The Minnesota Society of Certified Public Accountants

Footnote

April 2013

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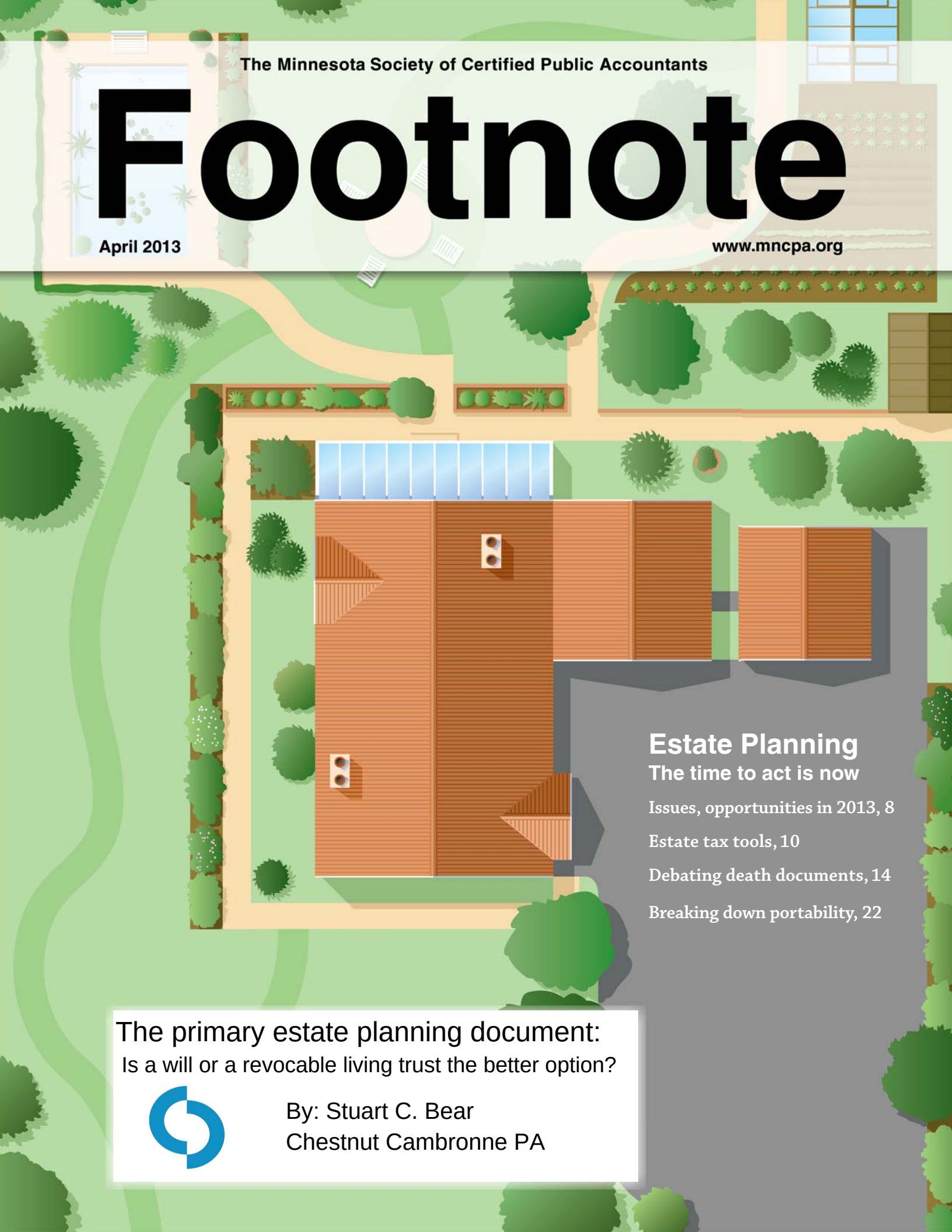

Estate Planning

The time to act is now

The primary estate planning document:

Is a will or a revocable living trust the better option?

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The primary estate planning document: Is a will or a revocable living trust the better option?

5 factors to consider

By Stuart C. Bear, J.D., Chestnut Cambronne

> **“While wills streamline the probate process, a properly established revocable trust serves to avoid the probate process.”**

The primary estate planning document for transferring assets at death is usually a will or, alternatively, a revocable living trust. Determining what is the most appropriate document for any given person is a key component in estate planning. But how do you and your clients know which one to choose?

Wills and revocable living trusts defined

A will is a method to transfer assets at death, for assets owned solely in the name of the deceased person. A will requires a probate procedure for singly-owned assets. Probate involves the judicial system, at some level, overseeing the orderly transfer of assets at death. Certainly, a will streamlines the procedure, as the will contains information regarding the beneficiaries and the appointment of the personal representative (i.e., executor) of the estate.

By contrast, a revocable living trust is analogous to a legal entity (other familiar legal entities are corporations, limited liability companies, and limited liability partnerships) that is established during a person's life. Typically, non-qualified assets (i.e., non-tax deferred assets) and real estate are transferred into ownership by the trust. The initial person establishing the trust, generally identified as the settlor or grantor, creates the trust document by agreement with a person or entity known as the trustee. The settlor/grantor may serve as the initial trustee. The trustee has control of the assets owned in the name of the trust. The settlor/grantor reserves the right to revoke or amend any provision of the trust, generally at any time. At the death of the settlor/grantor, assets are distributed much like a will.

Because the trust is analogous to a legal entity, once assets are owned in the name of the trust, there is no necessity for a probate procedure at the death of the settlor/grantor. With probate, individually-owned assets become “dormant” at death, with the necessity for a probate procedure to empower the personal representative to access the assets and distribute the assets to the beneficiaries. A revocable living trust requires no probate procedure for assets owned in the trust, because the access to the asset does not fall “dormant” at the death of the settlor/grantor; instead, by virtue of the fact that the assets are owned in the trust and not owned individually in the name of the settlor/grantor, “dormancy” does not take place and therefore there is no need for a probate procedure.

In each situation — a will or a revocable living trust — assets may be distributed to beneficiaries outright or in a testamentary trust arrangement. A testamentary trust arrangement is often used in connection with estate tax savings, as well as various other arrangements, particularly when providing for younger beneficiaries.

Therefore, each provides the same substantive measures in terms of distribution of assets at death, but the primary distinction is that while wills streamline the probate process, a properly established revocable trust serves to avoid the probate process.

Other assets may serve to avoid probate without the necessity to establish a revocable living trust. These assets include assets owned between one or more persons as joint tenants with the right of survivorship, assets traditionally governed by beneficiary forms such as policies of life insurance, retirement account assets such as 401(k) account assets, 403(b) account assets, and IRA account assets, as well as non-qualified assets established in the payable on death (P.O.D.), transfer on death (T.O.D.), or real estate established in a life estate or transfer on death (TODD) ownership arrangement.

Factors to consider

There are five main factors that come into play in determining whether a will or, alternatively, a revocable living trust, is the right primary estate planning document for any given person. The factors are:

1. **Asset accumulation vs. asset administration**
   Consider whether the person is in the asset accumulation phase of life or the asset administration phase of life.

   The **asset accumulation phase** of life is usually somebody younger to middle age, whether single, in a domestic partnership, or married. The person may have minor children. The person's assets are growing and likely will evolve into more diverse assets in the future, but for now are relatively straightforward. It is likely that this will not be the person's final estate planning document for the rest of their life, as it is always a good idea to review estate planning documents every three to five years. It's good to frequently review these documents because life can change quickly and often.

   For this type of person, the will is likely the appropriate estate planning document. The will streamlines the probate process, and probate may not be avoided anyway if minor children are involved, since the court retains final jurisdiction to appoint the guardian for a minor child.

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The person in the **asset administration phase** of life is generally a person who is approaching retirement or is in retirement. The estate plan the person adopts may be the final major substantive rewrite of the estate plan. This person may also be single, in a domestic partnership or married. The person's family situation and friendship structure is pretty well set, and the person typically has a diverse portfolio of assets (i.e., different types of financial assets, particularly non-qualified assets, and different parcels of real estate, such as homestead property and recreational property). The person is generally using assets and income to meet expenses, but the estate is not growing.

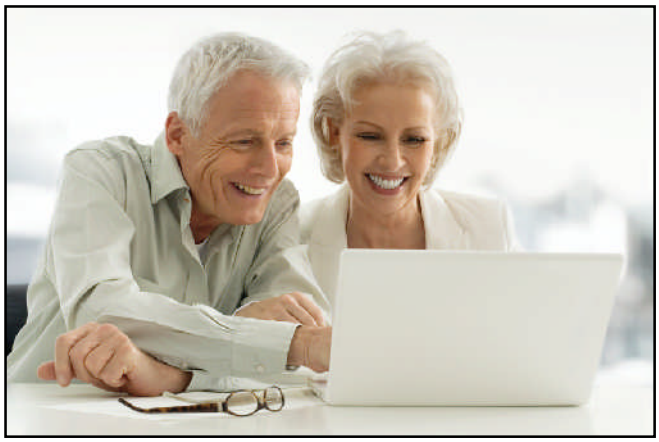
For this person, a revocable living trust may be the appropriate estate planning document.

2. Nature and extent of the assets

A person's assets may consist of life insurance, retirement accounts, annuities forming the vast majority of assets and possibly real estate and non-qualified assets. The life insurance, retirement account assets and annuities are traditionally governed by beneficiary forms and if it is an outright distribution to beneficiaries, the assets will avoid the necessity for a probate procedure. Similarly, non-qualified assets and real estate may be structured to avoid probate.

In this situation, with a person with this type of asset composition, it may be fine to structure the assets to avoid probate, but the person should adopt a will anyway, viewed as a "safety net" to ensure that if an asset is not properly structured to avoid probate, at least the will will serve to streamline the probate process. Thus, the person receives the benefit of avoiding probate without establishing a revocable living trust as the primary estate planning document.

However, someone with a diverse portfolio of assets — qualified and non-qualified assets, promissory notes for loans to family members, real estate in multiple states — would do well to establish a revocable living trust. The revocable living trust would consolidate assets, making for an orderly transition of assets at death. Moreover, because there is real estate held in multiple states, each state where real estate is held would need to be the subject of a separate probate procedure, an ancillary probate procedure, if a will and probate were relied upon to transfer assets at death. Conversely, retitling these parcels of real estate into ownership by a revocable living trust serves to avoid the necessity for the primary probate procedure in the person's state of residence, as well as ancillary proceedings in each state where parcels of real estate are owned.



3. Simplicity/complexity of estate plan

For the person who has a fairly straightforward estate plan — providing assets to desired beneficiaries, whether the beneficiary be a partner, spouse and/or children, typically in an outright fashion — a will is a fine probate document to put in place; structuring assets to avoid probate in that situation usually results in establishing a will as the primary estate planning document.

A person with a much more complex estate plan would do well to establish a revocable trust. This person may want to provide specific assets to specific persons or establish a series of testamentary trusts, such as a generation-skipping trust, supplemental needs trust, or spendthrift trust, in providing specific, fair treatment to beneficiaries. For this person, a revocable living trust would likely be the recommended estate planning document, due to the complexities of the estate plan.

4. Married couple — taxable estate

In Minnesota, if a married couple has an estate well in excess of the state exclusion amount for estate taxes (presently $1 million) and, in certain circumstances, an estate that would be subjected to federal estate taxes (present exclusion amount for a single person for federal estate taxes is $5.25 million and, with the portability benefit, $10.5 million for a married couple), it may be wise to split assets and adopt A-B testamentary trusts, or disclaimer trusts, as a component to the person's estate planning documents.

If that is the case, there may be limitations on holding assets jointly with right of survivorship, particularly in connection with the ability to disclaim assets. In light of this consideration, it is often best to split the ownership of assets, so that each spouse owns assets separately, in each spouse's respective name. By doing so, the legal documents govern the distribution of assets, ensuring that the testamentary trust arrangement is properly funded in order to position the married couple to double the Minnesota exclusion amount for estate taxes to $2 million, thereby sheltering the first $2 million of assets from estate taxes.

> **"It is commonly misunderstood that somehow by establishing revocable living trusts, there is an estate tax benefit that is far greater than establishing wills."**

If assets are to be separated, the separation of assets results in two probate procedures, one at the death of the first spouse and one at the death of the second spouse. Therefore, to avoid the necessity for both probate procedures, revocable living trusts are often established, one for each spouse, containing the proper testamentary trust language for distribution of assets to double the exclusion amount for estate taxes. In this situation, establishing revocable living trusts avoids the necessity for both probate procedures and is much more advantageous than wills.

It is commonly misunderstood that by establishing revocable living trusts there is an estate tax benefit that is far greater than establishing wills. This is not the case. The confusion is resolved when one understands that wills and, conversely, revocable living trusts, may have the same testamentary trust arrangement to double the exclusion amount for estate taxes. Revocable living trusts have an advantage over wills: It is best to use revocable trusts in order to avoid a probate process, or the two-probate process — one at the death of the first spouse and the second at the death of the second spouse. Assets can be properly structured in revocable trusts to allow each spouse to use the maximum exclusion amount for estate taxes.

5. **Confidentiality and contesting the estate plan**

An interesting evolution in estate planning is the concern about confidentiality, particularly in connection with estate settlement matters. A probate court procedure, by nature, is a public procedure. Although, the particulars of the probate matter, including the decedent's net worth and the identity of beneficiaries aren't typically broadcast in the media. Because the probate procedure is a public procedure, and anyone, whether or not they are a beneficiary, may have access to the probate court file. The probate court file would reveal assets, beneficiaries and the nature and extent of the estate plan through the will.

When thinking of confidentiality, one usually focuses on the decedent and, in point of fact, a person engaging in estate planning may well think about affording themselves confidentiality, even after they have long passed away. The evolution in this trend, however, has been an increased focus on confidentiality concerns for beneficiaries.

For the person whose beneficiaries may be subject to a lawsuit, divorce proceeding, judgment or who simply wants to protect the inheritance the beneficiary will receive, even protection from knowledge about the identity of the beneficiary — or the value of the inheritance the beneficiary would likely stand to receive — this person would want to avoid the necessity for a probate procedure. Therefore, this person likely would establish a revocable living trust as a means to afford confidentiality, not only regarding the person who is deceased, but also the beneficiaries.

Another interesting trend is the rise in estate litigation matters. Some attorneys in assisting clients in drafting estate planning documents find revocable living trusts beneficial, particularly long-established revocable living trusts. The idea is that the settlor/grantor that has a long-established trust and has long served as the trustee, operated with that trust in place, including its testamentary provisions, and therefore presumably knew full well what the trust provided for at the death of the settlor/grantor.

This notion is contrasted with a will, which directs assets at death, but is often placed in a safe deposit box, not to be reviewed for a number of years. While it is debatable whether a revocable living trust is likely to withstand a contest, as compared to a will, in light of the notion of confidentiality as set forth above, it may prove to be that much more difficult for someone contesting the estate plan to obtain information if the primary estate planning document is a revocable living trust as opposed to a will. In that sense, a revocable living trust certainly has advantages compared to using a will as a primary estate planning document.

What works best for you?

Deciding whether a will or a revocable living trust should be selected as the primary estate planning document is a determination based on a variety of factors. No one factor suggests that a will or a revocable living trust is the absolute correct primary estate planning document. Rather, the totality of factors in combination suggests what planning document is right for a person.

It is therefore the job of the practitioner, accountant, attorney, financial adviser or the combined efforts of professional advisers to properly understand a person's situation, including planning goals and objectives, and to recommend the most beneficial document to establish as the primary estate planning document. ■

Stuart Bear is a partner and shareholder at Chestnut Cambronne in Minneapolis. He is a fellow of the American College of Trust and Estate Counsel and a member of the National Academy of Elder Law Attorneys. He also teaches courses on wills and estates as an adjunct professor at the University of St. Thomas.

Learn more from Stuart Bear

Uncover smart client strategies at the 31st Annual MNCPA Estate and Financial Planning Conference, June 17-18. Gain insights from Stuart Bear and other leading financial planning experts such as Natalie Choate and Michael Kitces.

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