

## 19. How Complicated Does Your Will (or Trust Agreement) Need to Be?

With the phase-in of the estate and generation-skipping transfer tax exemption increases under the 2001 Tax Act, an increasing number of estates will be relieved of the consideration of estate and generation-skipping transfer taxes for planning purposes. See Chapter 17 update. Like all tax laws, change is inevitable and predictability uncertain.

The level of complexity in your Will or trust agreement (and related planning) will largely be influenced by your feelings about two questions: How much control over the use and disposition of property is desired? How much effort is to be expended in minimizing estate (and other related) taxes? The greater your motivation to control your estate after your death and to avoid taxes, the more complicated your planning will be.

Smaller estates can avoid estate taxes relatively easily. Larger estates require more effort and time. Almost every year, Congress changes the estate tax rules, usually in an effort to make estate tax avoidance in the larger estates more difficult.

Regardless of the size of your estate, the greater the control you wish to impose after your death, the greater the degree of complexity that will exist in your Will or trust agreement.

### A Review of Basic Estate Planning Arrangements

This chapter describes typical arrangements that you might consider for the distribution of your property at the time of your death. All of these arrangements may be accomplished through either a Will or a living trust. (See chapters entitled "Do You Have a Will Appropriate for Current Circumstances" and "Trusts: An Introduction.") The advantages and disadvantages and the relative complexity will be discussed for each of the arrangements

***Outright Transfers.*** Considering the phase-in of estate tax exemptions, an outright transfer may be appropriate if the aggregate total of your assets and those of the transferee (your spouse, child or other person) is less than the estate tax exemption then in effect. Like considerations would be applicable to lifetime outright transfers. U.S. citizenship of a spouse is also a major tax consideration because the unlimited marital deduction does not apply to a non-citizen spouse (see Chapter 17).

Outright transfers are transfers that are free of trust. The advantage of such transfers is simplicity. The property is transferred to the beneficiary without your retaining any control over the future use of that property. Your inability to limit the future use of the transferred property or to minimize future taxes is the most significant disadvantage of outright transfers.

In the example, the lack of control means that all of the net estate will pass to your spouse if our spouse survives you. You may expect and desire that everything that remains of your estate at the time of your spouse's death pass to your children. However, with an outright bequest to your spouse, you cannot guarantee that result. For example, if your spouse remarries, commingles his or her property with the new spouse's property, and then dies without a Will, all of your net estate may pass to the new spouse, and your children may receive nothing.

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In addition, outright transfers do not allow you to preserve the benefit of the estate and gift tax exemption for your children (see the chapter entitled "A Cost of Dying: Estate Taxes"), while making the property available for the use and benefit of your spouse. Also, an outright transfer to the surviving spouse will not qualify for the unlimited marital deduction if the surviving spouse is not a U.S. citizen.

Outright transfers are used to greatest advantage: (1) if you are not concerned with secondary beneficiaries (usually children or grandchildren); (2) if you are not married; (3) if your spouse will have sufficient other property so that you may transfer the estate and gift tax exemption amount to your children and grandchildren without compromising your spouse's financial security; or (4) if the property that you and your spouse owns is worth less than the estate and gift tax exclusion amount.

***Outright Transfer with Disclaimer Trust*** Example: In your Will or trust agreement, you state, "At my death, my personal representative [or trustee] shall distribute all of my net estate to my spouse; provided, however, that, if my spouse disclaims his/her interest in any portion or all of this gift, the disclaimed portion of this gift shall be distributed to [the designated trustee] in trust." (Directions for the administration and distribution of the trust assets will need to be specified in the Will or trust agreement.)

This approach, allowing the surviving spouse to take outright or to disclaim into a trust (which usually is drafted for the benefit of the spouse), may be appropriate to provide for alternative post mortem planning flexibility based on the then current tax laws and the substantive circumstances concerning the spouse at the time of death. To avoid undesirable tax consequences, your spouse should be the only current beneficiary of a trust funded by a disclaimer and no power of appointment should be granted.

An outright transfer with a disclaimer trust has many of the characteristics of an outright transfer except that it gives the primary beneficiary (your spouse in the example) the power to do your tax planning. An outright transfer with a disclaimer trust will offer the greatest flexibility where your primary beneficiary is your spouse because your spouse may

disclaim property and still benefit from that property after the disclaimer. No one other than a spouse may receive any benefit from property that he or she has disclaimed.

With greater flexibility and ability for tax planning comes greater complexity. The simplicity of a Will or trust agreement with outright transfers will be lost in a Will or trust agreement that offers the option of a disclaimer trust.

This disclaimer must be made (if at all) within nine months of your death.

***Transfer of Part or All of Estate In Trust.*** Example: In your Will or trust agreement, you state, "At my death, my personal representative [or trustee] shall distribute all of my net estate to (the designated trustee) in trust." (Directions for the administration and distribution of the trust assets will need to be specified in the Will or trust agreement.)

With a trust, you will have the greatest control over the distribution and uses of your property after you die. A trust created in your Will or trust agreement can last for up to twenty-one years after the death of all beneficiaries who are alive or in gestation when you die, and a charitable trust (that is, a trust set up for charitable purposes) may last forever. During that period, you can limit the use of the trust assets and may even designate powers to other people to change the uses and purposes of the trust. For example, you may specify that the trust funds only be used for education or support, or only for more restrictive uses such as the purchase of collectibles. Or you may limit distributions to a particular beneficiary until that beneficiary reaches a certain age. The efficacy of the provisions of your trust will of course depend in part on your ability to foresee future circumstances.

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1. ***Credit Trust.*** The amount of a credit trust is generally expressed in a formula funding the trust at the maximum estate tax credit or exemption equivalent. With the phase in of the increased exemptions, all death taxation may be avoided. However, if the trust is for the benefit of children from a prior marriage, care must be taken in expressing the funding formula by providing for a *cap* or one or more credit trusts. Arbitrary use of the standard formula could result in a maximized tax advantage while unintentionally disinheriting your spouse.
2. ***QTIP Trust.*** This trust is generally coupled with a "Credit Trust" where your estate exceeds the maximum exemption that can be sheltered in the "Credit Trust." Again, with the phase-in, the funding formula needs careful drafting to insure fulfillment of your desires to provide for your spouse. If your spouse is not a U.S. citizen, the "QTIP Trust" requires additional provisions to qualify as a Qualified Domestic Trust (QDOT).

3. ***Generation-Skipping Transfer Trust*** A trust may also be used to take advantage of the \$1,000,000 exemption (as indexed for inflation) from the federal generation-skipping transfer tax.

A trust will allow you to impose limitations on the use of your net estate after your death and will allow you to undertake considerable tax planning—but not without the addition of at least some complexity and length to your Will or trust agreement.

***Combination.*** Your Will or trust agreement may contain a combination of outright transfers and transfers in trust. Often a Will or a trust agreement will contain several outright transfers of specific property (such as personal effects or a residence), with the residue of the net estate being divided among one or more trusts. If you are married, you may want to include a Credit Shelter Trust (or a QTIP Trust) combined with an outright bequest, or a Credit Shelter Trust combined with a QTIP Trust, or a number of other combinations. If a formula is used to divide your estate among two or more outright transfers or trusts in order to obtain the maximum tax benefits, you will need to take care in selecting the formula that will best achieve your goals, and you should expect greater complexity in your Will or trust agreement.

### **Summary**

With the current tax law providing incremental phase-in of increased estate and generation skipping transfer tax exemptions through 2009, a repeal of the estate and generation skipping transfer tax in 2010 and a potential permanent repeal or a reversion to the status of those taxes as effective for 2011, careful drafting, often much more complex than before, will be required. As always, tax driven considerations should be incorporated into your plan only to the extent they do not adversely affect the beneficiaries you desire to benefit, the control you wish to impose after death, and the extent of asset protection you want to provide for your beneficiaries. As tax considerations are also introduced, the complexity of your estate plan increases.

If you are not concerned about reducing or eliminating taxes or if your estate is small enough so that estate and generation-skipping transfer taxes are not at issue, and in either case you are not concerned about control of your property after your death, estate planning can be

simple and inexpensive, On the other hand, your decision to limit the use of your property after your death and/or to avoid taxation can considerably increase the complexity of your estate plan. With increasing complexity, you should expect the costs of constructing and administering your plan to increase also.