

Family Advocate
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***27 TIME TO CHANGE YOUR WILL**

A Post-Divorce Look at your Estate Planning Options

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If you created a will during your marriage, now is the time to review and revise it. As you think about your estate planning options, ask yourself the following questions:

- What do you want to happen to your assets when you die?
- What estate planning tools are available to assist you?
- What are the tax consequences of your estate plan?
- What estate planning tools are available to protect you if you should one day become incapacitated?

A comprehensive estate plan will answer these questions and address many intertwined and overlapping issues.

Estate planning tools

Wills. A will is an extremely flexible estate planning tool. Your will controls the passage of all assets held in your individual name upon your death. Note, however, that jointly owned assets, assets held in accounts with beneficiary designations, and assets held in trust do not pass under the terms of your will.

In most states, any person 18 years of age or older, who is of sound mind, may make a will. Under the terms of your will, you may dictate how your tangible personal property (including personal and household effects, jewelry, furniture, automobiles, and any collections) passes upon your death. You may designate other assets or fixed dollar amounts to particular beneficiaries, including charities.

Your will may describe how any real property owned in your individual name shall pass upon your death as well as the terms upon which all of your remaining cash, securities, and other assets will be distributed.

In preparing a will, you may incorporate a few or all of the available tax planning tools described below (including charitable planning techniques). For example, your will may include charitable lead or remainder trusts (annuity or unitrust) and generation-skipping transfer trusts.

If you remarry, your will may include provisions for your new spouse that also establish as the ultimate beneficiaries your children from a prior marriage. You could, for example, create a qualified terminable interest property trust (QTIP), which may benefit your spouse for life, and then when your spouse dies, those assets pass to your children from a prior marriage.

In addition to dictating the terms upon which your assets shall pass upon your death, you may provide trusts for your children and grandchildren. Rather than allowing your assets to pass outright to your descendants upon your death, you may provide for assets to pass into trusts.

Thus, your will may dictate the terms and conditions of the passage of all of your assets and it may include an extensive array of tax planning mechanisms, tax savings trusts, as well as other trusts for children or grandchildren.

Revocable trusts. You may amend or revoke a revocable trust at any time. These trusts are commonly used as "will substitutes," because the revocable trust will control the passage of all assets that are held within the trust at the time of your death. If, however, you have not placed all of your assets into the trust, then you will also need a will (often referred to as a "pourover" will), which may be admitted to probate to pass your remaining assets into your revocable trust.

Assets held in a revocable trust pass upon your death without a probate proceeding. In addition, revocable trusts offer the opportunity and flexibility of placing whatever conditions and prerequisites you want to attach to the passage of your assets.

As in a will, under the terms of a revocable trust, you may include complex and sophisticated tax planning vehicles, charitable planning techniques, tax avoidance and savings mechanisms, and trusts for children and grandchildren. Besides avoiding probate, revocable trusts permit you to direct how your assets will be used for your own benefit should you become incapacitated.

*28 Joint ownership. Although not as flexible as a will or revocable trust in terms of tax planning or providing assets for your children or grandchildren, joint ownership is an important estate planning tool. However, be cautious about creating joint accounts and be sure they further your estate plan rather than frustrate it.

Irrevocable trusts. Unlike revocable trusts, irrevocable trusts are used for gift and estate tax planning, not as will substitutes, and they are not amendable or revocable. An irrevocable trust allows you to exempt assets owned in your individual name from your gross estate for estate tax purposes.

For example, you may create a grantor retained annuity trust (GRAT), a grantor retained unitrust trust (GRUT), or a qualified personal residence trust (QPRT). When forming such a trust, you transfer assets into an irrevocable trust and retain the right to either a fixed dollar amount per year or a percentage of the trust assets per year. In the case of a QPRT, you retain the right to live in your home for a term of years.

After the expiration of the term, the remaining assets in the trust pass to beneficiaries named in the trust. For example, if you placed \$500,000 worth of assets into a ten year GRAT, the value of the gift (and thus the amount of unified credit you must apply) is not the full \$500,000, but rather \$500,000 minus the value of your retained annuity interest.

Depending on the amount of the annual annuity payment, current interest rates, and the term of the trust, the value of your retained interest may be as much as 80 percent or more of the total value of the transferred assets. Thus, you may need to apply only \$100,000 or less of your unified credit, even if the full \$500,000 is left and passes to your children at the end of the ten-year-trust term.

In addition, planning with an irrevocable trust often incorporates the use of life insurance, which is not includable in your taxable estate. Without an irrevocable trust, the proceeds of any life insurance policies you own and control are 100-percent includable in your gross estate. However, if the insurance is owned by a trust, and the policy has been transferred to the trust at least three years before your death, then none of the insurance proceeds are includable in your estate. To accomplish the tax savings, you must surrender control of the policy and any rights to make loans against it.

If you are transferring highly appreciating assets, you may use irrevocable trusts to leverage your unified credit and generation-skipping-transfer-tax exemption (as explained in more detail below). You also may create an irrevocable trust to achieve your charitable purposes by establishing a charitable lead or remainder trust, which provides certain

benefits to charities while retaining other benefits for you or your family. Such planning may generate income tax deductions for the value of the charitable interest, plus gift and estate tax charitable deductions.

Outright gifts. Another estate planning technique is a lifetime gift, which will decrease the size of your estate, not be taxable at the time it is made, and not be included in your taxable estate. You may make unlimited gifts of up to \$10,000 a year per beneficiary. In addition, you may make unlimited gifts to pay for education (directly to the school) or health care expenses.

If you do not want to make outright gifts, you may make transfers to beneficiaries in irrevocable trusts. These transfers qualify for the annual exclusion of up to \$10,000 per beneficiary if you provide in the trust that the beneficiaries have the right to withdraw the amounts donated for at least a 30-day period. These rights of withdrawal are often called Crummey powers (named after the tax case approving them).

If the beneficiary does not exercise his or her right to withdraw within the 30-day period, then the right to withdraw may lapse and the assets may be held under the terms of the trust. Alternatively, assets may be gifted through a Section 2503(c) trust if the beneficiary may withdraw all of the trust principal upon his or her twenty-first birthday.

*29 Minor children

If you have minor children, then your estate plan must account for them. First, consider designating a guardian for the children and a guardian for their property. Often in a divorce, custody of the minor children is shared with a former spouse. If that is the case, it is unlikely that anyone other than your former spouse would be appointed their guardian upon your death.

Nevertheless, if you think that your former spouse should not be appointed, you may attempt to name someone else in your will. Ultimately, a judge will make the final decision, based on the best interests of the children.

On the other hand, especially after a contentious divorce, you probably do not want your former spouse to control your assets--not even in a fiduciary capacity as a guardian. Therefore, if your goal is to designate someone else as trustee, you should include in your estate plan trusts for your minor children.

Even if you have confidence in your former spouse, trusts for your minor children will ensure that they do not receive all of the assets you leave them, without restriction, on their eighteenth or twenty-first birthdays (depending on state law).

You might also consider trusts that provide the trustee discretion to use the assets for the benefit of your children's health, support, maintenance, and education (including college or trade school). Also consider providing the children with staggered rights of withdrawal (A child might receive one-third of the assets at age 25, another third at age 30, and the balance at age 35, for example). This prevents a child from squandering all of the assets during one brief period of bad decision-making.

Finally, consider naming your children as co-trustees of their trusts when they reach 18 or 21 years old. They may learn the valuable lessons of money management while apprenticing as co-trustees.

Transfer taxes

You may use several mechanisms during your life or in your will or revocable trust to take advantage of some of the federal gift and estate tax deductions, credits, or exemptions. These also will assist in passing your assets to beneficiaries with the least transfer tax liability. Some of the techniques are as follows:

Planning for the unified credit. The Internal Revenue Code of 1986, as amended (the Code), provides that every U.S. citizen or resident is entitled to a credit of \$192,800 against the gift and estate tax imposed by the Code. As computed, the unified credit shields an estate of up to \$600,000 in assets. If your entire estate is valued at less than \$600,000 and if you have not used any of your credit during your life, then your entire estate will be free of estate tax, regardless of to whom it passes. If your estate exceeds \$600,000, then the excess amount is subject to estate

taxes at graduated rates beginning at 37 percent and increasing to 60 percent.

To minimize gift and estate taxes on an estate that exceeds \$600,000, consider implementing an annual giving program to take advantage of the \$10,000 per donee annual exclusion. Gifts may be given outright or through the use of a Section 2503(c) or Crummey trust.

A Section 2503(c) trust must permit the child to withdraw all of the assets at age 21, while a Crummey trust must permit the beneficiary to withdraw assets placed in the trust within 30 to 60 days after the transfer.

In addition, consider creating irrevocable trusts, which permit you to leverage your unified credit. Similar leveraging of your unified credit may be achieved through the use of charitable trusts.

Generation-skipping transfer tax planning. The Code imposes a flat 55-percent tax on generation-skipping transfers. A transfer to a beneficiary more than one generation away from the donor would be subject to tax. There is, however, a \$1 million per transferor exemption from the generation-skipping transfer (GST) tax. When planning an estate of less than \$1 million, the availability of the \$1 million GST exemption shields the entire value of the estate from the tax. If your estate is greater than \$1 million, then consider some estate planning to maximize the availability of the \$1 million exemption.

The exemption may be applied to specific devises for your grandchildren or other descendants at least two generations away. If specific gifts are to be made from your estate either outright or in trust to such "skip persons," then the personal *31 representative of your estate may apply your GST exemption to those specific gifts. On the other hand, if assets are to be held in a trust for children, so that grandchildren, for example, may receive the assets at some time in the future--subject to the GST tax--then your estate plan should apply your GST exemption to such trusts.

Further, if only part of the assets in such a trust may be exempted from the GST tax, then your personal representatives or trustees should be empowered to divide any trusts created under your estate planning documents into exempt and nonexempt shares with amounts that are shielded from the GST in one share and not in the other.

By separating the assets in this way, you maximize the effectiveness of your GST exemption and minimize your overall exposure to GST tax.

These techniques to maximize the GST exemption may be incorporated into your will or a revocable trust. However, if your estate is large enough, consider leveraging your GST exemption through use of lifetime transfers.

Charitable planning. You may limit the application of gift, estate, or GST tax and achieve income tax deductions by planning to pass some assets to the charities of your choice. Charitable planning, either lifetime or under the terms of a will or revocable trust, may take several forms: (1) You may transfer assets outright to the charity; (2) You may create qualified charitable lead trusts that provide for the income in either an annuity or unitrust form to be paid to the charity for a set term of years, with the balance of the trust passing to your descendants at the expiration of that term and providing them with a tax deduction for the value of the lead interest; or (3) You may leave assets to a charity in the form of a charitable remainder trust, providing an annuity or unitrust amount to yourself or your beneficiaries for a specified period of years, with the remainder passing to the charity and providing you with a tax deduction for the value of the remainder.

Planning for incapacity

As you no longer have a spouse to make health care decisions for you, consider creating a living will, designating a health care surrogate or an agent under a durable power of attorney. You might want to select an adult child, a parent, or a sibling. Think too about how you would want your assets to be managed if you should one day become incapacitated.

Declaration. A declaration, commonly referred to as a living will, expresses your intentions concerning life-prolonging procedures. By executing a declaration, you demonstrate to your family, friends, and physicians that if

your condition is terminal you do not wish to be maintained artificially in a vegetative or comatose state with no hope of recovery.

Designation of health care surrogate. You may also use a designation of health care surrogate form to name a person (as well as successors) to make health care decisions for you if you should become incapacitated and incapable of informed consent. Note that a living will only affects individuals with a terminal condition, while a designation of health care surrogate is always effective. If you execute a designation of health care surrogate, the decisions regarding your health care, including the need or desire to be operated on, will be made by the surrogate.

Durable power of attorney. A durable power of attorney designates an agent who may exercise management, sales, transfer, and other ministerial and investment powers over your assets. The agent designated under your durable power of attorney could step in to use, invest, and manage your assets if you become incapacitated and are unable to do so on your own.

Revocable trusts. If you execute a revocable trust and fund it with all of your assets, then the successor trustee who is named under the trust agreement should be empowered to step in and control, manage, invest, and otherwise handle your assets in the trust if you become incapacitated. The trust is more flexible than a durable power of attorney and it permits you to spell out exactly how you want your assets managed.

Guardianship. If necessary, the appropriate courts in your state may be petitioned for the appointment of a guardian who may manage your assets or make decisions for you if you become incapacitated. Most of the actions of a guardian must be preapproved by the court or are subject to later court review. In addition, guardians are required at least annually to present to the probate court an accounting of all transactions involving the ward's assets and to describe the ward's care.

Preneed guardian

Typically, the guardianship process is difficult, cumbersome, and expensive. Nevertheless, many states permit you to appoint a preneed guardian, which means that you select the person to serve as your guardian if one is ever needed.

Estate planning is a complicated matter and a great deal of the planning depends on your family relationships, your intended beneficiaries, the size of your estate, and your estate planning goals. These are very important and complex issues, which you should consider and thoroughly understand. Then, armed with a fundamental understanding of your goals, you should contact an estate planning attorney to help you establish and implement your plan.

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