Published at www.fpaforfinancialplanning.org on October 19, 2009

Protect Your Legacy. Update Your Estate Plan.

If you don't have an estate plan in place, a will, a trust, a health care proxy and the like, now — regardless of your age or life stage — would be a good time to put your affairs in order. But if you already have an estate plan in place, do you know when you should be updating it?

Here are 12 things to consider, much of which is culled from a recent *Journal of Financial Planning* article co-authored by FPA member Randy Gardner, J.D., LLM, CPA, CFP®, a professor of tax and financial planning at the University of Missouri-Kansas City, and Leslie Daff, J.D., a Certified Legal Specialist in Estate Planning, Probate & Trust Law by the State Bar of California Board of Legal Specialization.

How is incapacity determined in your estate plan, and are the methods consistent?
Usually, if you become incapacitated, the successor trustee of your living trust will manage your trust assets, the agent under your durable power of attorney for property management will manage your non-trust assets, and the agent under your power of attorney for healthcare and living will (or advance healthcare directive in states where these two documents are combined) will handle your medical decisions. But how is incapacity defined in these documents and are the definitions consistent? Many older documents require written certifications from two licensed physicians to determine incapacity, which may be cumbersome to obtain in actual practice. More recently, incapacity is determined by the attending physician and a loved one, defaulting to the attending physician alone if the loved one is unable to make the determination.

Is there HIPAA authorization?
Many older plans do not have a HIPAA (Health Insurance Portability and Accountability Act) authorization, which is necessary to circumvent privacy laws surrounding your medical records. If that's true for your estate plan, be sure to execute a HIPPA authorization allowing named fiduciaries access to medical records so they can handle your affairs appropriately.

Does every member of your family who has attained age 18 have a power of attorney for healthcare and a living will (or an advance healthcare directive)?
You may have a power of attorney for healthcare and a living will (or an advance healthcare directive), but what about your parents and children? Every person who has attained age 18, whether or not they have assets, should have these documents in place because no one knows when incapacity will strike. What's more, you should carry a wallet card notifying medical providers that you have executed these documents, identifying the people you have designated to make medical decisions on your behalf, and listing their phone numbers in the event of an emergency.

Do the documents allow for planning during incapacity?
Most people do not think about whether their estates will exceed the "applicable exclusion amount" — the amount that can pass free of estate tax (currently $3.5 million, and unless the law is changed, $1 million beginning in 2011). They do not realize that homes, life insurance proceeds and retirement plans, even if they avoid probate, may trigger the federal estate tax (currently 45 percent on assets exceeding the applicable exclusion amount, and unless the law is changed, 55 percent beginning in 2011). If you become incapacitated and are unable to act, it is important that your named fiduciaries be able to take steps to reduce your estate if it exceeds the applicable exclusion amount. Specifically,

the agent should be able to make gifts or be able to establish and transfer your property to a revocable trust in order to avoid probate.

Do you only have a will and not a revocable living trust?
Consider a living trust for probate avoidance and privacy. A trust also enables your designated successor trustee(s) to step in and handle trust assets for your benefit upon incapacity and death without having to go to court.

Should your decision makers be changed?
One of the most important and comforting results of having an estate plan in place is knowing there are designated individuals and institutions to make decisions for you if you become incapacitated and upon your death. In a comprehensive estate plan, you name one or more successor trustees, personal representatives, guardians for minor children, agents for non-trust property management and agents for healthcare decisions. But over time, things may change. Individuals named as successor trustees, personal representatives, and the like may have moved, died, become ill or grown distant. If that's so, consider executing new documents and updating names. Also, consider naming an institution as a final back-up fiduciary.

Does your living trust provide for subtrusts and how are the subtrusts funded?
For married couples whose estates at death may exceed the applicable exclusion amount, revocable living trusts are often designed to split into two or three subtrusts at the first spouse's death for tax and control purposes.

The "A" Trust, often called the "Survivor's Trust," consists of the Survivor's share of the estate. The Survivor has unlimited access to the Survivor's Trust and the Survivor's Trust is completely amendable and revocable by the survivor.

The "B" Trust, often called the "Bypass Trust," "Credit Shelter Trust," or even "Family Trust," enables a married couple to use two applicable exclusion amounts instead of one. Essentially, the Bypass Trust holds the deceased spouse's applicable exclusion amount instead of giving it outright to the surviving spouse, who otherwise would have the assets subject to estate tax at his or her subsequent death. The IRS allows the surviving spouse to have access to the Bypass Trust for his or her "health, education, maintenance or support" without considering it part of the surviving spouse's estate. At the surviving spouse's subsequent death, assets remaining in the Bypass Trust pass to the remainder beneficiaries originally specified by the deceased spouse, free of estate tax.

In other cases, especially blended family situations, your revocable living trust may be designed to have a another subtrust created at the first spouse's death called a "C" Trust, often referred to as "QTIP Trust" or sometimes "Marital Trust." This trust is designed to hold the remainder of the deceased spouse's share of the estate for control purposes. Although the Internal Revenue Service (IRS) requires that the surviving spouse receive all the income generated by the QTIP Trust, the deceased spouse may or may not want to allow greater access to the surviving spouse. At the surviving spouse's death, the remainder of the QTIP Trust goes to the remainder beneficiaries originally specified by the deceased spouse.

What may need to change in your estate plan is the funding formula to create the subtrusts. Usually, either a "pecuniary" (dollar amount) or a "fractional share" formula is used to divide assets between the subtrusts. For income tax reasons, however, it may be better to use a fractional share formula rather than a monetary method to fund the Bypass and QTIP trusts because funding a monetary or dollar bequest, but not a fractional share, may trigger the recognition of gain or loss upon funding.

Does the surviving spouse have sufficient access to the Bypass and QTIP trust assets?

As mentioned above, the surviving spouse is typically given some invasion powers over the Bypass and QTIP Trusts. If necessary, make sure the surviving spouse has "health, education, maintenance or support" invasion powers over both the Bypass and QTIP trusts.

Does your spouse have a limited power of appointment over the remaining assets in the Bypass and QTIP trusts?
The Bypass and QTIP trusts are irrevocable trusts created upon the death of the first spouse — that is, the remainder beneficiaries designated by the deceased spouse who are to receive the estate after the death of the surviving spouse cannot be changed. However, if the deceased spouse would like his or her spouse to have flexibility to change the distribution — among their descendants, for example, because one child developed a drug addition, consider giving your spouse a testamentary limited power of appointment to change the distribution.

Is asset protection incorporated into your estate plan?
Some people mistakenly believe that by having assets in a revocable trust their assets are protected if they are sued. However, revocable living trusts provide little, if any, protection. To correct the problem, consider establishing entities such as LLCs and/or domestic asset protection trusts for certain assets in jurisdictions favoring such entities and trusts, such as Nevada and Delaware.

Are distributions to children protected from creditors and divorce?
Many trusts are designed to distribute property outright to your children if they are over age 21. Others stagger distributions over a designated period of time. You might instead establish lifetime beneficiary-controlled trusts for your children, in which a child becomes trustee of his or her own trust at a given age, with an income and invasion power. These trusts keep the assets separate from your child's spouse, preserve them for your child's heirs (your grandchildren), and include provisions to enable your child to protect the assets from creditors.

Is your trust funded?
Trusts are not effective if they are not funded; that is, your assets must be transferred to the trust. Most attorneys today ensure that your home, bank and brokerage accounts are transferred to the trust by preparing deeds and title transfers. Other assets, such as retirement accounts and life insurance, should be evaluated on a case by case basis with the help of an experienced professional.