

CHAPTER 3



ESTATE PLANNING TOOLS

Introduction

Everyone's situation is different—their personal and family situations, financial resources, estate planning objectives, and the particular needs of their family. Therefore, every estate plan is different. There may be common elements such as a will, trust, durable power of attorney, etc., but each plan will be unique. It should be designed to achieve your objectives. Your estate planning attorney, in conjunction with the advice of other professionals, will assist you in making the important decisions regarding the proper legal documents necessary to complete your estate plan.

The purpose of this chapter is to review the basic legal documents and procedures necessary to complete an estate plan. More complicated estate planning strategies, including the use of trusts, estate and gift tax reduction techniques, planning for Medicaid and government assistance, and asset protection planning will be covered in other chapters. If your current estate plan does not cover the basics outlined in this chapter, it is likely that your plan is incomplete and will not achieve your objectives. Poor or incomplete planning, like no planning at all, will result in increased expenses in the administration of your estate and the possibility that your objectives will not be achieved.

What is a will, and why is it so important?

It is helpful to think of a will as a blueprint. It tells your family, the court, and taxing authorities how your estate is to be administered and distributed.

Your will has no effect until your death; it is purely a testamentary document. After death your will is submitted to the court for review and approval and to appoint the personal representative of your estate. This is the beginning of the probate of your estate. Probate is discussed in detail in Chapter 9.

THE PERSONAL REPRESENTATIVE

An important part of every will is the designation of the person you wish to administer your estate (referred to as the “executor” or “personal representative”). If your personal representative is willing and able to serve, and if the person otherwise qualifies under the law, the court will appoint the person you designate. If there is no person named in your will who is able or willing to serve, the court will appoint someone to serve as the personal representative for your estate. This may be another member of

your family, or other qualified person or institution (such as a bank). Persons convicted of certain crimes are not allowed to serve as personal representatives. The person you designate in your will as a personal representative need not be a resident of your state.

DYING WITHOUT A WILL

If you do not have a will at the time of your death (or if it is otherwise determined to be invalid or ineffective for whatever reason) you are said to have died “intestate.” This means that the court will appoint a personal representative for you from a list of potential appointees under state law.

In addition, your estate will be distributed to those individuals who are entitled under state law (called “intestate succession”). This means that certain individuals, and perhaps the state of your residence or wherever you owned property, will receive your estate even if you would have not chosen to benefit them had you written a will.

CREATING A VALID WILL

The requirements of a valid will are fairly simple. First, a will must be in writing. Oral wills are recognized only under very limited circumstances. Second, the will must be witnessed. At least two witnesses are required. The witnesses should be disinterested, meaning that they will not receive any benefit from the estate. Many states, including Oregon and Washington, have relaxed these requirements but the consequences can be severe, so the use of an interested witness should be avoided.

The will should be signed before a notary public or signed by the witnesses in the form of a declaration that is recognized under state law as having the same effect as testimony in court. This will allow the court to admit your will into probate at your death without further testimony as to the circumstances of your execution of the will. This will reduce the time and cost of having your will entered into probate.

DISTRIBUTIONS UNDER THE TERMS OF YOUR WILL

Your estate may be distributed in many ways under the terms of your will. Again, your objectives will dictate how your will is drafted so your estate is distributed to your intended beneficiaries.

Every complete will should include a residuary clause. This is the provision that distributes the residue (also called the “remainder”) of your estate to the people that you wish to benefit and in the manner that you wish them to benefit. If there is more than one person to benefit, the distribution of the residue can be made equally among them or by shares or percentages.

Many people also like to include specific gifts (called a “specific bequest”) in their will. This can be in the form of a specific asset (“I give my

mother's wedding ring to ...”) or a fixed dollar amount (“I give the sum of \$500 to ...”). If the particular asset given as a specific bequest (e.g., the wedding ring) is not in your estate at your death, it is said to “lapse” and the person designated will receive nothing from your estate unless you have made an alternative gift to him or her in your will.

Many states allow you to include a provision in your will that indicates your intent to create a list of personal possessions to be distributed to the persons designated on the list. This list may be modified at any time without the need to change your will. This can be an efficient approach to dealing with the distribution of your personal items. The list must be executed with the formality that is required under law; anything short of exact compliance with the law will render the list void. Furthermore, the list cannot be used for the transfer of real estate or intangible personal property such as cash or financial assets. At present Washington State law allows for the use of the tangible personal property list, while Oregon law does not.

As to a specific bequest or a fixed dollar amount, it is important to note that these will be paid before the gift of the residue of your estate. Thus, if you include several specific distribution of large dollar amounts, there may not be much left for the beneficiaries of the residue of your estate.

It is also important to remember that the costs of administering your estate (such as legal fees, funeral expenses, taxes and debts) will need to be paid before your estate is distributed. Thus, using several specific gifts may be complicated if the estate has limited cash to pay these expenses.

GIFTS “IN TRUST”

Usually, the time of death cannot be predicted with any accuracy. Thus, your will must be drafted with enough flexibility to take into consideration changes in circumstances over time. A will needs to be modified from time to time to take into consideration changes in life and in the law that cannot be anticipated.

For example, if your intended beneficiaries are minors or otherwise lack the maturity to handle their inheritance if you died sooner than expected, you do not want to draft your will assuming that you will live your natural life expectancy. Some beneficiaries may never be able to properly manage their inheritance. These beneficiaries include the disabled, especially those who are receiving benefits from a governmental agency due to disability; those facing a major financial crisis such as bankruptcy or other creditor-related problems; and those who, for whatever reason, never gained the skills necessary to properly manage money (often called “spendthrifts”).

In these cases and others, the use of a trust is appropriate. A trust is a set of instructions in a will directing that a person's inheritance is to be held in

a trust for the benefit of that person and not distributed outright. The will also appoints a trustee who will hold, manage, and distribute the assets (referred to as the “trust estate”) for the benefit of the named individual. Trusts are covered in detail in Chapter 4. A trust can be as unique and flexible as necessary to meet the needs of the beneficiary, and as a result, the trust provisions need to provide direction to the trustee as to when and how distributions should be made to the beneficiary. Trusts can last for a term of years, until the beneficiary reaches a specified age or accomplishes certain objectives, or even for the lifetime of the beneficiary and beyond.

Most importantly, it is essential to be realistic about the capability of the persons who will benefit from the estate. Giving an inheritance to a person who is not capable of managing money is not a gift, it is a burden. Most likely, the inheritance will be lost to poor decisions, the beneficiary’s creditors, or expenses that would have otherwise been paid by a government program that the beneficiary would have been eligible for had the inheritance not been received.

WHAT ASSETS DOES MY WILL CONTROL?

A common misunderstanding is what assets your will controls at death. Many people believe the will controls the distribution of all of their assets at death; however, this is not true. A will only controls the distribution of assets that have no other means of being distributed. Thus, for example, bank accounts owned with another person at your death “with right of survivorship” will pass to the surviving joint owner. Likewise, assets with beneficiary designations are not controlled by your will. These assets include annuities, life insurance policies, and retirement accounts.

The community property agreement

The community property agreement, which is a contract between a husband and wife, is available in many community property states. In general, the community property agreement has three prongs. First, it will state that all of the assets owned by the couple are their community property. Second, the community property agreement may include a clause that will convert property acquired after the execution of the community property agreement into community property. Finally, the community property agreement may include a clause that will distribute all community property to the surviving spouse when one spouse dies. The third clause is authorized under Washington law but not necessarily in other community property states.

Community property agreements are appealing to couples because they are simple and will allow the surviving spouse to avoid probate on the death of one of the spouses. However, there are several disadvantages to the community property agreement and you should not sign one without the advice of an estate planning attorney. Some of these disadvantages include:

- Increased estate taxes at the surviving spouse's death. Since the entire estate is transferred to the surviving spouse under the community property agreement at the first death, there is no opportunity to use the estate tax exclusion amount on the first spouse's death. See Chapter 6 for a discussion on estate tax planning for the married couple.
- No planning for the protection of assets and eligibility for Medicaid and other benefits if the surviving spouse requires long-term care. Certain trust provisions can be included in your will that will protect assets on the first spouse's death should the surviving spouse require long-term care and want to maximize the opportunity for eligibility for government benefits such as Medicaid. See Chapter 11 for a discussion regarding eligibility for Medicaid and other government benefits.
- For couples with children from prior to their marriage, the community property agreement may result in the disinheritance of the children of the first spouse to die.
- Conversion of gifts or inheritances into community property. Gift and inheritances received by one spouse during the marriage are generally separate property. A community property agreement with the second prong outlined above will convert these gifts and inheritances into community property. The objectives of the couple must be considered before signing a community property agreement that includes the second prong.

The durable power of attorney

An integral part of any complete estate plan is the durable power of attorney. Planning for incapacity is an important part of proper estate planning. During incapacity, someone needs the authority to manage your financial affairs, including such tasks as paying your bills, filing your tax returns, and managing or selling your assets. Traditionally, a court-appointed guardian has been used for this purpose; however, guardianships are expensive and time consuming.

The durable power of attorney is intended to give you the authority to appoint someone for this purpose before you become incapacitated. In your durable power of attorney you appoint an attorney-in-fact to manage your financial affairs and make decisions for you. Alternate attorneys-in-fact can be appointed, as well, should your primary appointee be unable or unwilling to serve.

Your attorney-in-fact has broad powers and a significant level of authority over you and your property. Carefully consider whom you name to exercise these powers. You do not want the appointment of your attorney-in-fact to be the source of friction in your family or a cause for litigation.

Your durable power of attorney can be revoked at any time during your life and is revoked at your death. Your attorney-in-fact has no authority to manage your assets after your death; this is the responsibility of your personal representative.

In addition, your durable power of attorney may be revoked by a court if a guardian is appointed for you.

Many states also include restrictions on the authority of the attorney-in-fact to engage in certain transactions. For example, the power to change your estate planning documents, transfer assets to a trust for your benefit, make gifts of your assets to others, and certain other powers must be specifically referenced in the durable power of attorney or the attorney-in-fact will not be able to exercise these powers. There may be significant adverse tax consequences to granting these powers to individuals who will also benefit from your estate. Your estate planning attorney can counsel you on the propriety of including these powers and who should be named in your durable power of attorney to exercise them.

Furthermore, the Internal Revenue Service may not recognize the validity of a gift made under a durable power of attorney unless the attorney-in-fact is granted the specific authority in the durable power of attorney to make gifts. The power to make gifts may be important to reduce estate taxes payable at your death.

Health care and personal decision-making

The ability to have health care and personal decisions made during incapacity is a very important part of any thorough estate plan, perhaps the most important part. Certainly, how we are treated during incapacity is at least as important as when we are fully competent.

All states have enacted some form of legislation to address this concern. Most states such as Washington, allow you to execute a health care power of attorney and a living will. Some states, such as Oregon, have combined these two instruments into a single document, known as an Advanced Directive. Regardless of the form, the purpose is the same.

As the name implies, a health care power of attorney authorizes another person or persons to make decisions for you in the event of your incapacity and inability to give consent for treatment. A health care power of attorney will most likely also cover such areas as access to medical records, consent to work with your insurance providers (including Medicare), determining a proper placement care facility, and enforcement of your objectives regarding the use of extraordinary measures to prolong your life (often referred to as “life support”).

A living will, referred to as a Health Care Directive in Washington, is your statement regarding the use of extraordinary measures to prolong your life if your health care provider has determined that you are not likely to survive without the use of such measures. Most living wills now cover medical conditions that are certified by your health care provider as terminal as well as an irreversible coma.

Asset ownership and beneficiary designations

The form of asset ownership is very important in achieving your estate planning objectives. Proper designation of your beneficiaries on such assets as life insurance policies and retirement accounts is also critical in achieving your objectives. The reason is that your will or living trust can only control the distribution of your assets if the ownership and beneficiary designations are designed properly.

Many very well-written wills have failed to operate as the testator intended due to poor decisions made during life regarding the ownership of assets. If assets are owned or titled in a manner that is inconsistent with the terms of the will, there may be an increase in estate taxes, inadvertent gift taxes, family conflict, and/or other problems. Poorly planned beneficiary designations can have the same results.

A common example of this is where a parent places a child on the parent's banking or investment account. This is often done to provide for access to the account in the event of the death or incapacity of the parent. Unfortunately, most of the time this creates a joint tenancy with right of survivorship and the parent may be overriding the terms of his or her will by doing so.

The steps of designing the ownership of your assets and proper beneficiary designations are part of any thorough estate plan and you should discuss this matter with your estate planning attorney. Ask that the ownership and beneficiary designations be put in writing for you as part of the planning process.

It may be necessary to re-title assets that you currently own at the time your estate plan is implemented. In addition, it will be very important to follow the instructions with regard to titling when new assets are acquired or new accounts are opened in the future.