



HANDLER, THAYER & DUGGAN, LLC
ATTORNEYS AND COUNSELORS AT LAW

LEGAL & TAX

TRENDS

DATE: Summer 2005
TO: Clients and Friends of the Firm
FROM: The Advanced Planning & Family Office Practice Group
RE: Estate Planning Basics/Core Estate Plans

Skip the Fries and Order the Broccoli: Choosing to Implement a Core Estate Plan is Good for One's Financial and Mental Health

We all lead busy lives, with our minds and schedules packed with tasks and responsibilities. These tasks and responsibilities often come in varying degrees of complexity and enjoyment, with each competing for our attention at all times. It is no wonder that the issue of Estate Planning, loaded with heart-wrenching decisions about incapacity, death and in some cases, taxes, never gets much of a fighting chance. Estate Planning can be complex, especially given the changing nature of the laws in this area. As for enjoyment, Estate Planning

simply does not have the same appeal as, say, planning next year's family vacation. Rather, the topic of Estate Planning for some individuals can be compared to the likes of ordering a meal off of a menu that you know will give you indigestion *and* not taste very good in the process. Chances are, that entrée is not going to remain on the menu for very long. Estate Planning, however, is analogous to the countless number of foods that we *know* are good for us, yet such goodness is often outweighed by the food's unappealing qualities (think broccoli; no offense to those readers who are broccoli lovers). Yet while there is plenty of information available these days on the nutritional value of various foods, many of us are uninformed about the value and necessity of implementing a core estate

plan. Most of us simply cannot make it past the horrible thought of leaving our friends and loved ones behind. As a result, Estate Planning is often eliminated from our mental menu.

Many believe that eliminating the topic of Estate Planning from our mental menu will spare us from the "indigestion" that may arise as a result of contemplating our own incapacity and/or death. Everyone has undoubtedly heard the phrase "Ignorance is Bliss," and many people apply this mindset to the topic of Estate Planning, opting to continue on in their daily lives without giving it further thought. If we only knew, however, that the decision to make *no* decision about Estate Planning is often the worst decision of all. Such a decision inevitably leaves family members,

friends and, as we recently witnessed in the *Terri Schiavo case*, the courts, with the burden of making difficult decisions on our behalf. As a result of our own inaction, the task of sorting out our financial affairs (which, for some, are not as tidy as we would like them to be to begin with) now becomes the responsibility of our family members and friends, who often are left to put together the pieces with little or no guidance. Finally, such idleness may lead to having your assets transferred according to your state of domicile's laws on intestacy (i.e., state statutes which provide and prescribe the transfer of estates of persons who die without disposing of their estates by Last Will and Testament), which may be contrary to your own personal intentions. As a result, the consequences of having no estate plan in place will most likely cause more stomachs to rumble and heads to ache than if one had initially given these matters their proper attention. Therefore, while the initial stages of Estate Planning may generate some feelings of uneasiness, the end result is often a feeling that greatly outweighs such initial unrest: *peace of mind*.

As stated above, the decision to implement a core estate plan will require you to make several difficult decisions.

However, during the process of making these decisions, individuals can take comfort in knowing that they are taking responsibility for their own financial and health related affairs at a time when they are competent and fully able to understand the nature and importance of such decisions. Additionally, preparing an estate plan can also insure that your assets will pass to the family members, friends or charitable organizations of your choice, in the manner that you desire, with the least amount of expense and taxes incurred in the process.

If you have made it this far in this Legal & Tax Trends Letter, you probably are willing to consider adding Estate Planning back to your mental menu. Therefore, the remainder of this Legal & Tax Trends Letter contains a menu of documents that comprise a core estate plan. However, since *all* of the documents described below are equally important to achieving one's financial and estate planning objectives, we advise implementing one of each, rather than picking and choosing from the menu. These documents include the following: Last Will and Testament, Revocable Living Trust, Living Will Declaration, Power of Attorney for Health Care, Power of Attorney for Property, Limited Power of Attorney for Business

Matters, Estate Plan Adjunct Letter, Child Care Guides, Child Care Authorizations, and Emergency Medical Authorizations (if you have or care for minor children). The importance of each of these documents is described below. However, prior to digging into the nuances of each document, a brief discussion on the manners of passing property to another person or organization is warranted. As a result, it is the first item on the menu.

The Appetizer: Manners of Passing Property to Desired Individuals or Organizations

When it boils down to it, all of one's assets (e.g., stocks, real estate, retirement plans, life insurance, bank accounts, personal property, etc.) can be classified under one of two designations: 1) a probate asset, or 2) a nonprobate asset. A probate asset is an asset that is solely titled in that particular individual's own name. An example is a bank account (i.e., checking account) titled in one's own name (e.g., John Smith). Upon John Smith's death, this individually titled asset would pass pursuant to the terms of a validly executed Last Will and Testament ("Will"), if John created one during his lifetime.

A Will is a legal instrument that takes effect upon the death of the Testator (i.e., the

person who is creating the Will) and disposes of the Testator's real and personal property pursuant to the terms contained within the Will. Thus, if an individual has created a Will during life, then any real or personal property owned by such person in his or her name individually at the time of death will pass pursuant to the terms of the Will (e.g., in John Smith's case, his Will might say "Upon my death, I give the balance of my checking account to my spouse, Mary Smith"). If there is no Will, then any individually titled assets will pass pursuant to the laws of intestacy in the state where the individual legally resided prior to death. Additionally, any real estate owned by an individual and located in a state *other than* the state of the individual's legal residence at the time of death is governed by the laws of the state where the property is located. In some cases, a state's intestacy laws may give priority to certain individuals to receive a fixed percentage of assets of a decedent, when in fact the decedent may *never* have intended such assets (or such percentage of the assets) to be distributed to such individuals. Additionally, and most importantly, regardless of whether the individual died with or without a validly executed Will, all individually titled assets will likely be required

to pass pursuant to a legal proceeding known as Probate (unless, under limited circumstances, an exception is satisfied under state law).

In the alternative, if an asset is not held individually, and therefore is not a probate asset, the beneficiary is determined by some manner other than a Will or the laws of intestacy. The beneficiary of a nonprobate asset is determined by either operation of law or by contract. For example, an asset owned with another person that is titled jointly with rights of survivorship (e.g., a primary residence) will pass *automatically* to the surviving joint tenant by operation of law upon the death of the first joint tenant. Therefore, this jointly titled asset will *not* pass pursuant to the terms of a validly executed Will, if any, and will *not* pass pursuant to the laws of intestacy if there was no Will. With or without a Will, the property automatically passes to the surviving tenant, since the manner in which the property was titled determines its beneficiary.

In addition to legal title determining the beneficiary of an asset, other types of nonprobate assets include assets where the beneficiary is determined by contract. This contract is typically entered into between the asset owner and the company

issuing or managing the asset, and involves the owner designating a primary and contingent beneficiary of the asset upon the owner's death. Two of the most common forms of nonprobate assets are life insurance policies and retirement plans. For example, the beneficiary of the death benefit under a life insurance policy will be the individuals or organizations specified by the owner within the policy as the primary beneficiary. In the event that there is no living primary beneficiary, the contingent beneficiary, if living, will then receive the death benefit. This will also hold true under a retirement plan, whereby upon the death of the owner of the retirement plan, the designated primary beneficiary named under the retirement plan agreement will receive the benefits under the retirement plan. Again, to the extent that these types of assets name primary and contingent beneficiaries, these assets will *not* be distributed pursuant to the terms of a Will, if there is one in existence, or pursuant to the laws of intestacy of the decedent's state of legal residence prior to death.

As you can see, there are different ways to transfer title to your assets upon death, each producing a different result. The result of the transfer, however, may not always utilize the most efficient means to achieve the

objective of passing your assets to the desired beneficiaries while incurring the least amount of administrative expenses and taxes. This issue is further addressed below within the discussion on Wills and Revocable Living Trusts.

The Main Course of the Core Estate Plan: Wills and Revocable Living Trusts

The cornerstone of every estate plan is the implementation of a valid Will. There are several reasons why a Will is of vital importance in the estate planning process.

First, the execution of a Will entitles you to appoint an Executor of your probate estate. An Executor settles all of your outstanding debts, files tax returns and ensures the payment of taxes, if any, and then distributes whatever assets are left from your estate after such payments to those individuals or organizations named within your Will.

Second, a Will also enables you to appoint a guardian for any minor children or other dependents. This guardian will then be responsible for the care of the child, as well as handling the child's financial affairs. If you and your spouse should both die prior to a child attaining the age of majority and you have not taken the proper steps to

have a guardian appointed, then a court will appoint a guardian for the minor child or children without being able to look to your Will as guidance and direction for such appointment. Without any such guidance, the court will make the determination on its own. Additionally, this process may also involve members of both sides of your families making arguments before the court as to why they are more qualified than the others to serve as guardian for your minor children. To avoid such potential problems, you would want to be sure that you have appointed guardians for any minor children within a Will. A court generally will defer to the individuals that you have nominated within your Will.

Third, as stated above, if you should die without a Will, the law of intestacy of the state of your legal residence prior to death controls the disposition of your probate assets. Rather than having the state decide to whom and in what amounts your assets shall be distributed, a Will allows each individual to personally decide who shall receive his or her probate assets, in what amount, and in what manner the individual shall receive the assets (i.e., outright gift or to be further held in trust).

Most Wills either leave everything to a surviving

spouse (known as a "Simple Will") or contain provisions so that various trusts are created upon the Testator's death (known as "Complex Wills" with "Testamentary Trusts"). Simple Wills or Wills containing Testamentary Trusts, however, do *not* allow one to avoid a probate proceeding at death. Rather, as stated above, these types of Wills merely allow an individual to choose the individuals or organizations who shall receive their individually titled assets upon death, as well as the amounts and manner of disposition. A probate proceeding, however, is often the most disfavored manner of transferring title to one's assets upon death, since it is a public process that involves a considerable amount of time and expense before the desired beneficiaries can legally take possession to the transferred assets.

The majority of Wills that we implement are known as "Pour-Over Wills." The key distinction between a Pour-Over Will and a Simple Will, however, relates to the Will's dispositive provisions. A Simple Will names an individual or several individuals to receive the Testator's probate assets. In comparison, a Pour-Over Will nominates the Testator's existing *Revocable Living Trust* as the recipient of his or her probate assets.

Therefore, to the extent that the Testator passes away with any probate assets, the Pour-Over Will transfers these assets to the then existing Revocable Living Trust upon the Testator's death. Since a "Pour-Over" Will is created in conjunction with a Revocable Living Trust, the goal is to *avoid* a probate proceeding altogether by having the Revocable Living Trust hold title to any individually titled assets that one may own. This way, by converting these individual (i.e., probate) assets into Trust assets, there will be no probate estate to open upon an individual's death. However, to the extent that one either decided not to transfer, or neglected to transfer, an individual asset into one's Revocable Living Trust during one's lifetime and a probate estate is required to be opened, this asset will ultimately be transferred into the Revocable Living Trust upon one's death via the probate process. Therefore, the "Pour-Over" Will essentially functions as a safety net. Just like any safety net, the goal is to only use the net in event of emergencies.

A Revocable Living Trust, due to its ability to avoid probate, can be a very powerful tool in both financial and estate planning. A trust is an agreement whereby one person, the trustee, holds legal title to an

asset and manages it for the benefit of a stated beneficiary. The person who conveys the property to the trustee is called the settlor or grantor. In a Revocable Living Trust, the settlor, trustee and beneficiary may be the same individual. Changing legal title of an asset from the settlor's name individually to the settlor as trustee of his or her Revocable Living Trust (this process is known as "funding") can reduce or eliminate the costs and public exposure associated with a probate proceeding. The dispositive terms of the Revocable Living Trust will then determine who receives the Trust assets, as well as the amount and manner of disposition. Additionally, since a Living Trust is completely revocable, it allows the settlor to maintain maximum control over the assets in the Trust during his or her lifetime, and the terms of the Trust can be revoked or amended at any time prior to the settlor's incapacity or death.

In addition, funding a Revocable Living Trust during a settlor's lifetime has other advantages beyond avoiding a probate proceeding. A Revocable Living Trust can be particularly advantageous in the event that the settlor becomes incapacitated. In the event of such incapacity, the named successor trustee

of the Revocable Living Trust can seamlessly step in and manage the Trust assets for the settlor's benefit while the settlor is unable to do so, thereby potentially avoiding the court appointment of a guardian of the settlor's estate.

Finally, to the extent that an individual's estate is faced with the possibility of incurring an estate tax upon death, a Revocable Living Trust funded during an individual's lifetime can insure the use of an individual's estate tax applicable exclusion amount (i.e., the amount that can be transferred upon death without incurring any estate tax liability). This is particularly important for married individuals. Therefore, a Revocable Living Trust created for married individuals should utilize the appropriate language and formulas so that each spouse has the opportunity to fully and effectively utilize their own estate tax applicable exclusion amount in conjunction with the marital deduction upon the first spouse's death, thereby minimizing the estate tax liability, if any, upon the death of the surviving spouse. This same planning can occur within a Complex Will with Testamentary Trusts. However, incorporating such planning within Complex Wills requires a probate

proceeding to be initiated in order to allow various assets equal to the decedent's estate tax exclusion amount to pass into a "Credit Shelter" or "Bypass" Trust created at death. The use of a Revocable Living Trust, on the other hand, permits a successor trustee to efficiently transfer trust assets into a "Credit Shelter" or "Bypass" Trust without a probate proceeding, since the assets were titled in the name of the Revocable Living Trust prior to the trust settlor's death.

While the fees for creating and implementing a Revocable Living Trust are higher than those associated with implementing a simple Will, these fees must be considered in light of the fees that will be incurred if a probate estate is opened in one or more jurisdictions. It is often the case that the costs for implementing and funding a Revocable Living Trust are considerably less than the fees that would be incurred in a probate proceeding. Additionally, the publicity and time restraints involved in a probate proceeding can be avoided, with a trustee keeping the terms of the Trust document private and having the ability to make distributions from the Trust to its designated beneficiaries without court approval or intervention. For these benefits alone, clients are generally willing to pay

more for implementing a Revocable Living Trust as opposed to a Simple Will. As a general note, it becomes more critical to implement a Trust for individuals who are older, or with high levels of net income or net worth.

Essential Fixins: Durable Powers of Attorney and Living Wills

No Core Estate Plan is complete without having Durable Powers of Attorney and Living Wills accompany a Will or Revocable Living Trust. Durable Powers of Attorney are legal documents that an individual (known as the "Principal") creates during his or her lifetime, giving another individual (known as the "Agent" or "Attorney-in-Fact") the authority to make certain decisions *on behalf of* the Principal in the event the Principal becomes incapacitated and unable to make such decisions on his or her own. Therefore, Durable Powers of Attorney are critical to achieving a well-balanced estate plan. Depending on the situation, we recommend implementing a minimum of two Durable Powers of Attorney, one for Health Care and the other for Property. Additionally, a Limited Power of Attorney for Business Matters may be necessitated, depending on whether an individual owns an interest in a closely-held business entity.

A Durable Power of Attorney for Health Care allows a Principal to appoint an Agent to have all powers to control or consent to health care decisions in the event the Principal cannot make such decisions for himself or herself. These decisions can include the withholding or withdrawal of life-sustaining treatment and permitting surgical procedures or medication programs. Additionally, upon the Principal's death, the Agent can be given the authority to permit the performance of an autopsy, the donation of an anatomical gift and the handling and care of the Principal's remains according to the Principal's desires (e.g., cremation). A Durable Power of Attorney for Health Care can also be valuable in eliminating any potential guardianship problems in the event of one's incapacity.

The Durable Power of Attorney for Property appoints an Agent to make decisions concerning one's financial affairs and gives the Agent the power to control the management of one's property in the event of the Principal's incapacity. A Limited Power of Attorney for Business Matters allows an individual to appoint an Agent to act on one's behalf with respect to specific decisions concerning a business entity or group of business entities. Again,

these legal documents can also be valuable in eliminating any potential guardianship problems.

A Living Will Declaration is a document that informs family members, friends, treating physicians and others about the types of medical treatments one wishes to receive or not receive in the event that one is diagnosed with a particular medical condition. Typically the Living Will serves as evidence of *how* someone wants to be treated in the event that he or she is diagnosed with a certain medical condition (e.g., terminal condition, permanent unconsciousness or persistent vegetative states) and is unable to make medical decisions on his or her own. In the event that one has executed a valid Power of Attorney for Health Care, the Agent appointed under such legal document will make decisions on behalf on the Principal and look to the Living Will as *support* for such decisions. In the event there is no Agent available under a Power of Attorney for Health Care, a treating physician may, in certain circumstances, have authority to follow an individual's wishes contained within a validly executed Living Will. However, the circumstances under which a treating physician is permitted to follow the instructions contained within the Living

Will are limited by state statute. As a result, a Living Will will generally only operate on its own in limited circumstances, and should be implemented in conjunction with a Durable Power of Attorney for Health Care. Nonetheless, as we have all recently witnessed in the *Terri Schiavo case*, it is extremely important that we formally *document* our desires with respect to our care in the event of our inability to voice our own decision, particularly addressing situations involving the use of life-sustaining treatment in cases such as terminal conditions, permanent unconsciousness, or persistent vegetative states.

Icing on the Cake: Estate Planning Adjunct Letter, Childcare Guide, Childcare Authorization and Emergency Medical Authorization for Caregivers

An Estate Planning Adjunct Letter, Childcare Guide, Childcare Authorization and Emergency Medical Authorization help complete one's Core Estate Plan. The goal of these documents is to provide additional guidance and direction pertaining to one's assets, including those "assets" that are often one's most precious and prized possessions---one's own children. An Estate Planning Adjunct Letter is a private and personal letter written by each individual that provides

a "road map" for surviving family members, Agents and friends. This letter can contain a wide array of information and should be as descriptive and detailed as possible. The goal is to provide your family members, Agents and friends with as much information as you feel is necessary for them to handle your financial and family affairs in the event of your absence. These letters can include details on the whereabouts of important documents (e.g., original estate plan documents, life insurance policies, safe deposit box information, etc.), contact persons and information, the location of your secret "stash of cash," and any other information you feel is important for others to know in the event of your death. This letter can also provide for specific nonbinding bequests of personal property (e.g., "I would like my wedding band to be given to my son."). Finally, this letter can also provide instructions to any potential guardians of any minor children, and can address issues related to a child's upbringing, education, and social and moral development and responsibility. Again, since the letter is personal, it ultimately can contain any and all information you feel is relevant regarding your children and assets.

The Childcare Guide, Childcare Authorization, and Emergency Medical Authorization are necessary for any person who has minor children in the care of others, such as baby sitters, nannies and grandparents. The Childcare Guide provides the care giver with factual information with respect to a particular child, and should contain important medical information about each child (e.g., current medications, allergies, etc.) A Childcare Authorization provides specific authority to the caregiver to legally undertake some act, (e.g., to drive children or fly with children). If you are planning to travel outside of the United States with your minor children without being accompanied by your spouse, it is highly recommended that you also travel with a Childcare Authorization containing the other non-traveling spouse's written consent. The Emergency Medical Authorization is a written statement containing the parent's authorization to a

health care provider for any treatment that may need to be performed on a minor child in the event of an emergency and when a parent cannot be present to give verbal authorization for such treatment.

Take Time to Digest it All

It is obvious that the initial stages involved in preparing a Core Estate Plan can be mentally draining and daunting. While the discussions focus on one's assets and family, one key element in the discussion is missing: *you*. Thoughts of your own incapacity and mortality are often fleeting, causing a dramatic shift in focus to thoughts with happier endings. Estate planning will never be the "french fries" on a menu of appetizing items; rather, the subject matter is likely to leave a bitter taste in one's mouth. Once one considers all the important financial and health related decisions that one will accomplish by implementing a Core Estate

Plan, however, those initial thoughts (or bites) become much more palatable. In the end, we believe you will be left with a satisfied feeling knowing that your loved ones will be well provided for according to terms with which you are comfortable.

For those of you who have already "taken the bite" and believe that you have had your fill of estate planning, please keep in mind that your existing estate plan should be reviewed and updated at least every three to four years.

If you are interested in updating your current estate plan, finding out more about estate planning, or have any questions regarding any of the topics discussed herein, please contact Steven Bonneau, Senior Trusts & Estates Associate, the author of this Legal & Tax Trends Letter.

Visit our website at www.htdlaw.com for additional tax and legal updates and firm news.