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UNDERSTANDING ESTATE PLANNING

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I. Basics About Wills

Why do I need a will?

Your will is your way to direct what happens with your property, your business affairs and, most importantly, with your minor children after your death. If you die without a will, the descent and distribution laws of your state take over — and you may not like what they say.

As an example, if you die and leave young children, your state may require that a substantial portion of your estate pass to your children rather than to your spouse to manage in your children's best interests. This can be a particular issue in second marriages and where you do not want property for minor children to be held under the control of a probate court.

Your will gives you control:

- You name guardians for minor children. This is the single biggest reason most people make a will — and, perhaps, the biggest reason people avoid making a will. If you seem unable to agree upon guardians now, we can help you resolve this critical issue. This is not a decision to avoid and leave to fate.
- You appoint a representative for your estate, called the "executor" in most states. See our guidelines for choosing an executor.
- You waive bond, which your estate's representative may be required to post if you do not have a will.
- You give your executor power to sell assets, such as a house, without the expense and delay of obtaining appraisals and court approvals.
- You decide how estate taxes will be paid, such as "off the top" or proportionately against certain beneficiaries.

II. Estate Tax Planning

What is the federal estate tax?

- The federal estate tax is generally imposed on all property in which you have an interest at the time of your death, including your house, bank and brokerage accounts, life insurance, IRAs and family businesses.
- You can pass an unlimited amount of property to your spouse free of tax under the unlimited marital deduction. However, any unconsumed property still in the spouse's estate upon that spouse's death will then be subject to the tax.
- The federal estate tax "exclusion amount" is $5.45 million in 2016 and is indexed to inflation.
- Under current law, the federal estate tax rate is 40 percent on property above the estate tax exclusion amount.
- **Changes in the estate tax laws can occur rapidly on the federal and state level. It is essential that you seek advice on your specific situation.**

Good planning can reduce, or, in some cases, eliminate, the federal estate tax.

What is a credit shelter trust? What is portability?

A credit shelter trust (also called an "A-B" trust) takes advantage of each spouse's exclusion amount, enabling a couple to pass a minimum of $10,900,000 ($5,450,000 x 2 people) to children free of the tax while sheltering later appreciation from the tax.

This is how it works. Upon the first spouse's death, a "credit shelter" trust (the "B" or "Family" or "bypass" trust) is established for the ultimate benefit of nonspouse beneficiaries (typically, children, nieces or nephews). It is set up in an amount equal to that year's exclusion amount.

By definition, there is no estate tax on that trust because it is sheltered by the estate tax credit. The remainder of the client's estate goes into a marital (or "A") trust for the surviving spouse or is distributed directly to him or her. There is no estate tax on that portion of the trust at the first spouse's death. This is because that trust is covered by the unlimited marital deduction.

The credit shelter trust typically holds the assets for the surviving spouse's lifetime. He or she can use the assets in the credit shelter trust if needed for support or medical care. Upon the surviving spouse's death, the assets remaining in the credit shelter trust – including all appreciation on them – pass to the children (or other beneficiaries) free of estate tax. In addition, at the second spouse's death, the second spouse's own exclusion amount will be used against his or her own assets. Thus, both spouses' exclusion amounts will be used.

A new provision in the tax law can reduce a client's need for a credit shelter trust in some circumstances. Under changes to the tax laws that went into effect for individuals dying in 2011 or later, the estate of the second spouse to die is permitted to use federal estate tax exemption that was not used in the first spouse's estate by relying on "portability." Portability only applies, however, if the estate of the first spouse timely filed a federal estate tax return to elect to preserve or "port" the first spouse's excess exemption amount to the surviving spouse for his or her use. If no estate tax return is filed, then portability is not available for the surviving spouse.

Portability would not take full advantage of the exemptions in many cases. Additionally, asset protection for spouse and children and tax sheltering of appreciation on the first spouse's assets can be lost by relying on portability. Therefore, whether a credit shelter trust or other potentially tax-advantaged trust makes sense should be analyzed on an individual basis.

What are some other ways to reduce estate tax?

- The federal gift tax is imposed on gifts you make during your lifetime above the current lifetime exemption amount of $5.45 million. However, you can make gifts within the "annual" gift tax exclusion amount ($14,000 in 2016, but indexed to inflation) free of the gift tax and without using your "lifetime" exemption. These gifts remove assets from your estate, saving at least 40 cents on the dollar in estate taxes at current rates. You also can make unlimited payments for tuition or certain medical expenses if you pay the school or provider directly.
- Irrevocable life insurance trusts (ILITs) remove life insurance policies from your estate while making the proceeds available for a spouse and children after your death.
- Qualified personal residence trusts (QPRTs), grantor retained annuity trusts (GRATs) and other gifting techniques enable you to pass an asset, such as a residence or stock in a family business, to your heirs at a value frozen on the day you transfer it. The appreciation escapes estate taxation.

Are there state estate and inheritance taxes?

- Yes. Many states impose their own estate or inheritance tax. The Ohio estate tax was repealed for estates of individuals dying after January 1, 2013. Indiana and Florida do not have estate or inheritance taxes, but other states do, including Illinois and Kentucky. We can work with you to reduce or avoid these taxes.

What are some options for charitable giving?

- Charitable giving can benefit the causes you believe in with no estate tax on amounts you leave to qualifying charities. You can even benefit your family and your favorite charities by establishing a charitable remainder trust (CRT), which makes payments to family members for a period of time and the remainder to charities you designate. You can also benefit both family and charities with a charitable lead trust (CLT). A CLT provides payments to a charity for a period of time, with the remainder to your family.
- Foundations — private ones as well as funds established with community foundations — can enable you and your children to come together in making charitable gifts across the generations.

III. Naming Your Fiduciaries

Who should be my executor?

Duties of Executor or Personal Representative. The executor, also known as a personal representative, handles the probate of an estate, typically directed by an attorney. The executor is responsible for collecting the assets, determining and paying the debts, preparing the tax returns (final income tax returns, federal estate tax return, state inheritance and/or estate tax returns), preparing court accounts and making distribution of the assets to the beneficiaries. Unlike a trustee, an executor typically serves for only a year or two.

Typical choices. Many clients name their spouse, adult child or sibling as executor. This is often a good decision. However, it can also make sense to consider a professional as executor. Professionals bring independence, impartiality, lack of emotional bias, knowledge of financial affairs and general expertise in handling estates and trusts. On the other hand, they charge fees that a family member might waive, and they might not be as familiar with your wishes as would someone closer to you. Common sense, conscientiousness and honesty are more important in an executor than sophisticated financial and legal knowledge.

Ideally, your executor should be trustworthy, organized, accurate, willing to seek help from professionals, knowledgeable about the estate and willing to do the job.

Who should be my trustee?

Duties of Trustees. A trustee, unlike an executor, might serve for many years and will be asked to exercise discretion in distributing funds and to make sure that legal, investment and accounting matters are handled in accordance with the trustee's fiduciary duty. The trustee does not specifically need legal, investment or accounting knowledge because the trustee can retain professionals to guide him or her in those areas. The key characteristics of a good trustee are integrity and judgment, especially the judgment to know what is in the best interests of the specific beneficiaries and to try to determine what you would do in similar circumstances. Trustees need to be responsible, organized and mature.

Typical choices. Many people find that a family member, adult child, or close family friend is the person they trust to carry out the terms of their trusts. This may be right for you. A corporate trustee can also be an excellent choice. This is a subject we cover in an estate planning discussion. You should also name alternates. Co-trustees can be another approach.

More questions to ask

1. Trusts often last for many years and being a trustee is a large responsibility. Is the person you're thinking of willing to take on that responsibility for many years?

2. Does naming this person as trustee make sense as a business decision? Trustees have investing, accounting, and legal responsibilities. If your child or sibling is trustworthy but does not understand money, he or she may not be the best choice. A trustee can choose to hire professionals for these jobs, though, so the key is whether he or she will have good judgment in knowing when to seek professional assistance.
3. Do you trust this person to follow legal requirements like filing tax returns on time, sending notices to beneficiaries, and keeping up with changes in the law that might alter his or her responsibilities?

Considering a professional trustee

There can be good reasons to choose a professional, such as your bank or trust company, to be your trustee. Professionals are likely more experienced in investing. They will be knowledgeable about legal requirements and changes in the law. They can reduce family drama by bringing objectivity to a situation. Also, a family member might resign as trustee, die, or become incapacitated, at which point a new trustee must be appointed. Corporate trustees don't get sick and seldom quit, and they can devote their full time to this important job rather than trying to find time to do it.

Corporate trustees charge a fee, but they can have an extremely valuable role to play in many estate plans.

Who should be my health care agent?

If you are incapacitated and cannot express your wishes, a health care agent, also called a surrogate, has the authority to make health care decisions for you. You can grant your agent the authority to give, withhold or withdraw consent to medical, surgical and psychiatric treatments, nursing home care, hospitalization, home health care treatment and life support decisions. This way, you have planned ahead of time who will have the power instead of taking the chance that those decisions will have to be made by a court-appointed guardian.

Typical choices. Most people name their spouse, siblings, adult children or close friends to serve as their agent. It is not necessary that the agent have medical knowledge. It is important that the agent have good judgment and be willing and able to honor your wishes.

Who should be my agent for my financial power of attorney?

A financial power of attorney allows you to have someone you trust, your agent (sometimes called attorney-in-fact), to handle your finances. It can be used when you are unable to act on your own behalf or would prefer to have someone else, such as a trusted child, manage your finances. If you are ever disabled for a long period of time, a power of attorney is necessary to manage bank accounts and pay bills. It is better to choose who will take on this responsibility ahead of time rather than having your decisions made by someone appointed by the court.

Granting a power of attorney does not mean you are giving up the power to act on your own behalf. You can limit the power to a particular activity (e.g., selling your home) or grant your agent authority to act on your behalf in a wide variety of situations. Typically, Taft holds the original power of attorney and only releases it if we are notified that you have become incapacitated.

Typical choices. Many people name their spouses or one or more of their children as their agents, and this is often a good decision. If you are looking for someone else to act as your agent, the most important thing to keep in mind is that this person will be responsible for making decisions for you if you become incapable of making them yourself. You should choose someone you fully trust, who has your best interests at heart and who is willing to take on a great deal of responsibility.

You do not have to name the same person as agent for health care and finances.

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IV. Online Estate Planning: Buyer Beware

Online Estate Planning Considerations

Clients sometimes ask us about online estate planning companies that they see advertised on the Internet and in the media. They also encounter companies that promote "living trust packages" at seminars or other public places.

We have a great deal of experience with reviewing these kinds of arrangements and we have seen serious problems. Online "fill-in-the-answer" estate planning can undoubtedly reduce document costs. However, we have noticed that both the information provided by these companies and the "final" documents for the buyer frequently contain mistakes.

Examples of typical problems we have seen, much to the surprise of clients who thought their "documents" were acceptable, include:

- Failure to tell clients that their will does not control all of their property. For many people, the opposite is true. For example:
    - Houses, bank and brokerage accounts titled jointly to two people, with rights of survivorship, will pass to the survivor and not under the will. For instance, some people add a child to an account for ease of managing the account during the parent's lifetime. They do not realize it will pass to that child at death, outside the will. Online services and companies that sell "living trusts" often fail to explain this common misstep.
    - Life insurance passes by beneficiary designation, not by will.
    - IRAs, retirement plans and annuities pass by beneficiary designation, not by will.
    - **For many people, this mix of assets makes up most, if not all, of their estates and will not pass under their wills.**
- Failure to explain that if you sign a living will in some states or complete the form incorrectly, the individuals you name as health care agents will **not** control whether a doctor "pulls the plug." This sensitive subject often takes more time to talk through than all of the rest of the client's estate plan.
- Failure to advise that if your will relies on a "testamentary trust" in some states, your beneficiaries and trustees may be required to report to the probate court annually until the trust terminates, which might not be until a child is 30 or 35 years old. A living trust avoids this issue.
- Failure to analyze tax issues, which can result in severe tax problems. For example, credit shelter tax planning must include analysis of property holdings to make sure that titling and beneficiary designations are correct for each spouse. This is one of the most serious deficiencies we see in plans that purport to be "A/B" or credit shelter trust plans. The tax costs can be in the hundreds of thousands or even millions of dollars and could have been avoided.
- Failure of property to reach the persons for whom it was intended. This is the most serious failing of all. We have seen documents where there are no provisions for alternate recipients (when the clients clearly would have named an alternate if they had been properly advised) and where terms are ambiguous, which can trigger disputes or the need for court interpretation.

Technology can and should be used to reduce costs when possible. Taft relies on technology, including a custom-designed assembly system that uses Taft's own provisions. But the plan will always be custom to you, not a fill-in-the-blank form that parrots your own words back to you. Equally important, lawyers trained in estate planning point out issues that otherwise would not be addressed and that determine what the documents actually need to say.

As is the case with all responsible estate planning lawyers, Taft estate planners do not like to see planning that was done without regard to these issues or the heartache and expense that often follow.

As the saying goes: *caveat emptor* (buyer beware).

V. Powers of Attorney and Living Wills

Do I need a power of attorney for finances?

Yes. With a financial power of attorney, you authorize someone to manage your finances if you become incapacitated. Without this power, your family's only alternative might be to incur the expense and heartache of guardianship. Then you become a ward and your guardian will be accountable to the probate court.

Do I need a power of attorney for health care decisions?

Yes. With a power of attorney, you authorize someone you name to make health care decisions for you if you become incapacitated and are no longer able to make those decisions yourself.

What is a living will?

A living will is a document that allows you to express your wishes about whether you want extraordinary measures taken, including artificial feeding, if you are beyond recovery and unable to make decisions for yourself. We can advise you on the nuances of these very personal choices and ensure that you express your wishes clearly.

What does it mean that a power of attorney is durable?

Both financial and health care powers of attorney are called "durable" when they continue in effect even after the person who created them is incapacitated. Under old English and American law, powers of attorney actually lost their authority at the incapacity of the creator (also called the "principal"). This old rule of the law of agency, which seems counterintuitive when powers of attorney most often are needed precisely because the creator is incapacitated, does not apply in a "durable" power. The power continues in effect even after the creator's incapacity.

VI. Trusts 101

Do I need a trust?

A trust is an arrangement you make with a trusted person (the trustee) to convey property as you direct. This document can be one of two types: "**living**" (also called inter vivos) or "**testamentary**."

- If you create a trust during your lifetime by signing a trust document, it is a living trust. Living trusts are in effect even if they have no property in them until your death — they are "**unfunded**." If you title property in the name of your trust during your lifetime, then your trust is said to be "funded." The assets in a funded living trust avoid probate because they pass to your beneficiaries under the terms of your trust, not under the terms of your will.
- You create a testamentary trust through your will. Because wills do not take effect until death, these trusts do not exist until death. In many states, such as Ohio, testamentary trusts are undesirable because they are subject to probate court jurisdiction. The preferable approach is to use living trusts into which your property is titled before your death, or after your death pursuant to your will, beneficiary designations, etc.

Living trusts can:

- Reduce or defer estate taxes in some cases.

- Manage funds for children or other beneficiaries until the ages you have chosen.
- Permit planning for children from prior marriages.
- Facilitate business succession.
- Hold assets to avoid probate and provide privacy.
- Allow management of your finances if you become incapacitated.
- Provide creditor protection.
- Provide protection for children with disabilities.
- Manage a vacation home across generations (often through an LLC with or without a trust).

Many people have been led to believe that trusts are "**one-size-fits-all**" forms that solve tax and probate problems. That is not accurate. Instead, they are legal instruments that must be specifically prepared for each client's needs. They can be one part of a plan — often a crucial part — but they can be useless if you haven't carried out other parts of the plan, such as retitling assets and changing beneficiary designations.

VII. Understanding What Probate Is and Is Not

What is probate?

Property that passes under your will is subject to probate. Probate is the process of obtaining probate court approval to pass property as your will dictates, or, if you don't have a will, under your state's law of descent and distribution. This includes filing the will, appointing an executor, obtaining appraisals, making an inventory of assets and accounting for distributions from the estate.

A nearly universal misunderstanding of wills and probate is that all property is controlled by the will and that all property has to pass through probate. Neither is true, as we explain below.

Another common misconception is that "**avoiding probate**" means avoiding estate taxes. Estate taxes are determined under tax law. Tax law is entirely separate from probate rules.

Does any of my property pass outside probate?

Yes. It is very common for clients to have significant assets that do not pass under their wills, so those assets do **not** pass through "probate." What kind of property passes under a will and what kind of property does not? In general, only assets titled **in your name alone** pass through probate. This includes homes, bank and brokerage accounts titled **solely** in your own name. By contrast, any asset held jointly with right of survivorship passes **outside** probate to the surviving owner. Life insurance, IRAs and retirement plan assets pass outside probate according to your beneficiary designation. Many estate plans fail to work as the client intended because they did not complete beneficiary forms, mistakenly believing that property passes under their will.

Taft estate planners take into account all of the property you have as reflected in the questionnaire you complete and information you provide to us, so that each asset passes as you intend, whether under your will or otherwise.

VIII. Working with Taft Estate Planners

How does the estate planning process work with Taft?

You will work primarily with one of the estate planning lawyers in the group. Because our group has depth, often there will be a second person designated who you can contact if needed. In general, the depth of our group ensures that you will have questions addressed on a timely basis.

We'll ask you to complete a confidential questionnaire that includes family and asset information. We will schedule a meeting with you to discuss your priorities and design a plan. We will work with you so that you stay on track and complete the process by setting timeframes for us to get the job done. Procrastination can be a temptation for clients with this sensitive subject area, and we will work to keep you motivated. You made an investment of time and money to start this valuable process, and we want you to finish.

Drafts and finished documents

We will draft your documents and send them to you for review. Once we've discussed any changes, we will put the documents into final form and meet with you to execute them. We can also assist you in completing the other parts of your plan, such as IRA, retirement plan and life insurance beneficiary designations and asset titling.

Business services and succession planning

Taft serves individual clients not only in their estate planning, but also in helping them with business interests they have. We can assist you and point you toward other Taft attorneys and professionals who can meet your personal and business needs, whether in starting or selling a business, addressing tax and operating issues or planning for the next generation to inherit and step into the business.

Guardianships and Incapacity

Members of the group represent a wide variety of individuals who serve as guardians or who need, due to incapacity such as dementia, to have a guardian appointed. It is always our hope that powers of attorney have already been signed by our clients so that no guardianship is necessary. If that has not occurred, however, or if a controversy arises, we can advise clients on available options.

Trust Services

We advise trustees, both individual and corporate, on a broad spectrum of trust administration matters. These services include fiduciary tax issues, questions about how distributions should be made to beneficiaries, reporting obligations under state law, and options for reforming, clarifying or terminating trusts. When matters are contested, we call upon our highly experienced Fiduciary Litigation group for support.

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