simpler, easier, and less expensive to create and maintain than trusts. A gift made through a custodianship does not require the preparation of trust agreement or other legal work, an annual accounting, or a separate income tax return. You simply transfer the assets to a custodian, using the statutory language. Likewise, it is much simpler to name a custodian as the beneficiary of a life insurance policy or other right than it is to create a trust to receive the proceeds.

In contrast, a trust involves significant costs. A trust requires:

- The preparation of a will or trust agreement.
- An annual accounting by the trustee. A custodian is required to give an accounting only on removal or other court order.
- The filing of an income tax return. With a custodianship only the minor need file a return.

On the other hand, UTMA custodianships do not offer much flexibility. You cannot alter the terms of UTMA by will or other instrument. You cannot extend the custodianship beyond the age specified by state law, usually 21. You cannot place any restrictions on the gift, such as requiring the recipient to complete school. The only significant discretion available to a person making an UTMA gift is the choice of custodian. Unlike a trust, a custodianship cannot have more than one beneficiary.

A custodianship is not a desirable means of holding a closely-held business or large amounts of wealth because of the early age of termination and the possibility that the property could pass by intestacy if the minor dies.

## D. Trusts for Minors

### §5:27 How a Trust Works

A trust is a legal relationship in which one person, the trustee, holds legal title to property for the benefit of one or more beneficiaries. To create a trust, you transfer legal ownership of property to the trustee. The trustee then manages the property for the beneficiary. Often the trustee receives compensation for serving as trustee. A trustee has a fiduciary duty to act in the best interests of the beneficiary.

To leave an inheritance for your children, you can establish a trust in your will or revocable living trust. The trust comes into existence when property is transferred to it on your death. If the trust is established in your will, the trust property will need to go through probate. The trust property will avoid probate if the trust is established in a revocable living trust.

The trust will describe how the trustee is to use trust assets for the beneficiary. Usually, the trustee is given discretion to use trust assets as needed to provide for the beneficiary's health, education, maintenance, and support.

### §5:28 Deciding Between Individual Trusts and a Family Pot Trust

If you have more than one minor child, you can create a separate trust for each child or you can create a single trust with all children as beneficiaries.

With individual trusts, you specify the property or shares of your estate that are to fund each trust. The assets of each trust can be used to benefit only the one named beneficiary. Each trust terminates when the child reaches whatever age you specify and the child then receives the assets remaining in the trust outright.

A pot trust, which is sometimes referred to as a "family pot trust" or a "pot/sprinkle trust" is a trust in which you leave your assets for your children in a combined "pot." The trustee has the

discretion to take money from the "pot" for the needs of each child as they arise. Once all of the children have reached a specified age, the trust can terminate or the pot can be divided into separate shares for each of the children.

A pot trust allows the trustee to make unequal distributions among your children. If your estate is divided equally into separate trusts for each child, then extra distributions to one child will reduce the amount distributed to that child when the trust ends. A pot trust, however, can make disproportionately large distributions to one child during the term of the trust, and then give that child an equal share of the trust estate on termination. Effectively, the child who received the larger interim distributions receives a larger share of the estate.

Many parents like the concept of a pot trust because it more closely approximates the spending pattern that they intend to follow if they live until their children are grown. If one child attends a private university and the other attends a public one, the parents are not likely to reduce the first child's inheritance to reflect the larger tuition payments. Other situations might occur that would justify unequal gifts, such as:

- A serious illness.
- An unexpected financial setback.
- A decision by the child to pursue a laudable but low-paying career.

A pot trust also deals with the possibility that the parents might die after one child has finished college but before the other has started by allowing larger distributions to the child whose tuition has not yet been paid. Finally, a pot trust can facilitate the ownership of a single asset that you intend the children to share the benefits of the family's vacation home, for example.

## §5:29 Advantages of Trusts over Custodial Accounts

A trust is significantly more flexible than an UTMA custodianship:

- An UTMA custodianship ends at age 21 in most states and as early as 18 in some. All remaining assets must be transferred

to the beneficiary at that time. A trust can last for virtually any period. You can ensure that the beneficiary will not receive trust assets until he or she is mature enough to manage them.

- You can decide how the trust is to terminate. Termination can be staggered, so that the beneficiary will receive half the trust estate at age 25 and the remainder at age 30, for example. You can coordinate termination with educational attainments, such as: "The trust shall terminate when the beneficiary attains age 25, dies before that age, or receives a bachelor's degree (or any higher degree) from an accredited college or university before age 25."
- UTMA gives a custodian broad powers to use income and assets for the benefit of the minor. A trust is necessary where narrower authority is desired. A trustee can be given greater guidance and stricter limits. A trustee can be directed to distribute funds for a particular purpose, such as starting a business or buying a house, or distributions can be limited to income only.
- A trust can have multiple beneficiaries and a beneficiary of a trust can serve as trustee of that trust.
- A trust can limit the amount of compensation payable to the trustee, or specify an incentive-based compensation scheme. A custodian, by contrast, is simply entitled to "reasonable compensation.
- If the child dies during the term of a custodianship, the custodial assets become part of the child's probate estate. Unless the child is over 18 and has a will, the custodial assets pass by intestate succession to the child's heirs and this is usually the parents. If the gift was from someone other than a parent, this may frustrate the donor's intent (the donor may not have wished to benefit one or both parents). If the gift was made by parents as part of estate tax planning, having the assets pass back to the parents negates the planning. In contrast, if a trust is used, the disposition of the assets upon a premature death of the minor can be directed by the terms of the trust.

Consequently, most estate planners believe that custodianships are appropriate for relatively modest transfers to a child only. If the amount to pass to a child is significant, then the advantages of a trust are usually overwhelming.

Trusts that parents may use to make gifts to minors as part of an estate and gift tax savings plan are discussed in Ch. 6.

## CHAPTER 6

# Estate, Gift, and Generation-Skipping Transfer Taxes and Tax Saving Strategies


I. The Estate Tax
II. How Couples Can Use Both Exemptions to Reduce Estate Tax
III. Marital Deduction Trusts
IV. The Gift Tax
V. Using Gifts to Minimize Estate and Gift Taxes
VI. The Generation-Skipping Transfer Tax
VII. Income Tax Issues


## I. THE ESTATE TAX

### §6:01 Estate and Gift Taxes Are Integrated

Federal estate and gift taxes are an integrated system for taxing the value of property transferred from one person to another. The gift tax applies to transfers during the giver's life and the estate tax to transfers on the giver's death. The estate and gift tax rate is high, 40 percent as of 2019. However, despite the high rate, very few gifts and estates are taxed because of generous exemptions, exclusions, and deductions.

## §6:02 Estate and Gift Tax Exemption for Total Transfers during Life and at Death

Each individual is entitled to transfer a certain dollar value of property during life and at death without any estate (or gift) tax liability. It does not matter to whom the property is transferred. For deaths in 2019, the individual exemption is $11.4 million. For a married couple, the effective exempt amount is doubled. The exemption is indexed annually for inflation so it will probably increase each year. The amount of the exemption is reduced by any taxable gifts you have made during your life. Because of the exemption, less than .1 percent of estates are subject to estate tax.

**Note:** The estate and gift tax exemption is actually a credit against gift and estate taxes. The gift or estate tax is computed and the credit is subtracted from the amount of tax due. The credit translates into an exemption equivalent of $11.4 million.

## §6:03 Gross Estate and Taxable Estate

The estate tax is imposed on your taxable estate, which is your gross estate minus allowable deductions.

If you are a U.S. citizen or non-citizen domiciled in the U.S., your gross estate consists of everything you own at the date of your death no matter where located. Included in your estate are real estate, cash, stocks, bonds, annuities, businesses, and life insurance policies that you own.

If you are a non-citizen, your gross estate consists of all property you own located in the U.S.

## §6:04 Gross Estate Includes Probate and Non-Probate Assets

Your probate estate and your gross estate are not the same. Your probate estate refers to the property you own that must pass through probate. You might have no probate estate or a probate estate that is much smaller than your gross estate.

All assets you own are included in your gross estate whether they must pass through probate or not. So property you place in a revocable living trust, your share of jointly owned property with right of survivorship, and property that passes by pay on death transfer or beneficiary designation are included. Life insurance proceeds payable to your estate, or, if you owned the policy, to beneficiaries are also included in your gross estate.

## §6:05 Property Excluded from Your Gross Estate

Generally, your gross estate does not include property owned solely by your spouse or other individuals. For example, your spouse's share of community property is not part of your gross estate. Gifts made during your lifetime over which you have retained no powers or other control are not included (but taxable gifts made during your lifetime will reduce the amount of the estate and gift tax exemption available to your estate).

## §6:06 Estate Tax Deductions

The value of your gross estate is reduced by certain deductions to reach your taxable estate. The most significant deductions are the marital deduction for property you leave to your spouse and the charitable deduction. Your estate is also reduced by mortgages and loans against estate property, other debts, administration expenses of your estate, your funeral expenses, and losses during estate administration, although these deductions tend to be less significant.

## §6:07 The Estate Tax Marital Deduction

Property that you leave to your spouse is not subject to estate tax, no matter how much it is worth as long as he or she is a U.S. citizen. You can leave your spouse one dollar, one million dollars, or one hundred million dollars or more tax-free.

The estate tax marital deduction is in addition to the personal exemption.

The marital deduction does not mean that property passed to a spouse is never subject to estate tax. When the surviving spouse dies, the inherited property that has not been used up is part of the surviving spouse's estate and potentially subject to tax then.

**Example:**

Jeff has an estate valued at $22 million. When he dies in 2019, he leaves one-half of his estate to his wife Jeannine and the other half to his only child Sam. No estate tax is due on Jeff's estate because the $11 million that goes to Jeanine is sheltered by the unlimited marital deduction and the $11 million that goes to Sam is sheltered by Jeff's $11.4 million exemption.

The property must pass "outright" to the surviving spouse. However, some life estates and trusts qualify for the marital deduction. See §§6:20-6:25.

## §6:08 The Marital Deduction and Non-Citizen Spouses

The marital deduction is not available for outright gifts to a non-citizen spouse even if he or she is a permanent U.S. resident. Property left to a non-citizen spouse in a qualified domestic trust (QDOT) is, however, eligible for the deduction. See §§6:24, 6:25. Property left outright to a non-citizen spouse can be sheltered from estate tax by the deceased spouse's exemption.

Property left by a non-citizen spouse to a U.S. citizen spouse qualifies for the unlimited marital deduction.

## §6:09 The Estate Tax Charitable Deduction

Any property you leave to the United States, any state, a political subdivision of a state, or a qualifying charity for exclusively charitable purposes is not included in your taxable estate. See §§6:50-6:52 for charitable trusts.

## §6:10 Value of Your Estate

The value of your estate on which the estate tax is based is the fair market value of each asset in your taxable estate on the date of your death or on the alternate valuation date, which is six months after your death. Your executor decides which date to use.

Family-owned businesses may be eligible for valuation discounts. The theory is that when multiple beneficiaries each receive a share of a business, their minority stakes may be worth less than their proportionate share of the whole business.

## §6:11 Payment of Estate Taxes

The estate tax is payable with the filing of IRS Form 706, which is due nine months after the date of the decedent's death. No filing is necessary unless the gross estate exceeds the exemption amount or the surviving spouse wants to claim the unused portion of the deceased spouse's estate and gift tax exemption, if any. See §6:14 regarding portability of the exemption of the first spouse to die.

Your executor is responsible for filing your estate tax return and paying any taxes that are due from the property in your estate. In your will or revocable living trust, you can specify what property should be used to pay any estate taxes your estate might owe. You can designate specific assets, although it's always possible that those assets won't be in your estate when you die. Consequently, most people provide either that estate taxes should be paid from all gifts made by will or trust in proportion to the value of the gift, or that they be paid from the residuary estate, the assets not specifically given to particular beneficiaries. If you don't include a tax apportionment provision in your will or trust, your state law, which typically provides one or the other of these alternatives, will determine what property pays your taxes.

When a family farm or business makes up at least 35 percent of a gross estate, the tax may be paid in installments over 14 years at reduced interest rates.

## §6:12 Deciding Whether You Need Tax Planning to Minimize Estate Tax

To decide whether you need tax planning, you'll need to determine the value of your estate. Of course, you can't know how much your estate will be worth when you die, what assets will be in it, or what the estate and gift tax exemption will be. The exemption has varied considerably over the years.

| FOR DEATHS OCURRING IN | AMOUNT OF EXEMPTION |
|---|---|
| 1998 | 625,000 |
| 1999 | 650,000 |
| 2000-2001 | 675,000 |
| 2002-2003 | 1,000,000 |
| 2004-2005 | 1.500,000 |
| 2006-2008 | 2,000,000 |
| 2009 | 3,500,000 |
| 2010 | No Tax/Act Lapsed |
| 2011 | 5,000,000 |
| 2012 | 5,120,000 |
| 2013 | 5,250,000 |
| 2014 | 5,340,000 |
| 2015 | 5,430,000 |
| 2016 | 5,450,000 |
| 2017 | 5,490,000 |
| 2018 | 10,000,000 |
| 2019 | 11,400,000 |

The exemption was doubled by the Tax Cuts and Jobs Act of 2017. The doubled exemption is set to last through 2025 after which it will return to 2017 levels. But no one can predict what Congress might do to the exemption in 2025 or the meantime.

The best you can do is make a reasonable estimate. The inventory sheet in Ch. 1 should help. You can always revise your estate plan if the law or your circumstances change. See Ch. 9.

### §6:13 Techniques for Reducing Estate Taxes

If your estate could be large enough to owe federal estate taxes, you may be able to reduce the tax bite with some planning.

- If you are married, planning can ensure that both your estate tax exemption and your spouse's exemption are used to reduce the size of both your estates.
- You can remove assets from your estate before you die by making gifts. With the gift tax annual exclusion, you can make substantial gifts each year without incurring any gift tax liability. See §§6:28, 6:33. If you give away assets that you expect to appreciate, the future appreciation will also be removed from your estate. These gifts may be outright or an irrevocable trust. Certain types of irrevocable trusts enable the gift to qualify for the annual gift tax exclusion. See §§6:35-6:39. Other irrevocable trusts allow you to contribute an asset to the trust and remove it from your estate while continuing to enjoy some benefits from it. See §§6:45-6:49. Still others provide income and estate tax savings while benefitting a favorite charity. See §§6:50-6:52.

These tax planning techniques are complex. Below are basic descriptions to help you understand how they work. You will need help from an experienced estate planning attorney to decide which are right for your estate and to ensure that whichever methods you choose are implemented properly.

## II. HOW COUPLES CAN USE BOTH EXEMPTIONS TO REDUCE ESTATE TAX

### §6:14 Option 1: Portability of Exemption for Married Couples

If the first spouse to die leaves his or her entire estate to the surviving spouse (who is a U.S. Citizen), the estate passes free of estate tax because of the marital deduction. But the first spouse's

estate and gift tax exemption will go unused. When the second spouse dies, only one exemption will be available to reduce the size of his or her estate. The surviving spouse's estate will owe estate taxes if the amount of the estate is larger than the single exemption. The unlimited marital deduction postpones but does not eliminate federal estate taxes for estates of married couples that exceed the exemption.

To remedy this problem, Congress made the unused estate tax exemption of the first spouse to die transferable to the surviving spouse. This portability provision allows a married couple to use the marital deduction and their combined exemptions to reduce or eliminate estate taxes they might otherwise owe.

**Example:**

Ray dies leaving his entire estate of $8 million to his wife, Debra. He doesn't need to use any of his exemption to avoid estate taxes because property left to a spouse is not subject to estate tax. When Debra dies, her estate is valued at $16 million. Without portability (assuming an exemption of $11.4 million), $4.6 million of her estate is subject to tax ($16 million minus her exemption of $11.4 million). With portability, she can add her husband's unused exemption of $11.4 million to her $11.4 million for a total exemption of $22.8 million. Her estate won't owe any estate tax.

To claim a deceased spouse's unused exemption, the deceased spouse's estate must file an estate tax return within nine months after the spouse's death, even if no estate tax is due.

## §6:15 Portability and the Remarriage Problem

The portability provision was enacted to simply tax planning for married couples by eliminating the need for bypass trusts. For bypass trusts, see §6:16. However, the provision has a problem when it comes to remarriage. If the surviving spouse remarries, the surviving spouse forfeits the deceased spouse's unused exemption in exchange for the new spouse's unused exemption.

In many cases, the remarried spouse will lose the benefit of the new spouse's exemption because the new spouse will use his or her exemption to pass assets to children from a prior marriage.

**Example:**

When Peter dies, he leaves his entire $25 million estate to his wife Alicia. The entire estate passes to Alicia estate tax-free because of the unlimited marital deduction. Alicia makes the election on Peter's estate tax return to port his unused personal exemption so that she can add it to hers when she dies. Several years later, Alicia remarries. When her second husband William dies widowing Alicia for the second time, he leaves the bulk of his estate to his children from a previous marriage. The gift to his children uses William's entire exemption. When Alicia dies with an estate worth $35 million, she can't use Peter's unused exemption and William has no unused exemption that she can port. Alicia has only her exemption to reduce the size of her estate.

## §6:16 Option 2: The Bypass Trust

Bypass trusts (also called credit shelter trusts) are another method of allowing both spouses to use their exemptions.

The bypass trust is created by will or revocable living trust and comes into existence on the first spouse's death. The deceased spouse's estate goes into the bypass trust up to the estate tax exemption amount. The assets in the bypass trust are sheltered from estate tax by the deceased spouse's exemption. Income from the bypass trust is paid to the surviving spouse during his or her life. On the surviving spouse's death, assets in the bypass trust pass to the beneficiaries designated by the first spouse, typically the children. Assets in the bypass trust are not included in the surviving spouse's estate (they bypass it) because the second spouse is not considered to be the owner of the trust.

Any portion of the deceased spouse's estate that is larger than the estate tax exemption can pass to the surviving spouse estate tax-free under the marital deduction. This gift can be left

outright to the surviving spouse or in a marital deduction trust. See §§6:20-6:25.

When the second spouse dies, his or her estate will include assets (that have not been consumed) that passed tax-free from the first spouse (whether outright or in trust) under the marital deduction. These are sheltered from estate tax by the second spouse's exemption.

The same tax savings can be accomplished by an outright gift to the children on the first spouse's death of the exemption amount. However, an outright gift to the children leaves the surviving spouse with only the marital deduction gift, if any, which may not be sufficient. Instead, the bypass trust is used to allow income from trust assets to be paid to the surviving spouse in addition to the marital gift.

**Examples:**

Al and Vicki, a long-married couple, co-own an estate worth $30 million. Al leaves his entire estate to Vicki. When he dies, no estate tax will be owed on his $15 million share. It passes tax-free to Vicki under the marital deduction. When Vicki dies, her estate is worth $30 million. Assuming she did not elect to port Al's unused exemption, she has only her $11.4 million exemption so $18.6 million is subject to estate tax.

Phil and Liz, another married couple, also co-own an estate worth $30 million. They include bypass trusts in their wills (or living trusts). When Phil dies, $11.4 million of his $15 million estate goes into his bypass trust with the remaining $3.6 million passing to Liz tax-free under the marital deduction. Phil's estate owes no estate tax. When Liz dies, her estate is worth $18.6 million, but only $7.2 million is subject to estate tax.

A married couple with bypass trusts in their wills or living trust can generally leave an aggregate of twice the amount of the exemption tax-free. However, if one spouse has all the wealth and the other spouse dies first, the deceased spouse's exemption amount is wasted because the deceased spouse does not have enough property to use up his or her exemption. The solution is

for the wealthy spouse to give property to the less wealthy spouse to bring his or her net worth up to the exemption amount.

Unmarried couples can use a bypass trust to achieve similar tax savings.

## §6:17 Reasons to Use a Bypass Trust Despite Portability

Despite the portability rule, there are still some reasons to use bypass trusts. For example:

- The surviving spouse will not be at risk for losing the deceased spouse's estate tax exemption if the spouse remarries and is widowed a second time.
- Trust assets can be protected from creditors of the beneficiaries (the surviving spouse and children) and division on divorce.
- Appreciation of trust assets is not subject to estate tax. If these assets were passed outright to the surviving spouse, appreciation could be subject to estate tax in the surviving spouse's estate.
- On the second spouse's death, assets in the bypass trust pass to the beneficiaries named by the first deceased spouse. If instead they are passed to the surviving spouse, he or she will be able to name different beneficiaries, which may or may not be acceptable to the first spouse.

## §6:18 Option 3: Bypass Trust with Disclaimer Plan

A bypass trust with a disclaimer plan is used by couples who are not certain their estates will be large enough to require tax planning. With a disclaimer plan, you leave all or most of your estate outright to your spouse. You create a bypass trust and name it as the alternate beneficiary if your spouse does not survive you. On your death, your spouse can disclaim (reject) part or all of the outright gift. Then your estate or the portion of it that your spouse disclaims passes to the bypass trust as if your spouse had predeceased you.

A disclaimer plan allows you and your spouse to postpone the decision of whether to fund a bypass trust until after one of you dies. At that time, the surviving spouse will know both the size of the estate and the size of the applicable estate tax exemption and can make a more informed decision.

**Example:**

Aaron and Emily, a married couple, have a bypass trust disclaimer plan. Emily dies in a year in which the estate tax exemption is $11.4 million. She and Aaron have a jointly owned estate worth $10 million. Aaron decides not to disclaim any of his inheritance from Emily. Emily's bypass trust is never funded so does not come into existence. Aaron receives her $5 million estate outright and tax-free because of the marital deduction. When he dies, his $10 million estate passes tax-free to their children protected by his estate tax exemption, which may even be higher than $11.4 million having been adjusted for inflation.

## §6:19 Disclaimer Plan Disadvantages

Disclaimer plans have some disadvantages despite their flexibility. For the disclaimed property to bypass the surviving spouse's estate, the disclaimer must be "qualified" under IRS rules, which means it must meet the following requirements:

- The disclaimer must be made in writing within nine months after the death of the first spouse to die. Although the due date for the estate tax return can be extended, the deadline for a qualified disclaimer cannot. If the surviving spouse does not execute a qualified disclaimer within that time, the bypass trust cannot be used to save estate tax.
- The surviving spouse cannot have a special power of appointment over the bypass trust, which means he or she cannot decide who is to receive the trust property on his or her death.
- The power of the trustee to invade the bypass trust principal for the benefit of the surviving spouse must be limited

to health, education, maintenance, and support according with the spouse's accustomed standard of living.

- The surviving spouse must be careful not to accept the benefits of the disclaimed property. If the surviving spouse uses the property, accepts dividends or interest from the property, or directs others to act concerning the property before executing the disclaimer, the surviving spouse may not be able to disclaim it. If the surviving spouse is the trustee of the bypass trust, he or she may take most of these actions in the capacity of trustee, after the disclaimer is completed, and a surviving spouse who is serving as executor can act in that capacity as well without jeopardizing the disclaimer. Furthermore, if the spouse is a co-owner of real property, residing on the property is not considered to be an acceptance of the benefits for this purpose.

If the disclaimer is not qualified, but the surviving spouse transfers the assets to the bypass trust anyway, then the surviving spouse is treated as making a gift to the bypass trust. The gift uses up part or all of the surviving spouse's estate and gift tax exemption, and the bypass trust would be included in the surviving spouse's estate for estate tax purposes. Given these consequences, if a qualified disclaimer cannot be made, the surviving spouse is better off keeping the property.

## III. MARITAL DEDUCTION TRUSTS

### §6:20 How Marital Deduction Trusts Work

You do not have to leave property outright to your spouse for it to qualify for the marital deduction. Property left to your spouse in trust can qualify if the trust meets Internal Revenue Code requirements.

Two commonly used trusts that qualify for the marital deduction are:

- The qualified terminable interest (QTIP) trust.
- The general power of appointment (GPOA) trust.

Both types of trusts must require that all distributions during the spouse's lifetime be made either to the spouse or to someone designated by the spouse. Thus, as a practical matter all lifetime distributions will be:

- Used up by the spouse.
- Still owned by the spouse at death and included in the spouse's estate.
- Transferred to someone else by the spouse, and taken into account in the spouse's estate as a taxable gift (less any annual exclusion that may apply).

## §6:21 The Qualified Terminable Interest (QTIP) Trust

A qualified terminal interest property (QTIP) trust supports a surviving spouse and qualifies for the unlimited marital deduction. At the same time, it ensures that the remaining trust property is distributed according to the instructions of the first spouse to die.

A qualified terminable interest trust permits you, as the settlor, to do all of the following:

- Give your surviving spouse all the income from the trust property for the spouse's life.
- Claim an estate tax marital deduction for the full value of the property transferred to the trust (not just the income interest that is paid to the spouse).
- Name the ultimate beneficiaries of the property on your spouse's death.

You can create a QTIP trust in your will or revocable living trust.

The QTIP trust is used most often when the settlor spouse has children from other marriages. The settlor wants his or her surviving spouse to benefit from the trust property for life but

wants the property to pass to his or her children on the surviving spouse's death.

The settlor spouse's personal representative must elect the QTIP on the estate tax return. The election allows the deceased spouse's property that exceeds the federal estate tax exemption limit to be transferred to the QTIP trust. The estate tax on the property is not paid until the surviving spouse dies and the property is considered part of the surviving spouse's estate for estate tax purposes.

The QTIP trust allows the wealthier spouse to use the poorer spouse's estate tax exemption while permitting the wealthier spouse to retain control of the remainder interest.

The surviving spouse cannot change the QTIP trust beneficiaries.

## §6:22 IRS Requirements for a QTIP Trust

The IRS imposes the following requirements on QTIP trusts:

- All income from the trust must be distributed to the surviving spouse at least annually.
- The spouse can demand that any trust property that is not income producing be converted to income-producing property.
- No one may spend the principal of the trust for the benefit of anyone other than the spouse.
- The spouse must be a U.S. citizen.
- On the deceased's federal estate tax return, the personal representative of the deceased spouse's estate must elect to have the trust be treated as a QTIP. The final step for the election to treat the trust as a QTIP is essential. The election is irrevocable.

## §6:23 The General Power of Appointment (GPOA) Trust

The GPOA trust can be created by will or revocable living trust. The settlor leaves his or her estate in trust to the surviving spouse for use during the spouse's lifetime providing the spouse with income (and principal if needed). The trust gives the surviving

spouse a general power of appointment over the property, i.e., the authority to dispose of the trust property as he or she sees fit.

On the surviving spouse's death, the assets are distributed to the beneficiaries named in the surviving spouse's will or revocable living trust, usually the couple's children. The general power of appointment causes the entire trust to be included in the surviving spouse's estate and the surviving spouse's exemption can be used to reduce or eliminate estate taxes.

## §6:24 The Qualified Domestic (QDOT) Trust

A qualified domestic trust, often referred to as a QDOT, is a trust that allows married couples to take advantage of the unlimited estate and gift tax marital deduction when the surviving spouse is a non-US citizen. The transfer of assets outright to a non-citizen surviving spouse is not eligible for the marital deduction.

When property passes estate tax-free to a surviving spouse who is a citizen, it is subject to tax in the surviving spouse's estate (if not consumed during his or her life). The government's concern with a non-citizen surviving spouse is that he or she will take the property outside of the United States where it will not be subject to estate tax on the surviving spouse's death.

With a QDOT, the non-citizen surviving spouse is entitled to all of the income generated from the assets held in the trust for his or her lifetime, but he or she is not entitled to the principal absent the trustee's authorization. If principal is distributed, estate taxes may be owed. When the surviving non-citizen spouse dies, trust assets pass to beneficiaries, usually the couple's children. Estate tax is payable on the assets left in the trust after the surviving spouse's death.

## §6:25 IRS Requirements for a QDOT Trust

For a QDOT to qualify for the unlimited marital deduction, the IRS requires the following criteria to be met:

- The deceased citizen spouse's personal representative must make an election on the deceased spouse's return to treat the trust as a QDOT.
- At least one named trustee must be either a U.S. citizen or a domestic corporation.
- The terms of the trust must provide that the trustee may withhold any estate tax that is owed on distributions.
- The trustee must ensure that an adequate amount of trust assets remains within the United States to guarantee payment of federal taxes.

## IV. THE GIFT TAX

### §6:26 What Is a Taxable Gift?

The Internal Revenue Code imposes a tax on transfers by lifetime gift in a particular calendar year. Most gifts are not subject to gift tax because of the annual exclusion (§6:28) and the estate and gift tax exemption (§6:02).

You have made a gift if you give away property, including money, the use of property, or the right to receive income from property, without expecting to receive something of at least equal value in return. If you sell something for less than its full value or make a loan without charging interest or with less than market rate interest, you may have made a taxable gift.

Transfers to irrevocable trusts are treated as gifts for federal gift tax purposes

The gift tax applies to property wherever it is located so long as you are a U.S. citizen or legal resident. If you are a non-citizen and non-resident, the gift tax applies only to property located within the United States.

### §6:27 Gifts Not Subject to Gift Tax

The following gifts and payments are not taxable:

- Gifts that are worth less than the annual gift tax exclusion. See §6:28.
- Payments you make for the benefit of your minor child if the payments help fulfill your duty of support. A parent has a duty to provide for a child's basic needs for food, clothing, shelter and medical treatment.
- Tuition or medical expenses you pay for anyone. The funds must be paid directly to the provider of the medical service or the school. You cannot give the money to the patient or student. Only tuition is covered—not books, supplies, room and board or expenses.
- Gifts to your spouse provided he or she is a U.S. citizen. Gifts to a non-US citizen spouse are offset by a special annual exclusion. This annual exclusion for gifts to non-US citizen spouses is $155,000 for 2019 (indexed annually).
- Gifts to a former spouse if the transfer is incident to a divorce.
- Gifts to a political organization for its use.
- Gifts to qualifying tax-exempt charities.

## §6:28 The Annual Gift Tax Exclusion

The annual exclusion allows you to give away gifts up to a certain value to an individual tax-free each year. The amount of the annual exclusion is $15,000 for gifts in 2019. Like the estate and gift tax exemption, it is indexed for inflation so it is expected to rise over time.

You can give away gifts up to the annual exclusion to as many people as you like. You and your spouse are each entitled to an exclusion, so together you can double the amount of the gift to each person without any tax liability.

The value of the gift is determined on the date that the gift is made.

**Examples:**

In a year when the annual gift tax exclusion is $15,000, John gives each of his three adult children $10,000. John's wife Margaret

also gives each of the children $10,000. The children have received $20,000 each for a total of $60,000. These gifts are not taxable.

John's brother is taken ill and hospitalized. To help him out, John pays his brother's $20,000 hospital bill directly to the hospital. He also pays his nephew's $18,000 college tuition directly to the school. Finally, he gives his brother a gift of $25,000. The $20,000 John pays to the hospital and the $18,000 he pays to his nephew's college are not taxable. However, $10,000 of John's gift to his brother ($25,000 - $15,000) is taxable. But, because of the estate and gift tax exemption, no tax is likely due.

## §6:29 Gift Splitting for Married Couples

If you make a gift to someone other than your spouse, you and your spouse can agree to treat the gift as though it were made one-half by each of you. Gift splitting allows a married couple to give gifts of double the annual gift tax exclusion without making a taxable gift.

You and your spouse must file a gift tax return to show that you agreed to split the gift.

**Example:**

John's wife Margaret agrees to split the $25,000 gift John gave his brother to help him after his serious illness. Each is treated as having given the brother $12,500. The gift is not taxable because it is less than the annual exclusion.

## §6:30 The Present Interest Requirement for the Annual Exclusion

You can make gifts to an irrevocable trust for your beneficiaries' benefit. If your rights to and control over the trust are strictly limited, then the trust property will not be included in your estate for federal estate tax purposes. However, the gifts usually will not qualify for the annual gift tax exclusion.

To qualify for the annual gift tax exclusion, your gift must be of a "present interest." A "present interest" means that the

recipient of the gift has the immediate right to it. If the recipient does not get full access to the gift until some future time, the annual exclusion will not protect the gift from gift tax.

**Example:**

Ella places $25,000 in an irrevocable trust for the benefit of her 21-year-old niece, Emma. The trust gives Emma access to the principal when she turns 30. The gift is not a present interest and cannot be reduced by the annual gift tax exclusion because Emma does not have an immediate right to it.

Special rules apply to gifts to minors because minors can own only small amounts of property outright. Gifts in trust to minors can qualify for the annual gift tax exclusion if the trust meets certain requirements. See §§6:3506:40.

## §6:31 Filing a Gift Tax Return

An informational gift tax return (IRS Form 709) must be filed whenever you make a gift over the annual gift tax exclusion to any one individual in a given year, even though, in most cases, no gift tax is due. The return is filed at the same time that your income tax return (Form 1040) is due, i.e., generally April 15th.

## §6:32 Payment of Gift Tax and the Lifetime Estate and Gift Tax Exemption

Most people will never have to pay gift tax because of the combination of the annual exclusion and the lifetime exemption. The amount of any gifts you make above the annual gift tax exemption counts against your lifetime estate and gift tax exemption and reduces the amount that you can pass free of estate tax on your death. You will not have to pay any gift tax until your exemption is used up.

# V. USING GIFTS TO MINIMIZE ESTATE AND GIFT TAXES

## A. Annual Gifts

### §6:33 Giving Repeated Annual Gifts

If your estate could owe estate taxes and you are willing to part with some of your assets now, you may be able to achieve estate tax savings by making irrevocable gifts. The gift tax consequences can be minimized or even eliminated if each gift is covered by a gift tax annual exclusion.

One simple tax-saving strategy for people who expect to owe estate tax is to make repeated annual gifts.

**Example:**

William and his wife Carolyn are the owners of a family business. They intend to leave the business to their three children. Every year for 10 years, the couple gives each child stock equal in value to the annual gift tax exclusion. After 10 years, assuming the annual exclusion remains at $15,000, they have transferred a total of $900,000 tax-free ($30,000 x 3 x 10). The annual exclusion will likely increase over time allowing William and Carolyn to make even larger annual gifts.

### §6:34 What Property Should You Give Away

When choosing property to give away, consider property that is likely to appreciate over time. Because gift tax is determined on date-of-gift values instead of date-of-death values, all post-gift appreciation is transferred to the beneficiaries tax-free.

**Example:**

Derek gives his son Garrett $10,000 worth of stock in an up and coming technology company. No gift tax is assessed on the gift because of the annual exclusion. When Derek dies 10 years

later, Garrett still owns the stock which has doubled in value. The $10,000 in appreciation passes to Garrett free of gift and estate tax.

## B. Gifts to Minors in Trust

### §6:35 The Present Interest Requirement and Gifts to Minors

Minors cannot own substantial property without adult management. Yet gifts to minors can qualify for the annual gift tax exclusion even though the minor cannot be given complete access to or control of the gift.

A gift to a minor under the Uniform Transfer to Minors Act (UTMA) qualifies for the gift tax exclusion. To make an UTMA gift, you transfer the property to a custodian who will manage the property for the minor's benefit. The property must be turned over to the minor when he or she reaches the age of 18 or 21 depending on state law. See Ch. 5. You should not serve as the custodian if you are concerned about minimizing the size of your estate to avoid estate taxes. If you die before the minor beneficiary reaches age 21, the property will be included in your estate.

If you want more flexibility than is available under UTMA, you can create an IRC §2503(c) trust or a Crummey trust. See §§6:36-06:39.

### §6:36 Gifts in Trust Don't Qualify for the Annual Exclusion Unless...

Gifts in trust generally do not qualify for the gift tax annual exclusion because the beneficiary does not receive a present interest in the property. The beneficiary has to wait until the trustee distributes property to him or her.

There are three types of irrevocable trusts to which you can make gifts to minors that qualify for the annual gift tax exclusion:

- §2503(c) trusts
- Crummey Trusts
- Extended §2503(c) trusts

These trusts are typically used by parents to provide their children with lifetime gifts while sheltering their money from gift taxes as long as the gift's value is equal to or less than the annual exclusion amount.

IRC §2503(c) trusts, like an UTMA account, still have the disadvantage of terminating at age 21. Crummey trusts are more complex to administer but need not terminate when the beneficiary turns 21. Extended §2503(c) trusts, which also can last until the beneficiary is over 21, are a hybrid of a Crummey trust and a §2503(c) trust.

## §6:37 §2503(c) Trusts

An IRC §2503(c) trust is an irrevocable trust for the benefit of a child. Gifts to the trust qualify for the annual gift tax exclusion without the need for the withdrawal rights that are required for a Crummey trust.

A §2503(c) trust must terminate when the beneficiary turns 21 and all trust property must be distributed to the beneficiary outright. The early termination makes the trust undesirable if you want the assets to remain in trust until the beneficiary is older.

Both the trust assets and income must be available for the beneficiary's benefit while the beneficiary is under 21 years old, which means that the trust must have only one beneficiary. If the beneficiary dies before age 21, the trust property must be distributed to his or her estate or as the beneficiary directs under a general power of appointment.

## §6:38 Crummey Trusts

A Crummey trust is an irrevocable trust that enables you to take advantage of the annual gift tax exclusion while retaining the gift in trust until the beneficiaries are older than 21.

To satisfy the present interest requirement, the beneficiaries must have a right to withdraw each gift from the trust as the gift is made. The trustee notifies the beneficiaries of the withdrawal

right whenever a gift is made to the trust. The beneficiaries should have the right to withdraw each contribution for a specific amount of time from the moment it is made (usually 30 to 60 days). If a beneficiary (or his or her guardian if the beneficiary is a minor) doesn't exercise the withdrawal right within the period specified in the notice, the right lapses and the beneficiary then will be able to access the money only according to the terms of the trust. Even if a beneficiary decides to access trust funds, he or she can tap only the one contribution referenced in the notice.

If you set up a Crummey trust, you should avoid creating evidence of a prearranged understanding that the beneficiaries will not exercise the withdrawal rights, and should never offer any type of compensation to the beneficiaries for not exercising them. After a contribution is made, you may encourage the beneficiaries to keep the money in trust for their future benefit, but should not threaten the loss of other privileges.

The Crummey trust is named after Clifford Crummy, who was the first taxpayer to set up a trust in this manner.

## §6:39 Extended §2503(c) Trust

An extended IRC §2503(c) trust is a cross between a Crummey trust and a §2503(c) trust. An extended §2503(c) trust gives the beneficiary a right to withdraw the trust assets one time, on reaching age 21. If the beneficiary doesn't exercise this right, the trust will continue for as long as the trust instrument specifies.

The withdrawal right in an extended §2503(c) trust must allow the beneficiary to empty the entire trust. However, the withdrawal right can be limited in time. For example, if the beneficiary does not exercise it within 30 days after turning 21, the trust instrument can provide that the right will lapse and any funds not withdrawn will remain in trust for as long as the trust document provides.

This type of trust is simpler to administer than a Crummey trust because there is only one withdrawal right. The trustee is relieved of the burden of sending the beneficiary multiple Crummey withdrawal notices. However, it is riskier than a Crummey trust because

the 21-year-old beneficiary will have the right to withdraw all trust assets at one time rather than just the latest contribution.

### §6:40 Gifts to Minor Children in Trust and the Duty of Support

As a parent, you may give assets to an irrevocable trust for a child to remove them and any future appreciation in their value from your estate. However, if the trust income or principal may be used to fulfill your duty to support the child, then the portion of trust assets necessary to satisfy your support obligations will be included in your estate on your death.

## C. Gifts of Life Insurance Policies

### §6:41 Removing Life Insurance Proceeds from Your Estate

Many people are surprised to learn that life insurance death benefits are included in the estate of the policy's owner. For example, if you purchased a $1 million life insurance policy on your life, and you are the owner at your death, the entire $1 million would be included in your estate for estate tax purposes. (However, if your spouse is the beneficiary, the proceeds will not be in your taxable estate as they automatically pass tax-free under the unlimited marital deduction.)

If the policy proceeds are likely to push your estate over the estate tax exemption, you can remove them from your estate by giving the policy away.

The gift of an insurance policy is subject to gift tax, but the taxable amount is the value of the policy when the gift is made, which will be far less than the death benefit. The taxable value of the gift can be reduced by the annual gift tax exclusion.

**Example:**

Kristen owns a whole life insurance policy with a cash surrender value of $50,000 and a death benefit of $1 million.

She transfers the policy to the beneficiary, her daughter. If the annual gift tax exclusion is $15,000, the taxable gift is $35,000. The amount of the taxable gift counts against Kristen's lifetime estate tax exemption, but the $1 million death benefit is not part of her estate when she dies five years later.

### §6:42 The Three-Year Rule

If you give away a life insurance policy and then die within three years of making the gift, the IRS treats the gift as though it was never made for estate tax purposes. The proceeds will be included in your taxable estate. If you paid gift tax on the gift, the amount will be credited against any estate tax your estate owes.

### §6:43 You Must Give Up "Incidents of Ownership"

If you make a gift of a life insurance policy to remove the proceeds from your estate, you must give up all control over the policy. You cannot retain any "incidents of ownership." For example, you cannot keep the right to:

- Cash the policy in, borrow against it, or use it as collateral.
- Cancel, surrender, or convert the policy to a different type of life insurance.
- Name or change beneficiaries or determine how proceeds are to be paid out (in a lump sum or installments).

Furthermore, to avoid possible claims that you have retained incidents of ownership, you should not pay the premiums. You can make a gift of the premium to the owner of the policy or the beneficiaries, which will not be taxable if the amount is less than the annual gift tax exclusion.

If you give away a life insurance policy, you do face a risk that the recipient could cash the policy in or borrow against it or pledge it for a loan; let it lapse by not paying premiums; or change the beneficiaries. Any of these actions may be contrary to your wishes. Another option for making a gift of life insurance

that can prevent these possibly undesirable consequences is to establish an irrevocable life insurance trust.

To keep the policy proceeds out of your taxable estate, you should not name your estate, executor of your will, or trustee of your revocable living trust as a beneficiary.

## §6:44 Irrevocable Life Insurance Trusts

An irrevocable life insurance trust (ILIT) is a trust that you establish to hold your life insurance policy so that the death benefit is removed from your estate on your death. The trust allows you to give the policy away, yet prevent the new owner from acting contrary to your wishes by cashing it in, letting it lapse, borrowing against it, and so forth. You can require the trustee to keep the policy in the trust until your death when the proceeds are then distributed to the beneficiaries.

The trust must satisfy these IRS requirements:

- It must be irrevocable. Once you have transferred a life insurance policy into the trust, you cannot revoke the trust and take the policy back in your name. You also cannot change the beneficiaries.
- You cannot be the trustee. However, you can choose the trustee and the beneficiaries when you set up the trust. To avoid having the policy proceeds included in your estate for estate tax purposes, your estate, executor, or trustee of your revocable living trust should not be a beneficiary.
- The policy must be transferred to the trust more than three years before you die. If you die within three years of setting up the trust, the IRS will disregard it and the policy proceeds will be counted in your taxable estate. To avoid the three-year rule, you can have the trust purchase the policy.

When you die, the policy proceeds can be paid to the trust and then distributed according to your instructions in the trust instrument. An irrevocable life insurance trust avoids probate and protects the cash value of your life insurance policy from creditors.

The transfer of the policy to the trust is a taxable gift.

You can make further contributions to the trust from which the trustee can pay the premiums. To qualify for the annual gift tax exclusion, the trust will need to contain Crummey withdrawal provisions. See §6:38. The trustee must send a notification of the contribution to the beneficiaries and give them time to withdraw it. Once the time has elapsed, the trustee can use the contribution to pay the premium.

## D. Grantor Retained Interest Trusts

### §6:45 What Are Grantor Retained Interest Trusts?

There are several different types of grantor retained interest trusts, and they all work similarly. (Grantor is another word for settlor.) You transfer assets that you expect to appreciate to an irrevocable trust. The trust document specifies a period of years for which the trust will last, after which the trust terminates and the assets pass to your beneficiaries. You retain an interest in the assets for the term of the trust that allows you to benefit from them. It may be the right to receive income from the trust or the right to use trust assets.

The initial transfer of assets to the trust is subject to gift tax. It does not qualify for the gift tax annual exclusion because it is not a gift of a present interest. However, the value of the assets is less than their fair market value because of your retained interest. The IRS has various formulas and tables for computing this discounted value. Any appreciation in value of the assets during the term of the trust is not subject to additional gift tax. When you die, the assets are not included in your estate for estate tax purposes because you do not own them.

These trusts allow you to make a gift while saving on gift and estate taxes. They are for wealthy people who have large enough estates to owe estate taxes and who are able and willing to part with significant assets while alive.

Grantor retained interest trusts include:

- Grantor retained annuity trusts (GRATS).

- Grantor retained unitrusts (GRUTs).
- Qualified personal residence trust (QPRTS).

## §6:46 Grantor Retained Annuity Trusts (GRATS)

A GRAT is an irrevocable trust that is created for a specific period, for example, 5 years or 10 years, as a tool to minimize estate and gift taxes. It allows you to share the future appreciation of an asset with the next generation with minimal gift tax. You transfer assets (e.g., stock, real estate, business interests) to the GRAT and receive from the GRAT an annuity for a term of years. The annuity is a fixed amount payable at least annually.

The transfer of assets to the trust is a taxable gift in the amount of the fair market value of the assets, minus the value of the annuity. The value of the gift is calculated actuarially by reference to tables and interest rates published monthly by the IRS. The deduction for the value of the annuity greatly reduces the value of the gift subject to tax. You will have to pay gift tax only if you have used up your estate and gift tax exemption.

At the end of the GRAT term, any remaining assets are distributed to the named beneficiary or beneficiaries. All of the appreciation on the property transferred into the GRAT, plus the cash flow not distributed by the GRAT, is outside of your estate.

If you die during the term of the GRAT, the value of the property transferred (plus its appreciation) is drawn back into your estate. However, any gift tax paid on the creation of the GRAT is credited against estate tax.

## §6:47 Grantor Retained Unitrusts (GRUTS)

A GRUT is very similar to a GRAT except that the amount of the annual payment you receive from the trust is not fixed. It can vary from year to year because it is equal to a percentage of the value of the trust assets for that year. Each year, a new current value is determined. Typically, the payments to you will increase as the trust assets appreciate.

The value of the gift for gift tax purposes is deeply discounted by the value of the retained unitrust interest. Like the value of a gift to a GRAT, it is determined actuarially by IRS tables and formulas. At the end of the term, the remaining assets are distributed to the trust beneficiaries and they are not included in your estate.

If you die during the term of the GRUT, the value of the property transferred (plus its appreciation) is included in your estate. You get a credit for any gift tax paid on the creation of the GRUT.

## §6:48 Qualified Personal Residence Trusts (QPRTs)

A QPRT is an irrevocable trust into which you transfer your home or vacation home (or both in two separate trusts) while retaining the right to live in it for a specific term of years that you choose. A QPRT reduces estate taxes by allowing the home to pass to your children on the conclusion of the term without further gift or estate taxes.

Gift tax is imposed on the initial transfer of the home to the trust, but the value of the transfer for gift tax purposes is reduced because you retain the right to live in the home. The amount of the reduction depends on your age, current interest rates, and the length of the retained term. All appreciation in the home after the initial transfer passes to the children gift and estate tax-free.

If you fail to survive the selected QPRT term, the value of the home is included in your estate. However, the estate receives a credit for any gift taxes paid already paid on the initial transfer of the home to the trust. If you want to live in the home after the trust term, you must pay market rent to the new owners.

## §6:49 Drawbacks of Grantor Retained Interest Trusts

- These trusts are irrevocable. Once you transfer an asset to the trust, you no longer own the asset and cannot change your mind and get the asset back if you need the funds and want to sell it.
- Estate tax savings are not guaranteed. If you don't survive the trust term, the trust assets are part of your estate.

- If you do survive the trust term, the trust assets no longer belong to you. This could be especially troubling in the case of a QPRT. You will have to move from your home or pay rent to the trust beneficiaries who now own it.

## E. Charitable Trusts

### §6:50 Overview

You can make outright gifts to qualifying charities during your life or on your death. Outright charitable gifts are not subject to gift or estate taxes and they will provide you with an income tax deduction. The downside is that you and your family relinquish all financial benefits of the gifted property. Charitable trusts, on the other hand, allow you to give money to a charity and save on income, gift, or estate taxes while retaining a financial benefit from the gifted property.

The two principal types of charitable trusts are the charitable remainder trust and the charitable lead trust. Which type you choose depends on your estate planning goals, the amount and nature of the assets you have available to fund the trust, and prevailing interest rates. These trusts are for wealthy people who can afford to part with $1 million or more to fund the trust. They are irrevocable so you won't be able to end the trust and get the assets back in your name if you change your mind.

Large charities often have planned giving departments that can help you establish a charitable trust. Even so, you should consider hiring your own advisors to help you choose the type of trust that will best serve your estate planning goals. Charitable trusts are complex with many variations. You may want to consult an accountant on the financial aspects and an attorney experienced with charitable giving to draft or at least review the documents.

### §6:51 Charitable Remainder Trusts

A charitable remainder trust is an irrevocable trust into which you place assets that are contributed to charity when the trust

ends. During the trust term, the trust makes payments to one or more beneficiaries. These may be you, your spouse, your children, or other parties.

The payments from the trust can be either a fixed percentage of the value of the assets (a charitable remainder unitrust), which will vary from year to year, or an annuity (a charitable remainder annuity trust), which will always be the same amount. You can make ongoing contributions to a charitable remainder unitrust. Ongoing contributions to charitable remainder annuity trust are not permitted.

The trust can last for your lifetime or the lifetime of your spouse or other beneficiary, or a specified number of years up to 20. You can fund the trust while you are alive (an inter vivos or living trust) or on your death (a testamentary trust).

Typically individuals with highly appreciated assets use a charitable remainder trust to provide themselves or family members with a lifetime stream of income and achieve significant income and estate tax savings while supporting a favorite charity. If you establish the trust while you are alive, you get an income tax deduction for the value of the charitable remainder interest, which is also not subject to gift tax. If you establish the trust on your death, your estate gets an estate tax deduction for the value of the remainder interest, but you get no income tax deduction. The value of the interest is determined according to IRS rules that consider the length of the trust, the amount to be paid to the beneficiaries, and an assumed rate of return on trust assets.

The income earned by the charitable remainder trust is tax-exempt. Assets that have long term appreciation are exempt from capital gains tax when sold by the charitable remainder trust. Consequently, you can contribute an appreciated asset to the trust. The trust can sell the asset free of capital gains tax and use the proceeds to buy income-producing assets to fund the annuity or unitrust payments to you or your beneficiaries. Because of the tax savings, a charitable remainder trust can provide you with more income over your life than if you had sold the asset yourself.

Income you or other beneficiaries receive from the trust is taxable.

## §6:52 Charitable Lead Trusts

The charitable lead trust is the inverse of the charitable annuity trust. It is an irrevocable trust into which you place assets that are distributed to your beneficiaries (usually your spouse or children) when the trust ends. During the trust term, the trust makes payments to the charity. The payments from the trust to the charity can be either a fixed percentage of the value of the assets (a charitable lead unitrust), which will vary from year to year, or an annuity (a charitable lead annuity trust), which will always be the same amount.

Tax treatment of charitable lead trusts is complicated. A charitable lead trust can be either a grantor charitable lead trust or a non-grantor charitable lead trust. With a grantor charitable lead trust established during your life, you get an income tax deduction for the present value of the annuity or unitrust amount that will be paid to the charity. The value is computed according to IRS tables and formulas. The downside is that you have to pay income tax on income earned by the trust, even though you don't receive it.

With a non-grantor charitable lead trust, you do not get an income tax deduction for the charitable gift, but you also do not pay income tax on trust income. The trust itself must pay the tax but gets a deduction for the payments to the charity.

The non-grantor charitable lead trust offers estate and gift tax benefits that are not available with the grantor trust. If the trust is established on your death, property you contribute to the trust is in your estate, but your estate gets a deduction for the value of the annuity or unitrust interest that will be paid to the charity. The value of the interest is determined according to IRS rules that consider the length of the trust, the amount to be paid to the charity, and an assumed rate of return on trust assets.

If you fund the trust while you are alive, the value of the interest going to the charity will not be subject to gift tax, but the value of the remainder interest to the non-charitable beneficiaries will be. It is possible to write the trust to eliminate the gift tax by adjusting the length of the trust and the amount or percent payable to the charity. This is called zeroing out the trust. It happens when the

value of the income stream that is to be paid to the charity is equal to the fair market value of the property contributed to the trust.

## VI. THE GENERATION-SKIPPING TRANSFER TAX

### §6:53 What Is the Generation-Skipping Transfer Tax?

Besides the estate and gift tax, there one more wealth transfer tax you should be aware of, the generation-skipping transfer tax or GSTT. The GSTT imposes a tax on transfers of wealth that skip a generation, for example from a grandparent to a grandchild. It applies to transfers that occur on death and transfers that occur during life. The GSTT tax applies only to "gratuitous" transfers, i.e., bequests and gifts, not sales or exchanges of property.

The GSTT rate is the highest estate tax rate, 40 percent as of 2019.

### §6:54 The GST Exemption Amount and Annual Exclusion

Most people do not need to worry about paying the GSTT because of the GSTT exemption and the annual exclusion for gifts. The GSTT exemption allows you to make generation-skipping gifts during life and at death up to a certain total value without owing any tax. The GSTT exemption is the same as the estate tax exemption, $11.4 million in 2019.

The annual exclusion allows you to make tax-free generation-skipping gifts each year during your life up to a certain value. The annual exclusion is the same as the gift tax annual exclusion, $15,000 in 2019.

### §6:55 Why Was the GSTT Enacted?

Congress enacted the GSTT to close a loophole in the estate and gift tax system. The system assumes that family wealth will be passed down from one generation to the next, i.e., from parent to child, to grandchild, to great-grandchild, and so on. Estate tax is potentially imposed on the transfer to each generation.

For example, if a parent passes his estate to a child and the child passes her estate to a grandchild, estate tax could be levied on two transfers, from the parent to the child and from the child to the grandchild. But if the parent passes his estate directly to the grandchild skipping over the child, estate tax can be levied only once. The government misses out on one opportunity to collect tax revenues and the grandchild gets a windfall.

The GSTT tax imposes an extra tax on the transfer from the parent to the grandchild so that the government collects approximately what it would have received if the estate had first passed to the child and the grandchild gets what she would have received had the estate been taxed twice instead of once.

## §6:56 Who Is a Skip Person?

The GSTT applies to transfers of property to a "skip person." A skip person is a person who is two or more generations below the person making the transfer. Skip persons include grandchildren, great-grandchildren, great-nieces, and great-nephews, and second cousins (children of first cousins) of the person making the transfer. However, these descendants move up a generation on the death of a parent. For example, your grandchild is not a skip person if your child (the grandchild's parent) is deceased.

Skip persons are always descendents so a transfer from a grandchild to a grandparent is not subject to the GSTT. A spouse of the person making the transfer is never a skip person no matter how much younger he or she is. An unrelated person who is more than 37.5 years younger than the person making the transfer is a skip person.

## §6:57 What Types of Transfers Does the GSTT Apply to

There are three different types of taxable generation-skipping transfers:

- Direct skips.
- Taxable distributions.
- Taxable terminations.

## §6:58 Direct Skips

A direct skip occurs when you give a gift directly to a skip person rather than a gift through a trust. It does not matter whether the gift is made during your lifetime or on your death.

**Example:**

Grandmother gives grandson a check for $100,000. Because grandmother and grandson are more than one generation apart, the gift is a "direct skip."

## §6:59 Taxable Distributions

A taxable distribution occurs when a trust distributes money to a skip person.

**Example:**

Grandmother creates a trust that gives income to her son. The trustee of the trust is also permitted to give income to her grandson even though her son is still alive. Anytime grandson receives income from the trust, a "taxable distribution" occurs because the trust is distributing money to the grandson who is more than one generation younger than his grandmother.

## §6:60 Taxable Terminations

A taxable termination occurs whenever a trust changes so that a skip person has all of the current interest in the trust.

**Example:**

Grandmother creates a trust for her son. When her son dies, her grandson will benefit from the trust. Until the son dies, the grandson doesn't have a confirmed interest in the trust. After the son dies, the grandson is the only beneficiary. Since all of the money in the trust will benefit the grandson when son dies, the son's death is a "taxable termination."

## §6:61 Avoiding the GSTT

Estate planners generally try to plan an estate to avoid the GSTT tax given its expense and complexity. There are two ways you can make a gift to a skip person without paying GST tax:

- **Use the annual GSTT exclusion.** Any gifts to individuals that fall within this annual gift exclusion are exempt from GST tax. A grandparent in 2019 can give $15,000 per year to each grandchild without paying GST or gift tax on the gifts. The annual GSTT exclusion only applies to outright gifts to individuals, not to gifts made in trust.
- **Apply the GSTT exemption amount.** Every person can make a certain amount of generation-skipping transfers during life and at death that are exempted from GST tax. If you make the generation-skipping gift during your life, you need to claim the GSTT exemption amount by filing a gift tax return. If you make the gift in your will or revocable living trust, your executor needs to claim the GSTT exemption on your estate tax return.

**Example:**

Grandfather writes a check to his granddaughter for $100,000. This gift is a "direct skip" since granddaughter is more than one generation younger than her grandfather. The first $15,000 falls within the GSTT annual exclusion, but the remaining $85,000 gift is subject to GSTT. Grandfather must file a gift tax return and report the GST gift. He will not pay any GST tax because he can allocate $85,000 of his GSTT exemption amount to the gift.

## §6:62 Generation-Skipping Trusts

A generation-skipping trust is an irrevocable trust that lasts for two generations (or sometimes more) below the settlor. You can establish it during your life or on your death. The trust provides income to second-generation beneficiaries (typically your children). When these beneficiaries die, the trust ends and the

trust assets pass to the third generation beneficiaries (typically your grandchildren).

A generation-skipping trust provides a way to keep assets out of the taxable estates of the second generation beneficiaries, while still allowing the assets to be used for their benefit during their lives.

The trust is subject to estate tax or gift tax when established. But neither you nor your estate will owe gift or estate tax if the value of the assets you put in the trust is less than your lifetime estate and gift tax exemption. Trust assets are not subject to estate tax in the estates of the middle generation because they are not considered to be the owners of the assets.

The transfer to the third generation (your grandchildren) is a taxable termination. However, no GSTT will be owed if the assets you put in the trust were worth less than your GSTT exemption and your executor allocated your GSTT exemption to the trust on your estate tax return. This is true even if the value of the assets distributed from the trust to the third generation has grown larger than the GSTT exemption amount.

**Example:**

Hal establishes a $5 million generation-skipping trust that takes effect when he dies. His executor allocates $5 million of Hal's GSTT exemption to the trust on his estate tax return. Hal's son Roger receives income from the trust for his life. When Roger dies, none of the trust assets are included in his estate and no estate tax is levied on them. The trust terminates and the assets pass outright to Roger's children. No GSTT is due on termination of the trust no matter how much the assets have appreciated.

## §6:63 Before Settling Up a Generation-Skipping Trust Consider...

- If you plan to establish the trust while you are alive, can you afford to permanently part with the property you plan to put in the trust? Since the trust is irrevocable, you will

not be able to get the property back once you contribute it to the trust.

- Will your spouse need the property for his or her support after your death? Although your spouse can be an income beneficiary of the trust along with your children, he or she may need additional support.
- Will the income your children will receive from the trust be a sufficient inheritance for them?

## §6:64 Dynasty Trusts

A dynasty trust is a type of generation-skipping trust that is designed to last for many generations or even forever. Trust assets are subject to estate or gift tax when the trust is funded but can be sheltered from tax by the settlor's lifetime estate and gift tax exemption. After that, successive generations of beneficiaries are entitled to receive income from the trust. No additional gift or estate tax is ever owed. Trust assets are not included in the taxable estates of any of the beneficiaries because they do not own the assets. Termination of the trust (if and when it occurs) is a taxable termination for GSTT purposes. However, no GSTT will be owed provided the settlor's GSTT exemption was sufficient to cover the assets he or she transferred into the trust and was properly allocated to the trust on the settlor's estate return.

Dynasty trusts have the potential to accumulate vast sums over many generations. They also will likely acquire large numbers of beneficiaries as the settlor's descendants increase with each generation.

A dynasty trust must be set up in a state that has repealed the rule against perpetuities. The rule against perpetuities is an ancient law that requires a trust to terminate after several generations. Approximately 30 states have repealed the rule and allow perpetual or long-term trusts.

## VII. INCOME TAX ISSUES

### §6:65 No Income Tax on Gifts and Inherited Property

Your beneficiaries will not need to pay income taxes on the value of property that they receive from you, whether you give it to them while you are alive or you give it to them when you die. There is one exception to this rule for inherited tax-deferred retirement plans, such as IRAs and 401(k)s because no income tax was paid on plan contributions. The recipient must pay income taxes on distributions, but these accounts are subject to special rules that allow the recipient to spread distributions out over a number of years so that tax is not due all at once.

If the inherited property produces income, the recipient must pay income taxes on that income. If your beneficiary decides to sell the inherited property at some point, he or she may have a gain or loss on the sale that needs to be reported on an income tax return. If the sale results in a gain, the gain may be subject to income tax.

### §6:66 Stepped-Up Basis for Inherited Property

Basis is the value of property that is used to determine gain or loss on a sale. The basis of property that is purchased is its purchase price. The basis of property may be adjusted up if capital improvements are made to it (e.g., you put a new roof on your house) or down if it has been depreciated on tax returns. The gain or loss on the sale of property is the sale price minus the property's adjusted basis.

**Example:**

Nathan purchases a home for $300,000. He spends $20,000 on foundation upgrades. His adjusted basis in the home is $320,000. If he subsequently sells the home for $450,000, he has a gain of $130,000 on the sale ($450,000-320,000). This gain may or may not be taxable depending on whether the home was Nathan's principal residence and how long he occupied it.

A person who inherits property from you does not inherit your basis in the property. He or she gets a new basis that is equal to the property's value at the date of your death. This is referred to as a stepped-up basis because property usually appreciates over time.

**Example:**

Roz purchased her home 20 years ago for $200,000. It is now worth $350,000. If Roz dies and leaves her home to her son, his basis in the home will be $350,000. If he sells it immediately for its fair market value, he will have no taxable gain.

## §6:67 Basis of Gifted Property

The basis of property received as a gift is the same as the gift giver's basis, called a carryover basis, so long as the property's value has not depreciated below the giver's cost of acquiring the property. If the value of the gifted property is below the giver's cost, the basis of the property is its fair market value.

**Example:**

Rochelle purchases 100 shares of stock for $2000. Five years later she gives the stock to her nephew Avery when it is worth $4000. Avery's basis in the stock is $2000. If he sells the stock, he will have $2000 of taxable gain. If instead, the stock was worth $1000, Avery's basis would be $1000, the stock's fair market value at the time of the gift.

## §6:68 Special Rules for Property Held with Right of Survivorship

When property is owned as joint tenants with right of survivorship, a surviving joint tenant gets a stepped-up basis only for the inherited interest. However, if the property is owned by a married couple as community property with right of survivorship, the entire property gets a stepped-up basis when one spouse dies.

**Example:**

Stephanie and Alex purchased a home for $220,000. They took title as joint tenants with right of survivorship. When Alex dies 10 years later, the property is worth $320,000. The basis of Stephanie's half of the property remains at $110,000 (one-half of the purchase price) and the basis of Alex's half inherited by Stephanie is $160,000. Stephanie's total basis is $270,000. If the property was community property with right of survivorship, Stephanie's basis would be $320,000.

CHAPTER 7

# Durable Powers of Attorney for Financial Matters


I. Introduction
II. Deciding What Powers to Give Your Agent
III. Choosing Your Agent
IV. When Your DPOA Becomes Effective
V. Executing Your DPOA
VI. What to Do with Your DPOA
VII. Getting Financial Institutions to Accept Your DPOA


## I. INTRODUCTION

### §7:01 A Durable Power of Attorney Is Different from an Ordinary Power of Attorney

An ordinary power of attorney (POA) is a document in which you authorize another person to act for you. As the person giving the authority, you are referred to as the principal. The person to whom you give authority is called your attorney in fact or agent. The authorization may be limited to a specific matter, for example, to sign a contract, or it may give the agent broader powers to handle all your legal and financial matters. An ordinary POA ceases to be valid if you become mentally incapacitated.

A *durable* power of attorney (DPOA) is similar to an ordinary power of attorney with one important difference. It does not become invalid if you become mentally incapacitated. A DPOA remains in effect for the duration of your incapacitation, whether weeks, months, or years.

## §7:02 Why You Need a DPOA

If you become incapacitated, someone will need to manage your finances. You probably have checks that need to be deposited, bills that need to be paid, investments to manage, and a home or other real estate to be maintained.

If you do no advance planning, your loved ones will need to ask a court to appoint a guardian to handle your finances if you no longer can. Unfortunately, once you lose capacity, it is too late to give someone a power of attorney.

Most people want to avoid a court-appointed guardian. A guardianship proceeding is expensive, causes delay, and gives you no say in who is appointed to manage your affairs. Worse yet, family members may argue over who should be appointed or whether a guardianship is necessary. You will be subjected to an examination by one or more doctors to determine whether you lack capacity. Once the guardian is appointed, you will lose the authority to make many, if not all, decisions about your life.

You can prevent this undesirable result with a DPOA. One of the benefits of a DPOA is it is a voluntary delegation of rights. You get to (a) state the actual powers that will be granted (and any limitations) and (b) choose the person or persons to whom those powers are granted. In being proactive, you are not giving away control, but simply delegating your rights to a person you trust.

## §7:03 If You Also Have a Revocable Living Trust

People who plan to have a revocable living trust as part of their estate plan often ask whether they also need a durable power of attorney. The answer is yes. With a revocable living trust, your successor trustee can take over the management of all the assets in the trust if you are incapacitated.

Some of your assets may be outside of the trust. Your agent named in your DPOA will be able to manage assets that cannot be or simply were not transferred to your living trust, such as

life insurance, checking accounts, and retirement accounts. You can give your agent powers to write checks, collect government benefits, file tax returns, and even handle legal actions on your behalf, all of which are duties that fall outside of the parameters of a trustee's powers.

### §7:04 If You Have a Spouse

If you have a spouse, you may think you do not need a DPOA because most of your property and accounts are joint. Your spouse can indeed manage the joint accounts in the event of your incapacity. He or she can write checks, make deposits (even of checks that are in your name), and even trade stocks that are in a joint account. But if you own (or expect to own) real estate together, usually you both have to authorize the sale. If you are incapacitated and your spouse (or someone else) does not have your DPOA authorizing real estate transactions, your spouse is stuck. Your spouse will need to pursue a guardianship to complete the sale. The same may be true of a vehicle depending on how it is titled. And, to the extent that you do have separately owned property, your spouse will not be able to manage or sell it once you are incapacitated without your DPOA

## II. DECIDING WHAT POWERS TO GIVE YOUR AGENT

### §7:05 Choose Wisely After Careful Consideration

When you execute a DPOA you give your agent the power to act on your behalf regarding various financial obligations and transactions. Choosing the powers you want to give your agent requires careful consideration. The powers you grant him or her will be for the duration of your incapacitation. In the event you become incapacitated, you will no longer have a right to revoke or amend the DPOA.

## §7:06 Powers You Can Give Your Agent

Although it is possible to limit the powers you give your agent, most people grant their agents a broad spectrum of powers. The more limited the powers, the less useful the DPOA is in eliminating the need for a guardianship.

Powers usually granted to an agent under a DPOA include:

- Managing accounts with financial institutions, including writing checks and depositing funds into your accounts.
- Paying your bills from your assets.
- Buying, selling, and renting real estate including collecting rent on properties held in your name.
- Buying and selling stocks, bonds, and mutual funds.
- Buying and selling personal property.
- Accessing your safety deposit box.
- Managing your insurance and retirement accounts.
- Managing any government benefit accounts held in your name.
- Filing all your tax returns and paying any tax you owe from your assets.
- Handling any litigation or claims filed against you, or filing claims and suits on your behalf.
- Managing commodities or option transactions.
- Claiming or disclaiming an inheritance.
- Managing your small business.

In some states, you may be able to authorize your agent under a DPOA to make medical decisions for you. In others, you will need to execute a separate medical durable power of attorney (sometimes called a health care proxy). See Ch. 8.

## §7:07 Powers You Cannot Give Your Agent

Although your agent may be granted broad powers under your DPOA, certain personal activities cannot be delegated to your agent. These typically include: the power to perform a personal services contract for you; the power to make, amend, or

revoke your will; the power to vote for you; and the power to get a divorce for you.

Your agent is required to act in your best interests. Therefore, your agent is not allowed to give away your property to others, unless this power was otherwise specifically granted to him or her.

### §7:08 Powers That May Affect Your Estate Plan

Even though your agent cannot change your will, you should be aware that he or she may be able to alter your estate plan. In some states, you may be able to give your agent the power to create a trust or to amend or revoke a trust you created; the power to make gifts; or the power to create or change rights of survivorship or beneficiary designations.

Even if you don't give your agent these powers, he or she can make withdrawals for your benefit from accounts that you hold jointly with survivorship rights or with pay on death beneficiary designations. It's possible that on your death these accounts will be depleted or closed.

## III. CHOOSING YOUR AGENT

### §7:09 Your Agent's Responsibilities

Your agent is obligated to act in your best interests with strict standards of honesty and loyalty. Your agent is required to ensure that your property is safe and kept separate from his or her property. Part of your agent's responsibility includes keeping detailed and organized records of all the financial transactions made on your behalf.

### §7:10 Trustworthiness Is the Paramount Consideration

The most important quality in an agent is trustworthiness. You will be giving your agent access to your accounts. There is a

risk that your agent may abuse his or her powers and spend your money or sell your property contrary to your wishes.

If you have absolute faith in the loyalty, competence, and devotion of the agent, you can provide broad authority to the agent without concern about how he or she will use it. Most people select a family member, close friend, or a professional with a reputation for honesty.

## §7:11 Location and Willingness to Serve

You should also consider the agent's geographic location and willingness to serve. It will be easier for your agent to assist you if he or she is local, particularly if real estate management is required. Of course, you should discuss the job and your expectations with your proposed agent before executing your DPOA to ensure that your agent will accept the appointment and has the information necessary to carry out his or her duties.

## §7:12 Cooperation with Your Agent for Medical Decisions

Finally, you should give careful consideration as to whether your proposed agent can work with the person you designate to make your health care decisions if you plan to name different people to these roles. They will need to coordinate so that your medical bills are paid. See Ch. 8 medical powers of attorney.

## §7:13 Naming More Than One Agent

You can select more than one person to act as your agent. You need to decide whether you will grant your agents the authority to act individually or only jointly. Pros and cons exist for each method. Granting your agents the power to act individually allows one agent to act quickly on your behalf. On the other hand, requiring your agents to act jointly provides a built-in safeguard to ensure your agents are acting in your best interests. A downside of requiring the agents to act jointly is that they could disagree

on how to handle the matter, or one may be unavailable, which could cause delays.

If you want to name two agents who can act independently of each other, the best practice is to execute two separate DPOAs. If you name them both in one document, even if the document states that either agent may act alone, third parties may require authorization from both out of concern for liability.

Additionally, you may want to name an alternate agent. Listing an alternate ensures that you will have an agent if the first person you named is unable to serve.

## §7:14 Should You Compensate Your Agent?

Your DPOA can specify whether and how you want your agent to be paid. Most agents are close family members of the principal and do the job out of love and devotion and so do not expect to be paid.

If your financial matters are routine, expecting your agent to handle them without compensation is reasonable. However, if you have extensive assets and investments or a business and handling these matters will involve a great deal of time, you may want to provide compensation for your agent to encourage him or her to take on the task. Compensation is something you should discuss with your candidates for the job before you execute your DPOA.

## §7:15 If Your Agent Misuses Your DPOA

If you suspect that your agent is abusing his or her powers, you should immediately revoke the power of attorney. See Ch. 9 for how to do it. You should also notify all your banks and other financial institutions that you have revoked the power of attorney. Finally, you also have the option of going to your probate court and requesting an accounting of your financial affairs from your agent. To do this, you most likely will have to pay a filing fee to start the action, but then your agent will be forced to provide a detailed accounting of how he or she spent your money. If the accounting reveals irregularities, a breach of fiduciary duty claim may be appropriate.

## IV. WHEN YOUR DPOA BECOMES EFFECTIVE

### §7:16 Immediate or Delayed Effect

A DPOA can be drafted in two different forms. One form takes effect a soon as you execute the document and remains in effect if you become incapacitated. The alternative form, known as a "springing durable power of attorney," does not become effective until you become incapacitated. The document typically includes language that you are incapacitated once a doctor finds you are no longer able to handle your affairs. Sometimes the springing durable power of attorney is drafted to require two independent doctors to determine that you are unfit to handle your affairs.

A springing DPOA is not allowed in all states.

### §7:17 Potential Difficulties with a Springing Power

A springing DPOA does pose some difficulties for your agent.

Before your agent can begin to manage your affairs, he or she must get a certification from a doctor (or two doctors depending on the language in the document) that you are incapacitated. At the minimum, this will cause delay. Furthermore, a doctor may not be willing to provide the certification unless you have also executed a valid HIPPA release allowing the doctor to reveal your medical condition. See Ch. 8.

Even with the certification, some individuals and institutions may be hesitant to accept the springing DPOA and question its validity.

You may avoid the disability certification problems of a springing DPOA by executing a DPOA that makes the powers immediately effective, but then not giving the document to your agent until it is necessary. As long as the agent knows where to locate the document, this method can be a simple solution to the dilemma of not wanting to grant immediate powers but also not wanting to be burdened with the certification requirements of a springing power.

### §7:18 When Your DPOA Ends

Your agent's powers end when you:

- Die.
- Revoke the power of attorney. See Ch. 8.
- Divorce the agent if he or she is your spouse.

If your spouse is your agent and you decide to divorce, the best course of action is to immediately revoke the power of attorney.

Your agent's powers also end if he or she becomes incapacitated or is removed by a court.

## V. EXECUTING YOUR DPOA

### §7:19 Requirements for a Valid DPOA

A DPOA must:

- Be written.
- Be signed by you, the principal.
- Be notarized or witnessed by two witnesses.
- Designate another person as your agent.
- Contain language to the effect that the agent's powers will continue after the principal's incapacity (or will begin upon the principal's incapacity, if the power is a springing power).

You must be an adult and mentally competent to execute a DPOA. Courts regularly see cases where someone, often a family member, contests the appointment of the agent claiming that the principal was not of sound mind when the document was executed. The earlier (before any signs of incapacity) you can put your DPOA in place, the less likely an assertion that you were not of sound mind will prevail.

If the DPOA will be used to transfer title to real estate, it may need to be recorded with the deed.

## §7:20 Other Documents Your Agent Will Need

Your agent will need access to the same documents and information that you need to conduct your affairs. At a minimum, he or she will probably need:

- A list of all financial institutions at which you maintain accounts, the types of accounts, and the account number of each. These might include checking, savings, CDs, credit cards, retirement, and brokerage accounts.
- A list of all your bills/debts, payment amounts for those with a set payment, and their due dates.
- A list of the sources of income you receive and how and when you receive them (e.g., pensions, social security, etc.)

If you do your banking and bill paying online, your agent will need your user id and passwords.

Depending on the complexity of your finances and the powers you have given to your agent, he or she may also need these and other documents:

- A list of your real estate holdings and copies of the deeds and leases currently in effect.
- Your insurance policies.
- The title to your vehicles.
- Tax returns.
- Copies of documents pertinent to your business holdings such as partnership or LLC agreements, shareholder agreements, buy-sell agreements, and bylaws.

A good way to store this information is to scan the documents and save everything to the cloud or on a flash drive that you put in a secure location to which your agent has access.

## §7:21 Effect of Your DPOA on Your Right to Control Your Property

Executing a DPOA does not eliminate your power and control over your property and finances. The DPOA allows you to "share"

your power with a person whom you appoint as your agent. As long as you are still capable of making your own decisions, you can instruct your agent as to what actions he or she can do on your behalf. When you become unable to make the decisions for yourself, your agent can then handle your financial matters for you.

## VI. WHAT TO DO WITH YOUR DPOA

### §7:22 Your Choices

You have two choices:

- You can give you DPOA to your agent as soon as it is executed; or
- You can keep it until you are incapacitated or want your agent to use it.

### §7:23 Giving Your DPOA to Your Agent Immediately

If you want your agent to begin using your DPOA immediately, you should give the original to your agent as soon as you execute it.

You may want to give your agent the document immediately even if you do not want the agent to begin using the power until you are incapacitated or it is a springing power that does not become effective until you are incapacitated. After all, it is your agent who will ultimately need it, not you.

### §7:24 Keeping Your DPOA Until You Are Incapacitated

If the power is not immediately effective, some people are concerned about putting it in the agent's hands right away. Among other things, giving up possession can make revoking the document more difficult. See Ch. 9.

If you decide to keep the DPOA in your possession, you can store it with your other estate planning documents. Then you can decide when to give the document to the agent, and until then

you know exactly who has seen it which makes revoking it easier should you ever need to do so.

However, if you are the only person who knows where the power of attorney is (or even that it exists), there is a risk that the document will not be found after you become incapacitated. So you must be sure your agent knows about it and where you have stored it, and that he or she has ready access to it.

Storing the power of attorney at your home does create the risk that it will be found by the wrong person first and then hidden or destroyed.

If you choose to keep your DPOA in a safety deposit box, make sure that you arrange with your financial institution for your agent to have access to the box.

## VII. GETTING FINANCIAL INSTITUTIONS TO ACCEPT YOUR DPOA

### §7:25 Using a Statutory Form

Some states have a statutory form that can be used to create a DPOA. The form may be required or optional. Even if the form is optional, there may be a benefit to using it. Financial institutions may have grown accustomed to the form, which may mean they are more willing to rely on it, or at least will not need as much time to review it for compliance with the statute and their internal requirements.

### §7:26 Other Tips for Getting Financial Institutions to Accept the DPOA

Banks, title companies, and other third parties are sometimes reluctant to rely on a DPOA. They worry about liability stemming from the fact that the DPOA might be forged, invalid, or revoked.

Furthermore, relying on a DPOA requires extra work for the institution. The document must be read to make sure it meets

statutory requirements, and records must be checked to make sure the institution doesn't have a record that it was revoked.

The following steps may reduce these problems:

- Make your DPOA effectively immediately. With a springing power, financial institutions will be concerned with whether or not you are truly incapacitated. They may legitimately refuse to act without sufficient evidence of incapacity.
- If your DPOA may be used to sell or mortgage real property, identify the real property in the document. This is required by some title companies.
- Show the DPOA to your bank and ask the bank to confirm that it will allow your agent to write checks against the account, make deposits, and transfers funds between accounts.

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CHAPTER 8

# Advance Medical Directives


I. Introduction
II. Medical Durable Powers of Attorney (MDPOA)
III. Living Wills
IV. HIPAA Authorization


## I. INTRODUCTION

### §8:01 What Are Advance Medical Directives

"Advance directives" are documents in which you provide instructions or express your wishes about the medical care you want to receive if you become incapable of making treatment decisions for yourself.

Two types of advance directives are:

- The medical durable power of attorney (MDPOA) in which you name an agent to make medical decisions for you when you no longer can make them for yourself.
- The living will in which you state your wishes for treatment at the end of life or if you are in a permanently unconscious state.

### §8:02 You Need Both an MDPOA and a Living Will

The best policy is to have both documents. They work together to ensure that your wishes are understood and followed. A living will allows you to make your wishes clear so that your medical

agent will not have to rely on guesswork to determine what you would have wanted.

Your family members can be reassured that your agent is acting consistently with your wishes, and both your agent and family members are relieved of the emotional burdens of making these difficult decisions. A living will that is consistent an MDPOA may make doctors and hospitals more willing to follow your instructions.

A medical agent can serve as a tie-breaker if your family members do not agree on your treatment.

## §8:03 When to Put These Documents in Place

Living wills and MDPOAs are not just for the sick or elderly. Every adult should consider creating these documents. A catastrophic accident or medical crisis rendering a person permanently unconscious could occur at any time. Many people execute living wills and MDPOAs as part of a comprehensive estate plan prepared by their estate planning attorney.

## §8:04 Medical Decision Making Authority in the Absence of an MDPOA

If you do not have an M DPOA, state law will determine who makes medical decisions for you if you are not able to make them for yourself. As a general rule, the authority goes to your guardian (if you have one), spouse, a majority of your adult children, parents, other adult relatives, and close friends. If none of these are available, the decision is likely to be made by a hospital social worker.

# II. MEDICAL DURABLE POWERS OF ATTORNEY (MDPOA)

## A. How the MDPOA Works

### §8:05 What Is an MDPOA

A medical durable power of attorney is a document in which you name a person to make health care decisions for you when you are not able to make your own decisions. Depending on where you live, the person you name may be called your medical agent, surrogate, proxy, or representative.

The MDPOA allows you to outline your philosophy as to the types of treatment you want to receive or decline while you are incapacitated or unable to communicate your wishes. It is much broader than a living will, which only expresses your desires if you are terminally ill or permanently unconscious and are unable to express your wishes regarding the use of life-prolonging procedures.

### §8:06 Requirements for a Valid MDPOA

To make an MDPOA, you must be a mentally competent adult. "Competent" means you can understand and appreciate the nature and consequences of a treatment decision.

Every state has its requirements for the document. Some states provide a preprinted form that you must use. Others provide a form, but using it is not mandatory. Typically an MDPOA must be in writing signed by you and notarized or witnessed by two competent adults. If you are physically unable to sign, you can ask another person to sign for you in your presence.

Certain persons may be disqualified as witnesses such as relatives, beneficiaries of your estate, the person named in the MDPOA as your agent, and your health care providers.

## §8:07 When Your MDPOA Goes Into Effect

You do not give up your right to make your own health care decisions when you execute an MDPOA. Your agent cannot make health care decisions for you until your doctor certifies that you are incompetent. Incompetent means that you cannot understand the consequences of a treatment decision, including its risks, benefits, and possible alternatives.

## §8:08 When Your MDPOA Ends

Once you are certified as incompetent, your agent's authority under your MDPOA continues until you:

- Die. However, some of the directions or instructions in the document may remain effective after your death for some very limited purposes. For example, your agent may be allowed to supervise the disposition of your body, including authorizing an autopsy or organ donation if your MDPOA gives these powers.
- Regain competency to make your own medical decisions.
- Revoke it. See Ch. 9.
- Divorce the agent if he or she is your spouse.

If your spouse is your agent and you decide to divorce, the best course of action is to immediately revoke the MDPOA.

Your agent's powers also end if he or she becomes incapacitated or is removed by a court.

## §8:09 Court Determines Your MDPOA Is Invalid

Although very rare, challenges to the validity of an MDPOA do sometimes occur. Most often they occur when family members disagree with the agent's decisions. Some reasons a court can rule MDPOA invalid include:

- You lacked the mental capacity to execute an MDPOA.
- Your MDPOA was not executed correctly.

- You were acting under duress, fraud, or undue influence at the time of execution.
- Your agent is not acting according to your wishes or best interests.

### §8:10 What to Do With Your MDPOA

Once you have executed your MDPOA, keep the original along with your living will in a safe place where you and family members can easily locate it. Give a copy to your agent and your alternate agent as your agent may need to present it to health care providers to prove his or her authority. Provide a copy to your doctor and your hospital or care facility when you are admitted. Take a copy with you when you travel. You may also want to put a card in your wallet stating the name of your agent and where your original MDPOA and living will can be found.

## B. What Decisions to Allow Your MDPOA Agent to Make

### §8:11 Decisions You Can Authorize Your MDPOA Agent to Make

You can decide what decisions you want your health care agent to make. You can give your health care agent broad authority to make virtually all health care decisions for you if you are unable to make them for yourself. Or you can limit the agent's power. Some people limit their agent's power to the instructions in their living wills.

With broad powers, your health care agent will be able to:

- Consent to or refuse most types of medical and mental health treatment.
- Access your medical records.
- Decide in which medical facilities you will receive care.
- Choose your health care providers.
- Visit you when you are in a hospital or medical facility

So long as you have full confidence in your agent, consider giving him or her broad powers to make decisions for you as it can be difficult to foresee what anyone's medical needs may be in the future. Giving your agent full authority will reduce the chances of having the issue end up in court.

Your agent must make your health care decisions according to the agent's knowledge of your wishes, which is why you need to have a candid discussion with him or her. If the agent does not know your wishes, the agent must base the health care decisions on your best interests.

### §8:12 Decisions You Cannot Allow Your Agent to Make

State law may provide that your health care agent cannot consent to certain treatments or can consent to them only if you specifically so state in your MDPOA. These include abortion, sterilization, electroshock therapy, voluntary commitment to a mental institution, withholding or withdrawing life support if you are pregnant, and experimental treatments.

## C. Choosing a Medical Agent

### §8:13 Who Can Serve as a Medical Agent

Your agent must be a competent adult. Most people choose a spouse or an adult child or sibling. However, your agent need not be a relative. A trusted close friend can be an excellent choice. If you have named an individual as your agent for financial decisions in a durable power of attorney, you may want him or her to also serve as your health care agent.

State law generally precludes you from naming as your agent your doctors or any other health care providers or employees of your health care providers or of the hospital or other facilities at which you receive care.

### §8:14 Qualities to Look for in an Agent

- You should name a person with whom you can comfortably discuss your wishes for medical care and end of life treatment. This should be a person who is willing and able to listen to you and capable of understanding your wishes. Having a frank discussion with your agent (and with your doctor) is probably the most important thing you can do to ensure your wishes will be followed.
- You want to name a person whom you trust to carry out your instructions.
- You should name a person who is nearby, if possible, and will be readily available to discuss your needs with your health care providers.
- You want to choose someone assertive. You want someone who can articulate your wishes to health care providers and firmly insist they be carried out in the face of possible resistance from health care providers and family members.

### §8:15 Naming More Than One Agent

You should consider naming an alternate agent who will serve if the first person you designate is unable to serve as your agent. Naming two agents to serve together is generally not a good idea. It creates the possibility of disagreements which may confuse health care providers, cause delays, and need to be resolved in court.

## III. LIVING WILLS

### A. How a Living Will Works

### §8:16 What Is a Living Will?

A living will (also known as a directive to physicians or health care declaration) is a document in which you set forth the types

of medical care and treatment you want to receive or don't want to receive when you can no longer speak for yourself because you are terminally ill or permanently unconscious.

## §8:17 Why Have a Living Will

There is no legal requirement that you have a living will. However, a living will is a good idea for several reasons:

- To ensure your wishes are followed regarding medical care at the end of your life or if you are unconscious and have no hope of recovery.
- To relieve your loved ones of the burden of making end-of-life decisions without knowing your wishes.
- To enable your doctor to follow your instructions. Without a living will, a doctor may be concerned that it may constitute medical malpractice or even a crime if he or she withholds or removes treatment.
- To keep your private wishes on dying out of the probate court, where these disputes may end up. Without a living will, your family and medical care providers may disagree as to what care should be provided or withheld. If they don't all agree, the matter may end up in court.

## §8:18 Requirements for a Valid Living Will

You can make a living will so long as you are mentally competent and an adult. "Competent" means you can understand and appreciate the nature and consequences of a treatment decision.

The specific requirements for the document vary from state to state. Some states provide a pre-printed form that must be used. In others, the form is available, but you are not required to use it. Typically you must sign your living will and your signature must be notarized or witnessed by two competent adults. Certain persons may be disqualified from serving as witnesses, such as relatives, beneficiaries of your estate, and your health care providers.

If you are physically unable to sign, you can ask another person to sign for you in your presence.

## §8:19 When a Living Will Takes Effect

States may have somewhat different laws about when a living will takes effect, but generally, it takes effect only if you are deemed incompetent to make medical decisions by at least one doctor and death is imminent or you are in a persistent vegetative state. If you are temporarily incapacitated, the living will does not take effect. For example, if your medical condition does not allow you to speak but you are likely to recover, your doctors cannot invoke the living will.

In situations of temporary incapacity, an agent under an MDPOA will be able to make decisions for you.

## §8:20 What to Do with Your Living Will

Your health care providers can follow the instructions in your living will only if they know what your instructions are. To ensure your wishes are known, you should give a copy of your living will to your doctors and your hospital or care facility when you are admitted. If you have an MDPOA, you'll want to provide your agent with a copy of your living will. Also, consider giving a copy to family members who are close by and likely to be in a position to see that your wishes are carried out. And you'll want to take a copy with you when you travel. You may also want to put a card in your wallet stating the name of your health care agent and where your living will (and MDPOA) can be found.

See Ch. 9 for information about how to change or revoke your living will.

## B. Treatment Decisions in Your Living Will

### §8:21 Treatment You Can Request or Refuse in Your Living Will

In your living will, you may request that your health care providers administer life-sustaining treatment, withhold life-sustaining treatment, or withdraw life-sustaining treatment when you have a terminal illness, an end-stage condition, or are in a persistent unconscious state. You have a federal constitutional right to refuse medical treatment, even if that refusal is likely to lead to death.

You may want different instructions for different situations, for example, the last stages of a terminal illness versus a state of unconsciousness from which you are not expected to recover.

### §8:22 Specific Types of Treatment to Consider

Living will forms vary from state to state but all cover similar topics related to end of life care and death. Some spell out particular treatments that you can choose or decline, while others simply allow you to choose between requesting life-prolonging treatment and refusing life-prolonging treatment. In some states you are not required to use the state form, but can use a custom-drafted one that may better express your wishes.

The types of treatment you'll want to consider include:

- Cardiopulmonary resuscitation. If your heart stops beating, do you want health care professionals to administer CPR, drugs, and electrical shock with a defibrillator to attempt to restart it?
- Intubation and ventilation. If you are unable to breathe on your own, do you want to have a tube inserted in your windpipe that is connected to a machine that will help you breathe?
- Feeding and hydration. If you are unable to eat or drink, do you want to be fed and hydrated with an IV or feeding tube?

- Dialysis. If your kidneys fail, do you want to be connected to a machine to remove toxins from your body?
- Antibiotics/antivirals. If you have an infection, do you want it treated with medications, or allow it to go untreated even if that may hasten death?
- Surgery. If surgery becomes necessary to prolong your life, do you want to undergo it or let nature take its course?
- Palliative care. Instead of aggressive life-prolonging care, would you prefer to receive only medications and other treatments to keep you pain-free and comfortable?

Discussing these decisions with your doctor before making your living will is a good idea. Your doctor can explain the risks, benefits, and consequences of these treatments so you can make a more informed decision. Your doctor should tell you if he or she has reservations about following your instructions in which case you can seek another doctor.

A living will may also indicate your:

- Desire to become an organ or tissue donor.
- Religious preferences.
- Burial and final disposition wishes (e.g. cremation).

## §8:23 Withdrawing Life-Sustaining Treatment If You Don't Have a Living Will

Who has the power to withdraw life-sustaining treatment if you haven't executed a living will varies by state. Some states will not allow the termination of life-sustaining treatment unless you have previously expressed a desire that it be done. Others allow another person to make the decision based on your best interests or what you likely would have wanted. The persons who may decide are specified by law and usually include in order: an agent under an MDPOA or a legally appointed guardian, a spouse, adult children, then parents.

## C. Will Your Doctor Abide by Your Living Will

### §8:24 Your Doctor's Obligation to Honor Your Living Will

Your doctor is not required to honor your living will. Your doctor may refuse to follow your instructions if he or she has moral, religious, or ethical objections or believes it would not be consistent with sound medical practice. Your living will merely gives your doctor immunity from liability for following your directions. However, if your doctor objects to following your living will, he or she may have an obligation under state law to make a reasonable effort to transfer you to another physician or facility that will follow it.

### §8:25 Increasing the Chances Your Doctor Will Honor Your Living Will

There are some things you can do to increase the chances that your doctor will honor your living will. First, discuss your wishes with your doctor and seek assurances that he or she will follow them. Second, make sure your doctor has a copy. Third, make sure your family members are aware of your wishes and give them a copy of your living will. Finally, execute an MDPOA naming an agent to make decisions for you. Make sure your agent knows your wishes and is prepared to advocate for you.

# IV. HIPAA AUTHORIZATION

### §8:26 What Is HIPPA?

HIPPA is short for The Health Insurance Portability and Accountability Act of 1996. It is a federal law that restricts disclosure of health information by health care providers and health care plans to third parties unless the patient has consented. Penalties for violators range from fines to substantial prison time.

These rules have raised concerns that family members may have trouble obtaining a person's medical records when they need them.

A professional judgment exception allows health care providers to make disclosures that are in the best interests of the patient, even if the patient is not present and has not consented. This exception should allow health care providers to share information with family members in most situations in which it is needed. However, in light of the penalties, some health care providers may be hesitant to rely liberally on it. The solution may be a written HIPPA Authorization.

## §8:27 What Is a HIPPA Authorization?

A HIPAA Authorization is a document in which you authorize your health care provider to release information about you to a third party. It must contain:

- A description of the information to be released.
- The persons (or class of persons) authorized to request and receive information.
- The purpose of the disclosure.
- An expiration date or event.
- A statement that you have the right to revoke the authorization unless your provider has relied on it.
- Whether the provider can condition treatment, payment, enrollment, or eligibility for benefits on your willingness to sign.
- A warning that the information disclosed under the authorization will not be protected by HIPAA from re-disclosure by the recipient.
- Your signature and the date you signed.

## §8:28 When You Might Want to Execute a HIPPA Authorization

It may be a good idea for you to execute a HIPPA authorization in certain situations:

- Your financial durable power of attorney does not become effective until you are determined to be incapacitated by

a doctor or a doctor must certify your incapacity before your successor trustee can take over the management of your living trust. A HIPAA Authorization might be helpful if your agent or trustee ever needs to establish your incapacity. Without it, a doctor may be unwilling to provide the needed determination.

- You are concerned about a situation in which your capacity to make medical decisions has become questionable. Your agent under a medical power of attorney that has become operative will have access to your health information, even if you have not executed a separate HIPAA Authorization. However, if your capacity is questionable, HIPAA could create a vicious circle in which the doctor cannot certify your incapacity until the medical power of attorney takes effect, but the medical power of attorney will not take effect until the doctor certifies the incapacity.
- You want people other than your medical agent to have access to your medical information. For example, you may have named your spouse or one child as your agent, but you may want all your children to be able to talk to your doctors about treatment options.
- You are not incapacitated but are presently suffering from a serious illness and have frequent contact with the health care system. You want to ensure that family members or other loved ones are kept up to date on your condition and can consult with you and your doctors on treatment decisions.

Although the professional judgment exception should allow these results, an explicit written authorization may provide greater assurance that your wishes will be respected.

CHAPTER 9

# Reviewing and Revising Your Estate Plan

I. When to Review Your Estate Plan
II. Changing Your Will
III. Changing Your Revocable Living Trust
IV. Changing Your Durable Power of Attorney (DPOA)
V. Changing Your Advance Medical Directives

## I. WHEN TO REVIEW YOUR ESTATE PLAN

### §9:01 Estate Planning Is Never Done

Once your estate plan is in place, you can congratulate yourself. You will have given a tremendous gift to your loved ones and yourself. Your plan will ensure your assets pass to the people you want to benefit and to the causes and organizations that matter to you. It will protect you if you are incapacitated, ease the emotional burdens on your family, and give you great peace of mind.

Many families have been destroyed by bickering over what a departed loved one would have wanted when he or she left no estate plan or a defective one. Yours should not be one of them.

Still, you need to recognize that your estate planning is not done even though you have made all the crucial decisions and executed all the necessary documents. You must now monitor your plan to make sure it accomplishes your goals and revise it when changed circumstances mean it no longer does.

## §9:02 Review Your Plan at Regular Intervals

Estate plans need to be reviewed and updated periodically. What you may need in your 30s for an estate plan will certainly be different than what you will need in your 60s. Once you have established your estate plan, make sure it stays sound by revisiting it at regular intervals. Reviewing your estate plan at regular intervals, at least every three to five years, will help ensure that your documents express your current wishes and that your beneficiaries receive their benefits as smoothly as possible.

## §9:03 Review Your Plan After Major Life Events

In addition to regular reviews, you should review your plan and update it if necessary after life events such as the following:

- Your marriage or divorce.
- The birth or adoption of a new child or grandchild.
- The death or change in circumstances of the guardian named in your will for minor children.
- Changes in the number of your dependents, such as the addition of a dependent adult.
- A child or grandchild becomes an adult.
- A child or grandchild needs educational funding.
- A change in your or your spouse's financial or other goals.
- The death, illness, or disability of your spouse or another family member.
- A change in your life or long-term care insurance coverage.
- The purchase of a home or other large asset.
- Borrowing a large amount of money or taking on liability for any other reason.
- Large increases or decreases in the value of your assets.
- The receipt of a large inheritance, gift, or other windfalls by you or your spouse.
- The death or change in circumstance of your executor, trustee, or agents under a durable power of attorney or medical durable power of attorney.

- Career changes, such as a new job, promotion, or opening or closing of a business.
- A change of residency to a different state.
- Your diagnosis with a serious or terminal illness.
- Changes occur in federal or state laws covering taxes and investments.

## §9:04 The Danger of Failing to Review Your Plan

Although your estate planning attorney drafted your documents to account for foreseeable changes, there is no substitute for keeping your plan up to date. Failure to do so can lead to litigation among your heirs and unintended consequences. For example, when Michael Crichton, the writer of Jurassic Park, died, his wife was pregnant. Although ill with cancer, he did not update his estate plan to provide for their child. Moreover, his will contained a clause disinheriting any relative not named in the will. After his death, his widow went to court seeking a share of his estate for their child. Crichton's adult daughter from an earlier marriage objected, but his widow ultimately prevailed. If Crichton had revised his estate plan or if his original will had been written to provide for after born children, the litigation could have been avoided and his widow saved the stress of not knowing whether their child would be provided for.

## §9:05 The Risks of Do-It-Yourself Revisions

If it becomes necessary to revise your estate planning documents, the best choice is to work with your estate planning attorney. For the same reasons that you hired a qualified estate planning attorney to draft your initial estate plan, you should also hire a qualified estate planning attorney to revise or amend your estate plan.

There are rules about how estate planning documents can be revised. If your revisions are done improperly, your efforts to update your documents could prove disastrous to a carefully thought out estate plan.

Never write on the original documents. If you want to make notes for your attorney of revisions you would like to make, be sure to do it on a photocopy.

Do not attempt to make changes to your will, revocable living trust, or other estate planning documents by crossing out provisions you want to delete and writing in your changes. Similarly, never unstaple the original documents to make copies or to remove or add pages. Your handwritten changes are likely to be ineffective and they may even void the entire document. At the very least, they will raise questions about your intentions and the genuineness of the document that will probably end in litigation.

### §9:06 Beneficiary Designations on Life insurance and Retirement Accounts

Don't forget to review your beneficiary designations as part of your estate planning review. To change these, you will need to get the appropriate forms from the insurance company or financial institution. It's a good idea to run your proposed changes by your estate planning attorney to make sure they are consistent with the rest of your estate plan and do not cause adverse tax consequences for you or your beneficiaries.

## II. CHANGING YOUR WILL

### §9:07 Two Methods for Revising a Will

You can make changes to your will two ways: with a codicil or by making a new will that revokes the old one. A codicil is an instrument that changes or revokes a prior will or codicil. A codicil must be executed with the same formalities as a will. Usually, that means you must sign it before two witnesses who must also sign the codicil. Then it is attached to your will. See Ch. 3.

Never attempt to change your will by crossing out provisions you no longer want and handwriting in your changes. After you

make the handwritten changes, the will would need to be re-executed in front of witnesses, which rarely happens. You could end up with no will or a will that you never intended to make.

## §9:08 A New Will Is Usually Preferable

In light of word-processing software, a new will is usually just as easy to prepare as a codicil. Since a codicil requires the same formalities as a will, often it is easier to write a new will altogether that revokes and replaces your original will.

A new will is the best choice if you want to make significant changes. The difficulty with using a codicil is that the codicil and the will need to be consistent with each other. The more complex the codicil, the greater the risk you face of inconsistencies between the two documents. These can lead to conflict between your heirs, will contests, and a court interpretation of the documents that is contrary to your wishes. Therefore it is generally advisable to simply execute a new will that contains the full estate plan, rather than try to coordinate and keep track of multiple documents.

The new will should state that it revokes all previous wills and codicils.

## §9:09 Dangers of Revoking a Will by Destroying or Defacing It

You can revoke a will by destroying it or defacing it with the intent to revoke it. Thus, you can revoke a will by burning it; tearing it up; writing canceled, void, or revoked on it; or crossing through it. The obvious problem with these methods is that they leave you without a will. If you die, your probate assets will pass according to your state's intestacy laws.

Another problem is that these methods may raise questions about your intentions. When your family is unable to find your will, is it because you have destroyed it or because it's lost or been hidden by a disappointed heir? Should they attempt to probate a copy? If your will is defaced, did you do it, or is a malcontented

beneficiary the culprit? If some of your will is crossed out, did you intend to revoke just that part or the whole will? These questions can result in litigation among your beneficiaries and heirs. The outcome could be other than what you wanted and, regardless of the outcome, litigation expenses can eat into your estate.

The best policy is to revoke a will by replacing it with a new one. Once you have your new document in place, you can then destroy the old one. However, keeping a revoked will may be a good idea in certain circumstances.

## §9:10 When Should You Keep a Prior Will

An earlier will does not become worthless just because a new will has been executed that revokes it. If the latest will is revoked or successfully challenged, the next most recent will can become operative again. This can be a boon or disaster, depending on the contents of the will. If the previous will benefits substantially the same beneficiaries as the current will, then you should consider keeping the previous will as "will contest insurance." An heir that is left out of both wills would need to set aside both of them to accomplish anything. On the other hand, if you would prefer no will to your earlier will, you may wish to destroy the prior one to keep unscrupulous beneficiaries from concealing the new will.

## §9:11 When a Codicil May Be Preferable to a New Will

In some circumstances, a codicil may be preferable to a new will. For example:

- The testator is seriously ill, close to death, or in danger of losing testamentary capacity.
- The testator has physical ailments that make reading or signing difficult.
- The changes are minor.

## §9:12 "Deathbed" Changes

Occasionally, a testator may desire to make a "deathbed" change to the will. He or she may:

- Have an illness that affects mental capacity.
- Be taking medication that degrades alertness or ability to think clearly.
- Be in the early stages of dementia, so that any testamentary changes would need to be made before the testator loses the capacity to make them.

Diminished capacity may invite a will contest. If the original will is long, a minor change may be difficult to notice. This may invite an allegation that the testator was not aware of the change. By contrast, a short codicil highlights the change. Not only is this reassuring to the testator, but it enhances the proposition that the testator was aware of the change.

Shorter documents also make the execution ceremony less tedious for the physically stressed testator. Also, if the codicil is ultimately held invalid for lack of testamentary capacity, then executing a codicil may be more advantageous than executing an entirely new will. An invalid codicil leaves the will intact, but a standard revocation clause contained in an otherwise invalid will could revoke all previous wills, leaving the testator intestate.

## §9:13 Difficulty with Long Documents

If the testator is not seriously ill but has poor eyesight or some other physical problem, such as arthritis, that makes it difficult to handle and read a lengthy document, then a short codicil is convenient. Although a testator who is executing a codicil is expected to reread the original will, a testator's failure to do so does not invalidate the codicil. The attorney can always review the original will with him or her.

## §9:14 Only Small Changes Are Needed

With a codicil, you can make simple changes to a will while leaving all the other provisions the same. Executing a codicil is a less time-consuming way to change the appointment of a personal representative, or to add a clause that addresses a new tax law, for example.

## §9:15 Amending a Personal Property Memorandum

If you disposed of personal property with a personal property memorandum that you referenced in your will, you can make changes to the memorandum without having to redo the entire will. Simply redo the memorandum and sign and date it. It does not have to be witnessed like a will, but it must be referenced in your will. Then destroy the original memorandum to prevent any possibility of confusion. Not all states allow you to use a personal property memorandum so you'll need to check with your estate planning attorney to make sure your state does.

# III. CHANGING YOUR REVOCABLE LIVING TRUST

## §9:16 Three Methods for Revising a Revocable Living Trust

You can make changes to your revocable living trust at any time, so long as you are legally competent. Depending on the extent of the changes, three methods are available. You can:

- Execute an amendment.
- Restate your trust
- Revoke the trust and create a new trust.

## §9:17 Trust Amendment

If you wish to make a minor change to your trust, you can create an amendment to the trust. A trust amendment is a simple

document that contains the amended trust provisions. It should be executed with the same formalities as the original trust (usually signed before a notary). It then can be attached to your original trust document.

## §9:18 Trust Restatement

If you need to make substantial changes to your trust, you can create a trust restatement (also called a trust amendment and restatement). A trust restatement repeats the entire trust incorporating whatever changes you want to make. The document will state that it is a restatement of the original trust mentioning the trust's name and execution date. It also needs to be executed with the same formalities as your original trust. A trust restatement avoids your having to transfer all the property in the old trust into a new trust. Some people prefer a trust restatement to a simple amendment even for small changes because it completely replaces the original trust document. With a trust amendment, the original document is still in effect and beneficiaries may be able to see what it said contrary to the settlor's wishes.

## §9:19 Revoking an Existing Trust and Creating a New One

This option is the most work and is suitable for sweeping changes. You'll need to transfer all property currently in your trust back into your name. For real estate, you'll need to execute and record new deeds. For financial instruments, you'll need to contact the financial institution or your broker to get the appropriate forms. For personal property, you may need to execute a bill or sale or assignment. Essentially, you have to do the reverse of whatever you did to put the property in the trust in the first place. Then you'll need to execute a document stating that you are revoking the trust in the presence of a notary.

Once the trust is revoked, you then need to execute a new trust document before a notary and transfer your property into the new trust.

## §9:20 Moving Property in and out of Your Revocable Living Trust

The need often arises to add property to a revocable living trust or to remove property from it. You do not need to amend your trust to do so. Your trust is written to allow you to transfer property you own to the trust and, as the trustee, to sell or transfer property in the trust just as if the title were still held in your name. So long as you have your own, individual living trust, you may transfer property in and out of your trust as often as you wish. If you own a joint trust with another person, such as a spouse, you may need his or her written consent when moving the assets.

Do not neglect to transfer newly acquired property to your trust. One of the principal reasons people include a revocable living trust in their estate plans is to avoid probate. However, if you do not transfer your assets to the trust, probate will still be required. Moreover, if assets are left out of the trust, they cannot be distributed according to the provisions of the trust.

A trust document typically has attached to it a schedule listing the assets to be transferred to the trust. Many people mistakenly believe that the schedule transfers the property. That is not the case for any assets that have title documents. The schedule merely indicates which assets you intend to transfer. To fund the trust, you must still take steps to change the title of the assets to the name of the trust. For real property, this involves changing the property deed. Stocks and bank accounts must be re-titled by the financial institutions where they are held. The schedule may be sufficient in some states to transfer personal property, while others require a separate document. Transferring property to a revocable living trust is discussed in detail in Ch. 4.

# IV. CHANGING YOUR DURABLE POWER OF ATTORNEY (DPOA)

## §9:21 Revoking a Durable Power of Attorney (DPOA)

You can revoke your DPOA as long as you are mentally competent. If you never gave the DPOA to anyone, you can simply destroy it. However, if you have provided your agent and any other financial institutions with a copy of the document, you will need to prepare another document that revokes your DPOA. This document should be notarized or witnessed in the same manner as your original DPOA.

Then, you should send a copy of the revocation to any persons or institutions that have copies of your revoked DPOA or that may have relied on it and to any government offices where your revoked DPOA was filed. If the DPOA has been recorded in the deed records of a particular county, a revocation should also be filed in the same deed records. You should also send a notice of the revocation along with a copy of the revocation document to your agent.

A revocation is not effective as to third parties who do not have actual knowledge of it. If you want to preserve the ability to revoke the DPOA, you may want to take steps to limit its exposure, such as by retaining all copies until you become incapacitated.

## §9:22 Amending a DPOA

It is possible to amend a durable power of attorney. However, whether you want to appoint a new agent or change the powers you have given to your agent, in most cases, the better approach is to revoke the DPOA and execute an entirely new document. When you execute a new DPOA, it can include a statement that you have revoked the previous one. With the execution of a new document, there will be no question about the validity of your intentions.

### §9:23 If You Divorce

If your agent is your spouse, a divorce will typically revoke your DPOA. However, because the revocation may not take effect until the divorce is final, if you decide to divorce, the best course of action may be to immediately revoke the DPOA.

### §9:24 If You Move to Another State

Laws on durable powers of attorney vary for each state. Therefore, if you move, you should consult an attorney within your new state to ensure that your DPOA is effective and satisfies the requirements of your new state to make your document enforceable.

## V. CHANGING YOUR ADVANCE MEDICAL DIRECTIVES

### §9:25 When to Review Your Advance Medical Directives

You can revoke or change your medical durable power of attorney (MDPOA) and your living will at any time so long as you are mentally competent. Especially appropriate times to review these advance directives are before you enter the hospital for treatment, when you are diagnosed with a serious illness, and if your marital status changes.

### §9:26 Revoking an Advance Medical Directive

You can revoke an MDPOA or living will by:

- Destroying the original.
- Executing a written revocation.
- Executing a document that is materially different from the preceding one.
- Orally stating that you revoke it.

If you revoke your health care DPOA make sure your agent and health care providers know the document has been revoked and is no longer effective.

## §9:27 Combining Methods Is Best

The safest practice is to destroy the original and then execute a written revocation or new documents expressing your current desires. Then you should be sure to give the new documents to everyone to whom you gave the old ones, i.e., your current agent and alternate, your doctor, and hospital or care facility, and family members.

## §9:28 Divorce

If you name your spouse as your MDPOA agent and you divorce, the divorce will typically revoke your agent's authority. In this circumstance, if you named an alternate, he or she will become the agent. However, to avoid confusion and because the revocation may not take effect until the divorce is final, it may be best to execute a new MDPOA as soon as you and your spouse decide to divorce.

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# Afterword

Planning your estate can be a daunting prospect. Most people find it difficult to face their mortality. The financial and legal aspects of estate planning can be intimidating. The decisions that need to be made may seem overwhelming.

You may tell yourself you have time. You will get to it eventually, next month, next year, after you retire, or when you get a serious illness. Truthfully, the best time to make your estate plan is now. It's never too soon and you cannot predict when it could be too late.

If you work with a good estate planning attorney, you may be surprised at how smooth and rewarding the process can be. An experienced estate planning attorney will help you understand and implement the best strategies for achieving your goals. Once your plan is in place, you will have the satisfaction of knowing that you have done everything possible to reduce the burden of your passing on your loved ones.

I hope this book has provided you with the background you need to move forward with your planning. If you would like to meet with me in person to discuss your situation and possibly have me assist you with your estate plan, my contact information is:

[Attorney name and contact information]

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