Planning Your Will: Insights and Options

When a person dies without a valid will, the state of his or her domicile furnishes a ready-made will that distributes that person's property according to a legislative formula. The formula distribution will seldom coincide precisely with the person's wishes or take into consideration the unique circumstances of the various heirs.

Naturally, under such a system of distribution, inequities can result; undeserving individuals may be included at the expense of a person's intended beneficiaries. Tax-saving opportunities may be forfeited, and the estate may suffer because of restrictive administration procedures.

How can the potentially adverse effects of intestacy be avoided? Simply by exercising your privilege to execute a will.

Estate Distribution

Under your will, you can determine exactly *who* will receive *what* and make arrangements keyed to the unique needs of each of your heirs. You may incorporate a timetable determining *when* certain beneficiaries will receive their shares. Or you can give the "income" benefits from property to one beneficiary for a period of time and then give the property itself to another beneficiary. Such **time-delayed** and **split bequests** can be effected by setting up trusts during your lifetime or in your will.

Although the privilege of determining how your assets are to be distributed is reason enough to have a will, other important goals can also be accomplished with a carefully drafted will.

Other important goals:

Continuing family income: It takes time before the family of a decedent begins to receive income from the estate. Under a will or trust, an individual can provide the surviving spouse with monthly income that will commence at death and continue until other income begins to flow or a distribution is made from the estate.

Guardianship for minors: When minor children are involved, a will allows a person to name a guardian of his or her own choosing and invest the guardian with the power to act in the best interests of the children without undue interference by the probate court.

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In the absence of a will, the state will appoint a guardian—usually the surviving parent or a close relative—who must seek the approval of the probate court with respect to nearly every action involving the child's property, including the disbursement of funds for the essential needs of the child.

Estate administration: Through your will, you can also perform another important function—designating a qualified **executor** to collect, manage, and distribute your estate's assets in accordance with your wishes. It is usually wise to name an **alternative executor**, one who can serve should your first choice move away, predecease you, or be unable to act for any number of reasons.

In the absence of a will, the state appoints an estate **administrator** whose powers are severely restricted by law, causing delays and possible losses in the estate. (***Note:*** In some states the executor or administrator is called the *personal representative* of the estate.)

Planning pointers: • During the probate process your executor can be responsible for as many as 20 major duties, including gathering and valuing your estate's assets (a task that can be difficult), making investment decisions, handling claims against the estate, and distributing estate assets. One way to assist your executor and perhaps speed up the probate process is to keep a list of all your property, its location, and its approximate value. This list should be kept in a place where it can be easily located and checked periodically to ensure its accuracy.

• Another advantage of choosing your own executor is that he or she can be given powers that may not be available to a court-appointed administrator. Such powers may be essential if a portion of your estate's assets consists of business interests. Executors are often required to manage the business interests during probate. The choice of your executor and the powers you give this person may mean the difference between success and failure of the business during this crucial period.

Tax Planning

Major tax legislation enacted in 2001 presents significant challenges (and opportunities) for individuals looking at the tax implications of their estate-distribution plans. Increases in the amount exempt from federal estate taxes, reduction in the top income- and estate-tax rates, and the scheduled repeal of the estate tax entirely for 2010 make it imperative that you keep in close touch with your tax advisors.

The estate tax is scheduled to disappear in 2010 and reappear in 2011—with a $1 million exemption per individual and pre-2001 tax rates. Many of the current tax-saving arrangements that you can implement under your will can still make a big difference in the amounts your beneficiaries may receive. For example, you can make sure that the **marital deduction** is used to its best advantage in your will. Although the marital deduction is unlimited (*at the death of the first spouse, no federal estate tax will be due on qualified property passing to the surviving spouse regardless of its value*), it may not be wise from a tax standpoint to rely only on the marital deduction. ***Reason:*** Everyone is entitled to an exemption-equivalent credit that exempts increasing amounts of the estate from federal estate tax—up to $3.5 million in 2009. If the first spouse makes use of only the marital deduction, he or she forfeits the use and tax savings of his or her exemption, causing everything to be taxable at the death of the surviving spouse.

Scenario 1: *Assume that at Mr. Clark's death in 2011 his estate is valued at $1,500,000. By taking advantage of the unlimited marital deduction, his estate will not be liable for any federal estate taxes. Further assume that Mrs. Clark does not use any of the principal she receives from her husband's estate for living expenses, and she dies in 2013. At her death, her estate will be subject to a potential federal estate-tax liability of $210,000.*

Scenario 2: *Mr. Clark divides his estate, leaving $500,000 to his wife outright* ***(or in trust qualifying for the marital deduction)*** *and $1,000,000 in a trust that does not qualify for the marital deduction. Mrs. Clark enjoys a lifetime benefit from her husband's entire estate. His estate-tax liability is zero because the federal estate tax on the $1,000,000 that does not qualify for the marital deduction is offset by his estate-tax exemption of $1,000,000.*

At Mrs. Clark's death, the $1,000,000 placed in the nonmarital trust will not be subject to the federal estate tax. The $500,000 that she received outright ***(or in a marital deduction trust)*** *will also be free of tax because of her*

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$1,000,000 estate-tax exemption. ***Result:*** *With minimal planning, the federal estate tax at Mrs. Clark's death is reduced by $210,000.*

Note: The above scenarios assume that Mr. Clark is the sole owner of all the couple's assets. In a community-property state, each spouse is deemed to have one-half interest in all community property acquired during the marriage. A transfer of one spouse's interest to the other, however, does qualify for the marital deduction.

Prepare for contingencies such as simultaneous death: Under his or her will, an estate owner can establish the order of death should both spouses die simultaneously as the result of a common disaster. When the order of death cannot be determined, it is usually presumed that each spouse has survived with respect to his or her own property. ***Result:*** No marital deduction, since nothing passes from one spouse to another. By reversing the presumption in the will, an estate owner can ensure that his or her estate will be able to take advantage of this valuable deduction. *Without a will, it's not possible to plan for this contingency, and the presumption of survivorship will stand.*

Allocate the tax burden: While careful estate planning can minimize the burden of federal and state death taxes, it may not eliminate taxes altogether. Therefore, it is essential to plan the most effective distribution of the tax burden. Under your will, you can direct whose share of the estate will be used to pay estate taxes. ***Charitable planning pointer:*** It's important that a charitable bequest be relieved from the payment of any taxes so the charitable deduction will not be reduced by any tax allocated to the bequest—which in turn would both increase the overall tax liability and decrease the amount of the charitable bequest.

Without a will, or in the absence of a tax-allocation clause in a will, taxes will generally be allocated in a ratio proportionate to all shares in the estate—which may have a result contrary to the intent of the estate owner.

Coordinating Your Estate Plan with a Pourover Trust

The process of planning an estate can be like piecing together a jigsaw puzzle. After reviewing your assets and the needs of your beneficiaries, you may find it exceedingly difficult to match the right asset with the right beneficiary. And you may have pieces that just don't fit! The **pourover trust** may be one answer to the problem of coordinating your assets to meet both your objectives and the needs of your family.

For example, you could

- name a pourover trust as the beneficiary of your life insurance policies,
- specify that benefits from a qualified employee benefit plan be paid to the trust, and
- have assets poured over from your will. If you fund a trust during your lifetime, it could ensure continuous income for your surviving spouse during the period of estate administration. As you add assets to the trust, your beneficiaries will be provided for according to your instructions.

Note: While a pourover trust can be an excellent way to unify an estate plan, every trust is governed by state laws.

The Effects of Different Types of Bequests

Whether a will is short and simple or lengthy and complex, it begins and ends with certain formal provisions whose purpose is to establish the validity of a will to the satisfaction of the probate court. The body of a will contains the *dispositive provisions*, commonly referred to as bequests. You may choose from a variety of bequests to achieve various objectives:

A **general bequest** is used to give a stated sum of money to any beneficiary, either in a lump sum or in installments. ***Caution:*** If there is insufficient cash in the estate, the executor may have to sell other assets of the estate to satisfy the bequest.

A **specific bequest** is used to make a specific gift of property to a beneficiary (e.g., "I bequeath my coin collection to my daughter Elizabeth"). ***Caution:*** If the property that makes up the specific bequest is disposed of during life and does not exist at the time of death, the beneficiary may receive nothing; the gift is considered to be cancelled. A will can provide for the bequest to be made up in some other way.

A **residuary bequest** is used to give all the rest, residue, and remainder of your property after all the debts, expenses, and taxes have been paid and all

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the general and specific bequests have been satisfied. ***Caution:*** If you intend the residuary bequest to provide the main source of your family's security, you should be aware that any reduction in your estate's value will have a severe negative impact on the residue and, thus, on the family.

Example: *Mr. Taylor has an estate valued at $600,000 when he executes his will. He makes general bequests totalling $100,000 to his children; the rest, residue, and remainder of his estate he bequeaths to his wife. At the time of his death, his estate has diminished in value to $400,000.* ***Result:*** *His children still receive $100,000, but his wife receives only $300,000—not the $500,000 he originally had intended.*

Planning with Charitable Bequests

You may find a bequest to be an excellent method of making a meaningful gift to our organization. With careful planning, you can realize the personal satisfaction that comes from knowing that your gift will help us to maintain our standard of excellence without jeopardizing your family's security.

Any of the various types of bequests in their many forms may be used to memorialize your philanthropic interest. Again, the choice of the specific mode of making a gift will depend completely on your unique circumstances and personal and financial objectives.

Outright charitable bequest: The **outright bequest** is the most popular method of making gifts—large and small—to charity. The bequest may be expressed in terms of a percentage of the residuary estate—a **percentage bequest**. ***Note:*** Since it protects all your intended beneficiaries against possible shrinkage in the estate's value, it may be a better arrangement than a **fixed-dollar amount bequest**.

In addition to the personal satisfaction of making a philanthropic bequest, there are definite estate-tax benefits attached to such a gift. The government, in effect, will share the cost of a charitable bequest by allowing a federal estate-tax deduction for the full value of the gift.

Usually an outright charitable bequest is in cash, but any type of property—stocks, bonds, real property, tangible personal property, business interests, etc.—may be given. However, when deciding what would be suitable for a charitable bequest, the nature of the property should be examined to determine all of the tax consequences.

For example, **ordinary-income property**—property that if sold would produce any ordinary income or short-term capital gain, such as Series E and H bonds, nonqualified stock options, and certain types of depreciated realty—can produce favorable tax consequences if left to charity under a will. ***Reason:*** A charitable estate-tax deduction will be allowed for its full fair-market value. And of course the charity will avoid having to recognize any tax on the distribution because of its tax-exempt status. *The tax savings from an outright charitable bequest can best be illustrated as follows:*

Example: *Mrs. Williams, a widow, dies in 2011 leaving a gross estate valued at $2,300,000. A comparison of her estate-tax picture with and without a bequest of $200,000 to charity illustrates how the charitable estate-tax deduction can substantially reduce the cost of the bequest.*

	Without Bequest	**With Bequest**
Mrs. Williams' Gross Estate	**$2,300,000**	**$2,300,000**
Debts and Administration Expenses	<100,000>	<100,000>
Adjusted Gross Estate	$ 2,200,000	$ 2,200,000
Charitable Deduction	—	<200,000>
Taxable Estate	$ 2,200,000	$ 2,000,000
Tentative Estate Tax	878,800	780,800
Exemption-Equivalent Credit	<345,800>	<345,800>
Estate Tax	$ 533,000	435,000
Estate-Tax Savings		**$ 98,000**

Mrs. Williams makes a bequest of $200,000 at an actual cost of $102,000, while reducing her federal estate-tax burden by $98,000.

Deferred bequest: You may find that family considerations simply do not permit the making of an outright charitable bequest. You may wish, for example, to preserve assets to provide income for surviving family members.

A charitable **time-delayed bequest** offers a viable alternative to an outright bequest. What's more, such a planned gift generates significant financial and tax

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benefits and may actually augment your family's financial security. ***Reasons:*** First, the government shares the cost of the gift by allowing an immediate deduction for federal estate-tax purposes for the portion of the gift that represents the **present value** of the charity's interest. An immediate deduction is permitted even though the charity will not receive the property until some future time—usually at the death of the life beneficiary you have designated. Second, your estate's federal estate-tax liability is correspondingly reduced, leaving more of these assets to generate additional income for the benefit of your beneficiaries.

Example: *Mr. Henderson, a widower with no children, directs in his will that property valued at $400,000 is to be placed in a* ***charitable remainder annuity trust*** *that will make annual payments of $24,000 to his sister for life. He leaves the remainder of his estate to his sister outright. At Mr. Henderson's death in 2011, his sister is 70 years old.*

By placing $400,000 in the charitable remainder annuity trust, Mr. Henderson reduces his federal estate-tax burden by $72,447. Thus, his sister will have $72,447 more to generate cash flow. In contrast to an outright bequest, under the annuity-trust plan his sister will receive an annual payment of $24,000 for life. Upon his sister's death, the trust principal will pass to us.

	Without Annuity Trust	With Annuity Trust
Mr. Henderson's Gross Estate	**$1,300,000**	**$1,300,000**
Debts and Administration Expenses	<100,000>	<100,000>
Adjusted Gross Estate	$1,200,000	$1,200,000
Charitable Deduction	—	<176,700>
Taxable Estate	$1,200,000	$1,023,300
Tentative Estate Tax	427,800	355,353
Exemption-Equivalent Credit	<345,800>	<345,800>
Estate Tax	$ 82,000	$ 9,553
Estate-Tax Savings		**$ 72,447**

Accelerated bequest: You may find in examining your estate plan that from both personal and financial standpoints it would be advantageous to make a **living bequest**. For example, property that you intend to leave to us under your will could be placed in a *lifetime* charitable remainder trust. Such an arrangement can produce the following benefits:

- You will be relieved of the management responsibilities of the property.
- The trust will make a stream of payments to you and/or another person for life.
- You will be allowed an immediate charitable income-tax deduction based on your age(s) for the present value of our remainder interest.

Planning pointer: Even further tax savings are possible if you fund the trust with appreciated property and avoid potential capital-gain tax.

Income-only bequest: Under certain circumstances, a bequest of income from property—rather than the property itself—may be an excellent way of retaining property in the family while making a sizeable bequest. For example, you may want a tract of income-producing real estate to be distributed to your grandchildren eventually *and* you are able to give up income from the property until the grandchildren reach a certain age.

You can satisfy both objectives by specifying in your will that the property be placed in a **charitable lead trust**. From your estate, the property is placed in trust for a specified number of years, and specified payments (either fixed or variable) from the trust are distributed to us annually. After that, the property goes to the grandchildren.

Such an arrangement will allow you to retain the property in the family, provide annual payments to support our work for the duration of the trust, and entitle your estate to a charitable estate-tax deduction for the present actuarial value of the payments we receive.

Contingent bequest—A charitable alternative: You may wish to consider naming us as a contingent beneficiary in your will. If a specific event happens—such as a beneficiary disclaiming a bequest—or a certain condition is met—such as a beneficiary predeceasing you—property you bequeath to that particular beneficiary would then pass to us.

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A **contingent bequest** ensures that your property will not pass to unintended beneficiaries. And if we are the recipient of a contingent bequest, your estate will be allowed a charitable estate-tax deduction for the full value of the property.

FINAL NOTE

You may restrict your gift by specifying how you want your bequest to be used. This may be done with both immediate and time-delayed bequests.

If you would like more information on how you can make a gift through a planned bequest, please contact or visit our office. We will be delighted to assist you in selecting the gift mechanism that best suits your objectives.

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You should consult your attorney about the applicability to your own situation of the legal principles contained herein.

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