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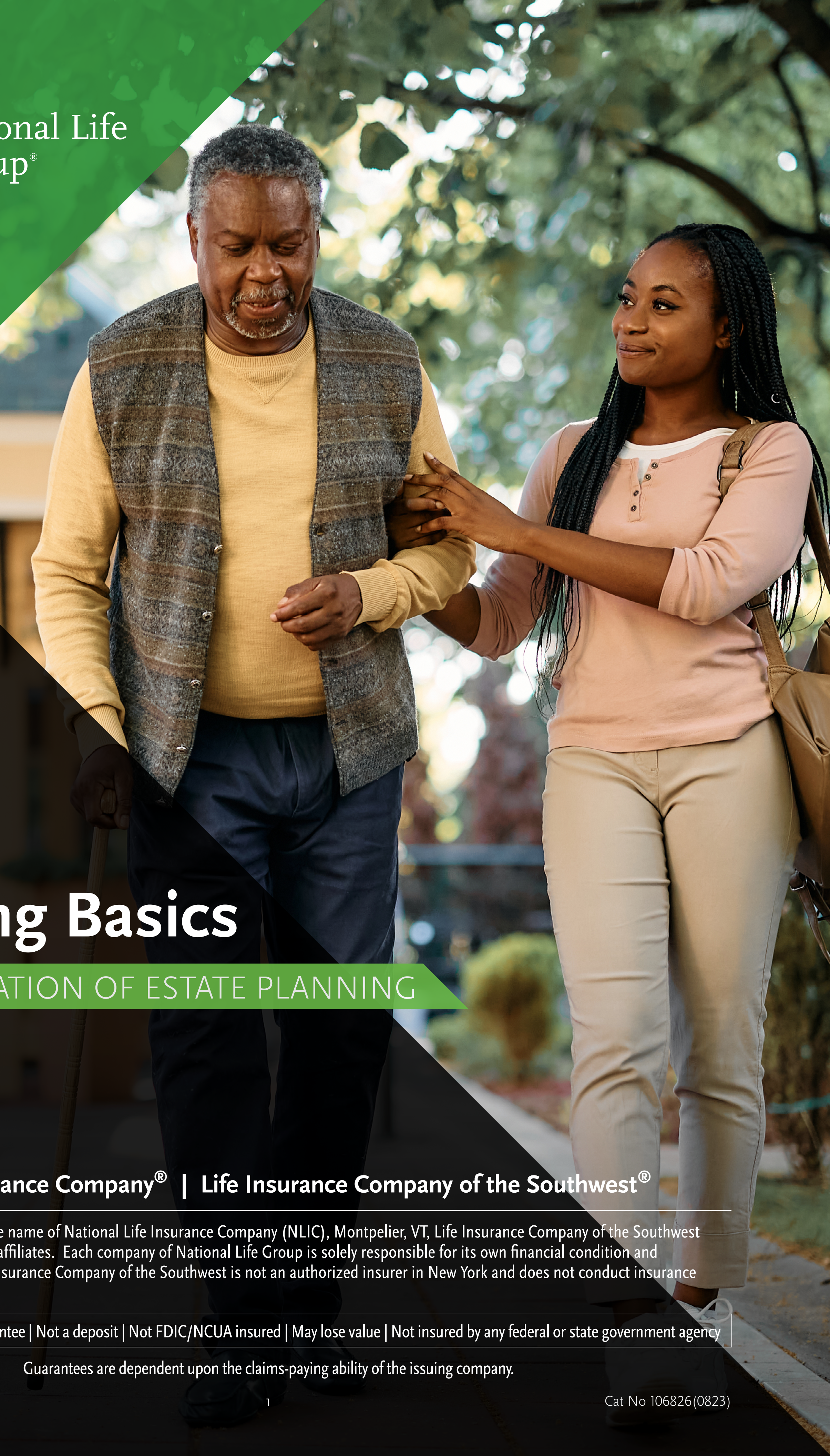

Estate Planning Basics

THE FOUNDATION OF ESTATE PLANNING

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Introduction

Estate Planning is the process of determining and documenting how individuals want their estate to be handled upon their incapacity or death. It is the process of getting the right assets to the right people at the right time and in the right way. To accomplish these wishes, there are five pillars of estate planning that everyone should fully and thoughtfully consider:

- Pillar 1 – Last Will and Testament
- Pillar 2 – Powers of Attorney
- Pillar 3 – Advance Directives
- Pillar 4 – Revocable Trusts
- Pillar 5 – Life Insurance

Through these pillars, you can ensure your assets are distributed according to your wishes, as well as providing financial/medical direction in the event of incapacity and minimizing estate settlement costs – with the ultimate goal of providing for your loved ones.

Pillar 1 – Last Will and Testament

A last will & testament is a legal document in which a person declares their final wishes regarding how they want their property administered and distributed after their death. A well-written last will and testament can accomplish numerous personal and financial objectives, such as:

- Appointing an executor to administer the estate
- Designating beneficiaries of assets
- Nominating guardians for minor children
- Making specific bequests of personal assets or charitable donations
- Creating one or more testamentary trusts to help meet important goals such as funding children's education or providing for elderly parents

The rules, restrictions, and requirements of a will are dictated and governed by State law. While the following information generally represents these requirements, State laws can vary. Therefore, it is important for you to consult with an estate planning attorney licensed in your residency State to assure your will is properly drafted and executed.

Generally, for a will to be valid, the person making the will must possess a sound mind and generally must be at least 18 years of age. In addition, certain formalities must be followed, such as the will must be: 1) in writing, 2) signed by the testator or by someone under the testator's direction in the testator's presence, and 3) signed by two competent, objective witnesses (individuals who are not named as beneficiaries of the will) in the testator's presence.

What is Probate?

When a testator dies, their estate must go through a judicial process called probate. This process validates and gives recognition to the will. The probate court officially appoints an executor of the estate, typically the individual named in the decedent's will. The executor then begins the estate administration process, which entails identifying assets, reconciling any debts, and paying any taxes owed. Once this process is complete, the executor distributes the remainder the decedent's property pursuant to the terms of the will.

The probate process may be costly and time-consuming depending on State rules and any disputes that may arise regarding the handling of the estate. Many States afford smaller, less complex estates simplified court proceedings, which are more efficient and less expensive. Each State has its own rules on what is considered a "small" estate, and the rules differ from State to State.

What Assets go through the Probate Process?

Estates are commonly comprised of both probate and non-probate assets. As the name suggests, probate assets are those that must go through the probate process. Probate assets are generally those that are individually and solely-owned by the decedent, such as cars, boats, bank accounts, real estate, business interests, digital assets, art, and personal/household items. Also, an individual's share in certain jointly-owned accounts (such as property owned as tenants in common), and their share of community property are considered probate assets. Each of these assets would become part of the decedent's probate estate and would transfer pursuant to the terms of their will.

Non-probate assets are those that pass automatically and directly to the intended individual(s) outside of the probate process. Therefore, these assets are not generally controlled by the terms of a decedent's will. There are many types of non-probate assets, examples of which are as follows:

- Pension and retirement accounts, including Individual Retirement Accounts
- Health Savings Accounts
- Jointly-owned assets titled as Joint Tenancy with Rights of Survivorship or Tenancy by the Entirety
- Accounts with financial institutions or brokerage firms designated Payable on Death (POD) or Transfer on Death (TOD)
- Life insurance and nonqualified annuity contracts with designated beneficiaries

It is imperative to name a beneficiary of non-probate assets. If there is no named beneficiary, typically the default beneficiary is the decedent's estate. If this occurs, these once non-probate assets become probate assets and must go through the probate process. This may cause surviving family members additional strain during an already difficult time due to the cost and time of probate. Also, all too often these beneficiary designations are not updated to reflect changing life circumstances, and assets end up passing to individuals other than those the decedent intended. Therefore, it is important to regularly review and maintain beneficiary designations.

What happens if I Die without a Will?

If an individual dies without a valid will, the decedent is referred to as an intestator, or a person dying intestate. Without a will, the State intestate succession laws dictate how and to whom assets are distributed upon death. The asset distribution rules under State law may not match the goals and needs of the decedent or the family. Therefore, a will is an important estate planning document in order to give the right assets to the right people at the right time and in the right way.

Pillar 2 – Powers of Attorney

A power of attorney ("POA") is a legal document in which an individual (the principal) authorizes someone (the agent) to handle the principal's affairs upon the principal's incapacity. POAs further the principal's estate planning objectives because a POA can generally avoid court proceedings to appoint a guardian or conservator over the principal's property, and the principal may grant the agent customized powers to fit the principal's specific needs.

For a power of attorney to be valid, the requirements under State law must be met. State laws generally require the following:

- The principal has the capacity and intent to sign the power of attorney.
- The document must be signed and dated by the principal.
- The signature must be either acknowledged before a notary public and/or witnessed by two disinterested individuals.
- The agent must be appropriate.

Generally, if an agent is an individual, the agent must be a legal adult and of sound mind. In addition, the agent might need to possess capacity to contract depending on the State and the scope of granted powers. The principal may determine the scope of authority granted to the agent, which can be broad or limited.

What are the Types of Powers of Attorney?

There are two types of POAs: a financial POA and a health care POA.

Financial POA

A financial POA is for financial affairs and gives the agent powers to handle the principal's finances including:

- Using assets to pay everyday expenses
- Collecting Social Security, Medicare, or other benefits
- Handling transactions with banks or other financial institutions
- Filing tax returns and paying taxes
- Transferring property to a trust
- Managing retirement accounts
- Accessing safety deposit boxes

Health Care POA

Under a power of attorney for health care, sometimes called a health care proxy, the principal authorizes an agent to make health care decisions if the principal is unable to do so. Based on the principal's direction, the agent determines what treatment the principal will receive or if treatment should be withheld. Since the agent is accepting the responsibility to act on the principal's behalf, the agent should be fully informed about what type of treatments the principal would or would not want and what to do under different circumstances. The agent will start making decisions based on State law requirements – generally when two doctors determine that the principal is unable to make health care decisions for themselves.

Pillar 3 – Advance Health Directives

Advance health directives are legal documents that allow an individual to convey decisions and instructions related to health care preferences ahead of time. They can be revoked or amended at any time. These documents communicate the individual's wishes to the family and health care professionals to avoid confusion if the individual becomes incapacitated. In addition to a power of attorney for health care, other types of advance directives include a Living Will and a Declaration for Mental Health Treatment.

Living Will

Also referred to as a health care declaration or a health care directive, a living will is a legal document that addresses the types of medical treatments and life sustaining measures the principal does and does not want. Health care providers are legally obligated to follow the directions contained in a living will. Some examples of directions include withholding or withdrawing life support, nutritional and hydration assistance, and other treatments during the end stages of life. Living wills usually do not go into effect unless the principal is in a permanent vegetative state or terminally ill and unable to communicate.

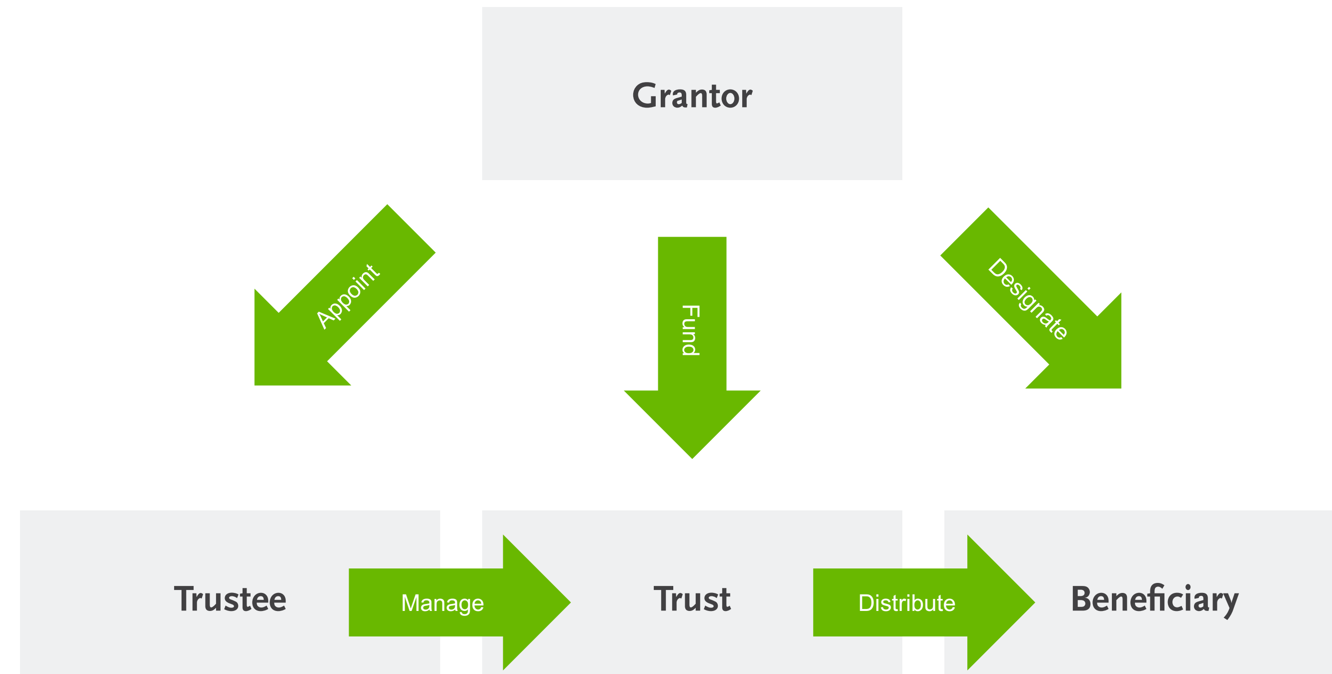
Declaration for Mental Health Treatment

Many States allow an individual to use advance directives to make decisions in advance about mental health treatment. Although the rules of declaration for mental health treatment differ by State, individuals generally can specify wishes including psychotropic medication, emergency mental health treatment, or admission to a mental health facility.

Pillar 4 – Revocable Trusts

A revocable trust is an instrument for wealth transfer. It is a written legal document that an individual establishes during their lifetime to set forth how their assets will be managed both during their lifetime and after death.

There are three players involved with all trusts (revocable or irrevocable): a grantor, a beneficiary, and a trustee. These roles may be depicted as follows:



The grantor of the trust is the individual who establishes the trust. A grantor is also referred to as a settlor, a trustor, or a donor. As the name suggests, the beneficiary is the individual(s) entitled to the benefits of the trust, including the trust assets or income generated by such assets.

The trustee of the trust is the individual appointed by the grantor to hold legal title to the trust property. As directed by the trust document, the trustee manages the trust property for the benefit of both the grantor and the beneficiaries. Generally, the grantor will typically serve as the trustee of the trust until such time that the grantor is unable to serve (i.e., the grantor becomes incapacitated) or chooses to no longer serve. During the grantor's lifetime, a revocable trust is amendable and revocable, which means the grantor retains control of the trust and can make any changes to or revoke the trust in its entirety at any time.

Upon the grantor's death, the trust becomes irrevocable, and the named successor trustee will take over and administer the trust based on the terms of the trust document. This includes distributing the assets to the beneficiaries in accordance with the trust provisions.

Because the trust document, rather than a will, directs how the assets will be distributed, the trust assets bypass probate. Thus, probate costs can be effectively reduced through the use of a revocable trust. A revocable trust is commonly paired with a type of last will and testament referred to as a "pour-over will." A pour-over will is designed to "pour" any assets remaining in a decedent's estate "over" into the revocable trust upon the decedent's death. Although any remaining assets can be transferred to the revocable trust upon death through a pour-over will, the assets do not avoid probate.

How is a Revocable Trust Funded?

After establishing a revocable trust, the grantor must properly fund the trust. This is critical because an asset generally does not bypass probate until it is transferred to the trust. The transfer can be completed by retitling assets from the grantor's name to the name of the trust. The change of title/ownership procedures vary by the property type. The trust can also be set up to receive assets such as life insurance proceeds and death benefits from the grantor's employee benefit plans. If the trust holds life insurance, the grantor has continued access to the policy's cash value while the grantor is alive.

Are Revocable Trusts Taxed?

From an income tax perspective, a revocable trust is not a separate taxpaying entity and therefore does not have to file an income tax return or pay taxes as an entity. Instead, the income is reported on the grantor's individual tax return even if the grantor does not actually receive income from the trust. What's more, because the grantor has the right to remove assets from or fully revoke the trust, transfers to the trust are not considered gifts and therefore not subject to gift tax. Finally, assets in a revocable trust are included in the grantor's estate for federal estate tax purposes. Thus, a revocable trust is not a strategy that addresses potential exposure to estate taxes.

What are the Advantages and Disadvantages of Revocable Trusts?

There are both advantages and disadvantages associated with revocable trusts. The table below highlights some of the key considerations.

Advantages	Disadvantages
Assets owned by the trust are non-probate assets and therefore avoid the costs and delay of probate.	The revocable trust requires administration during grantor's lifetime, including funding the trust.
The trust document is generally not a matter of public record and thus maintains the grantor's privacy after death.	Lack of creditor protection, as most States allow the grantor's creditors to reach the assets of the revocable trust during grantor's lifetime.
By consolidating assets in one place, a revocable trust simplifies estate administration and distribution, reducing estate settlement costs.	State law may provide that the revocable trust assets can be used to pay the grantor's final expenses and debt.
Provides a plan for incapacity, as it enables the grantor to include instructions for someone to manage personal assets or a business after a disability or if the grantor becomes incapacitated.	No income tax benefits, as the grantor must include in income any income generated by assets owned by the revocable trust.
Bypasses court-appointed conservatorship or guardianship in the event of incapacity.	No estate tax benefits, as the value of all trust assets will be counted in the taxable estate for federal estate tax purposes.

It is important to discuss all of these features and characteristics with an estate planning attorney to ensure moving forward with a revocable trust (as opposed to an irrevocable trust) satisfies your overall estate planning goals and objectives.

Fiduciary Selection

During the estate planning process, you will need to identify an executor of the last will and testament, an agent under the powers of attorney, and a trustee of the revocable trust. Each of these roles are fiduciaries, and therefore deciding whom to appoint is one of the most important decisions in an estate plan. Note these roles can be served by different persons or by a single person, giving you flexibility based on your unique situation.

To select the right fiduciary, the candidate should:

- Be reliable and trustworthy.
- Have the capacity to work on all needed tasks under authorization. An ideal candidate should be good at task management and financial issues.
- Be willing to deal with disputes in a reasonable manner. The fiduciary should have skills to bring interested parties to the table, keep them calm, and seek to preserve the relationship among beneficiaries – especially when they are close family members.
- Not be too senior. While age can bring people wisdom and experience, it is not ideal to have only the older generation such as one's parents serve as agents because the older generation is likely to have a shorter life expectancy than the principal.

Finally, it is preferable that the fiduciary's location is in close proximity to the principal. While the fiduciary can always leverage the expertise of others, this may be more challenging if certain decisions require some knowledge of State or local practices. Also, living close to the principal is more convenient if the fiduciary is requested to appear in person, e.g., for identity verification.

Pillar 5 – Life Insurance

Life insurance plays a critical role in fulfilling one's estate planning objectives. First and foremost, a life insurance policy helps in beneficiary care and expense coverage. Most families may not be able to maintain the same life quality after the death of a working parent. The death benefit payout can reduce the financial hardship after losing such a family member. The death benefit can also be used to cover expenses including funeral expenses, outstanding debts, and taxes of the decedent and the estate. In addition, life insurance can be used to leave a legacy, satisfy unique needs of small business owners, and address special situations.

For more information on the uses of life insurance in estate planning, please check out another brochure from National Life – Estate Planning and Life Insurance

Conclusion

Contrary to some people's belief that estate planning is only for the wealthy, the five pillars are essential for every household to specify to whom the assets should be distributed upon death, how and when the distributions will happen, who shall serve as guardians to care for minor children, etc. As mentioned at the beginning of this piece, an estate plan is about getting the right assets to the right people at the right time and in the right way. However, to achieve such goals, State law must be followed. State law provides specific rules governing the validity or limits of estate planning documentation; thus, it is critical that you consult with an estate planning attorney licensed in your State of residency.

Once the drafting and signing are done, you will walk away from the estate planning process with a stack of documents. In most cases, the original of an estate planning document should be left with a responsible person or in a safety deposit box to which the appointed fiduciary has access. Copies of the healthcare power of attorney and advance health directive should be provided to the individuals who will act under the documents, as well as to family members and health care providers. Copies of these documents and other important documents, such as life insurance policies, annuity contracts, trust documents, and retirement account numbers, should be kept in a central place so that the information is organized and easy to retrieve. Computer passwords and other digital assets should be kept in a secure place known to a trusted friend or family member who may need to access the information.

Last but definitely not least important, even if an individual has put into place all the necessary estate planning documents, the documents should be routinely reviewed to determine if the documents still meet the individual's needs. When life events happen including marriage, divorce, or having a child, it is also beneficial to review and amend the estate plan to reflect those changes as appropriate.

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