Basic Estate Planning: Married Couple

Just the FAQs

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From the Estate Planning & Probate Group

What is an *estate plan*?

An *estate plan* is a set of documents that provides for the orderly arrangement and management of your affairs in the event that you become incapacitated and sets forth the desired disposition of your estate after your death. A basic estate plan typically includes a Will, Financial Durable Power of Attorney, Health Care Power of Attorney, and a Health Care Directive. One of the primary goals of any estate plan is to minimize (or entirely eliminate) any and all taxes due at the time of death.

Do I need an estate plan?

Yes. Everyone needs an estate plan, although for a variety of reasons. Parents with young children need an estate plan in order to appoint someone to care for their minor children or to set up a trust for their benefit. Other people need an estate plan to minimize taxes. Everyone needs an estate plan to appoint a family member or trusted friend to act on their behalf in the event of incapacity.

What happens if I die without a will?

If you die without a will, the court will appoint an administrator to oversee the distribution of your assets. After payment of taxes, debts, funeral expenses and administrative costs, your assets will then be distributed according to state law, which represents the legislature's "best guess" as to how the average person would want his or her assets to be distributed. This law is quite rigid and does not take into account concerns such as tax minimization, family dynamics, and an array of other concerns unique to each individual. The law also does not make provisions for your minor children, leaving the court with ultimate authority to choose the person who will care for your children and their property. Finally, without a will, the administrator of your estate will generally be required to post bond and be obligated to ask permission of the court before taking any action on behalf of the estate.

If I already have an estate plan in place, do I need to update it?

The shelf life of your estate plan depends on a number of different factors, including changes over the years in (1) family circumstances; (2) tax and probate laws; and (3) financial circumstances. With the passage of time, any number of changes could potentially have a significant effect on your estate plan. Therefore, we recommend that you and your attorney review your estate plan every few years simply to ensure that it continues to properly represent your wishes, and that it complies with the current probate and tax laws.

What is a *revocable living trust*?

A *revocable living trust* is a substitute for a will that is designed to distribute your assets at death without having to go through probate. A trust agreement is drafted that sets forth how a person's assets are to be managed during his or her lifetime and how the assets will ultimately be distributed at death. Once this agreement is in place, the person then transfers all of his or her assets into the name of the trust, retaining complete control over the management and use of the assets as trustee. Upon the individual's death, there is no need for probate since the decedent didn't own anything (the trust does!). A successor trustee then distributes the trust assets according to the terms of the trust agreement. The trust agreement is completely revocable, meaning that during the individual's lifetime, he or she can amend or terminate the trust at any time. Finally, a revocable living trust is tax neutral, meaning that there are no tax benefits or detriments to using a revocable living trust in lieu of a will.

Should I use a revocable living trust instead of a will?

A revocable living trust may be more advantageous than a will because it: (1) avoids probate, (2) is a private document that is not filed with the court, and (3) provides for continuity of asset management after death or incapacity. However, a revocable living trust has certain disadvantages as well: (1) it is more complicated than a will, (2) all assets must be transferred into the name of the trust, and (3) it can be an inconvenience because persons dealing with the trustee (such as banks and title insurance companies) may want to review the trust agreement to confirm the trustee's powers and duties. In Washington, a revocable living trust is often used by individuals who own out-of-state real estate, are contemplating moving out of Washington State, or have a history of long term disability. If an individual owns out-of-state real estate, the real estate is subject to probate in the state where it is located. Therefore, by using a revocable living trust, an individual can avoid probate in Washington as well as other states where his or her real estate is located. Additionally, many other states have onerous probate laws. For example, California probate attorneys' fees are based on a percentage of the value of the estate, regardless of the amount or quality of work performed by the attorney. For clients moving out of Washington, a revocable living trust may help them avoid such onerous laws.

What is probate?

The technical definition of "probate" is the legal process of settling a decedent's estate. In practice, probate involves the appointment of a personal representative to step into the deceased's shoes and wind up his or her affairs. This includes, among other responsibilities, filing the will with the court, creating an inventory of the assets, paying off all creditors, filing the decedent's final income and estate tax return (if required), and ultimately distributing the assets of the estate.

Is probate as bad as I've heard?

Not in most cases. While we've all heard "probate horror stories" over the years, the truth is that Washington State has one of the simplest probate systems in the nation. Assuming your will gives your personal representative all of the necessary powers, our system allows the personal representative to act with complete power and without court intervention on nearly all matters, saving a significant amount of time. Furthermore, unlike some other states, attorneys' fees are not determined by the value of the estate. This makes the probate procedure significantly less expensive than many other states, such as California, Hawaii, Montana, and Wyoming. Of course, there are instances where assets are difficult to locate, family members simply don't trust each other, or heirs contest the validity of the will. In those instances, yes, probate can be a long and costly endeavor. However, that is a function of particular circumstances surrounding the family, and not an inefficiency of the probate process itself.

What is *community property*?

Community property is all of the property earned or acquired during marriage and all income generated from such property. Each spouse owns an undivided ½ interest in the community property assets. At death, each spouse has the right to dispose of his or her ½ of the community property. Washington is one of just a handful of states in the U.S. that follows the concept of community property.

What is *separate property*?

Separate property is that property owned by a person prior to marriage and all income and appreciation generated from such property. Separate property also includes property received by gift or inheritance during the marriage. Each spouse owns 100% in his or her separate property assets and at death he or she has the right to dispose of all of his or her separate property assets. If separate property and community property are "commingled" (mixed together), the resulting property is generally deemed to be community property.

Has the estate tax been repealed?

No. While there has been a significant amount of coverage in the media about the possible repeal of the estate tax, the fact is that the federal estate tax is very much in effect. In fact, not only does the federal estate tax still exist, but in May of 2005, Washington State enacted its own estate tax independent of the federal tax.

Will I have to pay estate taxes?

Whether or not you have to pay estate tax depends solely on the value of your estate at the time of your death. The IRS and Washington State give each person an exemption against the estate tax. This is referred to as the *exemption amount* (see Estate Planning insert for the current exemption). If the aggregate value of all of the assets of your estate (including life insurance proceeds payable on your death) exceeds the federal or state estate exemption amount, your estate may be subject to the federal and/or state estate tax.
The chart in the Estate Planning insert outlines the recent past and the current federal and state exemptions and tax rates.

What happens to my estate when I die? Should I give it all to my spouse?

The primary goal of most couples is to ensure that the surviving spouse is provided for during his or her remaining lifetime and that he or she has sufficient funds to raise young children. Therefore, most couples simply want to leave everything outright to the survivor. While this would certainly accomplish the intended goal, it may cause significantly more estate tax upon the death of the surviving spouse. Rather than leave everything outright to the surviving spouse, a couple should consider using testamentary trusts to achieve their goal and minimize tax at the same time.

What are testamentary trusts and how can I use them to save estate taxes?

Testamentary trusts are trusts established in your will if you are the first spouse to die. While they provide additional benefits, they are mainly used to minimize exposure to estate taxes. There are two main types of testamentary trusts, the "credit trust" and the "marital trust" (although each goes by a number of different names in the estate planning world).

What is a *credit trust*?

A *credit trust* is a trust that the deceased spouse establishes under his or her Will for the benefit of the surviving spouse. The trust is funded with a portion of the deceased spouse's assets up to the estate tax exemption amount. By directing assets to this trust rather than outright to the surviving spouse, the deceased spouse preserves his or her exemption amount and avoids subjecting the same assets to estate taxes upon the surviving spouse's death. The credit trust is referred to by a variety of different names such as the *credit shelter trust*, *bypass trust*, *exemption equivalent trust*, or *family trust*. While the name varies, the technique is the same.

1. **Are credit trust assets available for my spouse?**
   If the goal is to give the surviving spouse maximum control and benefit, the surviving spouse can serve as trustee of the credit trust. As such, he or she will have full control over the trust assets and may invest or withdraw as much of the trust income and principal as he or she needs for his or her health, support, and maintenance during his or her lifetime. However, if limitations on access are desirable, these can be incorporated into the trust provisions as well and you can name someone other than your spouse as trustee.

2. **What happens to the credit trust assets when my spouse dies?**
   Upon the surviving spouse's death, the first spouse's will governs who receives the remaining credit trust assets. The assets may be distributed to trusts for minor children, to other family members, friends, charity, or any other person or entity identified in the first spouse's will. The surviving spouse has no ability to distribute credit trust assets through his or her will.

3. **What are the tax advantages of using a credit trust?**
   The assets of the credit trust avoid the estate tax…twice! Upon the first spouse's death, assets placed into the credit trust are not subject to estate taxes. Later, upon the surviving spouse's death, the credit trust assets escape taxation again. Because the surviving spouse's assets may be subject to the estate tax, it is recommended that he or she use his or her own assets during life, which reduces the amount potentially subject to estate tax and preserves the assets that pass tax free (the credit trust assets).

4. **Can you illustrate an example of the benefit of the credit trust?**
   Suppose that Dave and Sue have an estate worth $7 million, which is entirely community property. This means that at Dave's death, his will disposes of $3.5 million and the other $3.5 million belongs to Sue. For illustration purposes we have made a few simplifying assumptions: (1) neither Dave nor Sue has made any lifetime gifts, (2) the federal and state estate tax rates and exemptions in effect in 2014 (when Dave dies) are still in effect in 2020 (when Sue dies).

   a. **Without a credit trust.** Dave dies in 2014 with a will that leaves his entire estate outright to Sue. No tax is due upon Dave's death because all assets passing to Sue qualify for the marital deduction. However, upon Sue's subsequent death in 2020, she leaves her entire estate (now worth $7 million) to their children. Sue's $2.012 million state estate tax exemption is applied to her estate, leaving $4.988 million subject to state estate tax, creating a liability of $727,840. Sue's $5.034 million federal estate tax exemption is applied to her $7 million estate leaving $1.966 million subject to federal estate tax, creating a liability of $372,864. The total state and federal estate tax at Sue's death will be roughly $1,100,704.

b. With a credit trust. Now, suppose that Dave dies in 2014 with a will that leaves an amount equal to the Washington estate exemption to a credit trust established for Sue's benefit and the rest to her outright. Sue is appointed as the trustee of this trust and has full access to credit trust assets for her maintenance, health, and support. No tax would be due upon Dave's death. At Sue's subsequent death in 2020, the credit trust (the original $2.012 million plus all growth on such amount) passes tax-free to the children pursuant to the terms of Dave's will. Sue's estate is worth only $4.988 million because it does not include the value of the credit trust. Her $2.012 million state estate tax exemption will be applied, leaving only $2.976 million exposed to state estate tax. Her state estate tax liability drops to $386,400. Her federal estate tax exemption amount of $5.034 million is applied and shelters her entire estate, leaving no federal estate tax liability. By using a credit trust, Dave and Sue can save approximately $372,864 in federal estate taxes and $341,440 in state estate taxes. If Dave and Sue had an estate over $7.35 million they could shelter even more of their estate from federal estate taxes by using a marital trust or by electing portability of the deceased spouse's unused exclusion amount (see next sections for more information).

What is a *marital trust*?

Unfortunately, the maximum amount that can be distributed to a credit trust is limited to the deceased spouse's unused estate tax exemption amount. Assets remaining in the deceased spouse's estate in excess of this amount can either be distributed outright to the surviving spouse, or held in another type of testamentary trust, known as a marital trust (also known as a QTIP trust…no, not the ear cleaning kind, this tax jargon actually stands for "Qualified Terminable Interest Property" trust). *Marital trusts* are designed to hold that portion of the deceased spouse's estate that exceeds the exemption amount, and to qualify those assets for the unlimited marital deduction.

1. **Are marital trust assets available for my spouse?**
   Like the credit trust, the surviving spouse may serve as the trustee of the marital trust, giving him or her the power to invest assets as he or she desires, and withdraw income or principal for his or her health, support and maintenance. However, in order to qualify for the unlimited marital deduction, the marital trust *must* require that all income of the marital trust be distributed at least annually to the surviving spouse. Of course, more restrictive provisions can be placed on the distributions of principal if desired.

2. **What happens to the marital trust assets when my spouse dies?**
   Also like the credit trust, upon the surviving spouse's death, the first spouse's will governs who receives the remaining marital trust assets.

3. **If leaving assets outright to my spouse and leaving assets to a marital trust for the benefit of my spouse both qualify for the unlimited marital deduction, why would I complicate matters by using a marital trust?**
   Although a marital trust lacks the significant tax benefits of the credit trust, it does offer two very important non-tax benefits. First, it allows the deceased spouse to provide for the survivor, and direct who gets the remaining marital trust assets upon the death of the surviving spouse. This is very important if the deceased spouse wants to protect his or her assets in the event the surviving spouse remarries, or when the first spouse wants to make sure that after the survivor's death, the marital trust assets are left to his or her children (rather than to the surviving spouse's children). Secondly, a marital trust protects the trust assets from creditors' claims during the survivor's lifetime. In the event the surviving spouse is sued, these assets are generally beyond the reach of creditors.

What is Portability?

Portability allows the surviving spouse to apply his or her *deceased spouse's unused exclusion* (DSUE) amount to his or her federal taxable estate when he or she dies. Portability of the DSUE amount, used in conjunction with a credit trust, can help minimize federal estate taxes. The federal estate tax savings are similar to using a marital trust in conjunction with a credit trust. However, the portability benefit is limited. First, portability does not apply to the state estate tax exemption, only the federal estate tax exemption. In our example 4(a) above (without a credit trust), if Dave's estate elected portability of the DSUE amount, upon Sue's death, her estate would still owe $727,840 in state estate taxes. Second, portability does not apply to the federal generation skipping transfer tax exemption, leaving bequests to grandchildren sheltered only by the survivor's exemption. Finally, in order for Sue to use the portability benefit, Dave's estate must have filed an estate tax return at his death, electing to give Sue his exemption. Only estates large enough to exceed the federal estate tax exemption of $5.034 million (indexed for inflation) are required to file federal estate tax returns. Therefore, Sue would have had to incur the additional time and expense to file a return that was not required in order to preserve her ability to potentially use the portability benefit. As long as Sue must file a state estate tax return, filing a federal return just to elect portability will not significantly increase time or costs. However, filing a federal return does subject the estate to more scrutiny by the IRS. Relying on portability in lieu of an estate plan is not recommended; however, a well-written will enabling a portability election may allow the surviving spouse to delay decisions regarding certain trusts until the time of the first death rather than making a decision at the time the estate plan is created.

Are there any special estate planning considerations for non-U.S. citizens?

Amounts passing to the marital trust (or outright to the surviving spouse) are not subject to tax at the *first* spouse's death because these assets qualify for the unlimited marital deduction. However, this deduction is only allowable if the surviving spouse is a United States citizen. If the surviving spouse is not a U.S. citizen, the marital trust must have certain additional provisions that allow it to qualify as a *Qualified Domestic Trust* (QDOT). The most significant additional provisions of a QDOT are that (1) at least one trustee must be an individual citizen of the United States or a domestic corporation and (2) no distribution (other than income) can be made unless the trustee who is a citizen/domestic corporation has the right to withhold from the distribution the tax on distributions under the Internal Revenue Code. While these additional restrictions are not ideal, it is a small concession to defer significant tax payment.

What are my options for leaving money to my young children?

Children under the age of 18 can inherit money, although an adult must be appointed by the court to manage the funds until the child turns 18. Rather than involve the court, there are two simple ways to structure a bequest to children: (1) establish a custodial account under the *Uniform Transfers to Minors Act* (UTMA) or (2) establish a trust for the child. Under the UTMA option, you choose a trusted friend or family member (a *custodian*) to manage property you are leaving to a child. The custodian will then manage the property until the child reaches age 21, at which time the funds are turned over to your child. While the custodial arrangement is simple, it may place too much money into a child's hands at a very young age. For that reason, you may want to consider the second option and establish a trust at the time of your death to hold the funds for your children. In your will, you name a trustee to manage and invest the trust property and make distributions to your child for his or her health, maintenance, support, and educational needs. Unlike the custodial arrangement, a trust allows you to distribute the entire trust remainder at any age you desire or to stagger distributions (i.e. one-third of the trust principal at age 25, another portion at age 30 and the balance at age 35). While the funds remain in trust, the trustee will continue to make distributions for health, support, maintenance, and education. Because the trust may be held until children are out of college and heading in the right direction, the trust is generally the more popular option.

What happens to my estate if my spouse, children and I die together?

A well drafted will should cover the possibility that your immediate family dies together, leaving no living descendants. Many people choose to leave their estate to their extended family, friends, or charity.

Who is the personal representative?

In your will, you appoint a personal representative who will be responsible for stepping into your shoes and winding up your affairs. Generally, a personal representative (sometimes also referred to as an executor or administrator) does not need special financial or legal knowledge, and many individuals feel comfortable naming a spouse as the primary personal representative with a friend or family member as the alternate. When the time comes, the person you appoint can accept or decline this responsibility. Many personal representatives work closely with attorneys throughout the entire probate process, while others prefer to keep costs low and handle much of the work themselves. The personal representative is entitled to reasonable compensation, which is paid from the estate.

Who is the trustee?

The trustee is the person who is responsible for all aspects of the administration of a trust. The primary duties of any trustee are twofold: (1) to prudently invest and protect the assets of the trust, and (2) to make distributions to the trust beneficiaries according to the terms of the trust. If desirable, more than one individual may be named to serve as co-trustee. Some couples will designate the surviving spouse as the primary trustee and name a friend or family member as the alternate. However, other individuals do not have family members or friends that they feel could (or should) take on this role. In such event, it may make sense to name a qualified bank or trust company to undertake this responsibility. The trustee is required to act in the best interest of the trust beneficiaries. This duty of loyalty is known as *fiduciary duty*, and it places a very high (and legally enforceable) standard of care and expectations upon the trustee.

What happens to my pet?

We understand that pets are part of the family, and it is often important to plan for their future as well. Because pets are considered property in the eyes of the law, you can make a provision in your will to give your pet to a trusted friend or family member that has the ability to care for your pet. In addition, you may choose to set up a trust for your pet in order to provide for future costs associated with owning a pet.

How should my assets be titled?

There are a number of ways to title your assets, and doing so improperly could lead to unintended results. The most common titling in Washington for married couples is either as *community property* (or simply as *husband and wife*) or *joint tenants with right of survivorship*. Upon the first spouse's death, all of his or her separate property and one-half of all community property is subject to disposition under the deceased spouse's will. However, property held in joint tenancy with right of survivorship will pass directly to the surviving tenant, regardless of what the will states. Therefore, these assets generally cannot be used to fund the testamentary trusts. Assets held as community property, on the other hand, will be distributed pursuant to the terms of the deceased spouse's will and can be used to fund testamentary trusts and achieve the tax savings. Therefore, most of your *joint* assets (as opposed to your *separate* assets) should be titled as community property unless there is an overriding reason to own an asset as joint tenants with right of survivorship.

What about my life insurance policies and retirement plans?

While your will controls the disposition of your assets upon your death, certain assets (cleverly named *nonprobate assets*) are not subject to the terms of your will. Life insurance policies and retirement plans (i.e. 401(k)s, IRAs, 403(b)s) are nonprobate assets and are distributed to the people that you have named on your beneficiary designation form. Part of estate planning includes coordinating the distribution of your nonprobate assets with the distribution plan set forth in your will. Because distributions from retirement plans are subject to income tax, there are a number of tax pitfalls that must be negotiated when designating a retirement plan beneficiary. Needless to say, improperly coordinated beneficiary designations can result in a significant tax loss.

Do I need a financial durable power of attorney?

Yes. Regardless of the size of your estate or your family circumstances, you should have a financial durable power of attorney. This is a legal document signed by you that appoints an *attorney-in-fact* to handle all financial transactions on your behalf in the event that you become incapacitated. Generally, one spouse will appoint the other as the primary attorney-in-fact, and designate a friend or family member as an alternate. Your attorney-in-fact will handle mundane tasks such as sorting through your mail and depositing your checks, as well as more complex jobs like handling your investment accounts or filing your tax returns. Without such a document in place, a court supervised guardianship proceeding is necessary to appoint someone who will act on your behalf. This proceeding can be very expensive and cause a rift between family members. This potential problem is easily avoided by having a financial durable power of attorney in place.

Do I need a health care power of attorney?

Yes. You should have a health care power of attorney to appoint a spouse, trusted friend or family member to make medical decisions on your behalf in the event you are unable to make such decisions yourself. Your health care attorney-in-fact will work with your doctors and other health care providers to make sure that you get the kind of medical care you wish to receive. When arranging your care, your attorney-in-fact is legally bound to follow your treatment preferences to the extent that he or she knows them.

Do I need a health care directive?

Yes. *A health care directive* (often referred to as a living will) allows individuals to express their desires regarding medical treatment under certain circumstances. You are strongly encouraged to let others know your wishes regarding the termination of life support by executing a health care directive. Washington allows you to state that you want life support procedures continued or terminated if (1) you are terminally ill, unconscious, and on life support; or (2) you are in a persistent vegetative state and on life support. A health care directive should not be confused with a request made under the *Washington State Death with Dignity Act*. Such a request allows you to receive medication to terminate your own life. This request can be made only by a person who is already terminally ill, and who is still competent to make decisions.

Allowing others to make a life support termination decision for you is a very large burden to place on your loved ones. Every individual is encouraged to make his or her own decision and execute a health care directive to provide guidance to family members.

How do I get started setting up an estate plan?

The first step is to contact one of the attorneys in our Estate Planning & Probate Group. We will send you some background information and an initial questionnaire to get you started with the process. We will then set up a time to meet to discuss your family circumstances, specific estate planning goals, and tax issues.

To learn more, contact our

Estate Planning & Probate Group

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