



Smart Planning



Volume 18 Issue 1

ESTATE PLANNING OVERVIEW

March 2005

CREATING YOUR ESTATE PLAN

In this issue we intend to provide you with a clear & simple overview of the estate planning process. I suppose 'simple estate planning' seems like an oxymoron. People going through the process tell us it sometimes seems like they are wandering through a maze. We hope this report will bring you out of the maze and gently lead you to your goals.

Your Goals. For most folks they are about the same:

- Take good care your family.
- Select a Guardian for your minor children.
- Provide cash or liquid assets to pay family expenses & taxes.
- Avoid or limit your estate taxes.
- Minimize future income taxes.
- Make gifts to the persons or charities you desire.
- Choose the right people to serve as Trustee & Executor.
- Create a plan everyone involved can understand.

The process of creating your personal estate plan is more art than science. It involves meetings with someone who is familiar with all the legal, tax, and investment consideration and then working with them to weave their knowledge through your goals into a unique tapestry. A well constructed plan is your last great gift to your family.

The Unplanned Estate. Sadly, a majority of people never make this gift. Instead, the last memories they

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"We hope to lead You out of the Estate Planning Maze."

The information furnished in this newsletter about investments, tax provisions, and planning techniques is intended solely for your general information. This is a complex area with many ramification not mentioned herein. You should consult your attorney and other professional advisors before making any decisions or taking any course of action mentioned herein.

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JOINT WILLS or LIVING TRUST

Instead of using Joint Wills a couple can create a Revocable Living Trust. The Trust is a separate legal entity requiring its own set of books and records. Assets must be legally transferred into the Trust by deeds (real estate), bills of sale (personal property) or a transfer of title (cars & boats). Living Trusts are normally accompanied by a "Pour over Will" that transfers everything they still own outright into their Living Trust after their death.

The Grantor can amend and revoke the Living Trust at any time until they die. Then it becomes irrevocable. While it is revocable the income, gains and losses flow through into the Grantor's income tax return. So no separate tax return is required. The assets in your living trust are considered part of your estate for estate tax purposes. Creditors can reach them the same as any other assets you own. The tax advantages of your home all continue to apply if its in a Living Trust.

The big advantage of a Living Trust is that the assets in the trust do not have to go through probate. This is a major selling point in some states where probate is long and expensive. But I don't think the Living Trust is the best choice for most residents of Washington state. Our laws favor using Non-Intervention Wills. Probate is a relatively simple process here. See the sidebar on page 5. The disputes and problems associated with wrapping up a deceased's financial matters can occur regardless

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CREATING YOUR ESTATE PLAN



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leave their families are filled with confusion, fear, and disappointment. If you die without proper estate planning documents here is what happens:

- Your assets are distributed in accordance with state law.
- People you want to benefit often get nothing.
- Estate tax payments to the IRS can eat up your estate.
- A local Judge appoints a Guardian for your children.
- Your business may be sold at a discount to raise cash for family expenses and to pay taxes.
- Your survivors have to prepare your plan themselves.

The last result is the worst. Instead of spending the time after your demise grieving & honoring your life your surviving heirs must spend many hours going from lawyer to accountant to financial planner trying to salvage what they can. They have to create a piecemeal plan after the fact, using the limited techniques available at this late date. You will have a plan. The only question is who does it and when.

I hope you will be one of the people who does not let things happen that way. We like to say that estate planning is not simply planning for your death but in fact is actually planning your life. Identifying the things that pass to certain people on your demise is just one part of the tapestry. Devising a plan to eliminate or sharply reduce your gift & estate taxes is also important.

Estate & Gift Taxes. All of the real and personal property you own at the time of your death are considered part of your estate for purposes of calculating estate taxes. This includes your bank accounts, stocks

and bonds, retirement accounts, life insurance, 1/2 of your community property, your share of jointly owned property, assets held in your living trust, your share of private corporations, LLCs or partnerships, and your home & furnishings. Since different types of assets have very different estate & income tax consequences we ask all new clients to fill out a detailed list of assets.

The Chart below shows each person's lifetime exemption from Federal estate & gift taxes. Washington state now matches the federal estate tax exemption. The federal tax rate ranges from 45 to 47%. The Washington State inheritance tax ranges from 10 to 19%. The top brackets will pay a combined rate of 66%. Remember that it is called a "lifetime" exemption. Up to \$1 million dollars of your lifetime gifts count against your exemption, unless they fall into one of the exclusions listed below.

Year	Total Exempt	Gift Limit
2004	\$1,500,000	\$1,000,000
2005	\$1,500,000	\$1,000,000
2006-8	\$2,000,000	\$1,000,000

Gifting. One of the key elements of your plan will be to maximize your excluded gifts. The major exclusions are:

- Gifts of \$11,000 per person per calendar year.
- Gifts to qualified charities.
- Gifts to your spouse.
- Direct gifts to the vendors for education or health care expenses.

The \$11,000 exclusion includes gifts to a trust where the beneficiary has withdrawal rights known as a "Crummy Power". Gift direct to a child, into their UTMA account, or

"Why is my Will so Long?"

- It is custom crafted to fit your unique needs & desires.
- They are designed to survive many years of life changes.
- The law has many default rules we can override to provide the things you want
- There are many gaps in the law we try to fill with provisions in your will.
- We try to limit creditor's rights.
- The estate tax laws are detailed and complex.

into a Trust with a crummy power all count toward that child's \$11,000 annual limit. The \$11,000 annual exclusion is indexed for inflation and will increase in future years in \$1,000 increments. Most lifetime gifts to a trust will not qualify for the exclusion since they are not a gift of a "present interest".

In the Article stating on page 4 we have outlined a typical Will using plain English, so you can get a feel for the things we cover. The paragraph headings correspond to the section headings in the Will. The various sidebars and short articles provide a more in-depth look at certain topics. The process takes some study, but it is worth the effort. □

Elements of a Typical Plan

- Wills with requested Trusts for both husband & Wife
- General Powers of Attorney
- Medical Powers of Attorney
- Health Care Directives
- Review & customize Beneficiary Designations
- Clarify unclear Ownership or debt Interests
- Provide Owner's Manual for Wills and Trusts

Your Non Probate Assets

There are many types of assets that pass directly to your named beneficiaries and do not go through probate. They include:

- IRAs, SEPs, Keoghs, 401ks, profit sharing plans, qualified corporate retirement plans, deferred compensation plans, and other retirement accounts.
- Life insurance, and annuities.
- Bank and brokerage accounts held in joint tenancy with a right of survivorship.
- Bank and brokerage Pay on Death, or Transfer on Death accounts. Also called POD or TOD accounts.
- Real estate held in joint tenancy with a right of survivorship.
- A Community Property Agreement used as a Will substitute.

These items pass directly to the named beneficiaries by virtue of the written beneficiary designation in the account documents themselves. Thus they are not distributed in accordance with the terms of your estate planning documents, like your will or living trust. Many people forget this, or never knew it. People like them because they appear to be a simple, low cost method of estate planning. Regretfully they have a multitude of disadvantages.

- Each one is usually handled separately on a piecemeal basis so there is no overall estate plan.
- The beneficiary designation forms used by the account holders are usually simplistic and rigid. Few have any provisions for alternative beneficiaries, contingent beneficiaries, or gifts to trusts.
- Some choices can have very adverse tax consequences. E.g.

naming your estate as the beneficiary in a retirement account means the recipient has to withdraw the entire balance in five years and pay taxes on it.

- The account holders can not legally provide any assistance or advice in filling out those forms.
- They don't fit well in community property states where the spouse of the account owner may have a passive community property interest in the account. A spouse should never consent to a beneficiary designation without professional advice.
- Non probate assets will normally not be available to help preserve your \$1.5 million dollar lifetime exemption from estate taxes in a credit trust.

You may not be able to use non-probate assets to preserve your \$1.5 million dollar lifetime exemption.

Because of these problems with the standard forms we often prepare special beneficiary designation agreements as a supplement to the standard form. Most account holders now agree to accept them.

Our custom beneficiary designations allow you to name your spouse as the first primary beneficiary and the credit trust as the alternative primary beneficiary. Your children can be named as the secondary beneficiaries if your spouse is deceased. If your estate plan provides for a descendant's trust until the kids reach a certain age then our custom form names this trust as the first secondary beneficiary and the children as the alternative secondary beneficiaries.

During the probate administration

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JOINT WILLS or LIVING TRUST

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of whether they used a Will or a Living Trust. See the sidebar on page 6. To eliminate creditor's claims the Trustee will have to use the special "non-probate notice to creditors" proceeding in Superior Court.

Living Trusts are more complex. So they are more costly to prepare than Joint Wills for a husband & wife. Depending on the assets you own, there is also the cost of time and money to transfer assets into the trust. Deeds must be prepared and recorded with the county. To extend title insurance to the trustees you must pay \$100 for an endorsement to your title insurance policy. There is also a fee to transfer titles to cars and boats.

They create another administrative layer you must be concerned about. Every time you buy something you have to make sure you have put the title in the name of your Living Trust. To preserve the Trust's probate exemption you must keep separate records for your trust, and your personal transactions. You will have to disclose the provisions of your trust to lenders and other people you do business with.

The biggest problem is that most people's life are changing rapidly and they forget to keep placing new assets into the Trust. If a resident of Washington state owns any real property, or \$60,000 of personal property, when they die their estate must go through probate. There is no exception for clothes, furniture, personal effects, sporting goods, jewelry, or motor vehicles. I have reviewed many existing estate plans with Living Trusts over the last few years. All of the clients owned more

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OVERVIEW OF A TYPICAL WILL



1. Family.

List family members and defines your family.

2. Specific Bequests.

Give specific items to certain named people.

People often name a charity as a partial beneficiary.

You can give tangible things to people by a Separate Letter. See Sidebar.

3. Residuary Bequest.

Describes who gets all the rest of your property.

Gifts to your spouse or charities are exempt from all estate taxes.

Typically most of the residuary goes to your spouse, and then to your children after he/she dies.

Identifies who will receive your assets if your spouse and children are gone.

You can name a charity or other institution as the last alternative beneficiary.

4. Trusts.

General Terms

You are the Grantor or trust creator, the Trustee is the manager of the trust, the Beneficiary is the future recipient of the trust principal or income.

Credit Trust (aka Credit Shelter or Bypass Trust)

This Trust is the foundation of any plan to avoid or limit estate taxes

See Extended article on Credit Trusts on page 7.

Only used after the death of the first spouse to die.

If your married & family net worth is over \$1.5 million you should have one.

This trust preserves each spouse's estate tax exemption.

It can save a 3 million estate up to \$695,000 in estate taxes.

Marital Trust (aka QTIP Trust)

Optional - An alternative to outright gifts to your surviving spouse.

Only used after the death of the first spouse to die.

Spouse must get all the income regularly.

Spouse can direct that principal be invested to produce more income.

Used when spouse can't manage money, in poor health, a second marriage, or very elderly.

Qualifies for the marital exemption to estate taxes when first spouse dies.

But all the remaining assets are considered part of your spouse's estate when they die.

Descendant's Trust

Money from the Credit and Marital Trust goes here after second spouse dies.

Controls how your gift is used while children and/or grandchildren are still young and immature.

Can be split into separate sub-trusts for each child or kept in a single pot.

Sets the child's age when the trusts end and the principal is distributed to the beneficiaries.

If no trust is created the money is managed by a custodian under Uniform Transfer to Minors Act (UTMA).

Under Wash UTMA the kids can withdraw their entire share at age 21.

YOUR PERSONAL PROPERTY LETTER.

Your Will contains a provision which allows you to leave a letter with your Will that contains a list of specific items of tangible personal property in your estate and the names of the people you wish to receive each item. The letter can be done in your handwriting or typewritten. It does not have to be witnessed or notarized. The letter must describe the items and the recipients of the property with reasonable certainty. You may change this letter at any time without having to amend your Will. You may identify an alternate recipient of a particular item of property if the first beneficiary dies before you do. The letter should be signed by you, dated, and kept with your Will. Old letters should be destroyed.

The letter can give any tangible personal property including personal and household articles, jewelry, furniture, home furnishings, electronics, automobiles, boats, airplanes, and sporting equipment. This also includes antiques, art, collectibles, precious metals (bullion or coins), or any other tangible articles held for investment purposes.

Your letter cannot give real property, mobile homes, or intangible property, such as money, debt instruments, bank accounts or other monetary deposits, documents of title, securities (stocks, bonds, promissory notes, & mutual fund shares), season tickets, or club memberships. □

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OVERVIEW OF A TYPICAL WILL



5. Estate & Trust Administration.

Names Key People

Name your choice for Personal Representative (aka the Executor) who manages your estate during probate.

See the Sidebar for a brief description of the probate process.

Name your choice for Trustee who manages your trusts after probate is done.

Describe terms for hiring and firing a bank trustee

Name your choice for the legal guardian of your children.

You can also name some alternatives for each role.

Allocates Death Taxes

Do folks receiving specific things like jewelry have to pay the taxes on them?

Or do you allocate all taxes to the residuary beneficiaries?

You can decide to allocate all estate taxes to one trust.

Who pays taxes on non probate items like your retirement accounts?

Your Will provides guidance and grants authority to your Executor.

No Contest Provision

If a beneficiary contests your Will they will receive nothing under the Will.

It's hard to contest a Will if it's properly prepared and you have legal capacity.

Capacity means you are of legal age, with a sound mind, and not being coerced.

Prevention of Perpetual Trusts

Required by state law against trusts with a perpetual length.

The length (term) of your trusts are limited to 150 years.

6. Powers and Duties of the Trustee.

General Powers & Limitations

All powers available under Wash. State law given to Trustee.

Use of certain powers is limited.

Trustee must receive fair market value upon a sale or loan of trust assets.

Waiver of Notice

State law requires notices & special procedures for non-routine transactions.

This section waives these rules.

Reliance on Investment Advisors

Extensive state laws regulating investments by trustees.

This section slightly softens them.

Trustee does not have to hire an investment advisor.

Determination of Principal & Income

State law has extensive guidelines as to what is principle and what is income.

Key issue for trusts that give different people the income and principal.

This section gives Trustee a little more discretion in making these decisions.

Distributions to Beneficiaries

Gives Trustee flexibility regarding how to make payments to minors.

PROBATE

Probate is the process by which the affairs of a deceased person are settled, any remaining debts are paid off, and title to their property is transferred to their heirs. Your Will does not avoid probate. However good estate planning can keep it simple. Assets in a Revocable Living Trust and the non-probate assets described in the Article on page 3 do not go through probate.

Probate in Washington is easier and faster than in most states. Attorneys fees are based on the actual amount of time spent handling the court filings and working for the Executor, not a percentage of the total assets in the estate. Our state law authorize you to make a "Non Intervention Will" which means that the Executor just does their job and the Probate Court does not "intervene" in the process unless there is a dispute. We only prepare "non-intervention" Wills. All routine items are signed by a Superior Court Judge or Court Commissioner in his/her office.

The steps in a probate are simple. The person named as Executor files the original Will along with a petition to be appointed as Executor. After that is approved the Executor then mails and publishes a notices to creditors in the required format. The Executor also must file the deceased's final federal income tax return, and an estate tax return if one is required. After the bills are paid the Executor then sells what needs to be sold and distributes the remaining assets to the heirs. After all of the above tasks are finished the Executor files a final report with the court. A list of assets need not be filed and can be kept confidential. Unless there is a dispute or Will challenge it is a simple efficient process. □

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OVERVIEW OF A TYPICAL WILL

(Continued from page 5)

If a trust only has a small balance the Trustee can end the trust.

Allows your stuff to be given to people (in kind) instead of selling it & just giving money.

Protection from Creditors

Creditors or ex-spouses often can reach a person's right to income or principal from a family trust.

This section gives extensive protection against creditors reaching those monies.

Annual Accounting

Extensive requirements under state law, including annual financial statement audited by a CPA.

Our section requires simple annual reports and inspection of records upon request.

This section frees your Trustee from all other accounting requirements.

Pooling of Accounts

Allows assets of Separate Trusts for each child to be combined for investing. But Trustee must keep records to show each child's share.

Merger of Trusts: Division of Trusts

Allows Trustee to combine similar trusts or divide trusts into separate trusts. Supplements existing state law.

Reliance on Good Faith: Liability

Extensive state law on fiduciary duty & liability of a Trustee.

This section softens liability if your Trustee acts in good faith.

Disclaimers and Releases

Allow Trustee to refuse to accept certain gifts into a trust.

Trustee can release certain claims or rights.

Useful in avoiding adverse tax impacts, or to settle disputes.

Disabled Beneficiaries--Purposes

A spouse, child or other beneficiary may become disabled in the future. Their right to trust income or principal will disqualify them from public benefits.

This section is written to preserve their right to public benefits.

Administration of Residential Property

Ideally a personal residence is not put into a trust created by a Will.

This section protects a surviving spouse if one must be placed into a trust to reduce estate taxes.

Prevents a Trustee from selling your current residence without your spouse's consent.

7. Execution of Your Will.

You must sign and date your Will in front of two witness who attest that you are of sound mind, and not under any coercion.

They can't be people who will benefit by the Will, or be named as a Trustee or Executor in the Will.

The two witnesses then sign a notarized affidavit to that effect. □

SMART LIFE PLANNING

Death is often accompanied by issues or disputes arising out of things that were under the deceased's control, but were never finished or properly handled. So their heirs have to spend a great deal of time and money working with attorneys, accountants, and other consultants to unravel them. Here are a few I have seen this past year:

- A business with multiple owners and no buy/sell agreement.
- Jointly owned real estate with no buy sell agreements.
- Property owned by tenants in common with no agreement.
- Unrecorded joint interest in boats, racing cars, or snowmobiles.
- Poorly documented loans to family friends.
- Vague hand scrawled beneficiary designations.
- Longstanding unresolved disputes with creditors.
- Incomplete or missing business or personal records.
- Verbal promises to "take care" of someone when you die.
- Undocumented investments in a private enterprise.
- Postponing your Will until you no longer have legal capacity.

Sometimes people include these matters when they are bemoaning the high cost of probate. This is not probate. They can occur regardless of whether the deceased left a Will, a Living Trust, or did nothing. For many different reasons some aspects of their life were not handled wisely. They are a result of life planning decisions, not the probate process. Do not saddle your family with these problems. Competent advisors can help you do what it takes to straighten out these issues now. □

WONDERFUL TAX SHELTER OF A CREDIT TRUST



The Credit Trust is a simple trust that should be part of a married couple's estate plan if all of the assets in their estate are worth over \$1,500,000. This Trust can be included in your Living Trust, if you decide to go that route, or in your Wills.

High Estate Taxes. Federal estate taxes are high. They start at 45% for estates over \$1.5 million and step up to 47% for the portion of your estate over \$2 million. There are two exemptions from federal estate taxes, however.

- 1. All bequests to your spouse or a qualified charity.
- 2. Each person's personal exemption. Your personal exemption is currently \$1.5 million in 2005. It increases to \$2 million next year.

Inadequate Planning. Many couples have simple wills which leave all their assets to their spouse. That works okay at the first death since transfers to a spouse are tax exempt. But when the surviving spouse dies, all of the couple's remaining assets will be included in her estate. She can use her exemption. But the exemption for the first spouse is wasted. If a couple has no estate plan all or part of that remaining exemption may be lost by inappropriate lifetime gifts or other transfers.

A Superior Plan. A far better approach is for each spouse to sign a will that contains a simple credit trust. After the first spouse dies, the exemption amount goes into the trust, and the balance of the deceased's estate goes to the spouse. The amount in the trust bypasses the surviving spouse's estate entirely. If the credit trust is properly administered as a separate entity, the origi-

nal principal and all of the later appreciation in trust assets are permanently exempt from estate taxes.

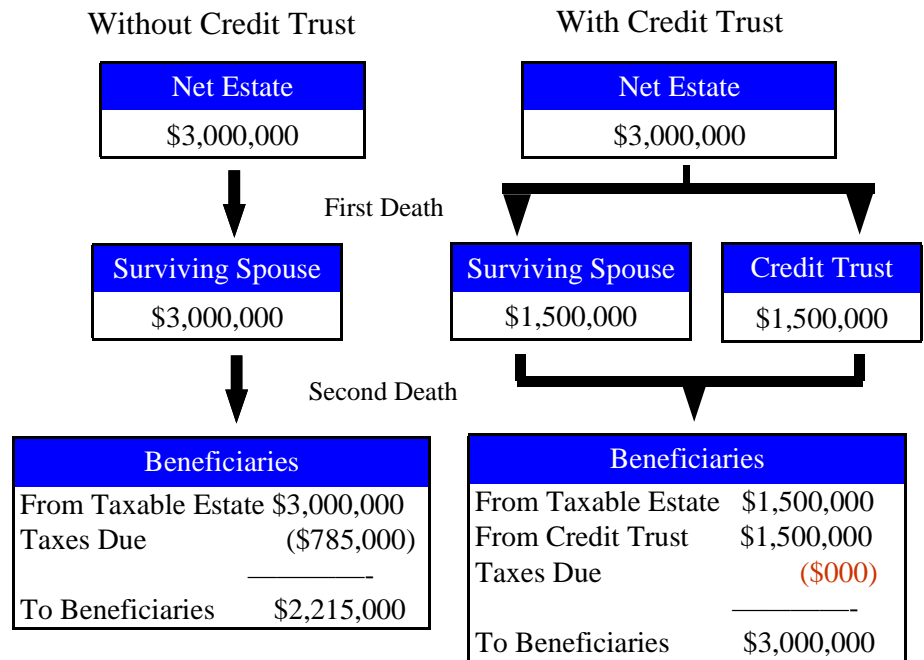
The Credit Trust is Accessible. Normally, the surviving spouse is named the primary beneficiary and their children are named the secondary beneficiary. Or, if they have young children, their portion could go into a children's trust until they reach certain ages. The surviving spouse can be the trustee and can receive distributions from the trust for their support and maintenance. This includes medical and other living expenses. So the trust is not locked up away from them. The surviving spouse will normally spend the money given to her outright or in a marital trust first. This is a best approach since

this is the portion of the family estate that is going to be subject to estate taxes upon her death.

Substantial Tax Savings. The chart below shows that a net estate of 3 million saves almost \$700,000 in federal & state estate taxes in 2005 with a credit trust. The tax savings will increase as the exemption amount increases over the next three years. Some people may want to put less than \$1.5 million in their credit trust -- depending on their total financial situation.

There are many other more sophisticated techniques for reducing or eliminating estate taxes in larger estate. But the credit trust should be the first line of defense in every estate plan. □

TWO ESTATE PLANS



Estate Tax Savings = \$785,000

NON PROBATE ASSETS



EPILOGUE

JOINT WILLS or
LIVING TRUST

(Continued from page 3)

the Executor must decide which assets to put into the credit trust and which to give directly to the surviving spouse. If the Executor decides to place all or part of a retirement account into a trust the beneficiary designations for the retirement account must allow this. Washington law allows any beneficiary to disclaim a bequest, and if they do, it goes to the next alternative recipient. If your Executor decides that she needs the retirement account in the credit shelter trust in order to use the full \$1.5 million exemption she can ask the spouse to "disclaims" her interest so it will flow into the trust. In our asset questionnaire we find out about all your non probate assets so we can include them in your estate plan. □

Most of the articles in this report have appeared in earlier newsletters or handouts we provided to our clients. We have updated them to reflect the most recent changes in state law and the latest federal tax law amendments. We wanted to put them all together in one place, so you would have a handy reference guide for Estate Planning. This report contains the basis essentials. In a later report we will present some of the more advanced techniques available for making large estates tax free. We hope that this special report is helpful to you.

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than \$60,000 in assets outside the Living Trust. So they would not avoid probate.

Some attorneys recommend Living Trust if you own real property in another state in order to avoid ancillary probate proceedings there. I recommend that you consider other more tax efficient alternatives; such as a Qualified Personal Residence Trust for a second home, or a Family LLC for other types of property.

Living Trusts do have a place for a some people. I think they are suitable for elderly or sick people with few life changes who need a 3rd party Trustee to manage their affairs. But for most residents of Washington I think Wills are the better choice. □

Smãrt Planning

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