GENERAL ISSUES IN ESTATE PLANNING

Estate Planning is About YOU:
How Do You Control What Happens in the Future?

I. The Definition of Estate Planning.

What is Estate Planning? A fundamental and descriptive definition is:

> *I want to control my property. I want to take care of myself and my loved ones. At my death, I want to give my property to whom I want, when I want, and the way I want. And in the process, I want to save as much in taxes, costs, and attorney fees as I can.*

II. The Three Elements of Estate Planning.

The estate planning process focuses our attention in three basic areas:

> ***First*, Health Care**: Who will make decisions about your health care, if you cannot? What directions do you want to give to them about tube feeding or life support? How much decision-making power should your agents have?
>
> ***Second,* Providing for those you love**: What process will your family face if you become disabled or when you die? Will they need to rely upon a court proceeding (such as a conservatorship or probate) in order to implement your wishes, or will transition occur privately? What are your wishes, goals, hopes, and dreams for the ones you love? How shall we care for them? Do you want to provide protection for them over years to come?
>
> ***Third,* Taxes**: Will your loved ones need to file an estate tax return when you die? Will they suffer a loss to the IRS? What will be owed to the State of Oregon? What about your IRA or other retirement accounts?

III. Focus on Your Own Personal Health Care.

If you should encounter a time when you are incapable of making medical decisions for yourself, what will happen? Without prior planning, your doctor or hospital would likely look to your spouse or family for decisions to be made. Your family may not have had the benefit of good communication with you on the subjects that will be presented to them. More importantly, it is altogether possible that your physician or hospital would require that a guardian be immediately appointed by a judge to answer those medical questions. There are documents which you can sign now, when you are healthy and when no one is under the pressure of a crisis situation, that can help

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your family immensely if a medical emergency ever does present itself.

A. Advance Directive to Physicians.

In 1993, the Oregon Legislature again made new law in this area. The prior Health Care Power of Attorney, first available in 1989, was revised. You now have the power, in one document, to do a number of things. You can:

--Appoint persons to make health care decisions for you, if you cannot do so yourself;

--Empower those persons to decide whether you wish life support systems to be continued or stopped;

--Empower those persons to decide whether you wish tube feedings (artificial administration of hydration and nutrition) to be continued or stopped;

--Express your own wishes on those topics; and

--Tailor the form to meet your own personal beliefs.

The persons you have appointed must accept the appointment and sign the power itself. This document is now valid until you revoke it (or for a shorter period that you may indicate on the document itself). The former law, which mandated a seven year expiration period for the health care power of attorney has been repealed. In addition, the former version of the Living Will has been incorporated into the Advanced Directive, described above.

B. HIPAA.

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") generated a new medical privacy rule, effective in 2003, which is designed to protect our privacy when it comes to medical matters. Unfortunately, application of this new rule can also hinder the family if you reach a point where you are unable to communicate. To avoid unintended barriers to effective communication and care, everyone should sign a proper authorization, specifically directing medical providers to share information about you with the people you have chosen. Without this Patient Authorization, the family can encounter very real and serious stumbling blocks at a difficult time.

C. Guardianships.

Guardianships are court procedures used when no future planning has been made. It is not a recommended path, but it does enable a guardian to be appointed to make health care decisions when a person cannot care for themselves, for whatever reason.

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IV. Understanding How Things Work.

What happens when you die, or if you become incapacitated? What work does your family face in dealing with these transitions, when it comes to taking of business, paying the bills, and managing assets? The first thing to understand is that the answers to these questions are determined by a very basic analysis of *how you own what you own.* Once you understand what work your family faces, you can decide if you want to continue with that plan or if you want to change it.

A. Types of Ownership. There are certain basic ways we own assets.

1. Joint Ownership.

Assets can be held jointly, with right of survivorship, such as a joint bank account owned by two people, or a piece of property, where the deed lists two owners.

a. At Death.

Transfer of jointly held property that has a right of survivorship is simple. Merely by operation of law, automatically, the survivor will own that property. The only details will be that of recording or providing a death certificate to remove the name of the deceased owner. The exception will be property held jointly as tenants in common; there the portion owned by the deceased owner will devolve to the heirs of that decedent, through probate or some other means.

b. At Disability.

Depending upon the nature of the asset, jointly held property can either be simple--such as the ability of a health owner to write checks on a joint bank account even if the other owner is incapacitated--or it can be difficult. If two people own a piece of property, one is not entitled to sign for the other (say, on the closing of a sale or refinance of real property) simply because they own that property jointly.

2. Accounts with Beneficiary Designation.

Some assets, like retirement accounts or life insurance policy have the ability, by contract to designate a beneficiary.

a. At Death.

These assets are very simple to transfer when an owner dies, because the company holding the funds will simply distribute them directly to the named

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beneficiary. While quite simple, it is also critically important that you review your beneficiary designations every so often, so that they match your intent. Many times, folks forget who they have named or make incorrect assumptions, and money can end up in places you no longer intend.

b. At Disability.

Beneficiary designations only work after the owner has died, so if is necessary to access funds, say to pay bills when a person is incapacitated, there is no easy way to do so.

3. Property Owned in One Owner's Name, Alone.

Some assets will have a single owner. There is no joint owner, no "Payable On Death" or "Transfer On Death." So what do we do when that single owner can no longer sign documents?

a. At Death.

These assets must pass through the probate process, using the power of the probate court to transfer ownership after the owner has died.

b. At Disability.

No one is empowered to act on behalf of the owner, and the conservator will need to be appointed by the court to manage such an asset.

4. Asset Held in the Name of a Living Trust.

To avoid the problems set forth above, many folks prefer to create a living trust, and transfer ownership of their assets out of their names--as human beings--and into their names--as trustees of their own revocable living trust.

a. At Death.

Because a trust never dies, assets it owns do not pass through probate; instead, the assets are administered in accordance with the rules of the trust, in a private manner.

b. At Disability.

Because a trust never becomes incapacitated, management of the assets by a successor trustee is simple and private, following the rules that the trustmaker

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wrote when the trust was created, using the assets to pay bills and provide for the care of the trustmaker and family.

B. Understanding Your Planning Choices.

1. A Will-Based Plan.

Many people choose to set forth their wishes in a will, letting the probate court transfer ownership of assets at the time the last owner dies. The time and cost of probate is simply borne by the heirs. A will-based plan should also include a general power of attorney and an advance directive for health care, with HIPAA authorization. This plan may not avoid a conservatorship, but it is the simplest and least expensive to implement today. For those with minor children, a will is also the document used to name a guardian to take on their care and custody, should you die before your children all attain the age of 18.

2. A Trust-Based Plan.

A revocable living trust is a set of instructions for what you want done with the assets you place in the trust. Those assets are managed privately when you are no longer able to manage them yourself, whether by choice, disability, or death. While more expensive to establish, it is the least expensive and the simplest way to handle transition at the time of death or disability.

C. Is One Method Better Than Another?

In choosing how to plan, it is important to understand what unintended consequences can arise.

1. Disadvantages of Joint Ownership.

Many clients seek to avoid probate by simply adding a child onto a bank account or deed as a joint owner with right of survivorship. But be careful! This type of ownership can seriously confound other planning goals.

a. No Ability to Control Disposition at Second Death.

Joint ownership is a kind of game where "winner takes all;" the survivor chooses who will receive that asset at the time both joint owners have passed away. If you have children from different marriages, an unintended result can occur where the children of the first owner-to-die receive nothing from that asset. The only exception to this rule is if both joint owners die

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simultaneously, where it is impossible to determine who survived longer; in that situation, the law does provide that jointly held property is divided evenly, and the estate plan of each co-owner controls one-half of the property. This consequence can also foil appropriate estate tax planning if you intend to use both spouse's estate tax exemptions.

b. Exposure to Risk.

Joint ownership exposes you to risk in the form of the other owner's creditors. What if the other owner suffers financial setbacks, with judgments attaching to the property or a bankruptcy trustee looking to get paid from your asset? What if your other owner gets divorced and his or her spouse makes claim to the property?

c. Lack of Control.

By giving up complete ownership of your asset, you give up complete control. What if you and your joint owner have a parting of the ways? The other owner may not choose to cooperate with your plans for your property.

d. Tax Ramifications.

If your plan is to name your children as a co-owner on your property, there will be tax ramifications. Depending on the nature of the asset, placing a child's name on your property may be construed by the government as a gift, subject to the need to file a gift tax return and pay gift tax (or use up some of your lifetime credit). In addition, from an income tax standpoint, you may be giving up some benefits, because property received by gift takes the same basis that the giver had in the property; whereas property received as a result of death (whether by a living trust or by probate) creates a new fair market value basis in the property. If your children intend to sell a greatly appreciated asset soon after your death (and you do not otherwise have a taxable estate), giving it to them while you live will cause them ultimately to pay more income tax because they will not receive the benefit of the step up in basis.

2. Disadvantages of Planning Solely By Beneficiary Designations.

When you "fill in the box" on an application for life insurance or on your retirement plan, you have executed part of your estate plan. While the use of beneficiary designations is simple and avoids probate (in most instances), the real question to be asked is: Does that planning fit with your big picture?

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a. Minors.

If you have named your children, and they are minors, you have just ensured that a judge will become involved in your affairs, for minor children cannot own property. If they, themselves, are named as your beneficiaries, a conservatorship will be necessary to manage that money for them. In addition, you have just given up control over how and when they will receive that money. A total distribution of a substantial amount of money, all at the age of majority, may not be the best thing for most young adults! By planning, you can appoint the person you trust to manage the assets and decide how to invest and distribute them to your children, all according to your own value system.

b. Tax Ramifications.

If you have named your spouse, and you do not have a taxable estate, you may have used a simple solution that will work for you. However, if you do have a taxable estate, this designation is very important and must be coordinated with your overall estate tax plan.

c. Probate.

If you have named your "Estate," or if the person you have named dies before you and you have not named a contingent beneficiary so that the policy directs that your "Estate" becomes your beneficiary by default, you have guaranteed that a probate will be required in order to receive that money, transforming a non-probate asset into a probate asset.

3. Disadvantages of a General Power of Attorney.

One method which is relatively quick and inexpensive is to grant a power of attorney to another person to enable that person to handle your business affairs during any period of incapacity. The power of attorney can be given to a spouse, a good and trusted friend, or a professional (such a Bank whose Trust Department staff has experience in this area). The power of attorney can go into effect immediately, or it can be a "stand-by" power, not to be used except with the written opinion of your treating physician or by some other method of determining when you are no longer capable of handling business affairs. Unfortunately, there are serious drawbacks to a general power of attorney, because third parties may refuse to accept them at the precise time they are needed; you cannot force a bank, a brokerage house, or a title company to rely upon a power of attorney. Moreover, no real instructions govern how a general power of attorney is to be used; it is akin to giving someone a "blank

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check," so you best be very careful about who you appoint!

4. Disadvantages of a Conservatorship.

The method of last resort when dealing with disability is a judicial remedy called "conservatorship." I recommend that it be avoided, due to its cost, publicity, and emotional burden it places on you and your loved ones. A conservatorship is really no planning at all, but it is what we must use when there is no other way to allow your business affairs to be handled. It entails litigation if objections are raised, requires the posting of a bond, and necessitates annual accountings to the court. At the conclusion of the process, a judge will appoint someone as your conservator, though not someone you necessarily may have chosen. That conservator will be given the power by the judge to handle your affairs after they have paid an insurance company a premium for a bond equal to the value of the assets they will handle; that premium is due each year the conservatorship is in place.

5. Disadvantages of Probate.

The only way to transfer an asset after your death, which is held in your sole name, is by probate. This is a court proceeding which involves the filing of the will and the appointment of a personal representative, whose job it is to gather together all of your assets, pay all debts--including estate taxes, if any--and then to distribute those assets according to the directions of your will.

a. Cost.

It can be *expensive*. Costs involve the court filing fee (determined by the size of your estate), publication costs, accountant fees, and attorney fees. While costs vary with the complexity involved, generally speaking, the more assets you have, the more expensive the process becomes. An estimate of $5,000 would not be an unreasonable starting place; a few probates may be less expensive; many will be more costly.

b. Time.

It is *lengthy*. Even the simplest of probates can take up to nine months or a year. More involved matters lengthen the time in the court process. During this time, the question of who controls your estate may be a big issue for your family.

c. Lack of Privacy.

It is *public*. Notices are published in the newspaper, and any citizen is free

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to look through your probate file in the courthouse. Notices to heirs can be an invitation to them to file a will contest.

6. Disadvantages of Living Trusts

a. Time and Expense of Initial Set-up.

Establishing and fully funding a living trust may be more expensive than drafting a simple will. The reason for that is that each individual asset that you own must be transferred to the trust in order for the trust to affect it. Thus, the client and the attorney must identify each asset and prepare and record the appropriate document to transfer it to the trust. This may entail deeds to real property, signing off stock certificates before a stockbroker or bank officer (a guarantied signature) and sending that certificate to the company to obtain a new stock certificate in the name of the trust, changing beneficiaries on insurance policies or IRA accounts, transferring ownership of bank accounts or certificates of deposit, transferring bonds, treasury notes, or savings bonds, etc. Some people simply do not want to work with the detail that is involved in initially funding their trust.

However, once the initial work is done, the continuing costs are minimal. Additional assets can be added simply by acquiring them in the name of the trust in the future. Most importantly, when all assets are owned in the trust name, there is no probate time, publicity, and expense at death. Moreover, when dealing with a taxable estate, this consideration fades, because it is likely that re-titling work will also have to be done, thereby making this factor a minimal consideration.

The ultimate question is whether your perspective is one of saving time and money for yourself, during your lifetime, thus leaving this work for your personal representative and heirs to do after you die; or whether you prefer to save time and money for your family overall. The living trust benefits the estate overall; it does so at your expense and effort in the here and now.

V. Summary of Pros and Cons.

The following table is intended to summarize the pluses and minuses of each planning approach described above:

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METHOD	TIME TO SET UP	TIME TO ADMINISTER	EXPENSE FOR YOU	EXPENSE FOR HEIRS	CONVENIENCE FOR YOU	CONVENIENCE FOR HEIRS
General Power of Attorney	Minimal	Minimal	Minimal	Minimal	Convenient	Risky, because some third parties refuse to accept it.
Advance Directive	Minimal	Minimal	Minimal	Minimal	Convenient	Convenient
Living Trust	Somewhat involved for you.	Ongoing but minimal for you; minimal for your heirs.	Moderate	Minimal, after your death.	Somewhat involved to establish, but then convenient.	Very convenient.
Will/Probate	Minimal for you.	Very time consuming for your heirs.	Minimal	Expensive, after your death.	Convenient for you.	Burdensome for your heirs.
Joint Ownership, with Survivorship	Minimal	Minimal	Minimal	Minimal, but can be costly if the asset is highly appreciated.	Convenient for you.	Convenient for survivor; burdensome for heirs after that.

VI. Concern About Taxes.

What will your family have to pay in tax before they can inherit from you? First of all, it is important to understand that there are three types of taxes we must consider: income tax, federal estate tax, and Oregon estate tax.

A. Income Tax.

The general rule is that those that inherit from you do not need to pay income tax on their inheritance. They did not earn the inheritance, so income tax does not apply. There is actually a benefit for your heirs when they inherit property that has appreciated in value, as basis in those assets adjust to equal fair market value on the day you die; in essence, your heirs get a fresh start and avoid the capital gains income tax on appreciated assets that you would have had to pay had you sold that appreciated asset during your lifetime.

1. Exceptions to the General Rule.

The exception to this rule is any asset where you have not yet paid the income tax yourself during your lifetime, such as a traditional IRA, a savings bond, a contract receivable where tax is reported on an installment basis, or an annuity. Whoever inherits those assets still must pay the income tax.

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2. Consider Charity.

Because charities do not pay income tax, they are good choices when considering who to name as beneficiary on a traditional IRA account. A charity can use 100 cents of every dollar distributed from your IRA after your death, but a human being has to pay income tax on that dollar.

B. Estate Taxes.

The government taxes each of us on our "privilege" of transferring wealth. Whether you give assets away during your lifetime--gift tax--or at death--estate tax, the issue remains that we must consider the transfer tax. To determine whether any federal estate tax will be due is a function of how much you own on the day you die. Add the fair market value of all assets, including life insurance, and subtract any deductions. If the net estate remaining is less than the exemption available in the year you die, no tax and no filing will be due.

How much is free of tax? For those who die in 2015, the federal estate tax exemption is $5,430,000; it will grow with inflation. The tax rate for dollars exceeding the exemption is 40%, and the tax is due nine months after the date of death. While Oregon has no gift tax, it does impose an estate tax, on each dollar over $1,000,000, starting at 10%.[1] Not all states have estate taxes, so everything depends on where you live and where things are located when you die.

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[1]

Column 1 Taxable estate equal to or more than:	Column 2 Taxable estate less than:	Column 3 Tax on amount in column 1:	Column 4 Tax rate on taxable estate amount more than the amount in column 1 (percent):
$ 1,000,000	$ 1,500,000	$ 0	10.0%
1,500,000	2,500,000	50,000	10.25%
2,500,000	3,500,000	152,500	10.5%
3,500,000	4,500,000	257,500	11.0%
4,500,000	5,500,000	367,500	11.5%
5,500,000	6,500,000	482,500	12.0%
6,500,000	7,500,000	602,500	13.0%
7,500,000	8,500,000	732,500	14.0%
8,500,000	9,500,000	872,500	15.0%
9,500,000		1,022,500	16.0

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C. The Bottom Line.

If your gross estate--the fair market value of everything you own, including retirement and life insurance proceeds--exceeds the amount that can pass free of tax, then you have a taxable estate. The exemption amounts are different from state to state and are not the same as the federal law; they will continue to change over time, so be sure to stay connected and informed about the law. Be prepared to revisit the tax laws regularly, as change in the law is the only constant you can count on.

For those whose estates are under these amounts, there is no estate tax return needed and no tax to be paid! To put things another way, estate taxes are a concern whenever your gross estate (meaning the fair market value of everything you own, including retirement and life insurance proceeds) exceeds the exemption amounts, both state and federal, available in the year that a person dies.

D. Planning to Reduce or Eliminate Estate Taxes.

There are some basic approaches to saving estate taxes. One, if you are married, you can plan using *both* applicable exclusion amounts. Two, you can reduce the size of your estate subject to estate tax. Three, you can give your wealth to charity instead of the IRS and control what happens to it. And, finally, you can buy life insurance to replace the wealth lost either to the IRS or to charity, so that your family receives that amount you desire.

1. Using Both Applicable Exclusion Amounts.

A married couple enjoys an enviable position in the realm of estate tax planning. Each person has can shelter from tax the amount of the exemption allowed in the year a person dies. With proper planning, a married couple can use both exemption amounts to double the tax-free size of their combined estate.

a. Portability.

One way to use both federal exemptions is to file a federal estate tax return, a Form 706, when the first spouse dies--even if his or her estate does not exceed the exemption amount. That way, any unused portion will be available to the surviving spouse, later, when that person dies. This concept is called "portability."

While enticingly simple, there are some drawbacks to relying upon portability to double the tax-free size of the estate.

(1) There is no similar concept that covers Oregon estate taxes; you must use your Oregon exemption, or lose it.

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(2) The Generation Skipping Transfer Tax Exemption does not "port." Those who are interested in multi-generational planning should not rely upon portability to achieve their goals.

(3) It is not indexed for inflation, so it will not grow over time. Compare that to assets owned in an irrevocable trust; no matter how they may appreciate, they are not counted in the estate of the surviving spouse and so not taxed at the second death.

(4) If the surviving spouse remarries and outlives the second spouse, the ported exemption is lost.

b. Disclaimer Planning.

Another way to use both exemptions--whether Oregon, federal, or GST--is to create a plan that lets the surviving spouse wait and see whether it makes sense to keep all assets or to disclaim some, directing them to a Family Trust, so that the assets are available to the survivor but not included in the survivor's taxable estate.

Disclaiming assets is flexible and simple, but it must be done within nine months of the date of death, in writing, before the survivor accepts any benefit of the inherited asset.

c. Automatic Use of the Family Trust.

There are times when you KNOW you will use both exemptions, and there is no reason to wait and see, no reason to risk that disclaimer will not accomplished in a timely manner. In that instance, the plan can be drafted to direct the assets of the first spouse to die to a Family Trust, available to the surviving spouse, but not owned by that survivor. In addition to the estate tax savings, a side benefit of this kind of planning is asset protection. No one--no creditor, no new spouse, no unscrupulous person seeking to take advantage of the surviving spouse in his or her elder years--can take assets away from the surviving spouse. Using this trust also protects the inheritance of your children--the ultimate beneficiaries of your estate.

Using a Family Trust to hold the assets of the first spouse to die focuses on the issue of control. Can the surviving spouse change the plan? Disinherit the children? With this plan, assets are divided--his and hers--and the survivor change his or her own plan but only has power over the trust to the

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extent you two choose to give that power. Some people choose to give NO power to change the plan. Others give the survivor limited power. Yet others will give complete freedom to rewrite the estate plan, even after the first person has died.

d. Disadvantages to Using the Family Trust.

Even though there are many benefits to planning to use both exemptions--saving estate tax, protecting assets, protecting the children's inheritance from change--this plan comes at a price.

(1) The surviving spouse has a higher administrative burden. A trustee--even if that trustee is the surviving spouse--must meet fiduciary standards, file 1041 fiduciary income tax returns, and account to the remainder beneficiaries annually.

(2) If federal estate tax is unlikely, due to the high exclusion amounts, then the tax being saved is Oregon estate tax, at rates of 10% to 16%. Some times, assets in the Family Trust have appreciated greatly. When the surviving spouse dies, the basis of those Family Trust assets do not change. When sold, the Family Trust may pay capital gains income tax rates (20% federal, 3.8% federal net Investment Income Excise Tax, 9.9% Oregon, for a net effective combined rate of 31.4%). In other words, saving Oregon estate tax could come at a high cost, if assets appreciate inside the Family Trust.

e. Getting the Best of Both Worlds.

Getting the best of both worlds--getting the protection of a trust without losing the step up in basis when the second spouses dies--can be achieved by passing assets to a trust that qualifies for the unlimited marital deduction. A QTIP election, made on the estate tax return of the first spouse to die, determines how that trust will be taxed. The successor trustee, when preparing that return, can decide which is best: keep the assets out of the survivor's estate and have no change in basis, or include the assets in the survivor's estate and enjoy a second step up in basis.

VII. Reducing the Size of Your Estate.

The concept is simple: the less you have, the less tax will be paid. Translating that into reality is oftentimes more difficult, both psychologically and technically.

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1. Gifts.

If you can't keep it, give it away. Every person has an annual exclusion from gift tax to allow you to give $14,000[2] each year to as many different people as may be desired. A married couple can thus give $28,000 per year per donee without suffering any tax.

2. Involve Charity in Your Estate Plan.

Anything you give to charity will qualify for a deduction on your estate tax return. You can keep things simple and make outright gifts to charity, giving a percentage or a specific dollar amount as a bequest in your trust or will, and that gift will generate an estate tax deduction, reducing the size of the tax bill. Or, you could change your beneficiary designation on your IRA or pension plan, and give some amount directly to your favorite charity, thereby gaining not only an estate tax deduction, but avoiding the payment of any income tax on that money as well! More complicated planning also exists.

3. Insure Against It.

In those cases where estate taxes will be due, even after using all of the methods set forth above, buying life insurance can be a good way to help the family pay the estate tax bill. Remember, ownership by an Irrevocable Life Insurance Trust ("ILIT")--from day one--will assure that the life insurance proceeds will not themselves be subject to estate tax. Let your trustee buy the insurance on your life, so that you avoid the three-year pull-back rule. Life insurance creates wealth. It replaces what the family has lost, whether that be to the IRS or to charity. You can use life insurance to be certain that your family receives the amount you want your family to receives, regardless of the estate tax question.

VIII. Summary.

Estate tax planning can be as simple as using up what you have accumulated, or it can be a very involved process, spanning over a long period of time. Only you can decide your own priorities and determine how much time and effort you wish to devote to the process of planning to help reduce the estate tax burden for your family. Please feel free to ask about more detailed information about any of the ideas expressed in this outline.

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[2] This is the annual exclusion amount for 2015; it is indexed for inflation and will increase in increments of $1,000.

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