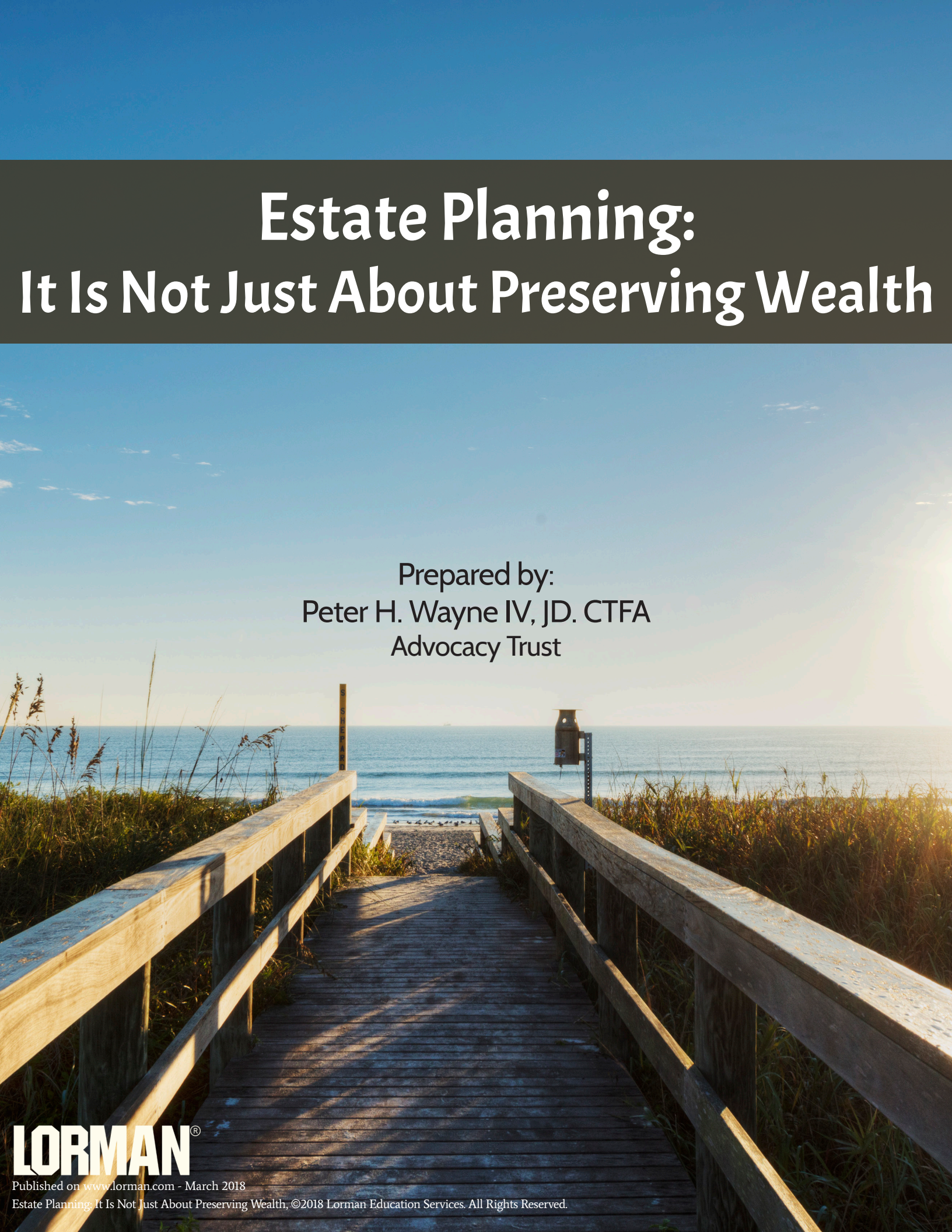
Estate Planning:
It Is Not Just About Preserving Wealth



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Peter H. Wayne IV, JD, CTFA

Estate Planning: It Is Not Just About Preserving Wealth

Estate planning is often considered only for those with high net worth, and sadly, this misguided belief is becoming more widespread as the estate tax exemption continues to increase year after year. In 2001, the estate tax exemption was only $675,000 per person ($1,350,000 for married couples), but it has grown over the last 15 years and is currently $5,450,000 ($10,900,000 for married couples).[1] This substantial increase in the exemption and the enactment of portability laws, laws that permit a surviving spouse to claim the unused portion of the federal estate tax exemption of their deceased spouse and add it to the balance of their own exemption, has resulted in fewer people using sophisticated estate planning techniques. It is a mistaken belief that estate planning is only for those who want to limit their exposure to estate taxes.[2] Most fail to realize, however, there is far more to estate planning than simply passing on wealth from one generation to the next. As such, any well-drafted plan should include documents for both incapacity and death. Thus, most estate plans for persons of all income levels should include the following:

1. Last Will and Testament (will);
2. Revocable Trust;
3. Power of Attorney;
4. Living Will/Healthcare Surrogate; and
5. HIPAA Release.[3]

Each one of these documents is not only vital to protecting oneself, but also necessary to protect one's family and help simplify what is an emotional and complicated experience—incapacity or death.

Last Will and Testament

Many people are unaware that should a Kentucky resident die without a will and leave a surviving spouse and children, their assets (those without a beneficiary designation form) are divided—half to the surviving spouse and half to the surviving children—an outcome rarely, if ever, desired. In addition, if a Kentucky resident dies without a spouse or children and without a will, the end result still may not be desirable as their probatable assets are distributed to their parents, if living, but if not, then to their siblings. Therefore, in order to avoid assets being distributed in an unintended manner, it is vital that Kentucky residents execute a will.

A will permits those who survive a decedent to administer his or her estate through probate. Probate is the court process by which a will is proved valid or invalid, and this process includes the accounting and distribution of the assets of the decedent's estate.[4] During the probate administration of one's estate, a will tells the court exactly how the decedent's assets are used and distributed. For example, a will directs how estate assets are used to pay outstanding taxes and debts, how to distribute any tangible personal property,[5] and finally, how the residue of the estate is distributed.[6] Also, if the testator, the person executing the will, has minor children, the will should also include a designation of the individual(s) to be appointed as guardian of the minor children (assuming there is no surviving spouse or said spouse is incapable of serving). Note, while the designation of a guardian for a minor child is not binding on the court, the deceased parent's final wishes are incredibly powerful and are given great deference by a judge.

In addition, beyond providing direction as to where estate assets are distributed upon death and the appointment of a guardian for minor children, a testator's biggest decision, with respect to a will, is who should be appointed as executor. An executor is a person, bank or trust company nominated in a will by the testator to account for all of the estate assets, pay all debts enforceable against the decedent, and after payment of any tax due and of the costs of the administration, to distribute the estate according to the terms of the will. [7] Often, a surviving spouse, adult child or relative is nominated to serve in this capacity, but there are times where the appointment of a corporate executor is not only helpful, but also appropriate. For example, serving as the executor of an estate is often a time consuming and stressful

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experience, especially when serving as the executor for the estate of a parent, spouse or child. Thus, in order to simplify the estate administration process and avoid compounding the emotional loss of a loved one, a bank or trust company may serve as the executor of an estate and ensure the decedent's final wishes are satisfied.

> **Example:** A husband suffers from early onset dementia and the children reside outside of Kentucky. Therefore, the husband and wife elect to nominate ABC Bank & Trust Company as executor of their estates to simplify the estate administration process for the family. ABC Bank & Trust Company consists of lawyers and investment specialists, and therefore, is perfectly positioned to serve as executor of both husband's and wife's estates. Further, by nominating ABC Bank & Trust Company as executor, husband and wife's family have the time to focus on the needs of the surviving spouse or, upon the surviving spouse's death, the emotion of losing both parents rather than on legal aspects of administering an estate.

Note, while the focus of this article is on Kentucky, the importance of executing a will is as critically important to someone from Louisville, Kentucky as it is to someone from Louisville, Colorado.

Revocable Trust

A revocable trust (trust) is a legal document wherein a grantor (the individual establishing the trust) reserves the right to modify its terms or to terminate its existence at any time. Upon the death of the grantor, the trust becomes irrevocable (unmodifiable), and the trust property is transferred directly to or placed into further trust for the benefit of the remainder beneficiaries.[8, 9] While most correlate the use of a trust with estate tax planning, there are other valuable benefits gained from their use as well. This includes the avoidance of ancillary probate, the protection of assets and the ability to control when and how assets are accessed by trust beneficiaries.

Ancillary Probate

Ancillary probate is a probate proceeding conducted in a state other than the decedent's primary state of domicile at the time of death. Such a proceeding is often necessary when an individual owns property outside his or her primary state of domicile, such as a vacation home. If, however, the property was retitled into the name of the trust before the decedent's death it is not subject to probate. Therefore, it is often good practice to retitle vacation property into the name of the trust to avoid the time, cost and stress of ancillary probate.

The Protection of Assets

Asset protection, in this author's opinion, is the single greatest benefit obtained from establishing a trust. While certain states, such as Tennessee, permit grantors to establish trusts in order to protect their personal assets from possible future lawsuits or claims from creditors against themselves,[10] such is not the case in Kentucky or in the vast majority of states throughout the country. However, under Kentucky law by establishing a trust for the benefit of a surviving spouse and/or children (and not for oneself as permitted in Tennessee), a grantor, upon death, is able to provide loved ones with the protection from the claims of future creditors, lawsuits and divorce proceedings.[11] Therefore, from a financial planning perspective, establishing a trust is the greatest benefit an individual can bestow upon their children and/or surviving spouse.

> **Example:** A husband in Kentucky establishes a trust for the benefit of his surviving wife and children (often referred to as a family trust) during his lifetime and directs, per his will, that all of his assets be transferred to the trust upon his death. Subsequent to husband's death, the surviving wife remarries and later divorces. Fortunately, however, because the husband left his assets in trust for the benefit of his wife and children, the assets held therein are not subject to the subsequent divorce proceeding, but rather are protected for the sole benefit of the wife and children. Note, this same protection would be afforded to the children as well. Thus, assuming all of the couples' assets are left in trust for the benefit of their children upon the surviving spouse's death, the assets held therein are afforded the same asset protection described above.

Appointment of Trustee and Access to Trust Assets

A trust permits the grantor the ability to determine when and how assets are made available for the benefit of loved ones and to also determine who is responsible for making the assets available. When establishing a trust, the grantor must decide who serves as the trustee of the trust. A trustee is most

often either an individual or a bank or trust company who is responsible for deciding when trust assets are made available to trust beneficiaries. With respect to married couples, it is often the case that the surviving spouse is nominated to serve as the trustee of the trust upon the grantor's death. This may change, however, as the couple ages or one spouse dies. If naming a spouse is not an option because either the grantor is single or the spouse is incapacitated or deceased, then a corporate trustee might be the best option until the beneficiaries of the trust are of a certain age. Thus, many believe naming a corporate trustee as the successor trustee after the death or incapacity of a spouse is best so the beneficiaries can go on living their lives with the comfort and confidence in knowing that a team of lawyers and investment specialists are managing the trust assets in order to provide for their needs. This level of oversight and protection is invaluable to both young children and adults alike.

> **Example:** A husband and wife are in their early 40s, have two minor children, and have a net worth of around $2,000,000. If the husband survives wife, the wife's assets, upon her death, will be deposited into a family trust for the benefit of the husband and the two children. If, however, the husband predeceases the wife or upon the husband's subsequent death following the wife's death, the estate assets are held in one trust for both children until the youngest child reaches a specified age (an age defined in the trust agreement, but generally between ages 22 and 25). The assets held in this trust are available for the health, education, maintenance and support of both children. Then, once the youngest child reaches the specified age, the trust is divided into two separate trusts, one for each child with the assets made available for each child's health, education, maintenance and support. Generally speaking, these trusts never terminate.

Without trust planning, the children would receive the assets immediately upon the husband's death, leaving the children free to make whatever decisions they desire while exposing the assets to unnecessary liability to claims from creditors and divorce proceedings. However, by implementing the aforementioned estate plan, the husband and wife are able to protect their children from claims from creditors and divorce proceedings for the entirety of their children's lives. The benefit of this type of planning and asset protection cannot be understated.

Tax Planning for Married Couples

Even though trusts are not established for tax planning purposes as much as they were just several years ago, because of the increasing estate tax exemption and the enactment of portability laws, tax planning with trusts is still important. For example, it is important that married couples with significant net worth (those with $5,000,000 or more in assets) understand how trusts can limit unnecessary estate taxes being paid upon death. The most common form of estate tax planning is still referred to as A/B trust planning. This form of trust planning permits an individual to transfer the maximum amount permitted under the estate tax exemption to a "B" trust (or family trust) for the benefit of a spouse and surviving children and to pass the excess under the spousal exemption to

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the "A" trust (or survivor's trust) for the benefit of the surviving spouse.[12]

> **Example:** A husband and wife have $12,000,000 in assets. Without planning, the wife would become the sole owner of the full $12,000,000 upon the husband's death. As a result, $6,550,000 ($12,000,000 less the wife's $5,450,000 estate tax exemption) is taxed upon the wife's subsequent death because an individual can only exclude $5,450,000 from the estate tax upon death. If, however, the husband and wife had executed an A/B plan prior to husband's death, then $5,450,000 is disbursed to the B trust for the benefit of the wife and children, and $6,550,000 is distributed to the A trust for the benefit of the surviving wife. The $5,450,000 would pass to the B trust tax free due to the husband's ability to use the $5,450,000 estate tax exemption. Furthermore, $6,550,000 would pass to the A trust tax free due to the unlimited spousal exemption. Subsequently, upon the wife's death, any amount in excess of $5,450,000 left in the A trust is subject to estate tax because she is only permitted to exclude $5,450,000 of this trust as part of her personal estate tax exemption. This is because the assets in the A trust are deemed a part of her estate upon death. Therefore, the takeaway is that it is beneficial for the wife to use assets from the A trust during her lifetime in order to reduce its value and in turn reduce the assets subject to estate tax upon her death. Regardless, however, whatever the amount in the A trust subject to the estate tax, if any, is far less, had the husband and wife not established an A/B trust plan.

Durable Power of Attorney

A durable power of attorney (power of attorney) is a document that permits a principal, the person who executes the legal document, to nominate someone (or multiple people) to manage his or her financial affairs.[13] The nominated person is often referred to as an attorney-in-fact. A power of attorney is an incredibly valuable resource because of its ability to permit the attorney in fact to immediately act on behalf of principal for personal, financial and business related purposes. If the principal has not nominated someone to act on his or her behalf, a court appointed guardian needs to be appointed should the individual become incapacitated and unable to manage their own affairs. Without a power of attorney, a guardian must be appointed before anyone can access bank accounts, perform routine business transactions or ensure the timely payment of outstanding bills. A guardianship proceeding in Kentucky involves a jury trial, and unless an emergency guardian is appointed (which is extremely difficult to achieve), the process can take up to three months to complete and can be quite costly. Therefore, not only does the power of attorney grant a trusted person with the ability to act on behalf of someone else, it also prevents against the unnecessary expenditure of dollars on attorneys who are helpful when navigating the guardianship appointment process.

Living Will/Healthcare Surrogate

Similar to a power of attorney, a living will and healthcare surrogate document enables people to appoint others to make medical decisions on their behalf and provides direction as to how life-prolonging treatment, such as artificial food and water and artificial respiration, should be administered. If no such document is in place, Kentucky law provides the following list of individuals , listed in order of priority, with the necessary authority:

1. Court appointed guardian(s)
2. The attorney-in-fact named in a durable power of attorney so long as the durable power of attorney specifically includes authority for health care decisions;
3. The spouse of the patient;
4. An adult child of the patient, or if the patient has more than one child, the majority of the adult children who are reasonably available for consultation; and
5. The parents of the patient. While Kentucky law thankfully provides those in the medical field with default guidance about who can make decisions on behalf of others, a living will and healthcare surrogate significantly simplifies the process and clear any confusion as to how medical care is administered. This lack of confusion can save time, and this time can truly be the difference between life and death.

HIPAA Release

Incorporating a HIPAA release into an estate plan is critical and is like wearing a belt and suspenders.[14] While a living will and healthcare surrogate document provides a healthcare surrogate with the requisite authority to access HIPAA protected medical information, there are times when a medical

provider or hospital raises concerns over the language contained in the legal document. Therefore, in order to avoid any issues, granting a healthcare surrogate the authority to access HIPAA protected information ensures the expedient and proper administration of medical care. In addition, it is often wise to grant an attorney-in-fact the authority to access HIPAA protected information because this person is responsible for paying medical bills. Accessing HIPAA protected information assists this individual when making sure the charges properly align with the medical care provided.

As previously mentioned, each and every one of these documents: the will, trust, power of attorney, living will and healthcare surrogate, and HIPAA release, are not only vital to protecting oneself, but important to protecting one's family while simplifying what is an emotional and complicated experience—incapacity or death. Therefore, it is important that individuals discuss these matters with their family wealth manager, attorney and accountant. While no one enjoys thinking about death or incapacity, a well drafted and fully vetted estate plan can be the greatest legacy gift someone can leave for their loved ones. Thus, in order to protect yourself, protect your spouse, protect your children, and protect your wealth—execute and implement an estate plan.

— Before joining Stock Yards Bank & Trust, Peter Wayne practiced law at Wyatt, Tarrant & Combs, LLP where he focused on special needs planning, litigation settlement planning, estate planning and estate administration. He is currently responsible for the administration of trust accounts and estates.

1 http://www.irs.gov/pub/irs-soi/ninetyestate.pdf

2 In order for a spouse to properly make the portability election, said spouse must file a federal estate tax return known as "Form 706." The Form 706 must be filed on or before nine months after the decedent spouse's date of death.

3 HIPAA stands for the Health Insurance Portability and Accountability Act of 1996.

4 *See:* http://legal-dictionary.thefreedictionary.com/Probate+of+a+will.

5 Tangible Personal Property is personal property that can be felt or touched. Examples include furniture, cars, jewelry, and artwork. In contrast, cash and checking accounts are not tangible personal property. *See http://definitions.uslegal.com/r/residue/*

6 Residue refers to what is left of an estate after the discharge of debts and distribution of specific gifts.

7 *See http://legal-dictionary.thefreedictionary.com/executor.*

8 Revocable Trust, Black's Law Dictionary, seventh edition, 1999.

9 A grantor is the person establishing the revocable trust for their benefit and the benefit of their surviving spouse, children and family.

10 The Tennessee Investment Services Act passed in 2007

11 When using a revocable trust most individuals leave, per their will, all of their non-tangible personal property, in to the trust in order to provide the trust beneficiaries with asset protection.

12 Under the spousal exemption, spouses are free to leave any amount in the A trust (or to a spouse outright) without subjecting the assets to estate taxes.

13 There are both durable and springing power of attorney documents. A durable power of attorney permits a nominated individual to act immediately on behalf of the individual regardless of their capacity, while a springing power of attorney is generally only valid and enforceable upon court approval or upon the authorization of two or more physicians.

14 Again, HIPAA stands for the Health Insurance Portability and Accountability Act of 1996.