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An Estate Planning Primer

This guide was prepared for those who wish to learn some of the basic concepts and terminology used by practitioners of estate planning. Without making you an expert, this basic knowledge will enable you to participate in discussions with your advisors as an informed consumer.

You may or may not need trusts or an elaborate investment and tax avoidance plan. But everyone should have a *will* and a *durable power of attorney*, and many will also want a *living will* and a *medical power of attorney*.

This guide begins with some basic ideas and definitions, lists the primary estate documents, and identifies various types of advisors you may wish to consult.

Basic Ideas and Definitions

Estate planning can be complex and confusing, but you can and should learn the basic vocabulary in order to be able to work intelligently with your advisors. Following are the key words you are likely to need.

Estate. A person's net assets (total assets minus debts) at death; i.e., the property subject to taxation and disposition upon death. A person's estate includes real property such as houses, farms, and land; personal property such as furniture, jewelry, collectibles, and vehicles; and financial property such as stocks, bonds, partnership interests, bank accounts, insurance proceeds, patents, and the present value of pensions, deferred compensation plans and other annuities; and retirement plans, such as IRAs, 401k and 403b plans.

Estate Planning. Preparing documents to control the disposition of one's estate and other affairs upon death to achieve one's goals and desires, and choosing advisors. Purposes of estate planning include: providing for the financial needs of surviving dependents; setting up guardianships for minors or incapacitated dependents; making charitable bequests; arranging for professional management of financial and other assets for survivors; minimizing taxes; and possibly avoiding probate.

Estate Settlement. The process of terminating a decedent's worldly affairs, including probating the will; determining the decedent's assets and liabilities; taking possession of estate assets and valuing them; paying debts; filing income and estate tax returns and paying any taxes

that may be due; and distributing net assets to beneficiaries.

Intestate. Not having a valid will. In the absence of a valid will, the distribution of the estate, as directed by State law, may not necessarily conform to one's wishes.

Probate. The procedure of proving to the clerk of the local court that a particular will is genuine and valid. Probate also creates a public record of the terms of the will and of the decedent's assets. Aside from disclosing one's assets and intentions, the probate process can delay distribution of estate assets to beneficiaries by months or even years.

Avoiding Probate. Techniques exist for transferring most or all of one's assets outside of probate to avoid delay and preserve confidentiality. This can be accomplished by setting up the ownership of property in joint form or in trusts and ensuring that beneficiaries are named for insurance policies, pensions, and similar assets.

Executor, Administrator. The person selected to settle an estate is called an executor if named in a will and an administrator if selected by a court. Relatives are often named. However, if an estate is at all complex, the technical nature of estate settlement makes it advisable to name a professional such as an attorney or trust officer. An unwilling executor of a person who is already deceased may petition a court to have another party named or can seek professional assistance.

Guardians. To provide for the personal care of minors or incapacitated or incompetent adults after a parent's or care giver's death, a will (or court) may name someone to serve as "guardian of the person". This might well be a close relative or other person most able *and willing* to see to the personal needs of the children or other person who requires care. Often a different person, usually a professional of some sort, may be designated as "conservator of the estate" to manage the financial assets of the estate on behalf of the incapacitated or incompetent beneficiaries.

Determination of Beneficiaries. The form of ownership of the estate property determines how property will be distributed to heirs and other beneficiaries. In the absence of any other estate documents, state law determines how a decedent's property shall be distributed. The provisions of a will override state law. However, some types of property pass immediately to the beneficiary outside the will, avoiding probate. For example, jointly-owned property (such as a jointly-titled bank account or a home) passes immediately to the survivor without any need for probate or other process. Similarly, property controlled by a trust agreement passes outside the will. Insurance proceeds, pension death benefits, deferred compensation death benefits, and balances of Individual Retirement Accounts (IRAs) are paid directly upon death to the beneficiaries named in the document that governs each piece of financial property. If beneficiaries are not named in these documents, the assets go into the decedent's estate and their distribution is controlled by the will, if one exists, or by state law.

Joint Property. An asset owned by two (2) or more people. For example, a house, car, bank account, or the right of access to a safe deposit box may be jointly owned. Joint ownership is convenient for spouses where the value of their combined estate does not exceed the amount of the federal estate tax exemption. Otherwise, it may be better not to own some property jointly as it may result in substantial taxes that might have been avoided. Estate planning can deal with this issue.

Per stirpes, per capita. As used in a will or trust, *per stirpes* means that an estate will be divided in equal shares among one's named beneficiaries and that, if one of those beneficiaries is not alive at the time of the distribution, that person's own heirs will split his or her share equally among themselves. (For example, two heirs A and B each get 50%, and if B is deceased, B's four children each get 12.5%.) The alternative form of equal distribution is *per capita*, which means that an estate will be split equally only among the beneficiaries who are alive when the testator dies, hence the descendants of a non-surviving beneficiary would be cut out. (In the above example, A would get 100%.) Of course, the testator can specify unequal shares for distributing his estate.

Marital Deduction. Federal estate tax law permits all the assets of a decedent, regardless of value, to pass to a surviving spouse without being taxed. Such assets are then included in that spouse's estate and taxed on his or her later death. Estate taxes may be deferred, but not necessarily reduced, by use of the marital deduction. Estate planning can avoid or reduce such taxes by splitting the ownership of property between spouses (rather than having it jointly owned) or by transferring the property to a trust for the surviving spouse's benefit.

Trust. Any written contract or arrangement whereby one person (the grantor) delivers property to another person (the trustee), who exercises the ownership attributes of the property for the benefit of a third person (the beneficiary). In some circumstances, the grantor, trustee, and beneficiary can all be the same person, as when a person merely desires to have a trust in existence prior to his death so the trust assets will not become a matter of public record. In other cases, the three persons are different people, as when a husband sets up a trust in his will to be administered by a bank trust department for the benefit of his wife. In any case, the trust becomes the owner of the property, but the provisions of the trust may allow or require that the income and even the principal of the trust may be expended to take care of the beneficiary. Trust terms can be extremely flexible, and trusts can be used for a number of purposes--providing professional management of investments, setting up a guardianship, treating different heirs differently, maintaining confidentiality, avoiding or reducing taxes, or protecting assets from creditors and predators.

Irrevocable, Revocable. If the transfer of property to a trust is not reversible and the grantor relinquishes all power to control the property, it is "irrevocable." An irrevocable trust is usually created to remove property permanently from one's estate in order to reduce income and estate taxes while making provision for a beneficiary. A trust is "revocable" if the grantor can amend, control, or terminate the trust. There are no tax savings to the grantor in a revocable trust, but there may be other advantages as suggested in the preceding paragraph.

Living Trust. Also called an *inter vivos* trust, this is a trust that exists during the grantor's lifetime. During his or her lifetime the grantor may be (but doesn't have to be) both trustee (to save fees) and beneficiary. Tax benefits depend on whether the trust is revocable or irrevocable and one whether a trust is properly funded (see below). A living trust is usually created for the purpose of having investment management during one's lifetime and, at death, automatic continuation of such management for the benefit of one's heirs. It is a useful device for avoiding probate.

Testamentary Trust. A trust established by the terms of a will. It comes into existence and is funded only upon the settlement of the deceased's estate. Unlike a grantor's living trust, which always remains confidential, the testamentary trust, as it arises from a will, is required to make annual accountings to the local court and these become public records.

Insurance Trust. A trust that is funded by the proceeds of one or more insurance policies. The purpose is primarily to provide for investment and management of the insurance money for the benefit of the decedent's survivors. If the trust is irrevocable, it can also prevent the payment of federal estate taxes on the insurance proceeds.

Funding. The act of transferring property, money or other assets into the trust. One may fund a trust during lifetime or by use of a will leaving all assets to a trust, commonly called a “pour-over” will. Funding can be critical to achieving estate tax savings and accomplishing the purposes of the trust.

Documents

Use professionals to prepare your will and other estate documents. Legal and tax issues are too complex for a non-specialist to deal with competently.

Well drafted documents can be quite understandable, though there may be some technical points you will need to have explained. You should also make an attempt to see how all the documents work together to accomplish your estate planning goals.

Will. A writing by which an individual expresses wishes for how obligations shall be settled after death and net assets distributed among heirs or other beneficiaries. Before the provisions of a will can be carried out by an executor or administrator, the will must be probated before the clerk of the local court. This task may incur expense and often creates considerable delay in the distribution of the assets.

Power of Attorney. A writing by which one person gives specified powers to another person to handle his or her affairs. Such a power can be quite limited--it might, for example, authorize someone only to sign a particular document for a single transaction. Or it may be quite general and broad in scope, permitting another person to handle all of one's affairs. Powers accepted for

financial matters generally are not accepted for health matters. The principal reason for powers of attorney in estate planning is to provide for continuity of financial management during one's disability.

General Power of Attorney. While the so-called "general" power of attorney is broad in scope, it is not accepted as being effective during one's disability. Such powers are little used currently.

Durable General Power of Attorney. This is the critical document that allows for the administration of one's financial affairs in the event of one's disability. Spouses usually give reciprocal powers to each other. The word "durable" means that the document can be used during your incapacity – precisely when protection is needed the most.

Medical (or Health Care) Power of Attorney. A document that allows another person, usually a close relative or friend, to make medical decisions on one's behalf when unable to do so oneself. In cases of extreme illness, it is well to show this document early on to the doctors to make sure it will be accepted by them when tough decisions eventually need to be made. This document is sometimes referred to as an *advance medical directive*.

Living Will. A document that specifies what medical treatments are to be given or not given when an individual is terminal or close to death. Its utility is that it prevents unnecessary expense and discomfort by excusing doctors and hospitals from attempting futile and expensive heroic treatments merely to protect themselves from liability. The document specifies the conditions under which life support systems may be withdrawn and usually requires only that adequate pain medication be administered to make one's final moments as comfortable as possible.

Trust Agreement. The legal document that governs the operation of a trust arrangement. Unlike a will, it provides confidentiality concerning the assets it contains and the provisions for their disposition. It must identify a grantor, a trustee (an individual or company with trust powers), a beneficiary (who may be the grantor as well as heirs or others), and the property that is to be owned by the trust and subject to its provisions. Well drafted trust agreements provide for flexibility in the administration of the trust; spell out investment and other powers of the trustee; the purposes for which the trustee may disburse money to the beneficiaries; and provisions for eventually terminating the trust and making a final distribution of the assets.

Safe Deposit Box Contents. Some states require that when a bank learns that its safe deposit box customer has died, the box must be sealed until the tax authority has had an opportunity to examine the contents of the box. To avoid this delay, estate documents and insurance policies should not be kept in a safe deposit box but should be kept in a fireproof safe at home or filed with one's attorney or trust officer. In some states, like Virginia, the person named as executor may open the safe deposit box for the limited purpose of retrieving the will for probate.

Advisors

You should work with competent and experienced professionals to make sure your estate plan and documentation is effective. Estate planning, like brain surgery, is not a do-it-yourself project.

To select competent and experienced advisors, by all means ask your friends about the professionals they use and whether they consider them competent, interested, communicative, reliable, and pleasant to deal with. But don't take advice from your friends about estate planning itself! Also ask for referrals from other professionals you know, such as your banker, accountant, financial planner, or friends who are themselves professionals.

Before taking on any advisor, make sure you are clear about what they are going to do for you and what their fees will be. It is entirely appropriate to ask for a letter that outlines their services and fees. Don't be shy! Good advice is not cheap, but you don't want to be surprised.

You need advisors for their expertise, but you have a right to make them explain what they are doing, or proposing to do, in reasonably simple English. If you don't understand, ask. If they cannot make you comfortable, get another advisor who can. However, don't get hung up in technical details. You only need to be sure that you comprehend the big picture.

Finally, be sure to understand that the professionals on the following list each have special primary competencies. The descriptions attempt to clarify these differences to help you select the most appropriate advisor for a particular need. How they are usually compensated for their services is also indicated.

Attorney. Drafts wills, trusts, and powers of attorney. Provides advice to, or undertakes the funding of trusts, creation of joint ownership, changing of property titles, and other such tasks required to implement the estate plan documents. To control the cost of producing documents, ask your attorney to quote a fixed fee for each document rather than an hourly rate. Select an attorney whose practice is limited to estate planning (rather than divorce law, real estate, litigation, etc.). An attorney can also serve as an executor of one's estate and handle investment of the assets, but the latter may not be his area of expertise, and he might also die before you do. It may be better to have your will or trust designate an institution for these tasks.

Trust Officer. An official of a trust company or bank trust department. Administers trusts, investment agency accounts, conservatorships, estate settlements, and personal services such as tax returns or health arrangements for trust beneficiaries who require such assistance. A good trust officer will assist in the design of your estate plan and issue suggestions to the attorney for preparation of the documents; trust officers, however, do not practice law. Trust institutions have investment experts to assist the trust administrators. Fees are based entirely on the value of and income from the assets managed, and trading fees are absorbed. Hence the trust department's motivation is not to trade for commissions but to maximize the beneficiary's wealth and income.

Certified Public Accountant (CPA). Useful primarily for tax advice. Also essential if the estate includes a business. Will have knowledge of the tax aspects of trusts and estates, but normally is not organized to provide investment management. Charges a fixed fee or by the hour.

Insurance Agent. Can be helpful in showing how insurance can be used in estate planning to provide funds for supporting beneficiaries and for paying estate taxes. However, it is sometimes better to rely on an attorney for advice on amounts needed to meet your goals. The Insurance Agent is not paid by the hour or project, but through commissions on the amount of insurance sold.

Securities Broker. Buys and sells stocks and bonds. Also frequently understands trust and estate matters to some extent but is not actively involved in estate settlement or trust administration. Should be relied on primarily for investment advice. Brokers are sometimes paid on trading fees, therefore they may be more inclined to urge transactions that run up the costs for an estate.

Certified Financial Planner (CFP). A person with special training and credentials for coordinating the planning of one's investments, insurance, and estate disposition plans. Some CFP's collect a fee for the plan, or charge fixed rates. Some CFP's make their living selling investments and insurance.

Banker. Handles deposit accounts and loans, credit cards, remittances, safe deposit boxes, and similar services. Some of the bank's deposit accounts may be part of an estate or estate plan--- certificates of deposit, money market accounts, mutual funds, annuities, individual retirement accounts. The bank may also have a trust department. Bankers often can recommend attorneys, trust officers, CPAs, and other advisors. Banks' fees and interest rates vary, and it is worthwhile to shop. Convenience of location and quality of service are also important considerations.

Appraiser. Estimates the value of real estate or personal property, such as antiques. As the "assessed value" of a house or land is normally less than market value, an appraiser may need to be employed to help set the price to be asked when selling such a valuable asset. A real estate appraiser collects a set fee for the appraisal. An appraiser of personal property collects a percentage of the total value of the articles appraised.

Real Estate Agent. Handles sales and rentals of real estate. While not necessarily as qualified as an appraiser, usually has a good idea what a residential property will sell for and how to set an asking price. Can also advise on what fix-ups will be needed to make a property saleable. Charges a percentage of the sale or lease.

Finally....Getting Started!

When you feel ready to talk to an attorney about starting your estate planning process, make an appointment. Then, collect the papers that will help them hold a good first conversation with you. First, prepare a financial statement of your estate:

1. Make a list of all the property you (or you and your spouse) own. Place approximate values on the assets, and indicate how the assets are owned--in your name, your spouse's name, or your joint names. Be sure to include the *face value* of life insurance policies.
2. Also list pension or deferred compensation benefits to which you and your spouse are entitled, and note the person named as the beneficiary of each.
3. List your liabilities: mortgage loan, other debts.
4. Assemble any current estate documents: wills for you and your spouse, trusts, powers of attorney, if any.

With this information in hand, you are ready to approach your estate planning and your estate planning advisors as an informed consumer. You may find the whole experience more complicated and time consuming than you had imagined. If so, just remember the tremendous peace of mind you will feel when all your documents are signed and the task is completed. Your spouse and heirs will feel much better, too. Good luck!

A final note of caution: This guide is believed to be accurate with respect to general principles and basic definitions of estate planning. However, the laws of estate taxation and administration vary from state to state and are modified from time to time. One should always rely on current advice of competent advisors before making decisions.

This article was prepared by Midgett & Preti PC and is intended to provide general advice only. For answers relating to a specific situation, you should consult a competent estate-planning lawyer.