

Estate Planning Primer for Advisors

1. The Will

The Will is the most universal and fundamental of all estate planning documents. Every formal estate plan must have a Will, even if you have established a revocable trust. The Will can be the single legal document that directs all aspects of the disposition your estate, including specific bequests, charitable gifts, establishing trusts, tax planning, etc. One of the most important functions of a Will is to name guardians for minor children.

Making the Will your primary dispositive document does have several drawbacks that may make it a less desirable alternative. If you have a Will as your primary dispositive document, your estate will need to go through Probate. This is not a very difficult process but it can be a bit expensive and can delay the distribution of your estate.

In addition, if a Probate estate is opened, your Will must be filed with the clerk of the court and becomes a public record. I can tell you from experience that all Wills filed with the court are read by someone.

Finally and most importantly, a Will does not address the management of your estate in the event of incapacity. If you were to become unable to manage your affairs, it may be necessary to have a formal court-supervised conservatorship established to manage all of your assets. This includes a formal declaration of incapacity on the public record, annual accountings presented to the court by an attorney (expensive) and the possibility that the appointed conservator will not be the person you would have chosen.

To avoid many of these possibilities, most of our clients find it in their best interests to couple a simple, skeletal Will called a **Pour-Over Will** with a Revocable Trust (discussed below).

A Pour-Over Will remains the document in which you name a guardian for minor children, but the dispositive provisions do no more than instruct your Personal Representative (Executor) to transfer any assets owned in your individual name to the Trustee of your Revocable Trust. If the Pour-Over Will becomes a public record, there is little information about your plans and your privacy is maintained.

2. The Revocable Trust

A trust is a relatively simple arrangement that has been used for hundreds of years. One party (the Grantor or Settlor) transfers property (the Corpus or Principal) to a second party (the Trustee) who holds that property for the benefit of a third party (the Beneficiary). For a trust to be valid these three things are all that are required: a trustee, a Beneficiary and some property.

A Revocable trust is a very common estate planning document. It allows individuals to be Settlor, Trustee and Beneficiary at the same time.

As its name implies, a Revocable Trust is fully amendable and may be revoked in its entirety at the discretion of the Settlor(s). In effect, it contains all of the dispositive provisions that could be housed in a Will, plus instructions regarding the management of assets during life and in the event of incapacity.

Once a Revocable Trust is established, it is important that your assets be titled in the name of the Trust. This is usually referred to as "funding" the Trust. It is a relatively simple task to fund your Trust. Account titles and deeds are simply changed from "Joe Smith" to "Joe Smith, Trustee of the Joe Smith Family Trust dated August 24, 2010." Assets titled in the name of your Revocable Trust are not subject to the Probate process at your death.

What may be an even more compelling reason to title assets in the name of your Revocable Trust is to avoid a process called Ancillary Probate. Ancillary Probate refers to the opening of a probate estate in each state where

property is owned. If properties held in states other than Colorado are titled in the name of your Revocable Trust, there is no need for Ancillary Probate.

One of the most important decisions you will need to make is the individual and/or institution that will act as your Successor Trustee at your death, resignation or incapacity. It is the naming of a Successor Trustee that allows continuity of management may avoid the need for a Conservator if you become incapacitated.

Finally, your Revocable Trust should never need to be filed with a court (unless there is a contest), so the details of your estate plan should remain private.

3. The Durable Power of Attorney for Property

The Power of Attorney for Property is a document in which you, as Principal, appoint another individual to act as your Agent with respect to your business and personal affairs. Historically, a Power of Attorney was only valid while the Principal was competent. This caused problems because the time when the Principal most needed an Agent was when he or she was incompetent. The Durable Power of Attorney for Property remains valid even if the Principal lacks capacity.

A Durable Power of Attorney for Property can be broad, allowing your Agent virtually unlimited power of your assets, or can be limited to specific actions. Careful drafting of the Power is critical.

Another type of Durable Power of Attorney for Property is known as a “Springing Power.” This is a Durable Power of Attorney for Property that allows your Agent to act *only* if you have been found unable to manage your business affairs.

As a companion document to the Pour-Over Will and Revocable Trust, the Durable Power of Attorney for Property should give your Agent the following enumerated powers:

- The power to fund your Revocable Trust;
 - If you lack capacity, your Agent can complete the transfer of assets from your individual name to the Trust, thereby reducing the need for a Conservatorship.
- The power to continue a pattern of gifting;
 - If you have been making regular Annual Exclusion or charitable gifts, your Agent should be given the power to continue to make gifts after your incapacity. This is particularly important to be sure that gifts are made to an existing Irrevocable Life Insurance Trust (discussed below).

4. The Durable Power of Attorney for Health Care

The Durable Power of Attorney for Health Care is similar in concept to the Durable Power of Attorney for Property. But, instead of giving your Agent the power to conduct business affairs on your behalf, you are naming an Agent to give informed consent for medical treatment.

Without a Durable Power of Attorney for Health Care, state law lists, in order of priority, individuals that can provide informed consent. The practical reality is that a doctor likely does not know who he or she should listen to. So, if there is a conflict among the family members, the doctor may choose to do nothing (remember Terry Shaivo).

In addition, the Durable Power of Attorney for Health Care can provide direction with respect to end-of-life decisions. For example, you can make it clear that you want life sustaining procedures abandoned if in a persistent vegetative state. Conversely, you can direct that all measures be employed to keep you alive, at all costs.

This document is very important for all individuals, but particularly so for single individuals and those living with domestic partners.

5. The Irrevocable Life Insurance Trust

The Irrevocable Life Insurance Trust ("ILIT") is, as the name implies, an irrevocable trust into which gifts are made and the terms of which grant the trustee the power to purchase life insurance on the lives of the Settlers. There is little reason for high net worth individuals or couples to own life insurance individually. The proceeds will simply augment what might already be a taxable estate.

Because insurance premiums are usually paid annually, most individuals want their gifts to an ILIT to qualify as Annual Exclusion gifts. An important requirement for any gift to qualify as an Annual Exclusion gift is that the recipient must have an immediate economic interest in the funds transferred. As a result of this requirement, ILITs are generally set up with Crummey rights of withdrawal ("Crummey Power").

A Crummey Power gives each beneficiary of the ILIT the right, for a specified period of time, to withdraw his or her pro-rata share of any contribution to the ILIT. It is this withdrawal right that allows gifts to an irrevocable trust to qualify as Annual Exclusion gifts.

If properly structured, the insurance proceeds are not included in the taxable estate of the individual or individuals insured. The insurance proceeds can be used to:

- Purchase illiquid assets from the estate;
- Replace funds used to pay estate taxes;
- Provide funds to children from a first marriage.

Estate Planning Definitions

7520 Rate

Statutory interest rate used to calculate the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest in a trust. Rate is set monthly.

Ancillary Probate

Concurrent probate process in any other state where an asset (usually real estate) is located.

By-Pass or Credit Shelter Trust

A trust established at death the value of which is equal to the amount of the decedent's estate that is exempt from estate taxation.

Charitable Lead Trust (CLT)

A "split-interest" trust in which a charity receives an annual distribution for a period of time after which the remaining assets transfer to named non-charitable beneficiaries.

Charitable Remainder Trust (CRT)

A "split-interest" trust in which the named beneficiaries receive a fixed payment over the course of a specified period, after which the remaining principal passes to charity. The payment can be structured as either an annuity (CRAT) or a unitrust (CRUT).

Crummey Trust

An irrevocable trust that gives the beneficiaries the right to withdraw a pro-rata share of each contribution made to the trust. This is required if gifts to the trust are to qualify for the Gift Tax Annual Exclusion. Most Irrevocable Life Insurance Trusts have Crummey provisions.

Durable Power of Attorney for Health Care

An instrument giving an adult the authority to make health care treatment decisions for the principal.

Durable Power of Attorney for Property

An instrument containing an authorization for one to act as the agent of the principal on personal business matters.

Equitable Apportionment

The process of sharing the estate tax burden, on a pro-rata basis, among all properties making up the taxable estate.

Estate Freeze

A group of strategies that transfer future appreciation of an asset to a future generation, or to a trust for their benefit. These strategies include the installment sale, Sale to an Intentionally Defective Grantor Trust (SIDGT), Zeroed-Out GRAT, etc.

Estate Planning

The process, either consciously or unconsciously, of structuring the ownership, management and disposition of your assets.

Family Limited Partnership (FLP)

An entity used by families to consolidate the management and transfer of assets and to protect assets from creditor claims. Interests are divided between General Partnership units and Limited Partnership units. In certain circumstances, transfers of Limited Partnership units may receive a valuation discount for lack of control and lack of marketability.

Generation Skipping Transfer Tax (GST)

The Generation Skipping Transfer Tax is a flat tax at the highest estate tax rate levied on transfers that skip at least one generation. (e.g., Grandparent to Grandchild). Under the estate and gift tax rules that are currently in effect, each individual can shelter up to \$5,430,000 from the GST Tax.

Gift Tax Annual Exclusion

The maximum amount that a person can give each year as a gift without having to pay a gift tax – currently \$14,000.00

Grantor Retained Annuity Trust (GRAT)

A “split-interest” trust in which the Grantor receives a fixed payment over the course of a specified period, after which the remaining principal passes to named beneficiaries. At inception, the value of the remainder interest must be reported as a taxable gift. A GRAT can be **zeroed-out**, meaning that the present value of the annuity interest is equal to the value of the assets used to fund the trust.

Grantor Trust

Any trust where the Settlor is treated as the owner of the trust assets for income tax purposes.

Intestate Succession

The transmission of property or property interests of a decedent as provided by statute, as distinguished from the transfer in accordance with a decedent's will.

Irrevocable Life Insurance Trust (ILIT)

An irrevocable trust that grants the trustee the power to purchase life insurance on the life of the Settlor(s).

Irrevocable Trust

A trust that cannot be revoked by the Settlor after its creation except under certain limited circumstances.

Joint Tenancy with Right of Survivorship

Ownership by two or more parties holding equal and simultaneously created interests in the same property and in which title passes by operation of law to the survivor upon the death of first tenant to die.

Marital Trust (QTIP)

A trust established for a spouse that qualifies for the Unlimited Gift and Estate Tax Marital Deduction. Certain rules apply, including (i) the spouse must be the sole beneficiary during his or her lifetime, and (ii) all trust income must be distributed to the spouse at least annually. The assets of the Marital Trust will be included in the spouse's gross taxable estate at death.

Minor's Trust (§2503(c) Trust)

An irrevocable trust for a minor, gifts to which may qualify for the Gift Tax Annual Exclusion if (i) the Trustee may distribute income and principal to or for the benefit of the beneficiary and (ii) the property is distributable to the beneficiary at age 21. Note: the terms of the Trust may limit the time during which the beneficiary may withdraw property after turning 21. The window can be as short as 30 days. After the withdrawal period, the assets can remain in trust.

Personal Representative

A person or institution appointed to administer a decedent's estate per the terms of his or her Will. Also known as the Executor.

Pour-Over Will

A will that operates to transfer all individually-owned property of a decedent to the Trustee of the decedent's revocable trust.

Power of Appointment

Not for client use. For internal use by advisors only.

A power that allows a trust beneficiary to direct the ultimate distribution of trust assets. The power can be either General or Limited. A General Power of Appointment may be exercised in favor of anyone, including the power-holder, his or her estate or the creditors of either. All property subject to a General Power of Appointment will be included in the estate of the power-holder. A Limited Power of Appointment may be exercised in favor of a limited class of beneficiaries per the terms of the Trust. Limited Powers can be broad (to anyone *other* than the power-holder, his or her estate or the creditors of either) or narrow (e.g., my lineal descendants). A Limited Power of Appointment does not cause assets subject to the power to be included in the power-holder's estate.

Probate

The process of proving in court that an instrument is the valid last will and testament of a deceased person; broadly, the process of administering an estate.

Qualified Domestic Trust (QDOT)

Specific type of Marital Trust used to hold property for a non-citizen spouse. If property passing to a surviving non-citizen spouse is to qualify for the Unlimited Marital Deduction, it must pass to a QDOT.

Qualified Personal Residence Trust (QPRT)

A "split-interest" trust in which the Grantor retains the right to occupy residential real estate for a term of years, after which title passes to named beneficiaries or to a trust for their benefit. The value of the real estate, less the present value of the right to occupy the real estate, is reported as a taxable gift.

Revocable Trust

A trust over which the Settlor has retained the power of amendment and/or revocation.

Sale to an Intentionally Defective Grantor Trust (SIDGT)

Strategy in which an irrevocable trust is established that is "defective" for income tax purposes (taxes flow out to the Settlor), but is recognized as a separate entity for estate and gift tax purposes (assets not included in the estate of the Settlor). No gains are recognized on the sale of assets to the trust, since the Settlor is still the owner for income tax purposes. This technique "freezes" the value of the assets sold to the trust.

Self Cancelling Installment Note (SCIN)

A form of installment note, the terms of which cancel the outstanding loan balance at the death of the note maker. For an installment note to be recognized as a SCIN, it is important that the terms reflect that the self-cancelling feature was bargained for. This generally is reflected in a larger purchase price.

Settlor

A person who creates a Trust. May also be referred to as the "Grantor".

Special Needs Trust

An irrevocable trust designed to provide support for a special needs beneficiary. The Trustee is given broad discretionary power over Trust distributions such that the Trust will supplement, and not replace, any public support for which the beneficiary may qualify.

Specific Bequest

A bequest of a specific item of personal or real property, or a specific sum; e.g., "I leave \$50,000 to my sister, Jane."

Split Interest Trust

An irrevocable trust that grants an interest for life, or for a term of years, to one beneficiary, and grants an interest in the remaining trust assets to another beneficiary.

Survivor's Trust (generally found in community property states)

A trust established at death to hold the surviving spouse's share of the community property and the surviving spouse's separate property.

Unlimited Estate and Gift Tax Marital Deduction

Law allowing an individual to give an unlimited amount of assets to his or her spouse, either during life or at death, without generating a gift or estate tax.

Will

A formally executed written instrument by which a person makes disposition of his or her estate after death.

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