Basics of Estate Planning

THE CORNERSTONE OF ANY ESTATE PLAN ARE THE DOCUMENTS THAT SET FORTH YOUR WISHES FOR THE DISPOSITION AND OVERSIGHT OF YOUR ASSETS AT YOUR DEATH. IN ADDITION TO PROVIDING GUIDELINES FOR THE PRUDENT MANAGEMENT OF FINANCIAL MATTERS, A COMPREHENSIVE ESTATE PLAN CAN ADDRESS FUNDAMENTAL PERSONAL AND EMOTIONAL ISSUES— SUCH AS THE HEALTH AND EDUCATION OF CHILDREN OR HOW END OF LIFE DECISIONS SHOULD BE MADE. THESE DOCUMENTS, TAKEN TOGETHER, ARE THE PRINCIPAL LEGAL MECHANISM FOR CARRYING OUT YOUR FAMILY'S LEGACY.

Your Will

The will has traditionally been a legal document responsible for directing the disposition of assets — including cash and financial assets, real property, collectibles and other personal belongings — upon death. Often, your first will is executed primarily to codify the care and guardianship of minor children, while purely financial aspects of an estate are a secondary consideration. Later revisions to these documents will usually focus more on the trust structures and tax planning decisions as your estate grows.

Families implementing an estate plan for the first time are often curious about the effect of dying without a will, which the law refers to as "intestacy," or the absence of a will. Without a will to establish your intentions, the specific state law where you are domiciled at the time of your death will determine asset distribution. The local court (usually the probate court or the family court) will appoint an executor to gather the assets and determine the extent of any debts to be paid, as well as appoint a guardian for any minor children. Depending on the laws of the state, assets may be distributed under intestacy provisions in a manner that is contrary to your wishes — for example, if one of a married couple without children dies intestate, a common distribution is to pay half the assets to the decedent's parents (if surviving) and the rest to the spouse. Intestacy distributions aside, the lack of a will can make estate administration longer, potentially more expensive and cumbersome for heirs.

Most wills follow a basic pattern: naming an executor (perhaps the surviving spouse) who will manage the process of distributing assets and administering the estate. The will also contains provisions for the payment of debts (including the cost of estate administration), the disposition of personal effects and then directs the distribution of financial assets.

These "dispositive provisions" determine which person or entity will receive possession of the decedent's assets at the time of his or her death. "Specific bequests" tend to identify discrete amounts of cash, personal property or unusual assets (artwork) that pass to an individual or entity. "General" bequests are usually funded with cash or financial assets, are usually divided among family members or trusts and are often driven by tax formulas, while "residual" bequests may leave the balance of an estate to an individual (spouse) or an entity (a trust or series of trusts or to charity). Specific bequests are filled first, and will fail (or go unfulfilled) if the asset is no longer owned

by the decedent at the time of death. Any remaining assets are used to fulfill general bequests and then the residual bequest. Most wills contain some type of clause that provides for the distribution of assets in the event that the beneficiaries of the general or residual bequests have died without heirs (issue), usually called the “doomsday” or “failsafe” provision.

CREATING TESTAMENTARY TRUSTS: Your will, or your revocable living trust (discussed below) is likely to provide for the creation of a series of trusts, usually driven by federal or state level transfer tax planning. The scope of the myriad of choices surrounding the creation of these trusts is covered in another paper entitled *“Why Taxes Drive Estate Planning.”* These trusts are created at the time of your death and may include provisions that mirror trusts created in your lifetime (as part of a lifetime planning program), or may direct that assets pour into trusts created in your lifetime. Important provisions to include in the will (or revocable living trust) include distribution provisions (when and how beneficiaries of these trusts are entitled to receive assets), tax allocations (for federal and state taxes) and provisions pertaining to how the trusts can be managed. Often these testamentary trusts were limited in their overall duration, to a period of time, usually the lifetime of those alive at the creation of the trust plus twenty-one years (the so-called “rule against perpetuities”). However, many states have repealed the “rule against perpetuities,” allowing trusts created under their specific state laws to last for several hundred years, or even permitting trusts to have a perpetual existence, thereby increasing the importance of trustee selection and administrative provisions.

THE PROBATE PROCESS

The probate process is designed to administer an estate in accordance with the most recent valid will's terms. State law determines the exact procedure but, in general, the process begins when the executor submits the will to the local probate court, at which point the court appoints the executor as the proper administrator of the estate. Without court authorization, the executor would be unable to manage the decedent's assets, including bank accounts, or to pay expenses from the estate. The executor eventually supervises the creation of any trusts called for under the will, and distributes the decedent's assets as the will directs. The executor, before closing the estate, must account to the probate judge for all assets collected, spent and distributed to heirs during the processing of the estate. The probate court also has jurisdiction over disputes involving the will or administration of the estate. Anyone contesting will provisions or objecting to the handling of the estate can file a claim with the probate court.

The probate process can be long—potentially lasting months for relatively simple estates — and costly, given probate court fees and legal expenses. Additionally, probate proceedings are a matter of public record. Any interested party can view probate records, including a copy of the will and a list of the decedent's assets and liabilities. If there is public interest in the proceedings, these documents often find their way to the Internet. These perceived disadvantages of a public probate process have led many individuals in recent years to rely on revocable living trusts and other structures as an alternative form of estate administration.

Revocable Living Trusts

Revocable living trusts have become the central component of the estate plan for many individuals. These vehicles are designed with two goals in mind: preventing assets from undergoing the probate process and providing for ongoing management of assets should the testator become incapacitated prior to death. Technically, assets held in an individual's name at death are subject to the state court probate process while assets held in a trust are not. By placing assets in a revocable living trust, you can pass assets to heirs without subjecting the estate to the probate process. There is no tax benefit to a revocable trust, just the control over assets and avoidance of the probate process, which can be expensive and public (requiring formal accountings which can be a matter of public record).

Often a husband and wife will establish a revocable living trust together, with both acting as trustees. Alternatively, (and often preferably, depending on state laws), spouses will each establish a separate revocable living trust. Each spouse then transfers assets into the revocable trust, sometimes by attaching a schedule to the trust that indicates which assets will be contributed. It is important to re-title assets — such as bank and brokerage accounts, valuable possessions, and other assets, including homes (depending on local tax considerations) — into the name of the trust.   Temporary assets, such as cars, are usually not transferred into revocable trusts.

In the event of incapacity or upon death, the successor trustee manages and distributes the trust assets according to the trust provisions. The distributive provisions of the trust are similar to the language used in wills, and the overall structure of the estate, in terms of funding trusts and making general, specific or residual bequests, will be the same. But the revocable living trust streamlines administration of assets at your death, and ensures that the provisions of your estate remain private. By titling assets in the name of a revocable trust, the assets are outside the state probate administrative process, thus reducing expenses and the public attention that sometimes accompanies probate proceedings. Although the revocable living trust is a separate legal entity, for income tax purposes the trust is generally disregarded. Establishing a trust will not affect your tax liability nor will it change your tax filing requirements. The revocable living trust can be thought of merely as a holding vehicle for assets during your lifetime.

Even with a revocable living trust, you still need a will to designate guardians for minor children, among other things. When used with a revocable living trust, your will should contain "pour-over" language that ensures assets held in your name at death will be transferred to the revocable living trust. Once that transfer occurs, the terms of that trust will govern the distribution of assets. Assets can also pass directly pursuant to the will, or in the case of retirement or insurance assets, pursuant to the beneficiary designations. You need to have a will whether or not you choose to use a revocable living trust. Without a will to place assets into the revocable living trust, any assets held outside the trust at death would be subject to the laws of intestate succession.

PLANNING FOR INCAPACITY:

With a revocable living trust, if you are incapacitated, your successor trustee can seamlessly assume the management of your assets, eliminating the need to go to court to have a guardian appointed and bypassing some of the limitations with durable powers of attorney. Depending on the powers granted to a trustee, they can engage in estate or tax planning which may be appropriate if you are terminally incapacitated. Your trustee could be designated as a co-trustee in your lifetime, allowing for management of your assets although most individuals prefer to use a successor trustee only.

PROPERTY AND TITLE CONSIDERATIONS: A common question regarding revocable living trusts is whether they change the nature of the individuals' interests in the property. There may be concerns, for example, that an asset previously held as separate property before a marriage might become community property once placed in a revocable living trust. It is possible to maintain the separate character of property in revocable living trusts provided care is taken to track the nature of the assets and to identify them properly.

CONSIDERATIONS FOR NON-U.S. CITIZEN SPOUSES: Special care also needs to be taken when individuals with an international presence enter into revocable living trusts. Although living trusts are normally disregarded for U.S. tax purposes, in foreign countries they can be treated as separate taxpaying entities. Consequently a U.S. citizen who moves to a foreign country — or a citizen of a foreign country who is a resident in the U.S. — should consult a qualified advisor to review the structure and ensure there is no overall adverse effect from establishing or maintaining the trust.

Durable Powers of Attorney

Should you become incapacitated, a durable "financial powers of attorney" will designate an individual or multiple individuals as your attorney-in-fact who will assume responsibility for managing your financial affairs. If you become disabled, having valid durable financial powers of attorney in place may avoid the need for a court-appointed guardian. They will not be revoked upon a subsequent disability. One problem with durable powers of attorney is that they may not be accepted by your financial institution for all activities on an account, or they may be too limited in scope to handle possible pre-mortem planning if you become permanently incapacitated. We usually recommend Durable Powers of Attorney be executed in conjunction with a Revocable Living Trust for complex situations.

Health Care Proxies or Living Wills

A health care proxy or living will allows you to declare your preferences on life-sustaining procedures—such as artificially administered food and water—in the event you are diagnosed as terminally ill. A durable health care power of attorney may be appropriate if you would prefer to leave these decisions to a close family member or friend rather than make a blanket decision about uncertain future events. The document appoints someone to make health care decisions, including decisions about life-sustaining treatment, on your behalf should you be unable to make them yourself. The durable health care power of attorney may be used in a broader range of situations than the living will, which only comes into effect when a patient is diagnosed as terminally ill.

When executing a durable health care power of attorney, consider signing a privacy waiver that authorizes the representative to gain the same access to health information, as you would have. The privacy regulations under the Health Insurance Portability and Accountability Act (HIPAA) of 1996 (enacted in 2003) may make it difficult otherwise for an appointed representative to obtain information. Some practitioners draft a separate page addressing the HIPAA issues, while others may include this language into the power of attorney document.

Living Wills are sometimes incorporated into Health Care Proxies, or created as a separate document. The "living will" sets out your end of life treatment wishes, including do not resuscitate (DNR) orders or organ donation directions. It is important to review your desires with the family members you are selecting as your proxy to ensure that they are willing to follow your wishes. Usually only one family member is given the power to determine end of life care but your proxy can direct that they consult with other family members in making these determinations.

Choosing a Trustee or Executor

Choosing the individuals tasked with the responsibility of carrying out testamentary wishes is an important part of the estate planning process. While you may naturally lean toward selecting a trusted family member or friend to serve as **trustee or executor**, it is important to appoint people who are capable of navigating the legal system (in the case of the executor) and managing and distributing assets (in the case of the trustee). While you do not need a friend or relative's permission to name them as trustee or guardian, remember that they are also free to reject the job. Careful attention to successor designations, as well as removal provisions, especially for trustees, is an important part of the overall planning process.

CHOOSING A GUARDIAN: In choosing a **guardian** for children, it is important to select the individual carefully and to communicate your wishes for the children's development and welfare. This will provide peace of mind and

enable the guardian to step into the parenting role, if needed, with greater confidence. The guardian does not need to be named as a trustee and many families choose to separate the oversight of the children from the oversight of their money.

CHOOSING AN EXECUTOR: In selecting an **executor**, many people select a family member to serve as the executor and then direct the family member, in a side letter, to hire the decedent's attorney or the family member's own attorney, to provide support to the executor (note that in some states, naming the attorney as an executor allows the attorney to charge executor fees instead of legal fees, which can be a percentage of the estate's total value and may often be significantly more expensive than just hiring the attorney on an hourly basis to advise the family executor and provide the administrative legwork). The attorney can obtain the necessary court documentation and will work with your named executor on administrative matters and with your accountant to file the federal and state tax returns as well.

CHOOSING A TRUSTEE: In selecting a **trustee**, many estate plans will name a family member, or series of family members as trustees or co-trustees of the entities created under the estate documents. The documents may also appoint, or allow the appointment of a corporate or professional trustee (either as a sole trustee or as a co-trustee with family members), thus ensuring professional expertise to help manage issues that may arise. Private Trust Companies, for some families, are an ideal option to take the place of a "commercial" corporate trustee and offer additional control for family members.

Many believe that choosing a friend or a relative to act as co-executor alongside a professional trustee, or corporate trust company, can provide the best of both worlds: The family member or friend offers deep insight into personal matters, while the professional trustee will relieve the individual of many of the burdensome tasks of acting as executor or trustee and will provide technical expertise and objectivity.

Ideally your professional support team will be able to combine investment experience with knowledge of tax and administrative issues. Working with a professional advisor ensures that your trustees and executors have access to the knowledgeable experts who can determine which assets should be sold to pay bequests, taxes and satisfy any creditors in an efficient manner. Additionally, these professionals can introduce (and oversee) business valuation experts, reputable appraisers and auction houses to value illiquid assets such as limited partnership interests, shares of a family business and art collections.

CONSIDERING A TRUST PROTECTOR: Increasingly, many estate plans are incorporating the role of a trust protector, namely a person who is granted certain provisions or powers (such as the ability to remove and replace trustees, or to change terms of the trust for clarity of legal or administrative purposes). The trust protector is not held to the same fiduciary liability as a trustee but is able to assist the family members over generations in ensuring that the trustees are acting in the proper manner, or to enable the trust to be amended to adapt to changing legal environments or to seize opportunities for further tax or estate planning.

USING SIDE LETTERS: Many people will draft side letters to their executors or trustees. These non-legally binding documents allow the decedent or testator to put into his or her own words their concerns for the management of trust assets as well as for caring for the beneficiaries over time. Sometimes family members will draft letters directly to the beneficiaries as well which can explain the goals for the use of money, recommendations on management or stewardship of family assets or explain the choices on dispositive provisions. Again, these letters are not legally binding but can provide peace of mind to the person executing the will or revocable living trust, clarity to a trustee who is called upon to make decisions in years hence or to the ultimate beneficiary who is wondering how assets should be used or preserved for future generations.

Updating and Revising Documents

Ideally your estate plan should be reviewed every five to ten years, sooner if there is a change in financial or personal circumstances. When dealing with young children, the trust provisions and dispositive outlines of an estate plan will be very different than if assets are left for adults or for successive generations. Likewise, changes in federal or state trust laws or tax exemptions can affect the overall estate structure. As this is an active area for state (and federal) activity, it is important to have advisors who can keep abreast of these developments for you and to check in with them periodically to review any possible changes that may require amendment to your will or revocable living trust.

CONCLUSION

Creating and updating an estate plan can be a complex process, but it can ensure that your family will be provided for after your death and is a core element of a long-term wealth management strategy. The basic estate planning documents described in this paper are usually the first phase of the estate plan, focusing on issues that arise at death. The second (and often more complex) part of estate planning usually focuses on lifetime wealth transfers to reduce future gift or transfer taxes and set up the trusts or other entities that will shape the overall family legacy. All aspects of estate planning, however, involve significant legal considerations and many tradeoffs in terms of control or tax savings. It is imperative to work with a qualified estate planning attorney or advisor to obtain expert advice in crafting your long-term strategy. Like any long-term financial planning structure, the estate plan will require a degree of maintenance over time. Changes in tax laws or in personal situations are a standard impetus to review the original plan and ensure that it accords with your family's ongoing goals.

WORKING WITH US: Wealthaven's independent views and deep expertise across business, investments, estate and tax planning can be an invaluable resource for settling estates with significant and/or complex assets. By supplying technical knowledge and an objective voice, we can support your executor and trustees to help ensure that tasks are handled properly and help avoid the costly legal disputes that can occur when large sums are involved.

Wealthaven can serve as a co- or sole executor but usually acts in a consultant capacity to the family member or friend chosen as an executor. This allows for continuity if there is a need to replace existing lawyers and accountants due to conflict issues or if other problems arise. Further, as part of our pre-mortem planning, Wealthaven works in partnership with your trusted advisors, proactively reviewing investment, insurance or estate planning issues, thus increasing the likelihood that assets will be preserved for future generations.

Wealthaven principals can be named to act as a trustee (sole or co-trustee) with your family members or can serve as a trust protector. We also work closely with families in the creation and operation of private trust companies as well as creating infrastructure to support the use of directed or administrative trust structures in conjunction with corporate (commercial) trustees, such as a bank or brokerage firm.

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