National Life Group®

Estate Planning Basics

ADVANCED PLANNING CONCEPT

The Foundations of Estate Planning

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Introduction

Estate Planning is the process of determining and documenting how individuals want their estate to be handled upon their incapacity or death. It is the process of getting the right assets to the right people at the right time and in the right way. To accomplish these wishes, there are five pillars of estate planning that should be fully and thoughtfully considered by everyone:

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Pillar 1

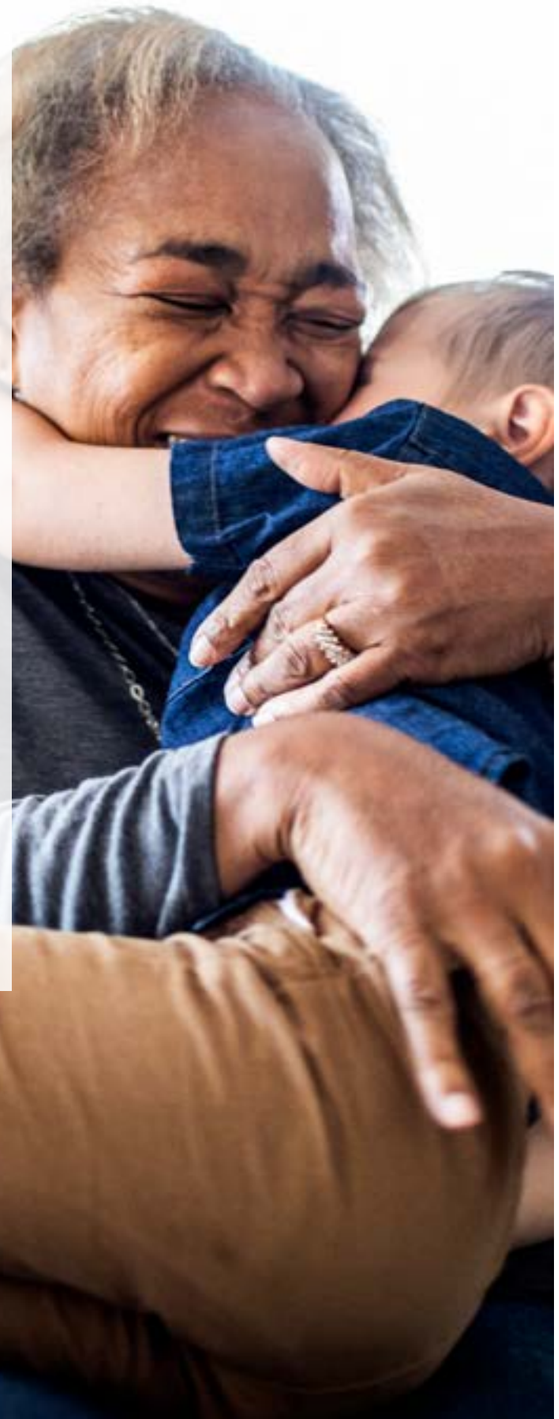
Last Will and Testament

A last will and testament is a legal document in which a person declares their final wishes regarding how they want their property administered and distributed after their death.

A well-written last will and testament can accomplish numerous personal and financial objectives, such as:

- appointing an executor to administer the estate;
- designating beneficiaries of assets;
- nominating guardians for minor children;
- making specific bequests of personal assets or charitable donations; and
- creating one or more testamentary trusts to help meet important goals such as funding children's education or providing for elderly parents.

The rules, restrictions, and requirements of a last will and testament are dictated and governed by State law. While the following information generally represents these requirements, State requirements can vary. Therefore, it is important for everyone to consult with an estate planning attorney licensed in their residency State to assure the will is properly drafted and executed.



Validity of a Last Will and Testament

As mentioned, the State law of an individual's domicile governs the validity of their last will and testament. Generally, for a will to be valid, the testator (the person making the will) must have testamentary capacity and testamentary intent. Testamentary capacity is the ability of an individual to make a will. Commonly, testamentary capacity requires one to be at least 18 years of age and to have mental capacity (meaning they possess a sound mind). Testamentary intent is one's intention of creating a will to control disposition of their property after death.

In addition, certain formalities must be followed, such as the will must be:

1. in writing;
2. signed by the testator or by someone under the testator's direction in the testator's presence, and
3. signed by two competent, objective witnesses (individuals who are not named as beneficiaries of the will) in the testator's presence.

Typically, individuals work with their estate planning attorney to draft a customized will based on their unique situation, goals, and objectives. However, some States permit standardized, non-customized wills. These wills are referred to as statutory wills because they are created by the State legislature. Statutory wills are available at no cost, but there is a trade-off: the testator must use them exactly as they are written by simply filling in the blanks with their own personal information. It is recommended that anyone relying on a statutory will have it reviewed by an estate planning attorney in their State to ensure that it supports the overall objectives of their estate plan.

Probating a Last Will and Testament

When a testator dies, their estate must go through a judicial process called probate. Probate is the formal legal process that validates and gives recognition to the will. Generally, the probate process begins when the executor submits the will to the court after the testator passes away. Filing the will with the probate court results in the will becoming a public document. The court officially appoints the executor of the estate, typically the individual named in the decedent's last will and testament. Once the court appoints the executor, the executor begins the estate administration process, which entails identifying assets, reconciling any debts, and paying any taxes owed. Once this process is complete, the executor distributes the remainder of the decedent's property pursuant to the terms of the will.

The probate court generally oversees and supervises the estate administration, which may be costly and time-consuming depending on State rules and any disputes that may arise regarding the handling of the estate. Many States afford smaller, less complex estates simplified court proceedings, which are more efficient and inexpensive. Each State has its own rules on what is considered a "small" estate, and these rules and thresholds vary significantly from State to State.

In the process of identifying the assets that comprise the decedent's estate, the executor will likely encounter both probate and non-probate assets. As the name suggests, probate assets are those that must go through the probate process.

The Internal Revenue Service provides public information about estate administration and tax return filing:

Irs.Gov/Individuals/Deceased-Person

Probate vs. Non-Probate Assets

Probate assets are generally those that are individually and solely-owned by the decedent. This generally includes assets such as solely-owned cars, boats, homes, bank accounts, real estate, business interests, investment accounts, digital assets, art, personal/household items. Also, an individual's share in certain jointly-owned accounts (such as property owned as tenancy in common), and their share of community property are considered probate assets. Each of these assets would become part of the decedent's probate estate and would transfer pursuant to the terms of their will. However, not all solely-owned assets are considered probate assets. Instead, some may be considered non-probate assets.

Non-probate assets are those that pass automatically and directly to the intended individual(s) outside of the probate process. Therefore, these assets are not generally controlled by the terms of a decedent's will. There are many types of non-probate assets, which can generally be determined based on the type of asset, the type of account, the form of ownership, or the existence of a contract.

Drilling a bit deeper, the following are some specific types of non-probate assets:

Non-Probate Assets	Mechanism for Transfer Upon Death
Pension and retirement accounts with a designated beneficiary, such as § 401(k) plans, Individual Retirement Accounts (Traditional, Roth, SEPs and SIMPLEs), § 403(b) plans	Retirement assets transfer to the intended individual(s) via the beneficiary designation
Health Savings Accounts (HSA)	HSA balances transfer via the beneficiary designation
Certain jointly-owned assets titled as Joint Tenancy with Rights of Survivorship and Tenancy by the Entirety	Jointly-owned assets with rights of survivorship pass to the surviving joint owner(s) by operation of law
• Accounts with financial institutions designated as Payable on Death (POD), used for bank accounts (checking and savings) and certificates of deposit. • A POD account is also referred to as a "Totten Trust"	The account transfers to the beneficiary named in the POD agreement
Accounts with financial institutions designated Transfer on Death (TOD), used with investment accounts, stock, and bonds	The investment asset transfers to the beneficiary named in the TOD agreement
Life insurance (both permanent and term)	• Life insurance death benefit transfers to the intended individual(s) via the beneficiary designation • Ownership of a life insurance policy transfers via the designation of a contingent owner (applicable when the owner and insured are different people)
Other assets under a contract such as a pension account, a non-qualified annuity, or business interests governed by a buy-sell agreement	Assets governed by a contract transfer to the intended individual(s) pursuant to the terms of the contract

There are additional ways that assets avoid the probate process. For instance, assets owned by trusts (revocable and irrevocable) are considered non-probate assets. Also, State law may classify certain contracts as probate or non-probate assets.

A word of caution about non-probate assets:
As you may have noticed in the above table, many of the listed non-probate assets automatically transfer to the named individuals/beneficiaries upon the decedent's death. If there is no named beneficiary upon death because the decedent failed to name a beneficiary or because any named beneficiary(ies) predeceased the decedent, typically the default beneficiary is the decedent's estate. If this occurs, these once non-probate assets become probate assets and must go through the probate process. This may cause surviving family members additional strain during an already difficult time due to the cost and time of probate. Also, all too often these beneficiary designations are not updated to reflect changing life circumstances, and assets end up passing to individuals other than those the decedent intended. Therefore, it is important to regularly review and maintain beneficiary designations — for both primary and contingent beneficiaries.

Dying Without a Will

If an individual dies without a valid will, the decedent is referred to as an intestator, or a person dying intestate. Without a will, the State intestate succession laws dictate how and to whom assets are distributed upon the intestator's death. The asset distribution rules under State law may not match the goals and needs of the decedent or the family. For example, some State intestacy laws divide the intestator's estate among the surviving spouse and children, even if the decedent might have wanted the estate to support the surviving spouse for a lifetime and then benefit children upon the surviving spouse's death.

Therefore, a will is an important estate planning document in order to give the right assets to the right people at the right time and in the right way.

Pillar 2

Powers of Attorney

A power of attorney (POA) is a legal document in which an individual (the principal) authorizes someone (the agent) to handle the principal's affairs upon the principal's incapacity.

POAs further the principal's estate planning objectives because a POA can generally avoid court proceedings to appoint a guardian or conservator over the principal's property, and the principal may grant the agent customized powers to fit the principal's specific needs.

Validity

For a power of attorney to be valid, the requirements under State law must be met. State laws generally require the following:

1. The principal has the capacity and intent to sign the power of attorney,
2. The document must be signed and dated by the principal,
3. The signature must be either acknowledged before a notary public and/or witnessed by two disinterested individuals, and
4. The agent must be appropriate.

Generally, if an agent is an individual, the agent must be a legal adult and of sound mind. In addition, the agent might need to possess capacity to contract depending on the State and the scope of granted powers. If the State law allows an institution to serve as an agent, the State law may have some requirements for such an institution. Last, while it usually does not affect the validity of a POA, the agent needs to accept the appointment before the agent could exercise the powers.

Choosing an Agent

A principal possesses much flexibility in determining whom to choose as their agent. The principal can choose nearly any person including a family member, a friend, or a professional fiduciary unless such a person is prohibited to serve under State law (e.g., a minor). In light of the important role an agent plays, principals can never be too careful in their selection. Some criteria for choosing an agent are provided in "Fiduciary Selection" on page 15 herein.

Types of Powers of Attorney

There are two types of POAs: a financial POA and a health care POA. Note that some States allow one power of attorney document to cover both financial and health care matters. However, it is more common to have two separate forms, one for financial decisions and the other for health care. In this way, it is easier for the various institutions to review and may take less time for them to accept the powers of attorney.

Financial POA

A financial POA is for financial affairs and gives the agent broad powers to handle all the principal's finances including:

- using assets to pay everyday expenses;
- collecting Social Security, Medicare, or other benefits;
- handling transactions with banks or other financial institutions;
- filing tax returns and paying taxes;
- transferring property to a trust;
- managing retirement accounts;
- accessing safety deposit boxes, and
- making gifts (if power is specifically provided).

Health Care POA

Under a power of attorney for health care, sometimes called a health care proxy, the principal authorizes an agent — commonly a family member or a trusted friend — to make health care decisions if the principal is unable to do so. While a health care proxy can include specific wishes, it does not provide the agent with specific instructions. Based on the principal's direction, the agent determines what treatment the principal will receive or if treatment should be withheld. Since the agent is accepting the responsibility to act on the principal's behalf, the agent should be fully informed about what type of treatments the principal would or would not want and what to do under different circumstances. The agent will start making decisions based on State law requirements — generally when two doctors determine that the principal is unable to make health care decisions for themselves.

Scope of Granted Powers

The principal may determine the scope of authority granted to the agent. Based on their unique needs and objectives, the authority can be broad or limited. When determining the scope, the principal should consider the following ways to qualify or restrict the agent's authority.

General vs. Limited Power of Attorney

With a general power of attorney, a principal can authorize an agent to act generally on the principal's behalf. A general power of attorney can also be tailored to grant the agent with limited authority on a particular matter or not to grant certain authority.

On the contrary, a limited power of attorney is used exclusively for a specific situation or in a specific context. In the estate planning arena, a general power of attorney is more frequently used.

Durable vs. Non-Durable Power of Attorney

A durable power of attorney remains in effect until the principal passes away or terminates the authorization. In other words, a durable power of attorney will be effective regardless of the principal's incapacity. A non-durable power of attorney terminates on the principal's incapacity.

Because the main purpose of creating a power of attorney as part of an estate plan is to take care of the principal's matters in case of incapacity, a power of attorney prepared for estate planning is typically intended to be durable.

Springing vs. Non-Springing Power of Attorney

A springing power of attorney means the powers granted to the agent will not become effective until a future date specified in the power of attorney document or until a certain event occurs, such as the principal's incapacity. A non-springing power of attorney is generally effective once signed by the principal.

A POA can also be a combination of both. For example, a spouse can be appointed as the agent of non-springing powers. If the spouse is not available, the child will serve as the successor agent but only with springing power.

As is the case with respect to most estate planning matters, State law may contain rules as to the permissible scope of POAs. Therefore, it is recommended that individuals consult with an estate planning attorney in their State to discuss what is allowable under State law.

Pillar 3

Advance Health Directives

Advance health directives are legal documents that allow an individual to convey decisions and instructions related to health care preferences ahead of time. They can be revoked or amended at any time.

These documents communicate the individual's wishes to the family and health care professionals to avoid confusion if the individual becomes incapacitated. In addition to a power of attorney for health care, other types of advance directives are discussed below.

Living Will

A living will is one type of advance directive. This legal document spells out the types of medical treatments and life sustaining measures the principal does and does not want. The statements in a living will are a direct communication to health care providers, and the physicians are legally obligated to follow those statements. Sometimes called a health care declaration or a health care directive, a living will is more specific than a health care proxy and may actually list conditions under which the treatment is to be given or withheld. Examples include withholding or withdrawing life support, nutritional and hydration assistance, and other treatments in the end stages of life. Living wills usually do not go into effect unless the principal is in a permanent vegetative state or terminally ill and unable to communicate.

Declaration for Mental Health Treatment

Many States allow an individual to use advance directives to make decisions in advance about mental health treatment. The advance directive addressing mental health treatment might be called a declaration for mental health treatment or an advance directive for mental health care. The rules of declaration for mental health treatment differ by State. For example, some States allow the principal to grant an agent with authority to make mental health treatment decisions similar to a power of attorney, and other States allow the principal to communicate directly with the treatment provider. Limited by State law, an individual generally could specify wishes regarding psychotropic medication, emergency mental health treatment, or admission to a mental health facility.

Each State has its own laws regarding advance directives and might have statutory forms available. Copies should be given to the principal's health care providers as well as to family members.

Pillar 4

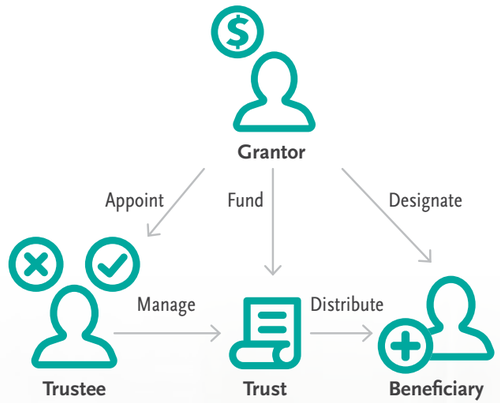
Revocable Trusts

Fundamentally, a revocable trust, also called a living trust or an inter vivos trust, is an instrument for wealth transfer. It is a written legal document that an individual establishes during their lifetime to set forth how their assets will be managed both during their lifetime and after death. It may also contain instructions for the management of trust-owned assets should the trust creator become disabled.

A revocable trust augments a last will and testament and is commonly used with what is referred to as a "pour-over will." A pour-over will is designed to "pour" any assets remaining in a decedent's estate "over" into the revocable trust. With a pour-over will, any assets not transferred to a revocable trust during the decedent's lifetime will be transferred to the trust upon death. Although any remaining assets can be transferred to the revocable trust upon death through a pour-over will, the assets do not avoid probate because rules applying to a last will and testament equally apply to a pour-over will.

Parties to a Revocable Trust

There are three players involved with all trusts (revocable or irrevocable): a grantor, a beneficiary, and a trustee. These roles may be depicted as follows:



The grantor of a trust is an individual who establishes the trust. A grantor is also referred to as a settlor, a trustor, or a donor but there is no legal significance of one term versus the others. As the name suggests, the beneficiary is the individual(s) entitled to the benefits of the trust, including the trust assets or income generated by such assets.

The trustee of the trust is the individual appointed by the grantor to hold legal title to the trust property. As directed by the trust document, the trustee manages the trust property for the benefit of the grantor. As a fiduciary, the trustee is entrusted with the power to act on behalf of the grantor, but also has the obligations to serve the best interest of the trust beneficiaries.

Revocable Trust Structure

Generally, a revocable trust has one grantor and one trustee at its setup. However, it is possible for there to be more than one grantor and trustee. This is most commonly seen with married couples, who establish a joint revocable trust whereby they are both initial grantors and trustees.

The grantor of a revocable trust will typically serve as the sole trustee of the trust until such time that the grantor is unable to serve (i.e., the grantor becomes incapacitated) or chooses to no longer serve. The grantor, through the power of trustee, can control the assets transferred into the trust. During the grantor's lifetime, a revocable trust is amendable and revocable, which means the grantor retains control of the trust and can make any changes to or revoke the trust in its entirety at any time.

At the grantor's death, assets in the trust are distributed to the beneficiaries or held in trusts for the benefit of the beneficiaries in accordance with the trust provisions. Upon the grantor's death, the trust becomes irrevocable, and the named successor trustee will take over and administer the trust based on the terms of the trust document.

Because the trust document, rather than a will, directs how the assets will be distributed, the trust assets bypass probate. If all of the grantor's assets are in the trust, the entire estate bypasses probate. Thus, probate costs can be effectively reduced (or eliminated) through the use of a revocable trust.

Funding the Revocable Trust

After establishing a revocable trust, the grantor must properly fund the trust. This is critical because an asset generally does not bypass probate until it is transferred to the trust. The transfer can be completed by retitling assets from the grantor's name to the name of the trust. The change of title/ownership procedures vary by the property type. For most personal property, like a TV or a painting, the grantor will execute a document assigning ownership to the trust. Title changes for bank accounts or investment accounts commonly require the grantor to submit signed paperwork to the financial institutions. Real estate is more complicated, as changing title often involves the preparation and recording of a new deed in the county where the real property is located. The trust can also be set up to receive assets such as life insurance proceeds and death benefits from the grantor's employee benefit plans. If the trust holds life insurance, the grantor has continued access to the policy's cash value while the grantor is alive. Regardless of asset, it is critical that the grantor transfers assets to the trust to take advantage of the benefits a revocable trust offers.

Tax Considerations

From an income tax perspective, a revocable trust is not a separate taxpaying entity and therefore is not required to file an income tax return or pay taxes as an entity. Instead, the income is reported on the grantor's individual tax return. Whether or not the grantor actually receives income from the trust, the Internal Revenue Service regards the assets as belonging to the grantor for income tax purposes. What's more, because the grantor has the right to remove assets from or fully revoke the trust, transfers to the trust are not considered gifts and therefore not subject to gift tax. Finally, assets in a revocable trust are included in the grantor's estate for federal estate tax purposes. Thus, a revocable trust is not a strategy that addresses potential exposure to estate taxes.

Advantages and Disadvantages

The table below highlights the advantages and disadvantages associated with revocable trusts.

Advantages	Disadvantages
Assets owned by the trust are non-probate assets and therefore avoid the costs and delay of probate	The revocable trust requires administration during grantor's lifetime, including funding the trust
The trust document is generally not a matter of public record and thus maintains the grantor's privacy after death	Lack of creditor protection, as most States allow the grantor's creditors to reach the assets of the revocable trust during grantor's lifetime
By consolidating assets in one place, a revocable trust simplifies estate administration and distribution, reducing estate settlement costs	State law may provide that the revocable trust assets can be used to pay the grantor's final expenses and debts
Enables the grantor to include instructions for someone to manage personal assets or a business during a disability or if the grantor becomes incapacitated	No income tax benefits, as the grantor must include in income any income generated by assets owned by the revocable trust
Bypasses court-appointed conservatorship or guardianship in the event of incapacity	No estate tax benefits, as the value of all trust assets will be counted in the taxable estate for federal estate tax purposes

As noted, a revocable trust is an extremely flexible instrument for wealth transfer. It gives the grantor the ability to provide detailed instructions for the distribution of assets – in effect, previewing the management of their estate. The trustee can also be instructed to withhold or distribute inheritances at their discretion based on the trustee's understanding of the grantor's objectives. For example, the trust document can specify how much individual children or grandchildren are to receive at certain ages and under what circumstances.

This can be especially useful for parents who want to provide equitably for children from previous marriages. In some cases, entrepreneurs and other small business owners may wish to transfer ownership of their businesses to a revocable trust. At death, the trust can provide for their beneficiaries while assuring the ongoing management of the business in the hands of a qualified trustee who can keep the business going.

It is important to discuss all of these features and characteristics with an **estate planning attorney** to ensure moving forward with a revocable trust (as opposed to an irrevocable trust) satisfies the individual's overall estate planning goals and objectives.

Fiduciary Selection

During the estate planning process, an individual will need to identify the executor of the last will and testament, the agent under the powers of attorney, and the trustee of the revocable trust. These roles are fiduciaries, and therefore deciding whom to appoint is one of the most important decisions in an estate plan.

The following should be considered in the selection of the right fiduciary:

- The candidate must be reliable and trustworthy. A fiduciary often has access to the principal's money and other assets. While beneficiaries or interested parties can always file lawsuit against the mistrusted fiduciary for violation of duty, it will be much easier to appoint the right person in the first place.
- The candidate must have the capacity to work on all needed tasks under authorization. Serving as a fiduciary is more like a job rather than a right. Sometimes entitled to reasonable compensation, a fiduciary is responsible for a variety of tasks which could be time sensitive or time consuming. Also, some tasks may require the fiduciary to make some difficult decisions. For example, an agent under a power of attorney may consider selling the principal's house or renting it out if the principal permanently moves to a senior housing. While the agent could consult with other professionals, such as a realtor, the agent should be capable of reaching a conclusion on their own. An ideal candidate should be good at task management and financial issues.
- The candidate should be willing and able to deal with disputes in a reasonable manner. Where there is money, disputes are likely to follow. It is not uncommon for beneficiaries to have conflicting opinions and disagreements. In this case, a fiduciary's role is to render fair decisions. The fiduciary should have the skills to bring interested parties to the table, keep them calm, and seek to preserve the relationship among beneficiaries — especially when they are family members.
- The candidate should not be too senior. While age brings people wisdom and experience, it is not ideal to have only the older generation such as one's parents serve as agents because the older generation is likely to have a shorter life expectancy than the principal.

Finally, it is preferable that the fiduciary's location is in close proximity to the principal. While the fiduciary can always leverage the expertise of others, this may be more challenging if the decision at hand involves some knowledge of State or local practices. Additionally, living close to the principal is more convenient if the fiduciary is requested to appear in person, e.g., for identity verification.

Pillar 5

Life Insurance

Life insurance plays a critical role in fulfilling one's estate planning objectives.

First and foremost, a life insurance policy helps in beneficiary care and expense coverage. Most families may not be able to maintain the same life quality after the death of a working parent. The death benefit payout can reduce the financial hardship after losing such a family member. The death benefit can also be used to cover expenses including funeral expenses, outstanding debts, and taxes of the decedent and the estate. In addition, the life insurance can be used to leave a legacy, satisfy unique needs of small business owners, and address special situations.

For more information on the uses of life insurance in estate planning, please check out another National Life Group brochure:
Estate Planning and Life Insurance

Cat No. 106489

Conclusion

Contrary to some people's belief that estate planning is only for the wealthy, the five pillars are essential for every household to specify to whom the assets should be distributed to upon death, how and when the distributions will happen, who shall serve as guardians to care for minor children, etc.

As mentioned at the beginning of this piece, an estate plan is about getting the right assets to the right people at the right time and in the right way. However, to achieve such goals, State law must be followed. State law provides specific rules governing the validity or limits of estate planning documentation; thus, it is critical that individuals consult with an estate planning attorney licensed in their State of residency. In addition, it is generally recommended to have such an attorney draft customized estate planning documents rather than using statutory documents or templates available online.

If you are interested in engaging your clients in a conversation about estate planning, National Life's **Estate Planning Assessment** is a great place to start.

Cat No. 106344

An estate planning attorney is likely to have a questionnaire for the client to complete before the attorney starts drafting estate planning documents. Therefore, it may be beneficial to coordinate with the attorney in terms of what information your clients would need to provide.

Once the drafting and signing are done, individuals will walk away from the estate planning process with a stack of documents. In most cases, the original of an estate planning document should be left with a responsible person or in a safety deposit box to which the appointed fiduciary has access. Copies of the health care power of attorney and advance health directive should be provided to the individuals who will act under the documents, as well as to family members and health care providers.

Copies of these documents and other important documents, such as life insurance policies, annuity contracts, trust documents, and retirement account numbers, should be kept in a central place so that the information is organized and easy to retrieve. Computer passwords and other digital assets should be kept in a secure place known to a trusted friend or family member who may need to access the information.

Last but definitely not least important, even if an individual has put into place all the necessary estate planning documents, the documents should be routinely reviewed to determine if the documents still meet the individual's needs. When life events happen including marriage, divorce, or having a child, it is also beneficial to review and amend the estate plan to reflect those changes as appropriate.

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