

CHAPTER 2



CONCEPTS IN ESTATE PLANNING

Introduction

Before beginning the process of designing your estate plan, it is important to understand the various laws that impact estates and how these laws may apply in your circumstance. This chapter is intended to introduce you to some of these considerations.

Planning considerations for everyone

Of course, the final objective of any successful estate plan is to have property distributed to those people or organizations that you wish to benefit, at the time and in the fashion that you intend with the least possible tax cost. However, it is important to understand that simply signing a will (or other estate planning document) may not achieve this objective. The manner in which you own your property may result in a distribution of your estate that is inconsistent with the written provisions of your will or trust.

A will controls only the distribution of assets that are subject to probate (see Chapter 9). A variety of other methods will control the distribution of non-probate assets. In general, the other methods of distribution fall into one of two categories: operation of law and contract/agreement.

Because only assets subject to probate are distributed in accordance with the terms of a person's will, it is important to have an understanding of how the titling of assets will — or will not — be consistent with the terms of your estate plan. In my experience, it is quite common for an asset to be distributed in a manner that is different than the intent of the client, at least as such intent was expressed at the time the estate planning documents were signed.

OPERATION OF LAW

The term “operation of law” refers to a variety of distribution mechanisms that rely on the law (typically the laws of the state where the assets are located) to determine the rightful recipients of the assets following a death. While there are many forms, common examples include joint tenancy with right of survivorship, transfer-on-death accounts, and pay-on-death accounts. These assets will be distributed to those individuals designated as joint owners (referred to as “joint tenants”) or death payees immediately upon your death.

Assets held in your name along with another person (referred to as a “joint tenancy”) with right of survivorship commonly include bank accounts and accounts held at other financial institutions. United States Treasury instruments (such as savings bonds) may also be held in joint tenancy with right of survivorship, as can real estate. Such assets will not be subject to the terms of your will.

For example, if your will provides for an equal distribution of your estate to children but you name one child as a joint owner with right of survivorship on your bank accounts, your assets will not be distributed equally among your children. The joint tenancy bank account will be distributed to one child, and only the other assets that are subject to probate will be divided equally among all of your children. If the child receiving the joint assets with right of survivorship elects to share a portion of the joint account with others, this will constitute a gift and, if substantial enough in value, may result in adverse tax consequences to the child making the gift.

Joint ownership (with or without right of survivorship) may also be subject to the claims of the joint owner’s creditors. Thus, it is generally not recommended to name another person as a joint owner on any of your assets. There are several other estate planning strategies that are available for achieving the same benefits of joint ownership without the risks inherent in such an approach. These strategies are reviewed in detail throughout this handbook.

CONTRACT OR AGREEMENT

Your estate may also be distributed by contract. This merely refers to the fact that you and another person (or entity such as an insurance company) have agreed to distribute your assets in accordance with your instructions. The two most common types of distribution plans subject to a contract or agreement are assets that are subject to the terms of a trust and assets that will be distributed according to a beneficiary designation.

The term “trust” refers to a form of legal relationship between the creator of the trust (referred to as the “settlor” or “trustor”) and the person responsible for the management and distribution of the trust assets, (referred to as the “trustee”). The trustee must hold the assets of the trust for the benefit of the beneficiary who is the person or persons entitled to benefit from the assets held in the trust. There are many different forms of trusts and these are discussed in greater detail in Chapter 4.

The other common form of distribution under the terms of a contract or agreement is a beneficiary designation. Similar to a payable-on-death or transfer-on-death account described above, a beneficiary designation is an agreement between you and another party to distribute your assets in accordance with your instructions following your death. Common

CAUTION: IT IS CRITICALLY IMPORTANT TO RECOGNIZE THAT THE BENEFICIARY DESIGNATION ON AN ASSET WILL CONTROL OVER THE TERMS OF YOUR WILL OR OTHER ESTATE PLANNING DOCUMENTS. IF THE BENEFICIARY DESIGNATION IS INCONSISTENT WITH THE TERMS OF YOUR WILL OR LIVING TRUST, YOUR OBJECTIVES CANNOT BE ACHIEVED OR WILL, AT THE VERY LEAST, BE COMPROMISED.

examples include life insurance policy death benefits paid at your death and retirement plan benefits (including individual retirement accounts). Beneficiary designations may be revocable or irrevocable.

PROBATE

The term “probate” refers to the legal process of transferring your assets (referred to as the “estate”) at the time of your death to those who are entitled to receive your property. Each state has laws regarding probate. Only those assets that cannot be distributed in some other way are subject to probate. The particulars of the probate process are discussed in greater detail in Chapter 9.

If you do not have a valid will at the time of your death, state law controls the distribution of your estate. The process of distributing assets of a decedent who died without a will is called “intestate succession” and is discussed further in Chapter 3.

Planning considerations for married couples



In addition to the factors outlined above, there are several other issues that married couples must take into consideration in the planning process. Some of these questions include: Will the children benefit from the estate at the first death or only after both spouses have died? Are there estate taxes likely to be due at the surviving spouse’s death that can be minimized through proper planning now?

Are there problems surrounding the children and other beneficiaries from this marriage or from a prior marriage (the blended family)? Are both spouses equally able to manage the estate after the first spouse’s death, or should the estate plan consider the need for assistance with the management of assets if the

“less capable” spouse survives? All of these questions, and many others, should be addressed in the planning process.

PROPERTY OWNERSHIP CONSIDERATIONS

Property ownership is a key component in the estate planning process. Whether the assets of the estate are owned by husband, wife, or both—with or without others—must be determined and factored into the plan.

As a general rule, property rights are determined by state law. The state in which real property is located will control the rights respecting real property, while the law of the state of a person’s residence will control rights regarding personal property.

In the marital planning setting, states are either community property states or common law states. Oregon is a common law state and Washington is a community property state. Estate planning in the Northwest can be complicated because Oregon is surrounded by community property states. Washington, California, Idaho, Nevada, New Mexico, and Arizona (along with a few others) are community property states. Alaska has an elective community property regime.

In common law states, the title to the property in question will likely control its ownership. For example, property held in the names of both spouses will be deemed to be equally owned unless there is evidence to the contrary. Property held in the name of only one spouse will, likewise, be deemed to be owned by that spouse.

Conversely, the title to the asset is almost meaningless in a community property state. Instead, community property law considers the “source” of the asset to determine its ownership. For example, under most circumstances, assets acquired during the course of the marriage (including the income earned by each spouse) is community property and is, thus, owned equally by both spouses (the “marital community”) regardless of the title on the deed or account.

One common exception to this rule occurs when assets are acquired by gift or inheritance. In community property states, a gift or inheritance received by one spouse during the course of the marriage is the separate property of that spouse and will not become community property unless the owner spouse chooses to convert it to community property. However, some community property states (such as Idaho) nonetheless characterize the income and increase in value (appreciation) of a spouse’s separate property as community property.

Assets owned by a spouse prior to marriage is another exception. Such assets may be retained by the spouse as his or her separate property, or converted in whole or in part to community property.

In preparing a comprehensive estate plan the estate planning attorney must consider the source and ownership of the assets owned by the spouses. Whether the couple lives in a community property or common law state, it may be necessary to modify the ownership rights of the spouses to achieve their estate planning objectives.

Similar to the property ownership considerations outlined below, the estate planning attorney must also consider the proper beneficiary designations to be utilized in coordinating the estate plan for the married couple. Assets such as life insurance, annuities, qualified retirement plans, and individual retirement accounts will most likely be distributed in accordance with a pre-established beneficiary designation. An incorrect beneficiary designation will thwart the effectiveness of the estate plan and may result in substantially increased estate and income taxes.

THE BLENDED FAMILY

Second (or more) marriages have become very common in our society over the last fifty years. As a result, it is common that one or both spouses may have children from a prior marriage (step-children to one of the spouses) as well as children together. Special attention is necessary to plan for such situations.

Similarly, your children may also have step-children. It is common that these step-grandchildren are treated the same as grandchildren by blood or adoption. However, step-grandchildren have no legal rights in your estate; therefore, if you wish them to benefit along with your grandchildren, you must name or properly designate them in your will or trust.

Planning to protect children in blended families can be complicated, but many strategies are available that can protect each spouse's side of the family. Many forms of trusts (described further in Chapter 4) may be used to benefit the surviving spouse during his or her lifetime while providing for the ultimate distribution of assets to the children (and their descendants) of the first spouse to die. In some cases giving your surviving spouse the right to live in your home for his or her life (referred to as a "life estate") may be a viable and relatively simple approach. At the end of your spouse's life, the home will pass to your children (or other intended beneficiaries).

Note that making provisions for your descendants (i.e., the step-children of your spouse) is not a matter of whether the spouses trust one another to



distribute the accumulated estate to both sides of the family. Instead, this issue is based on individual circumstances and how those circumstances may evolve following your death. If, for example, your spouse has limited contact with your children at the present, it is not likely that the communication between them will increase (or even exist) after your death. Thus, you cannot reasonably expect your spouse to provide for your children in any significant manner at his or her death, especially if your spouse has his or her own children. Your estate plan must provide a sense of security to your spouse and children after your death, rather than being a source of conflict.

Estate taxation considerations

As discussed in greater detail in Chapter 5, the United States Internal Revenue Code (“IRC”), along with numerous states, imposes a tax on a decedent’s estate. Generally, the tax is imposed on all assets owned at death. In some cases however, assets that you do not own at your death will also be taxed as part of your estate. These assets include those that may be subject to your control or from which you receive a benefit.

Subject to certain important exceptions, transfers between spouses during life and at death are not subject to gift or estate taxes. The “marital deduction” allows the value of the taxable estate to be reduced by the amount of any assets distributed to a surviving spouse. Outright transfers, transfers to a qualifying trust for the surviving spouse, life estates, and certain annuities will qualify for the marital deduction.

CAUTION: THIS DISCUSSION AND THE DISCUSSION THAT FOLLOWS ASSUMES THAT THE SURVIVING SPOUSE IS A UNITED STATES CITIZEN. THE AVAILABILITY OF THE MARITAL DEDUCTION IS SIGNIFICANTLY REDUCED FOR NON-CITIZENS.

Another important provision of tax law is the applicable exclusion. The applicable exclusion amount may be used at death to partially or completely shield your estate from estate taxes, during lifetime to offset gift taxes otherwise payable, or a combination of the two. Currently (in 2008) the applicable exclusion for gift tax purposes is \$1 million, and for estate tax purposes is \$2 million. The 2001 Tax Act provides for an increase in the estate tax applicable exclusion amount to \$3.5 million in 2009, a repeal of all federal estate taxes (but not gift taxes) in 2010, and a return to \$1 million as the exclusion amount in 2011. (See Appendix 2 for additional information about the 2001 Tax Act and its provisions on other tax issues related to estate planning.)

CAUTION: IF THE APPLICABLE EXCLUSION IS NOT USED AT THE TIME OF THE FIRST SPOUSE’S DEATH, IT WILL BE WASTED AND CANNOT BE USED WHEN THE SURVIVING SPOUSE DIES AND DISTRIBUTES HIS OR HER ESTATE TO CHILDREN OR OTHER INTENDED BENEFICIARIES. THUS, IF YOU LEAVE YOUR ENTIRE ESTATE TO YOUR SPOUSE, THERE WILL BE NO ESTATE TAX TO PAY SINCE THE TRANSFER WILL QUALIFY FOR THE MARITAL DEDUCTION. HOWEVER, YOUR SPOUSE WILL ONLY HAVE HIS OR HER APPLICABLE EXCLUSION AMOUNT AVAILABLE TO OFFSET ESTATE TAXES AT THE TIME OF HIS/HER DEATH.

Estate tax rates begin at 16%. The maximum rate at which estate tax or gift tax is payable is 45% until 2011, when the highest rate returns to 55% .

The applicable exclusion amount is part of federal tax law. Many states also impose an estate (or inheritance) tax of one form or another. For example, in 2009 the applicable exclusion amount available in the Internal Revenue Code is \$3.5 million. However, Oregon will only have a \$1 million exclusion amount, and Washington will have a \$2 million exclusion.

Needless to say, proper tax planning can be a critical component to your estate plan. Seeking advice from a capable attorney with experience in implementing strategies for the purpose of minimizing or eliminating estate tax can have a dramatic impact on the amount of your estate that reaches your intended beneficiaries.

Special considerations for the unmarried cohabitant

The increase in the number of unmarried couples (both heterosexual and homosexual) in our society has given rise to some special and particularly complex issues in estate planning. In planning for such situations it is important to remember that no matter how “permanent” the relationship may seem to the couple, the law will rarely grant to the partners the same—or even similar—rights and responsibilities that would exist if the couple were legally married.

Neither Oregon nor Washington recognizes common law marriage. However, both of these states, among others, have passed laws that grant certain rights to domestic partners as though the partners were legally married. The partners must meet specific qualifications and register their domestic partnership with the appropriate state office for the benefits of the laws to apply to their partnership.

Some of the rights that are granted under these laws include hospital visitation, the authority to give consent for medical procedures and the authority to con-

trol the disposition of a deceased partner's bodily remains. Furthermore, the laws grant to the surviving partner certain rights to receive a portion of the deceased partner's estate. However, a properly registered domestic partnership should not be viewed as a substitute for proper estate planning. Furthermore, none of the rights granted under these laws will apply to the unregistered domestic partnership.

Furthermore, unmarried cohabitants are not considered married for estate and gift tax purposes. Thus, transfers between unmarried partners during lifetime or at death are subject to gift and estate tax without the benefit of the marital deduction. However, most of the estate tax planning strategies that are utilized to reduce estate taxes are available to the unmarried couple.

More profound and painful are the issues that surround health care and personal decision-making during incapacity. In the absence of a durable power of attorney for health care or a properly registered domestic partnership, an unmarried partner has no legal right to make health care decisions for his or her partner during incapacity. State law presumes that a person would want a family member (such as parents or siblings) to give instructions to physicians and healthcare providers, not the partner. The partner also has no right to be appointed as guardian or to make funeral and burial arrangements.

These concerns can be overcome by a carefully drafted durable power of attorney for health and personal care. This durable power of attorney should include such powers as the authority to consent to medical procedures, to gain access to medical records, to hire and discharge medical personnel, to place a partner in appropriate health care facilities (including convalescent care), and to have the right of first priority for visitation in such facilities. In addition, the durable power of attorney may provide for the authority to take possession of personal property; to make funeral arrangements, and to take custody of human remains, including consenting to an autopsy.

An estate plan (including wills, trusts and appropriate beneficiary designations) will minimize complications in the transfer of an estate to a partner and other beneficiaries. Proper planning should be completed well before incapacity in order to ensure that objectives are achieved and to minimize the likelihood of a will contest or other litigation in the estate.

Incapacity

The term "incapacity" refers to the inability to make informed decisions regarding one's health and personal care, to properly manage one's financial affairs, or both. While the term defies a clear and concise definition, most people know it when they see it. Actions that others may deem to be unusual or eccentric do not necessarily mean that a person is incapacitated. Until we become incapacitated, we continue to have the right to make decisions for ourselves. The right of self-determination is fundamental to living in our society.

However, planning for incapacity is a critical part of any thorough estate plan. The days of living a healthy and physically fulfilling life up to the moment of death are over. Today, each of us must plan for a period of disability or incapacity. Death by accident or as the result of a critical and short-term medical emergency is rare.

If you fail to properly plan for incapacity, it is likely that a guardianship will be required in order to address the management of your financial affairs and give informed consent for your personal and medical care. A conservatorship or guardianship of the estate is used for the former, and a guardianship or guardianship of the person for the latter. One or both may be necessary depending on the gravity of your incapacity.

In the chapters that follow, several relatively simple and inexpensive options to guardianship are discussed.

Types of fiduciaries

The term “fiduciary” means a person (or institution such as a bank) appointed to act for the benefit of another. Common fiduciaries include the executor of your estate (called the “personal representative” in Oregon and Washington) or trustee of a trust. An attorney-in-fact under a power of attorney and a guardian are other types of fiduciaries.

Personal Representative. Commonly referred to as the “executor,” this person is responsible for handling the administration of your estate after death. This administration is called “probate.” The personal representative may be named under the terms of your will, or if you die without a will or the person or persons named in your will as personal representative(s) cannot serve, the court will appoint an appropriate individual to serve.

The basic duties of the personal representative include taking possession of your assets (called “marshaling”), giving notice of the probate to your heirs and those who are entitled to receive your estate, determining your debts and giving notice of the probate to your creditors (referred to as “notice to creditors”), filing your final income tax return and estate tax return (if required), managing and investing your estate, and distributing your estate in accordance with your will or state law.

Attorney-in-fact. The attorney-in-fact, often called an agent, is the person you appoint under a durable power of attorney to handle your financial affairs. Some durable powers of attorney become effective at the time of execution while others only become effective at the time of incapacity. Some powers of attorney are effective for a defined amount of time or for a specific purpose; however most durable powers are effective from the time of incapacity through the time of death.

An attorney-in-fact can have very broad powers including the purchase and sale of real estate, power to invest your assets, pay your bills, sign tax returns, and make gifts of your assets.

You may also appoint an attorney-in-fact to make health care decisions for you if you are incapacitated. Similar to the person acting under a financial power of attorney, the person acting under a health care power of attorney can have very broad powers, including the ability to give direction regarding the removal and withholding of life-sustaining treatment if you are terminally ill or in an irreversible coma.

Trustee. The term “trustee” is used in many areas of the law. In estate planning, the term trustee refers to the person or entity (such as a bank) that is appointed to manage the assets of another under the terms of a trust. A trust may be established under a will (referred to as a testamentary trust) or during lifetime (known as a living trust). For a more thorough treatment of trusts, see Chapter 4.

As with other fiduciaries, a trustee owes the highest duty of loyalty under the law to those persons entitled to benefit from the trust (called the beneficiaries). Common duties of a trustee include the investment of the trust assets (such as real estate, stocks and bonds, personal property, and businesses), working with the trust’s advisors (such as the accountant, lawyer and investment advisor for the trust), filing necessary tax returns, advising beneficiaries on the proper management of the assets distributed from the trust to the beneficiary, and many more.

In addition, it is advisable to name one or more successor trustees. Thus, if your primary trustee is unable or unwilling to serve or dies prior to the time determined for terminating the trust, a successor is named to take over the management of the trust. A third party (often called a “trust protector”) or even the beneficiaries of the trust, may be given the authority to remove trustees for proper reasons and to appoint successor trustees.

Unlike a personal representative, whose term of service may only last several months to a few years, a trustee may be required to serve as such for many years, even decades. Therefore, one of the considerations in selecting a trustee is that person’s ability to serve during the entirety of the trust. For many long-term trusts, it may be appropriate to name a bank or other financial institution as trustee or successor trustee to ensure that the assets will be properly managed during the entire term of the trust.

Guardian. The law recognizes two forms of guardian: the guardian of the person and guardian of the estate. The guardian is appointed to serve as an advocate, advisor, and often caretaker for a person who lacks the ability to properly manage his or her personal care and financial affairs. The person needing the guardianship is called the “incompetent,” “ward” or “incapacitated person.” Most states have replaced antiquated terms such as “incompetent” and

now use the generic reference “incapacitated person” to identify any person in need of a guardianship.

The guardian of the person is responsible for the personal care of the incapacitated person. This may include ensuring the incapacitated person’s living arrangements are proper, seeing to his or her health and personal care, serving as a companion during trips away from home, and acting as an advocate for the incapacitated person’s medical care and legal needs.

The guardian of the estate (called the “conservator” in many states) is responsible for the financial affairs of the incapacitated person including handling investments, collecting income, payment of bills, and working with providers of services to the incapacitated person.

Guardianship proceedings are initiated in the court, generally in the county where the alleged incapacitated person resides. The judge will appoint a guardian ad litem to evaluate the case and report to the court regarding the propriety of the guardianship and the appointment of a guardian. Usually, a member of the incapacitated person’s family will be appointed as guardian, although at times the appointment of a professional guardian is required. The decision is solely in the discretion of the judge.

An inventory of the incapacitated person’s assets must be filed with the court. In addition, the guardian is generally required to file an annual accounting of the income and expenses incurred by the guardian on behalf of the incapacitated person. Guardianships are a matter of public record; thus, the personal and financial affairs of the incapacitated person are available for anyone to review.

Guardianships are also expensive. Due to the complications associated with the legal proceedings, attorneys’ fees can be substantial. In addition, accountants and other professionals may be required. The guardian ad litem is also paid from the guardianship. Finally, the guardian must be bonded. A guardianship bond is an insurance policy that protects the incapacitated person if the guardian makes a mistake resulting in a financial loss to the incapacitated person’s estate.

Selecting your fiduciaries

Selecting your fiduciaries can be one of the most complicated and difficult parts of the estate planning process. Many clients default to using children or other family members without considering the complexities of such choices.

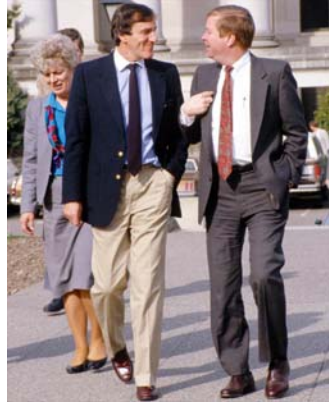
In selecting your fiduciaries, consider such factors as their background and education; personal temperament and concept of fairness; special abilities and training; and willingness to seek the advice of appropriate experts (such as an attorney, financial advisor and accountant). Individuals who, for example, lack the ability to make reason-based decisions in their own lives or ask for (and listen to) the advice and guidance of professional advisors are not likely to make good fiduciaries.

Each of us has certain talents, capabilities, and weaknesses. As a result, the parties that you appoint to manage assets and financial matters may be different from the parties to make health care and personal care decisions for you. Another factor to be considered is whether the proposed fiduciary will have the time and interest to take on the responsibility of serving in a fiduciary role for you.

You should also consider the use of a professional trustee such as a trust department at a bank or other financial institution.

This is especially true if, after considering the factors above and other issues relevant to your situation, you are unable to identify individuals to serve satisfactorily in one or more of the fiduciary roles that will be needed to carry out your estate plan.

The use of a professional fiduciary has many benefits including investment management, bill paying, training minors and adults with limited experience in the proper management of their financial affairs, and the preparation of necessary tax returns. In addition, the professional fiduciary has perpetual existence; it cannot die or become unable to handle your financial affairs.



Also, consider the duration of time that your fiduciaries will likely have to serve. The person you choose as your personal representative may only have to serve for a short period of time—several months to two years in most cases. However, incapacity may last for many years and your trustee or attorney-in-fact will be responsible for your financial and health care during this entire period.

Logistics matter as well. If you live in the Pacific Northwest, a fiduciary living on the East Coast may find it very difficult to handle your ongoing financial affairs and make your health care decisions from a distance, even with the broad spectrum of communication devices available today. This is less of a concern when it comes to handling your estate. Usually, a trustee or personal representative can administer your estate from a distance with little difficulty.

Careful consideration of the parties to serve in the various roles will be beneficial to you during incapacity and to your beneficiaries following your death. In short, the selection of your fiduciaries may be one of the most important aspects of planning your estate.