

Estate Planning: It's About the People You Love

By Archie M. Richards, Jr.

Estate planning benefits the people you care about, before and after your death. A professionally-prepared plan not only covers current conditions, it also provides for what *might* happen.

Say you leave your summer cottage on the lake jointly to your children. Which one of the children will pay for fixing the leaky roof? Will they use the cottage equally even though some of them live far away? Will the common ownership bring the children together or become a source of friction? Very likely the latter.

We consider the following subjects:

- People issues
- Special insurance needs
- Ways of transferring property
- Family gatherings
- Special issues for business owners
- A wonderful source of cash for the elderly

People Issues

Minor Children: If you have minor children, who should care of them if you die or become disabled? Caring for children requires different skills than caring for money. If the persons you choose as substitute parents approve, name them in a document as guardians.

Power of Attorney: Who should take care of you and your money when you're no longer able to do so yourself? Give that person a power of attorney. The attorney, who needn't be a lawyer, can be empowered to do just about everything with your money that you could do if you were competent. The powers should be "durable," meaning they remain effective even after you become disabled.

Health Care Proxy: A health care proxy gives an individual you name the power to decide what medical care is called for if you can't decide yourself.

Living Will: You might also sign a living will, specifying the degree of medical care needed to keep you alive. The document might say that in the event imminent death, you are to be kept free of pain, but otherwise to let nature take its course.

Are you to be buried or cremated? Do you want any of your body parts donated for medical purposes? What about your funeral? During the period when it's hard for your family members to think straight, it helps to have specified these matters.

Special Insurance Needs

Disability: If you become disabled while you're still employed, can you support yourself and your family, possibly for an extended time? If not, consider purchasing disability insurance, which pays you income while you're unable to work. The premiums are reduced if you're willing to pay for the first 180 days of your disability instead of 30 or 90 days. Cut the premiums further by being willing to go back to work in any job, not just your specialty.

Long-Term Care: Long-term care insurance isn't for you; it's for your family. Caregivers often die first. When you're chronically ill, the insurance may save a member of your family from becoming chronically ill. Long-term care pays for services children find the most difficult and embarrassing to perform. It also keeps the burden of your care from being shared unequally by family members, an inequity that can tear a family apart. The sooner you obtain the insurance, the less it costs. To cut costs, pay for the first year of care with your own money. Permit nursing care to be administered in your home as well as in a nursing home. Since the average stay in nursing homes is only two years, arrange for the benefits to extend for 3 or 5 years instead of for life.

Methods of Transferring Property

By Contract: The inheritance of property you hold in IRAs, pension plans, life insurance contracts, and annuities isn't affected by your will. The assets in these accounts go to the beneficiaries named in the contracts. Make sure to specify correctly. When your circumstances change, such as you acquire a new spouse, change the beneficiary designations pronto. Making your estate the beneficiary of your IRA can lead to problems. Instead, name a person. Better yet, name your living trust (see below).

By Law: In most cases, the inheritance of property you hold in joint name with others also is not affected by your will. The property passes according to the laws of your state. If it's joint ownership with rights of survivorship, the entire property becomes owned outright by the other joint owner. If it's a tenancy-in-common, the portion owned by the deceased passes according to his or her will.

By Probate: When an individual dies, the property he or she owns outright passes to others under the supervision of a probate judge. The judge endeavors to follow your wishes if you have a will. If you die without a will, the property passes according to the laws of your state. Those laws commonly provide that two-thirds of the estate goes to the children and one-third to the spouse. If the children are minors, the spouse must be appointed as guardian. He or she must submit regular accountings to the court. To avoid these inconveniences, write a proper will. Even better, write a living trust as well (see below).

Probate is especially arduous if you own real estate in more than one state. Your executor must undertake the probate process in each state.

Do not specify the inheritance of your tangible articles in your will. Amending a will is too cumbersome. Instead, provide that the tangibles pass according to directions you may record and change from time to time. Write the directions and store them in a fireproof box.

By Gift: Gifts you make to individuals may cause you to run afoul of the federal unified transfer tax. Often referred to as an estate tax, it's actually a tax on the value of assets you transfer at death *or* during life.

If you own an asset whose value is likely to grow, consider gifting at least a portion while the value is still low. Transfer taxes are calculated on the value at the time of the gift. Appreciation thereafter is taxed for income tax purposes to the donee, not the donor.

By Trust: The final means of conveying property – often the best means – is a living trust. Trusts call for one party to own property for the benefit of others. The person who creates the trust is called the donor, settlor, or trustor. The person who owns the property is the trustee. The individuals who receive income are called income beneficiaries. Those who receive principal at the end are called remaindermen.

There are hundreds of kinds of trusts; the one discussed here is the living trust. Assume that John Adams creates a living trust entitled The John Adams Living Trust dated June 20, 2006. Adams changes the registration of everything he owns to that name, including his closely-held business. He serves as his own trustee. Initially, he's also the sole beneficiary. He can do as he pleases with the property. He can also revoke the trust and cancel the whole thing.

But when Adams becomes disabled, he is immediately replaced as trustee by the successor trustee whom John named in the trust document. The trust becomes irrevocable, and the successor manages the property for John's benefit.

When John dies, the property is dealt with as the trust document specifies. For example, the trust might continue for the benefit of his widow. After her death, the income might be paid to the children. After a child's death, half of the principal might be paid to the child's children, providing they've reached age 30, with the balance paid at age 40. If any grandchild has special needs, his or her portion of the trust can continue for life. This is just an illustration; John can specify whatever he wants. Depending on state law, a trust can last for about 120 years after the donor's death. For charitable purposes, a trust can last indefinitely.

On Adams's death, the property held in trust avoids probate. The probate court supervises the distribution of properties owned by the *deceased*. When Adams dies, his trust does not. Hence, probate doesn't apply to the trust property. This saves money and prevents delays. It also avoids unwanted publicity, because the trust document isn't available for public scrutiny.

A living trust accomplishes everything a will can do, including saving transfer taxes. But a living trust also avoids probate. Plus, there's no better way for a donor's property to be taken care of during disability. Powers of attorney are often rejected by financial institutions as being out of date. Trusts are not.

Some attorneys avoid living trusts because they earn more from probate work. To find an estate planning attorney who favors living trusts, contact the American Academy of Estate Planning Attorneys (aaepa.com, 800-846-1555) or the National Academy of Elder Law Attorneys (naela.com, 520-881-4005).

Marilyn Monroe's gross estate amounted to \$820,000. The estate's costs came to \$450,000, for shrinkage of 55%. She could have used expert advice and a living trust.

Family Gatherings

Family gatherings are a vital ingredient in estate planning. Important issues can be resolved in a social setting. A neutral place for the gathering is probably best. Be sure to include spouses and grandchildren who are old enough.

Explain who will take charge of you and your money in the event of your disability. Tell your family how much medical care you want, who you're naming in a health care proxy. Tell them about your long-term care insurance. Discuss your philanthropic interests. The other members of the family needn't have the same interests, but they should know yours.

Some people consider death so abhorrent that they're reluctant to discuss these matters. I'm with you: Dying is the worst. But the second worst thing is leaving behind conditions that lead to a family feud. Believe it or not, members of your family will be upset when you die. If your estate plan is inadequate, people who are already upset may start fighting. Other than your passing, what could be worse?

Special Issues for Business Owners

Buy-Sell Agreement: Let's say you have a business partner and you die way too soon. Your spouse would end up with insufficient cash, and your partner would have to work with someone (your spouse) who doesn't know the business. While you're alive and well, set up a buy-sell agreement which provides that in the event of your death, the partner would acquire your shares at the price specified in the agreement. When death occurs, your spouse would receive cash, and the business would continue benefiting from knowledgeable management.

Succession: You may prefer that a member of your family own and manage the business after your retirement or disability. It shouldn't necessarily be the oldest child. It shouldn't necessarily be a male child. It should be the person who has the most talent in running the business and the greatest interest in doing so. Encourage the future manager to work for another company before he or she returns to the fold. Let the person develop a broad frame of reference, joining trade associations and attending conferences. When the future owner does return to work for you, give the child authority. Let him or her make mistakes without recrimination from you.

Sale of Business: Whether to a family member or not, there are many ways to sell a privately-held business, including an installment sale, private annuity, grantor retained annuity trust, or recapitalization into two classes of stock. These matters are extremely complicated. Be sure to obtain expert and experienced legal and tax advice.

Whoever will manage the company should probably be given majority control. No business can thrive if the person who has the talent, experience, and interest to run it must obtain business-strategy approval from others who have less talent, experience, and interest and whose primary interest may be their dividend checks. Some of the methods mentioned in the previous paragraph enable other family members to participate in the company without having voting control. At your family gathering, explain what you have in mind. Keep the others in the loop. Pay attention to feedback from your family and refine your estate plan accordingly.

A Wonderful Source of Cash for the Elderly

If you're at least 62 years old, have little or no mortgage, and need cash, a reverse mortgage turns your house into money. Your children may not care. They have their own houses and jobs and are raising children elsewhere. They're likely to care about inheriting your family heirlooms and investments, but not your home.

A reverse mortgage is a loan secured by your home. You choose how the money is paid to you - up front, from time to time, for life, or a combination thereof. The income is tax free, and you can use it for any purpose whatsoever.

When you move or die, the house is sold and the loan is repaid. If the proceeds exceed the mortgage balance, you or your estate receives a check for the difference. If the proceeds of the sale of the house are less than the mortgage balance, the insurance company *eats the loss*. Never are you required to repay the loan from your other assets. While the reverse mortgage is in effect, you must keep the house in good condition and continue paying property taxes. But you were going to do those things anyway.

Turn your house into money. A reverse mortgage could be just the ticket. And by all means, engage an estate planning expert to prepare an estate plan. It's not just for you. It's for the people you love.