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# Trust Me On This One

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## An Explanation of Wills and Trusts, Considering Children

Three common statements tax attorneys hear regarding estate planning are, "I need a will," "I need a trust," and "I need to avoid probate on my death."

The answer for all three is, "It depends." Every situation is different. You may not need any of the above; but, if you do, substantial benefits exist from advanced planning. Some appropriate follow up questions are, "Do you have children?" and, "Is your estate large enough where you can benefit from tax planning?"

### Wills

A will is a document providing for administration and distribution of property following death. The parties are the testator, who makes the will, beneficiaries, who receive benefit under the will, personal representative (executor), who manages the estate to assure compliance with the will and governing law. A guardian and conservator may be appointed to care for minor beneficiaries and property they are receiving. Not everyone needs a will, but personal circumstances should be considered. Wills may provide for minor children, plan for special circumstances, and allow tax planning and flexibility.

A substantial reason for a will is to designate a guardian for children. Designation assures the appropriate uncle, godparent, or friend will take care of minor children, instead of relying on the Court to sort through the process.

Unlike the scare tactics presented in ads, if you die without a will, property rarely goes to the state. The administration and distribution of the property is governed by state law. Typically, without a will, property will go first to the spouse, and if the spouse is not alive it will go equally to the children. Law reasonably reflects common desires and serves well in routine cases, but leaves no flexibility. To provide for distribution of specific items, or unequal distribution (for example, the oldest son is to receive the donkey, two goats and prized koumboloya), then a will is necessary to provide for that distribution. Charitable gifts also can be made through a will.

A will only covers property in the probate estate. Property held in joint tenancy will pass to the surviving joint tenant. Gifts made prior to death are no longer in your estate. Life insurance, financial accounts and other accounts or policies with beneficiary designations other than the estate are distributable according to those contracts and are also not part of the probate estate.

## Trusts

A trust effectively establishes an entity that manages and distributes assets and properties in accordance with the terms set by its creator. Either wills or trusts can provide for distribution of property following a person's death. Simple wills typically provide for distribution of property shortly after death. A trust typically provides for management and distribution of property over an extended period of time, either during life, after death, or a combination of both. Wills may establish trusts following death or pour over property into an existing trust; however, wills do not govern property in the trust.

A trust consists of a trustor (or grantor), trustee(s) and beneficiaries. A trustor establishes the trust and typically provides its funding. A trustee manages the trust in accordance with its provisions and governing law. Trustees may be individuals or entities such as banks. Beneficiaries are those who receive benefit under the trust. Trusts manage the assets and property, and distribute (or accumulate) the income and principal consistent with the trust provisions.

Trusts can provide substantial tax benefit for large estates. The benefit for children is in managing the distribution of inheritance. Children inheriting at age 16 may be more concerned about a new Porsche rather than college. Accordingly, a trust can determine how the trustees distribute trust money to the beneficiaries. For example, the principal can be used for support, maintenance, health, and education expenses as the child grows up, and 50% of the trust can be distributed to the child at age 25 and the remaining share of that child's trust is distributed to the child at age 30.

The most common trusts used in estate planning are revocable living trusts, irrevocable living trusts, and testamentary trusts. Trusts allow tremendous flexibility and are used in estate planning for providing benefits both during the lifetime of the trustor and after death. Trust purposes include caring for the trustor during life, administration of assets, charitable giving, care of minors, restricting efforts of spendthrift beneficiaries, special needs of incapacitated persons, second marriage issues including Qualified Terminable Interest Property trusts, various tax qualifying trust interests, and others. If you own property in another state, placing that property in a trust is recommended to avoid a secondary probate in that state.

Revocable living trusts are created during the lifetime of the trustor. They may be changed, modified or revoked. Following the death of the trustor, they can no longer be changed. They provide flexible and desirable tools for administration during life, caring for the trustor in the event of subsequent inability or incapacity, management and distribution of assets immediately after death or for extended periods thereafter, restricting efforts of spendthrift beneficiaries, and many other purposes.

Irrevocable trusts are means of transferring property out of an estate prior to death, while mandating directives and limitations on administration and distribution. They may be used to shift income tax to beneficiaries. Gifts are deemed made when property is transferred to an irrevocable trust, and a gift tax may be payable. Property transferred to an irrevocable trust retains the same income tax basis as it had in the hands of the donor, whereas substantial income tax savings may be available to the recipient if the transfer were made following the death of the donor.

A testamentary trust created under a will following and becomes effective following death. The will and its trust provisions can be changed during lifetime, but become irrevocable on death.

What type of trust is appropriate for minor children? Minor children cannot receive property. If transferred through a guardian, substantial court proceedings and related expenses are required. The common types of trusts discussed above efficiently provide for the needs of the beneficiary while allowing for final distribution at a more mature age. Any of these trusts can be appropriate.

## PROBATE

The best way to avoid probate is not die, or die without any assets. Probate is the orderly process for administering the estate of a decedent. It includes an inventory and appraisal of the estate, determination and payment of debts and taxes, and distribution of property. It is often found disappointingly simple.

Most states follow the Uniform Probate Code which greatly simplifies the probate process. Accordingly, fears of probate should be minimal. Provided attorneys charge on a time basis instead of percentages, total fees are typically comparable for probate, termination of a trust, or following up on the multiple processes transferring assets. In some states, probate is quite expensive and it may be desirable to use vehicles to avoid probate, like beneficiary designations on insurance and financial accounts (Payable

on Death or Transfer on Death designations), joint ownership of real estate, or placing all your property in a trust.

## PLANNING

### Effective

estate planning requires several processes and becomes effective only when all of those processes are coordinated. Currently federal estate taxes apply only to estates in excess of two million dollars. Most states no longer have an inheritance tax. Accordingly, most estates have little or no death taxes. Estate, gift and income tax implications should be evaluated for both the individual concerned and the beneficiaries. The form of ownership for each asset should be reviewed. Ownership and beneficiaries of life insurance policies, pension plans and IRAs may need updating. Liquidity requirements should also be evaluated. Powers of attorney, and living wills should also be considered.

A comprehensive process should include input of the attorney, the CPA, the insurance agent, trust officer, financial planner and other appropriate parties competent in estate planning. Advanced planning assures desires and special needs can be met.

### Andrew

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