

WILLS

1. **Do you need a will?**
 - a. **If you die without a will you forfeit your right to determine the distribution of your probate estate.**
 - b. **The State of Arkansas decides by statute how your estate is distributed. Contrary to popular belief, without a will, the surviving spouse may not receive all of the property of the deceased spouse**
 - c. **It costs more to probate an estate of a person dying without a will:**
 - (i) **the estate is subject to court supervised administration;**
 - (ii) **a court appointed administrator may have to post a bond;**
 - (iii) **the administrator must have court approval for payment of debts, sale of assets and distributions to heirs;**
 - (iv) **a hearing is required to ascertain the persons entitled to share in the estate and to determine proportionate shares;**
 - (v) **there may be a need for a court ordered partitioning or division of property;**
 - (vi) **if there is a minor heir, a guardian may have to be appointed until the heir is 18 years old;**

- (vii) an administrator may have to be appointed by the court before the deceased's remains may be buried or cremated.

All of the above add substantially to the cost of the administration of the estate.

2. Advantages of a Will:

- a. The estate is distributed according to the desires of the testator.

- b. Key roles in the estate are filled by the testator –

Executor: Gather the assets – pay debts and tax and distribute the estate as directed by the will.

Trustee: Manage the assets of a trust and make distributions as directed by the trust.

Guardian: Guardian for minor children is appointed if no parent survives to care for the person of the minor child.

- c. Important tax advantages can be realized. (See Paragraph 3)
- d. A provision can be included to discourage a fight over the will.
- e. Alternate beneficiaries can be named if a primary beneficiary fails to survive.
- f. Very broad powers can be granted to the executor to deal with estate assets.

3. **Estate Tax Advantage** – A will presents an opportunity to maximize estate tax planning (a living trust, properly drafted, can also accomplish the same purpose).
- a. **Unlimited marital deduction** – A gift by deed or will from spouse to spouse who is a citizen of the United States, normally is eligible for 100% marital deduction. Such transfers may be made outright or in trust if the trust complies with certain requirements.
 - b. **Lifetime Estate and Gift Tax Credit** – Everyone has a lifetime credit against estate and gift tax of \$345,800, which is the equivalent of the tax on an estate of \$1,000,000. The \$1,000,000 would be available on the death of a person who has not made any taxable gifts during his lifetime. If taxable gifts were made during the lifetime, then the amount available at the time of death would be the \$1,000,000 less the value of the taxable gifts made. It is important in will planning that provision be made for the utilization of the \$1,000,000 credit on the death of the first spouse to die.

To illustrate how this works, let's assume that there is an estate of \$1,200,000 owned by John and Mary. John dies and has a simple will which says "I leave all of my property to Mary". When Mary dies, assuming no increase or decrease in the total value of that estate, there is a taxable estate of \$1,200,000 with a tax due of \$82,000 after her executor had applied her credit on the first \$600,000.

With proper planning, instead of having that simple will, John would have left a will, which says "I leave in trust for my wife Mary that amount of my property which I can pass estate tax free. During her lifetime she has access to the income and principal of this trust, she can be named as trustee, but on her death this trust will pass to my children". Again, assuming that there's been no increase in the total estate, Mary now has the \$600,000 trust, plus the \$600,000, which is her property. She still has a \$1,200,000 available to her, but on her death, her estate is only \$600,000 and since her credit will cover the estate tax on

\$600,000, her estate pays no taxes at her death. Net result - \$82,000 passes to Mary and John's heirs through the simple tax planning of using a trust to take advantage of the maximum credit available for estate and gift taxes.

- c. Income tax benefits may also be obtained by using trusts to distribute income from the estate to lower tax bracket recipients. Be sure income is distributed to heirs and not taxed in the trust.**

- d. Generation Skipping Tax – Trust may also be created to take advantage of the generation-skipping tax exemption of \$1,112,000 available to each person. Generation-skipping tax is an onerous tax of 49%, which is charged on any gifts from one generation to two generations below the gifting generation. A grandparent's gift to a grandchild is a generation-skipping gift. If you contemplate making substantial gifts to your grandchildren, either during your lifetime or in your will, it is important that the consequences of the generation-skipping tax and its exemption be explored fully.**

- e. QTIP Trusts – Although there are a variety of trusts that can be used to qualify for the unlimited marital deduction, there is a particular kind of trust (QTIP), called a qualified terminal interest property trust, which has proven very popular, particularly in situations where the spouses have children of prior marriages. In such trusts, the marital deduction is held for the benefit of the surviving spouse. All income from that trust is paid to the surviving spouse, a requirement for the marital deduction. Access to the corpus of the trust may be somewhat restricted. Any property remaining in the trust at the death of the second spouse is taxed in the estate of the second spouse and the then remaining trust property, after the payment of estate tax, passes as the first spouse has directed in his will.**

- f. Charitable Gifts – Charitable gifts may be made outright or in trust to your church, your alma mater or your favorite**

charity, and such gifts normally qualify for a charitable deduction from your estate in the calculation of estate taxes.

- g. Non-citizen Spouse – If one of the spouses is not a citizen of the United States, a transfer to a specially designed trust, called a qualified domestic trust, will be required to qualify for the marital deduction. Every client whose spouse is a non-citizen should have their wills reviewed to insure the proper provisions are contained to qualify for the maximum marital deduction available.**

TRUSTS/LIVING AND TESTAMENTARY TRUSTS

- 1. Trusts** – A trust is a fiduciary relationship where A (the settlor) gives property to B (the trustee) to hold for the benefit of the C (the beneficiary). To have a trust, we need a settlor (who may sometime be called a grantor or a trustor and that is the person who creates the trust), a trustee (that is the person who takes legal title to the property involved in the trust and who has a fiduciary responsibility to the settlor and the beneficiary), we have the property itself (whatever the subject of the trust is) and lastly we have the beneficiary (that is the person for whose benefit property is held in trust). All of these are essential ingredients to a trust, however, if there is no trustee, a court may appoint a trustee.
- 2. Types of Trusts** – We are going to consider the two major types of trusts – testamentary trusts and inter vivos or living trusts. Testamentary trusts are trusts created at the death of the grantor, such as the marital trust and the credit shelter trust established by a will. These trusts can be created in a living trust to function on the death of the Grantor. Such trusts are irrevocable by nature.

Inter vivos trusts may be revocable or irrevocable. A revocable trust is one that can be amended or terminated by the settlor. In Arkansas all trusts are revocable unless the trust document itself says that the trust is irrevocable. There are other trusts, such as trusts for minors, insurance trusts, etc., which are generally living trusts created for specific purposes. These can be revocable or irrevocable depending on the purpose and intent of the Grantor.
- 3. Purpose of the Living Trust** – Directing our attention to the living trust, it is a revocable trust created for some or all of the following reasons:

- a. **Asset Management** – To provide for management of property, an individual may decide to have all or part of his assets managed by himself or someone else either for a limited time or for the duration of the settlor’s life. In many cases in the living trust the settlor himself will be the trustee, which means the settlor will retain the personal management of the assets. On the settlor’s death or prior to that if the settlor can no longer manage the trust, one or more alternate trustees are named and ready to assume responsibility for management of the trust assets.

- b. **Avoiding Probate** – A living trust may be used to avoid probate. Since the mechanism for managing the assets of the deceased is in place in the trust and **assuming** that all of the deceased’s assets have been placed in the trust, there is no need for a probate proceeding and no need for an administration of the deceased’s estate. The horrors of probate in Arkansas have been greatly minimized if at the time of death there is a properly prepared will, which provides for independent administration of the estate. With independent administration there is no great need for extended court involvement in the administration of the estate.

In most of the cases where there is a living trust, there is also a will. Often there will be assets which the settlor has decided not to place or has forgotten to place in this trust. This results for any number of reasons, including merely forgetting to title an object in the trust name. There are any number of ways in which property can be excluded from a living trust and understanding that, the attorney preparing living trusts will also prepare a Will. Presumably the Will is a “pour over will” which says “At the time of my death, if there is any property that is not in my trust, I leave it to my trustee to be distributed according to the terms of my trust”. If there is any property included in the deceased’s estate but not included in the trust, it requires probating the pour-over will. In Arkansas, I do not see avoiding probate as a principal reason for a living trust.

- c. **Avoiding Ancillary Administration.** If real property is located in another state, the use of a living trust to provide for the disposition of that property on the death of the owner is an effective way to avoid the need for an ancillary probate proceeding in the state in which the real property is located.
 - d. **Privacy.** Since a trust is a private contract, there is no need for it to be placed of record. The property of the trust, the identity of the beneficiaries and the terms of the trust are not available to the public as a matter of public record. In the case of a will, the will to be probated must be made a part of the public record and after the will is admitted to probate, an inventory of the assets of the deceased must be filed.
 - e. **Estate Tax Planning.** There is nothing you can do in the living trust that you can't do with the proper program during your lifetime and a properly drafted will.
 - f. **Disability Planning/Avoiding Guardianship of the Estate.** One of the primary advantages of the use of a living trust is in disability planning. Assuming that all of the principal's assets have been placed in a living trust and adequate provision has been made for successor trustees, in the event of the disability of the settlor, the successor trustee would take over. The successor trustee would continue to manage all of the assets in accordance with the terms of the trust, which should adequately provide for the care and maintenance of the settlor. Thus the need for a guardian to manage the estate of the now disabled settlor is eliminated. This is a particularly attractive where there is no individual the settlor can name to take over as a trustee and a corporate fiduciary (such as a bank or trust company) would have to be named as successor trustee.
4. **Functions of a trust during the lifetime of the settlor.** Assuming the settlor is named as trustee, then the settlor will deal with all of the property as he did when he owned it in his own name except the title to everything is held in his name as trustee. A tax return

for the trust would not be necessary since the settlor would treat any income on the trust assets as his personal income and report it on his Form 1040. If the trustee is not the settlor, then a tax payer identification number and an informational form 1099 will be required.

5. **Function of trust on death of settlor.** When the settlor dies, the trust should become irrevocable, at least as to deceased settlor's assets in the trust. If both the husband and wife are joint settlors, the trust should contain a credit shelter trust provision to hold the estate tax free amount (see Wills 3b) to be established on the death of the first settlor and possibly a marital deduction trust, if necessary. Both of these trusts would be irrevocable on the death of the first settlor.

Should the surviving spouse become disabled during the surviving spouse's lifetime and assuming that the surviving spouse was named as the successor trustee, then the next alternate trustee would take over and manage the affairs of the trust for the benefit of the surviving spouse, all in accordance with the terms of the trust. On the death of the surviving spouse, the trustee would then be responsible for paying the final debts of the spouse, any estate tax that is due and distributing the trust according to its terms which may or may not mean the continuation of the trust, depending upon the terms of the trust.

6. **Life Insurance Trusts.** An irrevocable trust is established for the purpose of owning life insurance on the life of the insured which will not be included in the insured's estate. All of the good reasons for having life insurance such as asset replacement and estate liquidity can be achieved through the use of the Life Insurance Trust –AND- the life insurance proceeds will not be included in the insured's estate for estate tax purposes – essential ingredients are-

- a. **a written trust agreement that is irrevocable** – Settlor has no control over the trust once established –
- b. **trust owns life insurance on the life of the insured** – If the trust buys the insurance, the exclusion should be immediate.

If an existing policy is transferred to the trust, the insured must survive for 3 years or the face the amount of the policy will be in the insured's estate.

- c. settlor gifts cash to the trust for trustees to pay premiums.**
- d. beneficiaries have certain withdrawal rights to qualify the annual or more frequent gifts to the trust for the annual gift tax exclusion.**
- e. spouse will not need access to trust assets – life insurance proceeds can be excluded from both spouses estates.**
- f. spouse does not need access to trust assets – the insurance policy and property gifted are from insured spouse's separate property.**
- g. use of proceeds of the life insurance policy – trustee has cash to use to pay estate taxes or costs of administration by lending money to the estate or purchase non-cash assets from the estate.**

NON-PROBATE ASSETS

There are several ways of transferring property at the time of death without a will or a trust. These are referred to as non-probate transfers. Many people will consider the use of the devices as an inexpensive way to avoid probate. To the extent that there are not substantial sums involved, they may be very effective devices. However, if there is an estate plan, particularly in a more complex estate where there may be minor children, disabled children or disabled adults that the testator is interested in providing for, it is important to be sure that the assets of the estate are available to be distributed according to the plan.

The major assets that commonly fall in the non-probate asset area are:

- 1. Life insurance where a specific beneficiary is named;**
- 2. IRAs or pension benefits that continue after the pensioner's death where a specific beneficiary is named;**
- 3. Joint bank accounts with right of survivorship where the money in the account passes to the co-account holder on the death of the principal depositor;**
- 4. Payable on death accounts which provide that on the death of the depositor the funds will go to a specific individual;**
- 5. Simple trust accounts where the depositor places the money in trust for a named individual. Such accounts are not really trust accounts because the depositor has the right to withdraw the money at any time, however, on the death of the depositor, the beneficiary named receives the balance of the account;**
- 6. Securities and other properties held as joint tenants with right of survivorship.**

If you remember our earlier illustration, John has a will in which he intends to leave the credit shelter trust for Mary's benefit to take advantage of the credit equivalent amount and reduce estate taxes that are ultimately paid on the death of the second spouse. Such planning will be completely paid on the death of the second spouse. Such planning will be completely frustrated if his assets consist of bank accounts, IRA's and life insurance policies in which he has named Mary as beneficiary. In such case, on his death all of that money would pass directly to Mary and there would be nothing in his estate to fund the credit shelter trust.

Another common problem area has to do with accounts that a parent having several children may establish with one (who lives close by and helps the parent handle his or her affairs) being placed on a substantial bank account of CD as a joint tenant with right or survivorship. The parent's intention all along is to distribute his or her estate equally among his or her children. However, when the parent dies, that CD or bank account goes directly to the child named as a joint tenant and is not shared with the joint tenant's siblings. It is not only important to know what property you have, but also how it is titled to be sure that all of your property is in proper mode to fulfill your estate plan.

GUARDIANSHIPS

1. **Types of guardianships.** A guardianship is a court procedure wherein an individual is determined to be incapable of caring for himself on a day-to-day basis and is declared a ward of the court. The court then appoints one or more persons as guardian of the ward's person and estate. There are two distinct forms of guardianship.
 - (a) “guardian of the person” in which the guardian is responsible for the day-to-day decisions in connection with the care, feeding, housing, clothing, education, recreation of the ward.
 - (b) “guardianship of the estate” in which the guardian of the estate is responsible for the assets of the ward.

In many cases where an incapacitated person is being provided for under the terms of a trust and all his income and support is coming from the trust, it is not necessary to have a guardian of the estate. The trustee manages the business affairs of the ward and a guardian of the person makes normal daily living decisions for the ward.

2. **Special form of guardianship.** If the Court finds a person lacks capability to do some things necessary to care for himself or to manage his property, the court may appoint a guardian with limited powers. This permits the person to care for himself and manage his property commensurate with his ability.
3. **Costs.** One of the major problems with a guardianship is that it can be expensive. An attorney is needed to handle the application for the guardianship. Once a guardian has been appointed for the ward and assuming there is a guardian of the estate and a guardian of the person, each would have to post a bond. The bond would be a nominal bond for the guardian of the person, but the guardian of the estate's bond would be determined by the value of the liquid asset of the ward at the time of hearing. The guardian

of the estate would then file an inventory in which all of the ward's assets would be listed. Each year it is necessary to file an annual accounting to account for any income, and all expenditures, received or made on behalf of the ward. The guardian must secure approval of the court to buy or sell an asset of the ward and to make expenditures for the ward. Guardianships are expensive, time consuming and cumbersome. If there is no other way to care for an individual, a guardianship can protect the assets of an incapacitated person. A guardianship can be avoided by using a durable power of attorney and power of attorney for health care, or a living trust with a power of attorney for health care.

LIVING WILLS

You may be familiar with the Living Will. That is the document whereby you the patient tell your doctor or health provider “don’t keep me alive artificially.” The Living Will has been around for many years and has been a very useful tool. Perhaps the most significant aspect of the Living Will is that it relieves your loved ones of the responsibility for making a very critical decision.

POWER OF ATTORNEY FOR HEALTH CARE

Several years ago the legislature gave us a Power of Attorney for Health Care. The Power of Attorney for Health Care resulted from the fact that the Living Will only applies in terminal situations. While you could name someone to make health care decisions for you under a Living Will, the Living Will would only apply in a terminal situation. If the doctors were not willing to concede that the particular diagnosis was a terminal one, then they could not give effect to the Living Will. Thus the Durable Power of Attorney for Health Care. In the Durable Power of Attorney for Health Care you name one or more people consecutively to make health care decisions for you if, and only if, you are unable to make them yourself. That person can make any decision that you could make and consent to any type of operation that may be described, to agree or prohibit the use of a drug treatment regimen.

A DURABLE POWER OF ATTORNEY

Powers of attorney have been in use in the world for many, many years and can be a very effective tool in managing your affairs. Limited powers are used for specific purposes and for limited times. For example, to give someone the right to sign a deed on your behalf on the conveyance of a piece of property, or someone the right to access or alter an account at a bank. The power can be made to terminate at a set date.

Remember that the person you appoint as attorney can do anything that you can do with your property. That person can empty your bank accounts, can sell your home, can sell all your stocks. Anything you can do your appointed attorney can do.

A recent change in the law lets us appoint an attorney to become effective only when we are incapable of acting. Previously, when we appointed an attorney, it was effective immediately. Now we have a choice of immediate or when we cannot act.

A power of attorney can authorize your appointed attorney to make gifts on your behalf, to file income tax returns and to make claims for income tax refunds, etc. It is a very, very useful and important document.

One of the reasons you should consider a Durable Power of Attorney and a Power of Attorney for Health Care is because with those two documents, in most cases, a person's affairs, both medical and business, can be handled during the person's disability without having to resort to a guardianship.

FAMILY LIMITED PARTNERSHIP

PURPOSE

The purpose of this plan is to restructure the ownership of certain family assets to maximize the preservation and use of those assets during the parents lifetime and provide a method to make periodic gifts of their property to their children.

Through the use of this method, you may accomplish the following:

- **Lower the valuation of gifts and the taxable estate on death;**
- **Maintain centralized management of the assets and provide continuity of management at parents death;**
- **Protect the parent's assets and the children's assets from creditors;**
- **Minimize probate time and costs;**

METHOD

The keystone for this program is the formation of a family limited partnership. The managing partner is called the general partner and is generally a corporation or limited liability company. The parents would own the stock of the corporate general partner or possibly their children.

The principal assets to be included in the family limited partnership would be the various properties in which family members have an interest. In addition, cash, stocks and bonds may be contributed. Assets such as the homestead, personal vehicles and boats would not be included. The children may contribute their assets for a proportionate interest in the limited partnership.

HOW DOES IT WORK

The ownership of the selected assets is transferred to the family limited partnership.

The limited partnership agreement provides that the corporate general partner has total control over the management of the partnership and its assets.

There is a shareholder's agreement of the shareholders of the corporate general partner's stock that the parents and other parties designated are to be elected directors of the corporate general partner during their lifetime. (This would give the parents total control of the corporate general partner and through the corporate general partner, control of the family limited partnership).

WHAT ARE THE BENEFITS

A. Estate Planning.

- 1. The family's interest in the limited partnership at the time of their death will be valued at a lower than proportionate market value of the assets held by the limited partnership due to the principal of discounts for lack of marketability and fractional ownership of an asset. This can be a very significant item in a substantial estate. Depending upon the final value of the estate, it can save \$0.50 or more on each dollar the estate's value is reduced.**
- 2. The use of the limited partnership makes it easy to gift to the children part of the parent's interest in the limited partnership on an annual basis and at a substantial discount (including a substantial gift equal to the credit shelter amount if that is desired) while still having those gifted assets remain a part of the limited partnership and therefore under the control of the corporate general partner.**

3. The use of the family limited partnership can also facilitate charitable giving if that is to be a part of the family's estate plan.

B. Asset Protection

1. The use of the limited partnership would protect the family from creditors having access to assets in the limited partnership. An equally significant advantage of this plan would be that the children's interest would be protected from their creditors.
2. The partnership assets are protected from the claims of judgment creditors of any of the limited partners. A judgment creditor of a limited partner would only have a right to a "charging order" against the income distributed from the partnership to the limited partner against whom the judgment was taken. This means a judgment creditor cannot take possession of any of the assets of the limited partnership nor can it vote the interest of the limited partner judgment debtor. If the general partner has a valid business purpose for keeping income in the partnership, all the creditor might receive at year-end is a copy of a K-1. That means the creditor receives no funds but would be charged with the income earned by the limited partner as reported on the K-1. This protection works for all of the limited partners and their limited partnership interests.
3. If there is concern that one of the parents may have a creditor with a substantial claim, you may need to consider protecting the innocent spouse. In such a situation, you may divide the property prior to the transfer of the property by the spouses to the limited partnership. In that case the spouse's limited partnership would be separate property.
4. It may be desirable to establish more than one limited partnership because of the nature of the different types of investments in which the family is participating. Several of the areas of investment have potential higher risks activities than others. It may be prudent to isolate a particular

investment or group of investments in a separate limited partnership to avoid exposure to other non high-risk ventures.

C. Control.

- 1. In addition to the estate planning and asset protection features mentioned above, one of the parent's high priorities may be control of the assets of his children. The program outlined above which calls for the use of the family limited partnership and a corporate general partner when properly executed would permit parent (while he is capable and desirous of doing so) to effectively control the operations of the assets listed in the family limited partnership. With parent's interest in the corporation, which is the general partner, a parent can be the president of the corporation and as president of the corporation, which is the general partner; he would effectively control the assets of the limited partnership. For this he would be paid a fee in the form of a salary. In normal situations the proceeds of the limited partnership can be disbursed to the limited partners proportionately to their interest. Again, if any of the limited partners should have a judgment creditor, it might be necessary to withhold distributions to the limited partners until the judgment creditor can be effectively dealt with. Obviously the ability of the limited partner to limit the assets available to his judgment creditor places that limited partner in a superior position to negotiate with a judgment creditor.**
- 2. A family limited partnership can provide for a reduction in estate and gift taxes, protection of assets from creditors and a method to give property to children and grandchildren without giving up control of the property.**

YOU SHOULD NOT RELY UPON THIS SUMMARY AS LEGAL ADVICE. LAW PROHIBITS US FROM PROVIDING LEGAL ADVICE. THE LAW OF ESTATE PLANNING, TRUSTS AND

WILLS IS COMPLICATED AND COMPLEX. BEFORE MAKING ANY DECISIONS OR EXECUTING ANY DOCUMENTS REGARDING YOUR ESTATE YOU SHOULD CONSULT AN ATTORNEY.