PRE-CRISIS PLANNING: THE VALUE OF BEING PREPARED

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I. WILLS

A. What A Person Can Do In A Will

The most common method for stating how to give away property at death is through a Will. A person may give property to anyone, with the exception that in most instances it is difficult to totally "disinherit" a spouse without a written agreement. There is no requirement to give property to children or other members of a family. In a Will, an individual may also do the following:

1. Name a "personal representative." This is the person who, if appointed by the Court, will gather the assets and distribute the property according to instructions. A Will can specify that the personal representative not be bonded. This can save the estate an unnecessary expense and more than make up for the initial cost of having the Will drafted.

2. Name a guardian for minor children who will be responsible for decisions regarding their personal care and well being.

3. Set up a trust for the benefit of minor children or other relatives who are unable to manage their own financial affairs, and name a trustee who will be responsible for making financial decisions.

4. Incorporate an estate tax savings plan, if a couple has a mutual estate in excess of the annual exclusion amount then in effect. The annual exclusion amount is $1,000,000 in year 2002.

B. What If A Person Doesn't Have a Will

If a decedent doesn't have a Will the property is distributed according to specific provisions set out in Oregon law. This is called the "law of intestate succession." In very general terms, without a Will, the property will be distributed as follows:

1. If a spouse is still living and the person has no lineal descendants, then the spouse will receive the estate. ("Lineal descendants" means children, grandchildren, great grandchildren and so on down the line.)

2. If the spouse is still living and the decedent has a child or children, and all of the children are born of the current marriage, then the property goes entirely to the spouse. However, if the decedent has any children who were not born of the current marriage, then one-half goes to the spouse and the other half goes in equal shares to the children. (The children of a deceased child take their deceased parent's share.)

3. If a decedent has no living spouse or lineal descendants then the property may go to parents, brothers and sisters or nieces and nephews, grandparents, or to aunts, uncles and cousins.

4. The estate will go to the State of Oregon if there is no person to take the property under this distribution scheme. Although State law sets out a scheme for distributing property without a Will, it does not mean a Will is unnecessary. In practical effect, the law of intestate succession is not suitable in many individual situations.

For example, if the decedent has minor children and not all of them were born of the current marriage, part of the estate could pass to those minor children without the benefit of a trust. Each child would get a separate and equal share, which could cause a shortage of available funds to cover basic expenses for the younger children as they grow up. As another example, if a person dies without a Will the estate may pass entirely to relatives on one side of the family to the exclusion of relatives on the other side, simply because one spouse outlives the other by a short time.

Another hazard of not having a Will is that the law of intestate succession does not recognize any relationships outside of blood, marriage, or legal adoption, so unmarried partners and close friends are completely excluded. With a Will you can anticipate these situations and avoid unwanted results.

C. Formal Requirements To Make a Will

A Will must be in writing and signed in the presence of two witnesses. A beneficiary under the Will should not be a witness. The witnesses must see the person sign the Will and then they must also sign it. It is not necessary that they read the Will or have any idea of its contents. Although not technically required for the Will to be valid, it is desirable to have the witnesses sign a notarized statement saying they witnessed the person signing the Will and that he or she is over the age of 18, of sound mind, and not acting under any duress. There are forms available for this purpose.

It is critical that the proper formalities be followed. A handwritten Will which does not otherwise meet the formal requirements (a "holographic" Will) is not valid if made in Oregon.

II. TESTAMENTARY TRUSTS

A trust is a fiduciary relationship in which the trustee holds title to assets with a duty to use it for the benefit of a beneficiary. There are always three roles: 1) a trustor (grantor, settlor, trustmaker), who creates the trust and transfers property to the trustee; 2) a trustee, who holds legal title to the trust property and has a duty to administer the assets according to the instructions found in the trust, and for the benefit of the beneficiary; and 3) one or more beneficiaries, who own the equitable interest in the trust property and receive the benefit of the trust property.

A. For Benefit of Minors

A parent with minor children has special estate planning considerations. A parent can name a guardian for minor children in the Will. Although the judge is not required to follow the instruction, Oregon law requires the judge to carefully consider the named preferences. A parent may name a guardian who is not the other parent, but the judge will generally not honor this nomination over the objection of the other parent unless there are compelling reasons to do so.

In a Will you can also provide that you want your estate, or a certain percentage of it, to go into a trust for your minor children. This means the property is given to a person named by you, called a trustee, to manage the property on your children's behalf. The property is usually held until each individual child or the youngest child reaches a specified age. The trustee must manage the funds according to your instructions. For example, if you have more than one child you can tell the trustee that any money should be held in a "pot" to be used for care of the children until the youngest reaches a certain age. This will insure that sufficient funds are available to meet the needs of all of the children until they are grown.

If children are intended to be beneficiaries or alternate beneficiaries of certain funds, such as life insurance, then the person will want to obtain advice about how to insure that the funds are paid to the trustee for the benefit of the children, where appropriate, rather than paid directly to them outside of the trust.

B. For the Benefit of Disabled Person Receiving Public Benefits

This is generally called a supplemental needs or special needs trust. It is written restrictively to insure that public benefits will continue. (See Part B below).

C. Insure Values Are Incorporated

Strict or discretionary guidelines can be set forth in the trust regarding distributions. Distributions can be broad (i.e. support, education, health) or limited (i.e. college at

accredited school of higher education, only in support of artistic endeavors, only if not using drugs/alcohol).

Values can also be reflected in the trust by including socially responsible investment criteria. It is possible to build in participation by the beneficiaries in the process.

D. Minimize Estate Tax

Trusts can be incorporated that will minimize or eliminate estate tax for couples with estates over the annual exclusion amount ($1,000,000 in 2002).

III. PROBATE

A. Purposes of Probate

The probate process serves several purposes.

1. Probate permits the state income and inheritance <u>tax</u> authorities to collect any monies owed by the deceased or the deceased's estate before property is transferred to heirs.

2. Probate permits <u>creditors</u> of the deceased to have any outstanding debts satisfied before assets are transferred to the heirs.

3. Probate process permits a determination of the rightful recipients of the deceased's estate.

4. To the extent property has been subjected to the probate process, heirs can receive the inheritance with the assurance that the property will not later be subjected to the claims of creditors and taxing authorities.

B. Wills and the Probate Process

If there are assets that need to be probated, and <u>if a Will has been executed</u>, the person named as Personal Representative in the Will petitions the court to admit the Will to probate and to be appointed Personal Representative.

C. Relationship between Probate and Death Taxes

Whereas the probate court is concerned only with <u>transferring</u> assets owned in the separate name of the decedent (if any), the taxing authorities are interested in the <u>value</u> of <u>all property</u> owned by the decedent or otherwise includable in the decedent's gross estate, without regard to whether there is a probate of the property.

D. Relationship between Probate and Having a Will

Contrary to popular belief, having a Will at the time of one's death will not prevent one's estate from having to go through probate. The necessity for a probate is determined solely by the form of title governing the assets at the time of death.

E. What does Probate Cost?

There are five potential costs in any probate: attorney fees, personal representative fee, bond, newspaper notices, and court costs.

1. Attorney Fees. Attorneys in Oregon are required to charge the Personal Representative a reasonable fee based on the amount of time expended in settling the affairs of the estate and on the complexity of the estate. Oregon attorneys are no longer permitted simply to charge a fee equal to a flat percentage of the value of the estate. The probate court must approve of all fees before they are paid to the attorney. Other beneficiaries can object to the fees if they are thought to be inappropriate.

2. Personal Representative's Fee. Absent a provision in the Will to the contrary, a state statute governs the amount of compensation paid to the personal representative. The fee on the first $50,000 of estate value is $1,630. To the extent the probate estate exceeds $50,000, the personal representative is paid an additional amount at the rate of 2% of the excess. The personal representative is also entitled to a fee of 1% of life insurance proceeds and other assets passing outside of probate but reportable for estate tax purposes. Additional compensation may be awarded by the court for any extraordinary and unusual services. ORS 116.173.

3. Bond. The personal representative is required to be bonded, unless the Will provides that no bond is required. ORS 113.105. On an estate of $100,000, the bond costs about $400.

4. Newspaper Notice. Publication of notice costs about $86.

5. Court Fees. The filing fee is based on the value of the estate. The filing fee for an estate valued between $100,001 and $500,000 is $410. Letters testamentary are $3.75 apiece.

F. How Long Does Probate Take?

The minimum time for a probate is four months, since creditors must be given that much time in which to file claims. Typically a probate proceeding is closed some time within six months to one year. Interim support orders may be obtained for spouse and dependent children.

IV. JOINT OWNERSHIP AND OTHER PROBATE AVOIDANCE TECHNIQUES

As a general rule, when a person dies, only those assets which are titled solely in the name of the deceased must be subjected to the probate process in order to effect a transfer of the assets to a another person. Assets that **may** not be subject to probate are as follows:

A. Jointly-Held Property

Assets which are owned jointly with a right of survivorship will automatically pass to the survivor upon the first joint owner's death, without an order from the probate court. This may work well. However, there can be unintended consequences.

1. Conflict with estate plan. An asset held in joint ownership with right of survivorship generally means that the owner who survives inherits the entire investment.[1] However, the original owner often actually intends that the asset be distributed according to the terms of his or her Will, rather than entirely passing to the joint owner. This can result in significant confusion and even conflict among heirs. Often the intention of the original owner is clear and the surviving owner plans to honor that intention by distributing the remaining balance according to the decedent's wishes. However, the survivor then may be making a gift, and in some cases this can have negative estate and gift tax consequences.

2. Loss of Control. By transferring a bank account into joint ownership the original owner is giving the other owner complete access to the account. This is convenient. However, the joint owner could withdraw the entire amount without permission. Joint ownership of real estate means that the original owner is giving up some portion of control of the asset. For example, he or she cannot sell the property or obtain a loan or reverse mortgage without the cooperation of the other owner. What if the other owner refuses to cooperate or becomes incapacitated? It may not be possible to do business related to the property without obtaining a court order.

3. Liability Exposure. Jointly held assets are potentially exposed to the liability of the noncontributing joint owner. All or a portion of the asset could be caught up in creditor collection efforts, (including a bankruptcy), or become an issue in a divorce proceeding.

4. Tax Consequences. Transfer of appreciated property such as real estate and stock can have unintended capital gains tax consequences. If a beneficiary inherits

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[1] Under Oregon banking law it is presumed that at the death of one owner the balance of a bank account will pass to the surviving owner without the need for a probate proceeding. The presumption that the balance of the bank account passes to the surviving owner at the death of the other joint owner can be overridden if at the time the account is established the original owner makes clear that the intent of the joint account is for convenience only. However, financial institutions rarely ask this question at the time the account is opened, so it is rare that the presumption is overridden.

appreciated property, then he or she takes it with a "step-up in cost basis" to the value at the date of death, which means that no one pays capital gains tax on the appreciation. However, if the individual is gifted appreciated property, he or she takes the donor's basis, which means that when the property is sold the donee must pay tax on the appreciation. Whether or not the transfer is a gift depends on the type of transfer, so the individual should obtain advice from a qualified attorney or CPA.

B. Contractual Designations

Life insurance, IRA's, annuities, retirement benefits, Pay-on-Death accounts, etc., are common examples of interests in property which may be structured to pass outside of probate. If the designation reads, "my estate", or if the named beneficiaries do not survive the decedent, then the property will go through probate. Beneficiary designations should be double-checked. If there are minor children, the beneficiary should be "trustee named in will" (generic description only), and not "my children".

C. Life Estates

If the client deeds property to another, reserving a life estate, the property will automatically pass to the remainderman upon the death of the life tenant.

D. Real Property

We have a special statute in Oregon that creates the presumption that title to real property automatically passes at death to the "heirs" of the decedent, subject to a subsequent probate (if any) being filed that results in the property being transferred to someone else. ORS 114.215. Title companies are sometimes willing to rely on this statute to insure title upon the sale of real property after the owner dies, without requiring the heirs to subject the real property to probate. The heirs are required to execute an Affidavit of Heirship. If there are any heirs who are minor, disabled, missing, then this method won't work. The title company will generally double the premium for the title insurance (to compensate them for the additional risk they bear because there was no probate).

E. Department of Motor Vehicles

Oregon law permits property titled through the Department of Motor Vehicles to pass to the "heirs" of the decedent without going through probate, assuming all heirs sign an Affidavit of Heirship.

F. Small Bank Accounts

If the decedent died leaving less than $25,000 in all the bank in Oregon (combined value), banking law allows the bank to release the funds based on an Affidavit of Heirship signed by all of the heirs.

G. Small Estates Affidavit

A "small estate" is defined as an estate consisting of not more than $50,000 of personal property (this includes cash, bank accounts, etc.) and $90,000 of real property (gross value, not equity value).

V. REVOCABLE LIVING TRUSTS

A Revocable Living Trust is an estate planning tool with some distinct advantages over joint ownership or Powers of Attorney for Finances when planning for incapacity. It avoids the disadvantages of joint ownership outlined above. Also, financial institutions are much more likely to honor the fiduciary relationship because ownership of assets is actually changed.

A. Trustor/Trustee/Beneficiary

A Revocable Living Trust is created during the individual's lifetime. The creator of the trust is called the "trustor" or "grantor." The trustor's assets are placed in the trust while the trustor is alive.

Typically the trustor names himself/herself as the trustee of the trust (which means that the trustor continues to manage income and assets so long as he/she is able). Within the trust the trustor names a successor trustee; that is, someone to handle the assets if the trustor becomes incapacitated. The trust usually provides that incapacity is established by one or two physician's statements to that effect.

Sometimes the trustor will name a co-trustee to act along with the trustor before he or she becomes incapacitated. This gives allows the trustor to transfer some of the responsibility. It also gives the trustor the ability to see if the trustee handles financial matters responsibly and according to expressed desires.

Naturally, the trustor names himself/herself as the beneficiary as the trust as well.

B. Trustor Retains Authority

The trustor retains the power to amend, revoke, withdraw assets and fire trustees. Thus the trustor is creating a mechanism for back-up management of assets while retaining complete control. Because this mechanism is set in place before the trustor's incapacity it avoids the need for a court order establishing a Conservatorship as to assets in the trust.

C. Other Advantages

A Revocable Living Trusts acts as a vehicle to avoid probate as to assets held in the trust. Also, it keeps financial affairs completely private. There is no court proceeding, so there is no public record.

D. Disadvantages/Considerations

A Revocable Living Trust costs more than a Will and Power of Attorney. While it may save money in the long run by keeping the estate out of court, the up-front cost can create financial hardship for some individuals.

A Revocable Living Trust is more complicated to set up. It requires more initial paperwork, and ownership of assets must be changed. Some people find this overwhelming and confusing. While a trust may objectively make sense, it is unwise for some individuals to create a Revocable Living Trust because they may experience unnecessary stress during the initial process and feel less in control of their finances once everything is complete.

A trustee is under a strict legal duty to follow the instructions set out in the trust by the trustor. However, a Revocable Living Trust is not subject to court supervision unless an interested person files a petition with the court because something is amiss.

Revocable Living Trusts are often aggressively marketed to seniors by unscrupulous individuals, who are not planning for the client but instead selling a product, whether or not it is appropriate for the client.

VI. POWERS OF ATTORNEY FOR FINANCES

A Power of Attorney is a document by which an individual (the "principal") gives someone else the authority to act on his/her behalf. The use of an appropriately drafted Power of Attorney can avoid several of the problems associated with joint ownership.

A. Degree of Authority

A Power of Attorney can grant very limited authority or broad authority. A Power of Attorney that is "general" typically gives broad authority to act.

The traditional broad Power of Attorney does not allow gifting or other powers which may be necessary to exercise for estate tax or public benefits planning. For example, if one spouse is in a nursing home receiving Medicaid Assistance, it may be advantageous to transfer the personal residence to the community spouse. If the spouse receiving care is incapacitated, and if his/her Power of Attorney does not allow gifts to the spouse, then the community spouse may not be able to obtain a transfer of the residence without a court order. A broader type of Power of Attorney typically includes specific gifting powers and has other "disability planning" powers as well.

A Power of Attorney that is "durable" is one that remains in effect after the principal becomes incapacitated. In Oregon, a Power if Attorney is presumed to be durable unless indicated otherwise in writing. Most commonly, then, a Power of Attorney intended for use during incapacity is a General Durable Power of Attorney (with or without disability planning powers). Of course, a Power of Attorney should be tailored to the specific needs of the client, who should only sign a Power of Attorney after becoming fully informed about the pros and cons.

B. Timing Issues

The principal must clarify when the Power of Attorney is to be used. Often a letter is given to the person named in the instrument (an "attorney-in-fact" or "agent"), telling him/her only to use it upon request or upon incapacity Sometimes clients ask their attorneys to hold a Power of Attorney, and only distribute it to the agent upon the request of the principal or when the agent proves to the attorney that the principal is incapacitated.

A Power of Attorney expires at the death of the principal. A Power of Attorney does not itself eliminate the need for probate.

C. Disadvantages

There is no ongoing court oversight of Powers of Attorney, which means they can be subject to misuse. When oversight is needed, a Conservatorship is a better option. A Power of Attorney for Finances should only be given to someone the principal absolutely trusts.

Also, some institutions refuse to honor a Power of Attorney. Typically institutions of the federal government insist that a Power of Attorney be made on their own internal forms.

Other financial institutions also sometimes balk at honoring a Power of Attorney, particularly if it is "stale," for fear of liability. The best way to insure that a particular financial institution will honor a Power of Attorney is to also sign a Limited Power of Attorney on that institution's internal form.

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