<u>Estate Planning – The Benefits of Peace of Mind</u> (by Matthew S. Dana, JD, CPA, LLM, CLU, ChFC)

I have been practicing exclusively in the area of estate planning for over 27 years. Yet, last week a questioned posed by a young couple seemed to resonate in my mind like never before. "What is the number one benefit of doing a trust?" My mind quickly raced to the 1980's movie "City Slickers" when the old crusty cowboy said to Billy Crystal, the city slicker, that he must find "just one thing" that is important to him in life and use that as a motivation to have a happy and successful life. This line made me realize that the "just one thing" in estate planning, like the movie, is different for each person. The true answer is the quintessential cliché, "it depends". The purpose of this article will list some of the most important factors that people should consider. In the end, whatever your "just one thing" is should motivate you to take action and provide "Peace of Mind" for your loved ones.

<u>Avoiding Probate</u> – This seems to be the relevant factor cited most frequently, although I disagree that it is the most important reason to plan. Probate in Arizona is not the costly, burdensome procedure that it is in some states like California or New York. Yes, it does cost some money, but in most cases the cost is only a few thousand dollars. The severity of probate depends largely on the make-up of the assets. The more "complicated assets" you have (ie Oil Leases, closely held family businesses, Partnerships, fractional interests in Real Estate, etc.) and the more states in which you own real estate, then you drive up the "Probate Meter" very quickly. If you own real property in more than one state, you will have to have a probate proceeding in each state, which means you will probably need an attorney in each state. But, if your assets are "simple", (a house, a car, some CDs) and primarily located in Arizona, then the "Probate Meter" is very low.

<u>Saving Taxes</u> – People have heard this phrase over and over again in newspaper ads inviting people to public seminars put on by a "national expert" that nobody has ever really heard of. But, how does a Trust really help to save taxes? Under today's tax laws, a common Revocable Trust does not save taxes for most people. First, a Trust doesn't save any income taxes. The Trust is ignored for income tax purposes and all of the income generated by the Trust is taxed to the individual Grantors of the Trust as usual. Also, for a single person, a Trust does not save any estate taxes. But, for a married couple, a Trust can save estate taxes. Most married couples have a Revocable Trust, that splits into an "A" and a "B" trust at the death of the first spouse. The primary reason for this split is that it guarantees that the couple will get two exemptions to apply against the estate tax. One exemption for the "B" trust when the first spouse dies, and then a second exemption against the "A" trust when the surviving spouse passes. Without an A/B trust, it is possible that the exemption of the first spouse could be wasted. But, since the federal estate tax exemption is now set at $5 million, most couples only need one exemption anyway. So, in the end, for probably 95% of married couples, having a trust will not save any estate taxes. Now, this is true as to the Revocable living trust. Don't confuse this with the 4 or 5 other "specialty trusts" that have the specific purpose of saving estate taxes. Examples of a "specialty trust" would be an Irrevocable Life Insurance Trust (designed to keep life insurance out of the estate tax system) and a Qualified Personal Residence Trust (designed to keep the primary and vacation residences out of the estate tax system).

<u>Restrictions and Incentives for Spouse</u> – A well drafted Trust should contain provisions as to what happens to the assets of the first spouse to die, if the surviving spouse remarries. Most clients want to adequately provide for their spouse, but they don't want to provide for their spouse's new husband or wife. Also, to what extent can the surviving spouse change the estate plan, after the death of the first spouse, to disinherit the children. My experience is that most spouses tend to remarry, and most of the time, that new spouse will also have children. Now, we end up with a "blended family". Over time, the surviving spouse feels love and loyalty to the new spouse, and perhaps the new stepchildren. We probably all agree that the surviving spouse should be able to do what they wish with respect to their community property half interest in the asses. The more difficult question is whether the surviving spouse can also control the ultimate disposition of the deceased spouse's community property half of the trust and make provisions for the new spouse or the new stepchildren out of the deceased spouses's half of the trust.

Restrictions and Incentives for Children – The key question here relates to the timing in which a child should gain unrestricted access, an outright distribution, to the assets after the death of both parents. We would all agree that if a child is a minor, then the assets should be controlled and restricted by an independent trustee for a period of time. What we may disagree on, is the appropriate age in which all restrictions and the independent trustee should be removed. Some clients say age 25, some say 30, and I have had many that say 50 or 60. My experience is that the older my clients are, the higher they will set the ages for their children to gain control. For example, if the kids are minors, then most couples will set the restriction to be lifted at age 30. However, if the couple is much older, and the kids are already over age 30, then these couples may set the restrictions to age 40 or 45. We may also want to build certain "incentives" into the estate plan. A common incentive is "if you earn a buck, then the trust will pay you another buck". So, you create an incentive for a child to go out and earn a living. Over the years, I have seen the destruction that is brought to a "trust fund baby". Money and inheritances can ruin a child and ruin a life. That is why many wealthy people will leave large portions of their wealth to charities, instead of their children (and yes, there are income tax advantages and estate tax advantages of doing this, but the primary reason would be to encourage the child to have a productive life). You may also want to provide incentives depending on if a child graduates from college or achieves some other educational benchmark. I do see the risk of using the trust as a "carrot" that is dangled in front of a child to be manipulative. But, some well thought out incentives can really go a long way to help a son or a daughter cope with the vicissitudes of life and be blessing to them, and not a curse.

Asset Protection – For example, having an A/B Trust as described above, can make sure that the assets of a deceased spouse are not subject to the creditor claims of the surviving spouse. As a firm, we are recommending A/B trusts for this reason more than the reason discussed above where an A/B trust can provide two estate tax exemptions. In variably, the surviving spouse ends up in a nursing home that chews up the net worth very quickly. So, having half of the estate in a "B" trust, protected from the creditors (ie nursing home costs) of the surviving spouse makes a lot of sense. Also, a good estate planning attorney can structure the inheritance for the children, to remain in trust for their lifetime. This will protect the inheritance from the potential creditors of the child such as divorce, bankruptcy, lawsuits, etc. My estate plan is structured that upon the deaths of my wife and I, our estate will be divided out into separate trusts to provide one trust for each of our children. We have an independent trustee and some incentives in each trust. At age 35, the child has the right to become his or her own trustee. So, in essence, the child can now take from the trust whatever the child wants for his "health, education, support and maintenance". The child is also free, as the trustee, to invest the trust assets into a beach house, a cabin, or any investment that he or she chooses. Meanwhile, if that child divorces, his or her spouse cannot touch that trust. Also, if that child files bankruptcy, then the creditors cannot reach the assets in this trust. I call this a "wrapper of protection" that we can place around the assets which gives the trust "bullet proof" creditor protection to our children. It is also important to remember that a child cannot create his own trust to provide this kind of protection. The law in most states is such that a trust provides creditor protection only in cases where it was created by one person for the benefit of another person. In other words, the grantor or creator of the trust, cannot also be a beneficiary of the trust and achieve creditor protection. So, as long as the trust is created by a parent, for the benefit of a child or grandchild, it can have the creditor protection described above.

Providing a Plan for Incompetency – As all of us age, we can see that our minds and our memories start to diminish. Most of the estate litigation that comes into our firm relates one way or another to the incapacity of one or both of the parents. When this happens we see many children turn against each other and a fight ensues as to what is in the best interests of mom and dad. Unfortunately, the children seldom agree as to what is best. So, a legal battle is waged to determine who has the control of the assets and who has the ability to make medical and financial decisions. Yes, some of these problems should be addressed in a Power of Attorney. But, Powers of Attorney were meant to deal with short term situations, not permanent solutions. It is much better to have a plan, drafted inside of the Trust, as to who will become in charge ("successor trustee") when mom and dad are no longer capable. Also, to what extent will the Successor Trustee have a duty to give an accounting to all of the kids and keep them informed? Under what circumstances can mom and dad be moved out of state? What is the plan when the assets run out? Will mom and dad live in a nursing home? Keep in mind that someone over 75 is much more likely to become disabled and incompetent in the next 5 years then they are to die in the next 5 years. Then, couple this with the fact that the children are more likely to fight over issues as to what happens to mom and dad, then they are to fight over the inheritance if mom and dad die. Clients are much more likely to avoid all of these fights if there is a well drafted estate plan in place.

Privacy – Many clients like the fact that an estate administered under a Trust is more likely to be kept private then an estate administered by the Probate Court. So, some of our clients will create a Trust for that simple fact. We have all seen the ads on TV where someone is talking about the real estate strategy of buying property from an estate. How do these professionals find the property and know what is in probate and what isn't? The answer is simple, in many probate proceedings, an inventory is filed with the Court and this inventory is a public record. So, all that needs to happen is that you have a person sitting in an office, searching the probate records to find real estate. Then, it is also easy to find the names and addresses of the heirs. Now, if most of the heirs are out of state, and there is local real estate, then the magic is in the fact that these heirs are now "motivated sellers" and you can make a low ball offer. The bottom line is that the financial affairs of the decedent are now public records that can be easily searched from any computer. The creation of a Trust provides privacy and avoids this issue of privacy altogether.

In conclusion, there are many benefits to estate planning. It is also true that there are many risks and problems that are created by not having an estate plan in place. The reason and benefit that is important to you will depend on your situation. In fact, I have listed the reasons that are least important to me first, and the reasons that are most important to me last. That is me, but is based upon 27 years of experience. You must decide what is important to you. But, in the end at least focus on the issues and plan for the inevitable. Early in my career I developed a "line" that I used in my public seminars. When the client said, "oh, I really don't think estate planning will benefit me at all." My response was "okay, put my business card on your refrigerator". I said this tongue in cheek knowing that the few dollars the client *should* have spent on the creation of an estate plan would multiply into huge legal fees when the children would begin to fight trying to unravel the many problems caused by lack of planning, or poor planning. There is a reason that our estate litigation department is the fasting growing practice area of our firm. Hopefully, your family will not fall into this trap. Whatever your reason, or "just one thing" may be, use that as your motivation to create a quality estate plan. This will ensure invaluable peace of mind for you and also for your loved ones.