ESTATE PLANNING GUIDE 6th Addition
2014

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TABLE OF CONTENTS

Page

Preface –
A Note from the Estate Planning Council

This is the sixth edition of the Estate Planning Guide published by the Estate Planning Council of Seattle. The Guide discusses issues of life, property, and death that all of us must face. The Guide reviews basic terms and concepts of estate planning, how to approach planning for disposition of your estate following your death, and what tools to put in place to manage your estate if you become incapacitated. It also provides an overview of taxes, lifetime giving, estate administration, and special issues involving children, as well as other related topics for Washington State residents. Estate laws can vary from state to state, and the Guide does not address the laws outside of Washington State.

This publication has two major goals: The first is to help you understand the need for estate planning and related personal planning, as well as the critical importance of executing the plan. The second is simply educational – to provide a non-technical resource that explains general estate and personal planning terminology, as well as related legal concepts. Estate planning is complicated and attempting to "do it yourself" often results in unnecessary cost and complications. A basic background in this area, however, will make your time with a professional advisor more productive and efficient. Property laws, tax laws, and regulations that apply to these areas are continuously changing. It is important that you seek the expertise of estate planning professionals who can provide you with complete, up-to-date counsel and recommendations to properly carry out planning goals.

The Estate Planning Council of Seattle hopes this Guide will motivate you to begin your own planning. Many are uncomfortable addressing matters involving death or incapacity, but it needs to be done. When it is, you will have peace of mind, knowing you have planned for and managed some of the difficulties that can arise with incapacity or at death.

The Estate Planning Council of Seattle has companion books available that may help answer questions in related areas. These are *The Fiduciary Handbook* and *Dealing with the Death of a Loved One*, which are available by contacting the Estate Planning Council office or any Council member. The Council's website, www.epcseattle.org, is also a good source of information. We encourage you to visit it.

The Estate Planning Council of Seattle is an organization whose members are attorneys, certified public accountants, insurance agents, brokers who are chartered life underwriters, trust officers, and other financial professionals. All members actively practice in the estate planning field in Washington State.

The Estate Planning Council of Seattle 2014

Introduction

In this Guide, we hope to acquaint you with some of the concepts and terminology of estate planning and to demystify the estate planning process. While the Guide contains important information you should be aware of, it is not an exhaustive or technical study of estate planning, and it cannot take into account the particular details of your situation. You should not use the Guide a "do-it-yourself" manual or a substitute for professional assistance. To get started, here are some common questions about estate planning.

Who needs to consider estate planning?

You need to consider estate planning if you:

- have others who are dependent on you,
- have property that would need to be distributed when you die,
- have property that would need to be managed if you become incapacitated,
- want to choose who would make financial and healthcare decisions for you if you become incapacitated, and/or
- want to provide for disposition of your remains or donate your organs.

What does estate planning involve?

Estate planning covers a wide spectrum of activities. In the broadest sense, it is a process in which you:

- identify your personal goals, during your lifetime and at death, as they relate to providing for yourself, your family, and others, and managing your property,

- develop a plan to use your available resources to accomplish those goals, and

- put into place the tools that embody the plan to ensure that it will be carried out.

Estate planning can include: tax planning and considerations; planning for substitute decision makers to manage your assets and healthcare if you become seriously ill or incapacitated; planning for the needs of your spouse, partner, children, parents, or others who are dependent on you or whom you wish to benefit; planning for death, including disposition of property, life insurance needs, personal arrangements, and instructions on the level of medical care to be provided, as well as organ donations; implementing your estate plan in the most tax-efficient manner; and establishing periodic reviews of your plan.

Who should be involved in your estate planning?

This planning process, though ultimately personal in nature, is impacted by many complex and technical issues, and it is important that you engage the assistance of estate planning professionals. These professionals can help you think through your objectives and goals, provide background and understanding of some of the complexities of estate planning, suggest alternative strategies, and assist you in determining how alternatives may meet your goals and objectives. Estate planning professionals include attorneys, certified public accountants, life insurance agents, brokers, trust officers, and financial planners. Each of these advisors offers unique areas of expertise to the planning process, and you may find that a team of advisors best meets your needs. Generally, you will be best served by working with a professional who devotes most of his or her practice to estate planning.

What are some common estate planning documents and terms?

- A ***will*** provides instructions as to who will receive your probate property following your death, how they will receive it, how debts and taxes will be paid, and who will administer your estate. It can also designate a guardian for your children. Because the will does not "speak" until your death, it must be executed with certain formalities.

- A ***personal representative, executor,*** or ***administrator*** is the person appointed by the court to administer your estate after your death. An "executor" is the personal representative appointed under a will, and an "administrator" is the personal representative appointed if there is no will or the persons named as executors in a will are unable or unwilling to serve. The term "personal representative" refers to both, and we will use that term throughout.

- A ***revocable living trust*** often serves as a substitute for a will. Like a will, it can provide instructions as to who will receive your property following your death, and how debts and taxes will be paid. Unlike your will, you cannot appoint a guardian for minor children in a revocable living trust. A revocable living trust is only effective for assets that have been transferred to it. If a revocable living trust is serving as a will substitute, you will also want a "pour-over" will to cover any assets that you may have inadvertently forgotten to transfer to the trust before your death and to appoint a guardian for any minor children.

- A ***trustee*** is the person who administers a trust. The trustee manages and invests assets held in the trust and makes distributions to the trust beneficiaries in accordance with the terms of the trust.

- Spouses or registered domestic partners may use a specific type of community property agreement known as a ***three-prong community property agreement*** to designate all property as community property and transfer all community property to the survivor on the first death. Note that there are different types of community property agreements and some do not provide for the transfer of all community property to the survivor on the first death.

- A ***financial power of attorney*** is used to designate an attorney-in-fact to handle your financial affairs under certain circumstances, such as if you become incapacitated. A ***healthcare power of attorney*** is used to designate an attorney-in-fact to make healthcare decisions for you if you cannot make those decisions yourself.

- A ***healthcare directive*** provides instructions to your medical professionals regarding life-sustaining treatments if you cannot provide those instructions yourself (sometimes referred to as a "living will").

- Your ***spouse*** is the person legally married to you. Washington recognizes both opposite-sex and same-sex marriages.

- Your ***registered domestic partner*** is the person with whom you have entered into a registered domestic partnership in the State of Washington. Both same-sex and opposite-sex couples can register as domestic partners, but at least one of the couple must be age 62 or older.

Registered domestic partners who are Washington residents have the same rights and interests as married couples under Washington law.

- A ***will substitute*** refers to either a revocable living trust or a community property agreement, both of which allow you to transfer your estate to others following your death.

What is probate or estate administration?

Your ability to own property immediately ceases on your death, and all of your assets must be transferred to someone else – *i.e.*, "you can't take it with you." In addition, your debts and liabilities must be settled and any taxes due must be paid. ***Probate*** is the legal process whereby your debts and taxes are settled and paid, and the property you owned is transferred to your intended beneficiaries. The probate process is based in the courts; however, unlike most states, Washington courts generally have little direct involvement in probate matters. Compared to many states, Washington has a simple and streamlined probate procedure in which a personal representative of a solvent estate generally administers the estate without involvement of the court, other than to open and close the estate.

If you use a revocable living trust or community property agreement as an alternative to a will, the trustee of the trust or the surviving spouse under a community property agreement essentially carries out the same role as a personal representative. He or she must settle and pay your debts and taxes, and then transfer your property to the intended beneficiaries.

Whether you choose to use a will, revocable living trust, or community property agreement, the personal representative, trustee, or surviving spouse will undertake the following tasks:

- locate, manage, and safeguard assets and determine who is entitled to them,

- identify and pay all authorized and verified debts and obligations,

- file your final income tax returns and any income returns due for your estate,

- file any required gift tax or estate tax returns, and

- transfer legal title to the remaining assets to the people who are entitled to them so that ownership and power over the assets will be recognized by others.

What is community property?

In very general terms, if you are married, there is a presumption that property you acquire during the marriage is community property unless it was acquired using separate property funds or you received it as a gift or inheritance. Property that you owned before the marriage and any property you receive by gift or inheritance is generally considered to be your separate property, as is all the income and appreciation on that property. Those presumptions can be altered by the actions of the parties or an agreement between the parties, such as a prenuptial, a postnuptial, or a community property agreement.

Under Washington law, either spouse may manage community property except that neither spouse can unilaterally (i) convey community real property; (ii) encumber community assets used in a trade or business in which both parties participate; or (iii) make a gift of community assets. On the death of a spouse, the deceased spouse's estate consists of an undivided one-half interest in each community asset and all of his or her separate property. In general, the deceased spouse can give his or her one-half community property interest and all his or her separate property to whomever he or she wishes without obligation to give any of it to the surviving spouse.

Does community property apply to same-sex marriages and registered domestic partnerships?

Yes. Under Washington law, people legally married, whether same-sex or opposite-sex, and people who are registered domestic partners, have all the rights and responsibilities of a married couple. Property owned by married couples or registered domestic partners is subject to Washington community property law.

Chapter 1
Basic Steps of Estate Planning

To make more effective use of your time with estate planning professionals and help them do a better job for you, you should understand the assets in your estate and your planning goals. Your estate planning professional can help you identify the information you need and may have a detailed questionnaire for you to complete. The more information you can gather and think about in advance, the easier and more efficient the process will be.

1.1 Identify Your Assets and Liabilities

It is important to identify your assets and liabilities and know the current value of each. If you are married, your estate consists of half of any community property and all of your separate assets.

Liabilities. Your liabilities include any outstanding obligations such as your mortgage, car loan, lease payments, credit cards, charitable pledges, child support, alimony, and any guarantees you have signed.

Assets. Your estate includes everything in which you hold an interest, such as your residence, vacation property, bank and brokerage accounts, retirement plans, life insurance policies, time share property, tangible personal property, savings bonds, and items like jewelry that may be in your safe deposit box. Your estate includes assets that you jointly own with someone else, such as a joint bank account. Your estate may also include future gifts or inheritances, and it is helpful to develop an understanding of such interests if possible. It is a good idea to confirm how title is shown for your more important assets. If you are married, you need to determine which assets are community property and which are separate property. To the extent possible, you should establish an estimated current value for each asset.

Certain assets warrant special consideration, including:

Tangible Personal Property. You may have certain items of tangible personal property that you want to go to particular people – such as giving your grandfather's watch to your son. Under Washington law, you can leave a list separate from your will that identifies who should receive particular items of tangible personal property. To be effective, your will must specifically mention that you may leave a separate list for tangible personal property, and the separate list must reference your will and describe the items with enough specificity to adequately identify them. The separate list can only be used for tangible personal property such as furniture, jewelry, china, books, works of art, cars, and airplanes. It cannot be used for gifts of cash, stock, bonds, or real estate.

Residence and Other Real Estate. Check the deed that conveyed title to you and confirm how you hold title (separately or jointly with someone else, and if jointly, the precise wording on the title). Make special note of any real property owned outside the State of Washington because it may require special planning.

Closely Held Business. If you own a business, or part of one, you should consider what would be needed to carry on the business when you die or become incapacitated. This is a particularly complicated asset that warrants special discussion with your estate planning professional. See Chapter 7 for more details.

Non-Probate Assets. Non-probate assets are assets that are transferred to others, but not under your will, such as retirement plans, life insurance, payable-on-death or transfer-on-death accounts, joint tenancy accounts, or property held in trusts. You should determine the scope of your interests in your non-probate assets and how your interests will pass on your death. If you are the beneficiary of a trust, you need to understand the extent of your rights and interests in the trust and whether you have any power to direct the disposition of your interest in the trust upon your death. Lack of attention to these non-probate assets can have dramatic and often unintended effects.

1.2 Identify Your Goals

The next step is to determine your estate planning goals. Common goals include:

- ensuring your financial independence until your death,
- providing and protecting people who are dependent on you, such as a spouse or partner and children,
- providing for others such as parents, friends, or charities,
- minimizing taxes, and/or
- ensuring easy administration of your estate.

1.3 Identify Beneficiaries

When you die, your ownership of all your assets immediately terminates and ownership must be transferred to someone else ("you can't take it with you"). Under Washington law, after payment of debts, expenses, and taxes, you are generally free to give your estate to whomever you wish. You can direct who will receive your assets under your will or will substitute (see Section 2.5). If you do not have a will or will substitute in place at the time of your death, the state will distribute your assets using a standard formula that includes your spouse, children, parents, and/or siblings, etc. See Section 2.2 for information about planning for your beneficiaries.

1.4 Identify Fiduciaries

If you cannot handle your affairs because you are either incapacitated or deceased, someone else needs to act on your behalf. That person is generally known as a fiduciary, and he or she is charged with a high standard of care in administering assets under his or her charge.

You can designate an ***attorney-in-fact*** to handle your financial affairs or to make healthcare decisions for you in the event of your incapacity by using a financial or healthcare power of attorney. If you do not do that, the court can appoint a ***guardian of an estate*** to administer your financial affairs and a ***guardian of a person*** to manage your personal affairs.

You can designate a ***guardian for minor children*** in your will or power of attorney (but not under a revocable living trust). Courts generally try to honor a parent's appointment as guardian. If you have not designated a guardian for your children, a court will do so.

You also can designate who will administer your estate following your death. If you are using a will, you can name a personal representative to administer your assets, pay any debts and taxes, and then distribute your estate according to your will. If you are using a revocable living trust, the person you designated as trustee will fill a role similar to that of the personal representative.

Whomever you choose for the roles owes you a fiduciary duty to always act in your best interests and not on the fiduciary's own behalf; however, because the scope of the fiduciary's power can be quite broad, you should have a high level of trust in whomever you appoint to these roles. You can appoint more than one

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person, but if you do, you should consider whether they should act jointly or separately. It is a good idea to name alternates so that if your first choice cannot serve for some reason, you have a designated back-up. You can designate someone who resides in another state as fiduciary but he or she may need to appoint a local agent, and there can be tax implications depending on the laws of the state in which the fiduciary resides. Fiduciaries are entitled to a fee for their services.

Chapter 2
Estate Planning Fundamentals –
Planning for Disposition on Death

When you die, all of your property must be transferred to others. If you do not leave legally enforceable directions about who will receive your estate and how and when they will receive it, Washington law dictates the beneficiaries. This chapter reviews what happens if you do not leave such legally enforceable directions, reviews considerations when naming beneficiaries and administrators of your estate, discusses issues involving children, and reviews the primary forms of legally enforceable directions – wills, revocable living trusts, community property agreements, and beneficiary designations for non-probate assets (such as life insurance, retirement plans, and certain financial accounts).

2.1 What Happens if You Do Not Plan

If you fail to leave legally enforceable directions, the Washington intestate statute defines who will receive your estate and who is entitled to administer it. While the statute attempts to follow what most people would want, failure to leave legally enforceable directions may mean delay, extra costs, and your estate being managed by and distributed to people whom you do not intend.

Under the statute, if you are married and have descendants at the time of your death, your spouse will receive all of your community property and one-half of your separate property, and your descendants will receive the other half of your separate property. If you are married but do not have descendants at the time of your death, your spouse will receive all of your community property and three-quarters of your separate property, and your parents, or siblings if your parents do not survive you, will receive one-quarter of your separate property. If you are not married and have no descendants at the time of your death, all of your property will pass to your parents, or if your parents are not living, to your siblings or descendants of deceased siblings. The statute allows no flexibility from this disposition.

If you do not designate someone to administer your estate in your will, the following individuals, in this order, have priority to administer your estate: (a) your surviving spouse or such person as he or she may request to have appointed; (b) your children; (c) your father or mother; (d) your brothers or sisters; (e) your grandchildren; (f) your nephews or nieces; (g) the trustee named in your living trust, the trustee of a trust established under your will, your guardian, or your attorney-in-fact acting under your power of attorney; (h) a beneficiary of your estate; (i) various government agents, depending on the facts of your situation; and (j) the creditors of your estate. If you are using a revocable living trust as a will substitute and do not designate someone to serve as trustee after your death, anyone can petition the court to serve as trustee.

If you do not appoint a guardian for your minor children in your will or power of attorney, anyone can ask the court to be appointed as “guardian of the person” and have physical custody of your children until they turn age 18, or as “guardian of the estate” and control your children’s inheritance until they turn age 18.

2.2 Planning for Beneficiaries

Under Washington law you can leave your assets to whomever you wish using legally enforceable directions. You generally have free reign to determine who should receive your estate and how and when they should receive it. As a result, you need to think about whom you want to benefit from your estate, in what shares, and how they should receive your property. Are there people who are dependent on you and whom you need to provide for such as a spouse, children, or parents? Are there people who you want to thank or honor in some way? Are there people who you want to recognize as being important in your life? Do you want to leave a legacy to a charity to further causes that are important to you?

Typically, married couples will leave all of their estate to each other (outright or in a trust for the spouse’s benefit) on the first spouse’s death, and to their children on the second death, but it may not be so clear for single people, and married couples may want to leave gifts to others also. Different types of beneficiaries raise different issues that you may want to consider.

Spouse. If you are married, your estate consists of your half of the community property and your separate property. You are not required to leave any part of your estate to your spouse, although there can be special rules that apply to federal retirement plans. In addition, your spouse is entitled to his or her half of any community property (but not your half) and may petition for a presumptive family support award ($125,000 in 2014). Other states allow a spouse to claim a forced share, and those laws may apply if you reside in one of those states at the time of your death. If you have children by a prior marriage or relationship, you may need to balance the needs of your current spouse and children and generally will want to do so in a manner that minimizes the risk of friction between them.

As noted earlier, registered domestic partners have the same rights as spouses to their half of any community property and may petition for family support.

Committed Partners. Washington does not recognize common law marriage. If you are in a long-term committed relationship, whether same sex or opposite sex, but are not married or in a registered domestic partnership, your partner is not automatically entitled to any rights or interests in your estate. Washington courts have made awards to committed partners in some cases – often after expensive litigation. Such cases are fact-specific, and this area is complex.

Children. Do you want to treat all your children equally or should some receive more or less than others or be excluded? Are there particular assets that should go to a particular child? Do you want to provide for children who may be born to or adopted by you after you sign your will? Do you want adopted children to be treated the same as natural born children? If you have a blended family, are children from a prior marriage to be treated differently than the children from your current marriage? What about stepchildren?

Parents and Siblings. Do you have parents or siblings who are dependent on you? Have you inherited wealth from your family that you want to make sure goes to your children, parents, or siblings?

Friends. Are there non-family individuals who are important in your life and for whom you wish to make some provision?

Charities. Are there charitable organizations or causes that you wish to benefit?

Once you have identified the beneficiaries, you need to consider what types of gifts, and in what amounts you want to make to them.

- How much do you want to leave each beneficiary of your estate?
- Should a gift be a specific dollar amount or a percentage of your estate?
- Should the beneficiary receive the property outright or in trust?
- If it is in trust, what are the terms of the trust and who should serve as trustee?
- Are any gifts conditional?
- Do you want to make gifts of cash or certain assets to particular people?

- Do you want the remainder of your estate to go to one beneficiary or divide it among many?
- Which beneficiaries' shares should bear the burden of debts, expenses, and taxes?
- What happens to the gift if the beneficiary does not survive you?
- How do the gifts under your will or revocable living trust coordinate with the beneficiary designations on any non-probate assets?
- Do you have pets that will need to be cared for after you die?

Typically, people require that a beneficiary survive them to receive the gift, and then provide for an alternate beneficiary if the primary beneficiary fails to survive. If you make a gift to your child and that child does not survive you, you may want to provide that his or her share goes to his or her children or that it is reallocated among the remaining children. You may also want to impose limitations on use of a gift, such as giving funds to be used for education or making a gift to a charity for a specific research project.

You may want to specify how and when beneficiaries will receive property by making the gift in trust. With a trust you can control when a gift goes to a particular beneficiary, such as delaying the final outright distributions to a child until he or she is more mature (while allowing the trustee to make distributions on the child's behalf before the final distribution). A gift in trust to a spouse can help ensure that on the surviving spouse's death, the remaining trust assets go to your children or another designated beneficiary – and not to the surviving spouse's new spouse. Trusts can be useful in helping minimize estate tax, providing for effective management of assets, and preserving property for the benefit of disabled children or parents needing special care, and in any number of other situations. (See Chapter 8 on trusts.)

Although the task of determining beneficiaries and proper shares among beneficiaries may seem daunting, do not let the perfect get in the way of the good. Make your best guess based on what you know today. You can always change things later if needed.

2.3 Planning for the Administrator of Your Estate

Whom do you trust to carry out your directions for administering your estate? With a will, that is the job of the personal representative; with a revocable living trust, it is the trustee. The person you choose should be reasonably competent in financial affairs, able to understand general business and money matters when working with professional advisors, and scrupulously honest. You may name your spouse, an adult child, a close relative, or a family friend, or a combination of them. If your estate is complex or large, or if the beneficiaries are likely to be in conflict (such as a second spouse and children from a first marriage), a professional may be more appropriate (*e.g.*, a bank trust department, trust company, or individual professional fiduciary). You can also have a professional fiduciary serve jointly with a relative or family friend. You should name alternates in case your first choice is unable to serve for any reason. It is generally a good idea to notify the individuals or professionals you have chosen and make sure that they are willing to serve.

Your personal representative has the duty and the legal authority to take possession of all your property, settle any claims or debts against you or your estate, and pay any estate taxes. The trustee of a revocable living trust has both the duty and the legal authority to take possession of all trust property, and can be given authority to settle any claims or debts against you or your estate and to pay any estate taxes. The goal of either the personal representative or trustee should be to complete these duties promptly so that your property can be transferred as soon as possible to your beneficiaries.

If you use a three-prong community property agreement so that all the property passes to the surviving spouse on the first spouse's death, the surviving spouse is the sole beneficiary and has similar responsibilities. When using a non-probate asset beneficiary designation, no one person has the authority to settle estate matters. See Section 3.2 for more details.

A personal representative or trustee is entitled to a fee for his or her efforts. The fee is taxable income to the fiduciary and is generally based on the amount of time spent in administering the estate or trust.

2.4 Planning for Care of Minor Children

For parents, possibly the most important benefit of preparing a will is that you can determine who will care for your children in the event that neither parent survives. You can name a "guardian of the person" for your minor children in your will or power of attorney (but not revocable living trust). This person is legally obligated to see to the child's proper upbringing if your child has no living parent. In other words, this person will determine how your child is educated, where the child lives, what religious training and medical care the child receives, and all other matters relating to the child's development. You should indicate an alternate choice in case your first choice cannot serve as guardian, and it is a good idea to discuss your plans with the person being nominated.

Note: If one parent dies, the other parent remains the natural guardian of the children. When parents are divorced and one parent dies, children generally go to live with the other parent.

If your child is a beneficiary of your estate, you should consider how and when you want him or her to receive his or her inheritance. Parents often establish trusts for children and appoint a responsible person as trustee to manage the trust.

2.5 Documenting Your Plan – Wills, Revocable Living Trusts, Community Property Agreements, and Specific Non-Probate Assets

You can leave legally enforceable instructions for distribution of your property at your death through a validly executed will or a will substitute such as a revocable living trust or community property agreement. In addition, you can transfer specific types of non-probate assets, such as financial accounts, life insurance, or retirement plans, through beneficiary designations.

You may use a combination of these documents and should make sure that they coordinate as you intend. For example, your will may give your probate estate to your children, but you may give a charity your retirement plan through its beneficiary designation, give a bank account to a friend through a joint tenancy designation, and give life insurance proceeds to another friend through its beneficiary designation.

Note: In general, your probate estate basically consists of all your assets other than those held in a trust or as non-probate assets that pass according to beneficiary designations. For estate tax purposes, probate and non-probate assets are taxed the same and you do not save estate taxes by holding them in one form over another.

(1) Wills

Most Washington residents dispose of their estate using a will. A will can direct who receives your property following your death, how debts and taxes will be paid, and who will serve as guardian for your children. Because your will is not effective until after you die (when you are not around to confirm its validity) Washington law requires that certain formalities be observed in executing a will, such as having two witnesses who can testify that the document is in fact your will. The witnesses should not be related to you or a beneficiary of your estate. You can revoke your will at any time. You can also amend your will (called a "codicil"), provided that you follow the same formalities as when executing a will.

A will automatically covers all your probate assets, and you do not need to take further steps to change title to your probate assets during your lifetime. Washington law also allows you to dispose of certain non-probate assets under your will if you meet certain requirements. If your will makes proper reference, you can also make gifts of certain tangible personal property in a document separate from the will. This separate document does not require the formalities of a will and can be easily amended and changed.

(2) Revocable Living Trusts

A revocable living trust can serve as a substitute for a will. Like a will, it can provide instructions as to who will receive your property following your death, and how debts and taxes will be paid. Unlike a will, it cannot appoint a guardian for minor children. A revocable living trust is only effective for assets that have been transferred to it, and you need to transfer legal title to all your assets from your name to the name of the trust. If a revocable living trust is serving as a will substitute, you should also have a will to cover any assets that you may have inadvertently forgotten to transfer to the trust.

With a typical living trust for a married couple, the spouses serve as trustees and are the sole beneficiaries during their lifetimes. Following both spouses' deaths, whoever is designated as successor trustee pays all debts and taxes and then, depending on the terms of the trust, will likely hold the assets in trust for the spouses' children or others, or distribute assets outright to them. One or more family members, including the spouses' children, may act as successor trustee, as could a friend, bank, trust company, or professional trustee.

Assets in a revocable living trust are subject to estate and income tax in the same manner as assets held in your name. There is also no creditor protection in Washington for assets transferred to a revocable living trust.

Note: while sharing a similar name, a "living will" is a healthcare directive and should not be confused with a living trust.

(3) Three-Prong Community Property Agreements

A married person in Washington can enter into a contract with his or her spouse – called a three-prong community property agreement – that serves as a will substitute on the first death. A three-prong community property agreement converts all present and future property of either spouse to community property and then directs that when one spouse dies, all assets go outright to the surviving spouse. There are other types of community property agreements that do not provide for disposition on the first death.

These agreements have limited use and can cause serious, unintended effects. They do not provide for disposition of the couple's assets on the second death or on simultaneous deaths, so both of you must also have wills if you are using a community property agreement. The agreements are generally inflexible and do not allow for gifts to anyone other than the other spouse. You cannot do any tax planning in a community property agreement, which often results in estate taxes being paid unnecessarily. The agreements can also create issues in second marriages because the surviving spouse receives all of the deceased spouse's estate outright. It is not unusual for the surviving spouse to give all of both estates to his or her children on death, rather than to the children of the deceased spouse (especially if several years have passed since the first death).

(4) Specific Non-Probate Transfers

Certain types of assets, called non-probate assets, can be transferred on death pursuant to pre-arranged beneficiary designations, and thus avoid probate under Washington law. These are not will substitutes because they are asset-specific. Common non-probate assets are bank or brokerage accounts that you and another person hold as joint tenants with right of survivorship, payable/transfer on death accounts, life insurance policies, and retirement plans (IRAs, 401(k)s, etc.). Owning assets in these forms (intentionally or unintentionally) trumps the provisions of your will or will substitute because the assets pass outside the will or will substitute, so you should coordinate disposition of any non-probate assets with the disposition plan under your will or will substitute. These assets are included in your taxable estate, even though they pass outside your will.

Joint Tenancy with Rights of Survivorship. With assets or accounts held as joint tenants with rights of survivorship, when one joint tenant dies, the surviving joint tenant automatically becomes the owner of the asset or account. Bank or financial accounts are the most common form of joint tenancy, but real estate can also be held this way. But beware – either joint tenant can take funds out of a joint tenancy account at any time, even before the death of the tenant who created the account.

Payable or Transfer on Death Accounts. Bank and financial accounts, U.S. savings bonds, and other forms of securities may designate a beneficiary to receive the asset on the owner's death. Unlike joint tenancy accounts, the beneficiary of a payable/transfer on death account cannot access the account during the owner's lifetime.

Life Insurance. Life insurance policies permit you to designate a beneficiary who receives the insurance proceeds when you die.

Retirement Benefits and Annuities. Retirement plans, IRAs, and certain annuities pass to the beneficiary designation. Care should be taken in designating beneficiaries for these types of assets to ensure that there are no adverse income tax consequences.

2.6 Instructions About Cremation and Burial

You can leave enforceable instructions regarding the place or method of disposition of your remains. The instructions must be in writing and signed in the presence of a witness. You can also pre-pay or file instructions with a licensed funeral establishment or cemetery authority.

2.7 Coordinating and Reviewing Your Estate Plan

If you are transferring assets other than under your will on your death, you need to carefully coordinate the various forms of transfer to make sure that your wishes are fully fulfilled. Inconsistencies between the disposition of probate and non-probate property can cause unexpected, harsh, and inappropriate dispositions of property that may have an adverse impact on a family for generations. The best way to coordinate your estate plan is to review with your attorney how you hold title to your assets.

Once you have met with an attorney and your estate plan is set up, you need to review it from time to time. It is a good idea to have your estate planning professional review your plan every three to five years or earlier if one of the following events occurs: death or disability of a family member, marriage, divorce, separation, birth or adoption of a child, significant increase or decrease in the value of your estate, change of state of residence, desire to change your nominated personal representative, trustee, or guardian, or purchase of real property located outside of Washington.

Chapter 3
Estate Administration

When someone dies (the "decedent"), all the decedent's debts and obligations must be settled and all of his or her assets must be transferred to someone else. This chapter summarizes what is involved in winding up a decedent's affairs. It reviews the common steps necessary to administer a decedent's estate and then discusses how those steps are taken if the decedent's estate is administered inside or outside of a probate proceeding. More details on this subject are available in the Estate Planning Council's book, *Dealing with the Death of a Loved One.*

3.1 Steps for Settling an Estate

When someone dies, certain steps must be taken to settle the decedent's affairs and transfer all of his or her assets to the legal beneficiaries. Those steps include:

(1) Accessing the decedent's funds to pay funeral expenses, the decedent's debts, and any taxes that may be due.

(2) Taking possession of and securing the decedent's assets.

(3) Collecting any income or payments due the decedent.

(4) Identifying the decedent's creditors and providing for timely payment of the decedent's debts (Washington law allows notice to creditors to be given both inside and outside of a probate proceeding).

(5) Selling the decedent's assets if necessary to pay the decedent's debts or taxes, or for efficient administration of the estate.

(6) Preparing and filing the decedent's final income tax return.

(7) Preparing and filing any gift or estate tax returns due, and paying any tax due.

(8) Determining who is legally entitled to receive the decedent's assets.

(9) Preparing the necessary documentation to transfer the decedent's assets to the legal beneficiaries.

(10) Pursuing any claims or lawsuits on behalf of the decedent.

(11) Defending any claims pending against the decedent.

If a will is used, the court-appointed personal representative has legal authority to carry out these steps. If a revocable living trust is used, the trustee generally has legal authority similar to a personal representative, as does a surviving spouse under a three-prong community property agreement. If you did not use any of the above, a court can authorize someone to act as an administrator to carry out these steps. Beneficiaries of non-probate assets also have some limited authority.

The time necessary to administer an estate depends on the type and value of the decedent's assets, the complexity of the decedent's affairs, whether there are any problem beneficiaries, whether there are any issues with the instructions that the decedent left for administration of his or her estate, and the degree to which the decedent organized his or her affairs.

3.2 Settling an Estate in Probate

Probate is a court-supervised procedure that is generally used if the decedent left a will or if the decedent died without a will and someone needs to be appointed to administer and distribute the decedent's assets and pay the decedent's debts. It may also be necessary if some but not all of the decedent's assets pass under a living trust or non-probate asset beneficiary designation. Unlike most states, Washington has a very streamlined probate procedure, and most probates are settled with little or no court interaction once the probate is opened. In addition, unlike many states, Washington also has no probate tax or statutory probate fees.

Typically, the person designated as personal representative will petition the court to open a probate. The court then admits the will to probate (or if there is no will, determines the legal beneficiaries of the estate) and appoints the personal representative. If there is a will, the court generally appoints the person designated in the will as personal representative unless there is good reason not to do so. If there is no will, Washington law specifies who is entitled to serve as personal representative. If the estate is solvent, the personal representative will generally be given non-intervention powers, which allow the estate to be administered without court involvement in Washington. The timing on closing a probate estate is the same as the timing on closing any other estate administration.

3.3 Settling an Estate Under a Revocable Living Trust

If a revocable living trust is used as a will substitute, and if all the decedent's assets were transferred to the trust before his or her death, then no probate proceeding generally needs to be opened. Under those circumstances, the trustee should be able to take all of the steps of administration listed in Section 3.1 with the possible exceptions of being able to pursue any claims or lawsuits on behalf of the decedent and defending any claims pending against the decedent (steps 10 and 11 above). If those steps are necessary, a probate typically needs to be opened and a personal representative appointed.

3.4 Settling an Estate Under a Three-Prong Community Property Agreement

If spouses execute a three-prong community property agreement, on the death of the first spouse, all community assets should pass outright to the surviving spouse. The surviving spouse, as successor to the community, should be able to take all the necessary steps to settle an estate outlined in Section 3.1. Typically, the surviving spouse needs to provide a certified copy of the death certificate, a copy of the community property agreement, and an affidavit to transfer assets to the surviving spouse's name. However, additional steps may be necessary if any of the community assets are held in non-community property states.

3.5 Settling Title to Non-Probate Assets

Generally, designated beneficiaries of a non-probate asset can arrange to have title to the asset transferred to them without opening a probate. The designated beneficiary, however, cannot take any of the necessary steps to settle an estate outlined in Section 3.1 other than giving non-probate notice to creditors.

Joint Tenancy Accounts and Payable/Transfer on Death Accounts. A deceased joint tenant's interest passes to the surviving joint tenant(s) on death. If the decedent designated a payable/transfer on death beneficiary for an account, the decedent's interest in the account should pass to the designated beneficiary. The financial institution may require a certified copy of the death certificate, and may also ask the surviving tenant(s) to sign an affidavit.

Life Insurance. Upon the death of the insured, proceeds from a life insurance policy will be paid to the beneficiary designated by the owner. If no beneficiary is designated, the insurance contract generally specifies a default beneficiary, typically the insured's estate. If the estate is the beneficiary, generally a probate must be opened and a personal representative appointed to apply for the proceeds.

Retirement Plans. Upon the death of the owner of the retirement plan or IRA, the remainder of the account will be paid to the beneficiary designated by the owner. If no beneficiary is designated, the retirement plan or IRA agreement will specify a default beneficiary.

Miscellaneous Non-Probate Assets. There are several statutory procedures available to transfer specific non-probate assets such as small bank accounts, minor unpaid wages due the decedent, vehicles, and savings bonds. The statutes define who can claim the particular asset. Typically it is limited to the surviving spouse, heirs, funeral director, or creditors. The statutes also generally require proof of death and a signed affidavit. There is also a very limited shortcut statutory procedure available for small estates that do not hold any real estate (in 2014, small estates are defined as those having less than $100,000).

Chapter 4
Planning for Incapacity

We are now living longer, and as a result, there is an increasing chance that at some point in our lives we may become incapacitated and unable to manage our financial or personal affairs. With proper advanced planning, you can provide instructions on how you want your assets and affairs managed if you become incapacitated and appoint people you trust to carry out those instructions. This chapter reviews what happens if you do not provide instructions and how to leave legally enforceable instructions.

4.1 What Happens if You Do Not Plan

If you become incapacitated and unable to manage your financial and personal affairs (*e.g.*, paying bills, managing accounts, monitoring medications, etc.) without having planned for it, a family member, friend, or other person can petition the court to be appointed as a guardian of the estate to manage your financial affairs and/or as a guardian of the person to manage your personal care. You may need one or both depending on the circumstances of your incapacity and affairs.

Guardianship proceedings can be expensive. In addition to the cost of the initial court proceedings for appointment of the guardian, annual accountings must be prepared, filed, and approved by the court. Expenses of your guardianship are paid from your assets. Guardianships also involve a loss of privacy. The court proceeding to determine your capacity and the annual accountings are generally available to anyone who wants to look at the court records.

In most cases, you can avoid a guardianship with advanced planning. You can designate an agent to manage your financial affairs through a durable power of attorney and designate an agent to make personal care and healthcare decisions through a healthcare power of attorney. You can also leave instructions regarding artificial life sustaining treatment to healthcare providers using a healthcare directive.

4.2 Durable Powers of Attorney for Financial Affairs

A durable power of attorney allows you to designate someone to make financial decisions for you. Unlike a guardianship, a durable power of attorney typically involves no court supervision or public proceeding. Although it is generally a fairly short document, you need to give it very careful consideration because you are putting someone in charge of your affairs without court supervision or anyone looking over his or her shoulder.

Under a durable power of attorney, you authorize someone to act for you with respect to certain legal matters (your attorney-in-fact). The attorney-in-fact is often a family member or friend. To be effective during incapacity, the power of attorney must specifically state that it is "durable," which means that it is effective even if you are incapacitated.

You have a wide range of options as to the scope and effectiveness of your financial power of attorney, and you should discuss the following with your attorney before executing one.

(1) Who Should Serve as Your Financial Attorney-in-Fact?

The person you designate as your financial attorney-in-fact should be responsible, have a certain degree of sophistication, and know when to seek professional assistance. Most importantly, your attorney-in-fact needs to be someone you trust implicitly. Ideally, your attorney-in-fact has an understanding of your financial principles and goals, and how you would wish to provide for any dependents, such as a spouse or minor children. The person acting as your attorney-in-fact is a fiduciary, which means that he or she is held to a high standard and must act for your – not his or her – benefit.

You can designate one person as your attorney-in-fact or appoint two or more to act jointly. It is a good idea to designate one or more alternate attorneys-in-fact in case the person you designate as primary attorney-in-fact is unable or unwilling to serve.

Having a power of attorney does not guarantee that no one will petition for appointment as your guardian, but you can provide an added layer of protection in your power of attorney if you designate the person you named as attorney-in-fact as your choice for guardian, should one be appointed.

(2) What Powers Should You Give Your Attorney-in-Fact?

In general, you can give your attorney-in-fact as many or as few powers as you want. For example, if you are going out of town and need to authorize someone to sign closing documents for a particular sale, the power of attorney could authorize your attorney-in-fact to sign certain documents on a certain date, but nothing more. On the other hand, if you want to allow someone to manage your affairs if you became incapacitated, your power of attorney could give your attorney-in-fact almost all powers that you would have if capable of acting for yourself. The choice is yours, and given the potential for abuse, you need to consider it carefully.

Although powers of attorney may recite that you are giving your attorney-in-fact as broad powers as possible, under Washington law certain powers are considered so powerful that your attorney-in-fact will not have them unless the power of attorney specifically provides for it. These include powers to make gifts, change certain estate planning documents, direct distributions from a trust on your behalf, or change beneficiary designations for non-probate assets (see Chapter 3). Note that even with specific authorization, your attorney-in-fact cannot amend, alter, or revoke your will.

(3) Can You Provide for Minor Children if You Are Incapacitated?

Washington law allows a parent to nominate a guardian for a minor child in the parent's power of attorney. Although most parents name a guardian for minor children in their will, the will only controls if you are deceased, so it is important to also designate a guardian for children in the event that you become incapacitated.

(4) Other Considerations

Generally, you should sign your power of attorney in the presence of a notary public. Although there is no statutory requirement that your signature be notarized, a notarized durable power of attorney is needed before real property can be transferred.

You can revoke a power of attorney at any time by destroying the original and any copies you have made. Your power of attorney is automatically revoked upon your death, and your attorney-in-fact has no authority to act after your death. You may want your power of attorney to provide for automatic revocation on certain conditions, such as if you regain capacity. If you named your spouse as your attorney-in-fact, you may want it to revoke automatically if either of you files for divorce (Washington law automatically revokes a spouse's power to act upon the final decree of divorce, but you may not want a soon-to-be ex-spouse to act for you while a divorce is pending).

After you have signed the power of attorney, you should let your attorney-in-fact and/or other trusted individual know whom you have designated as your attorney-in-fact and where you keep the original document. You can also provide them with copies of the document, but you want to be careful that there are not too many copies around that you would need to retrieve if you ever revoked the power of attorney.

Third parties can be wary of dealing with an attorney-in-fact. Under Washington law, your attorney-in-fact can go to court and enforce your power of attorney if needed.

4.3 Healthcare Powers of Attorney

In addition to giving someone the power to make financial decisions for you, you can designate someone to make healthcare decisions for you, including end-of-life decisions involving life-sustaining or -prolonging measures. You can use the same document to designate both financial and healthcare attorneys-in-fact; however, it is common to use separate documents because the powers are different and you may not want to appoint the same person to both roles.

In choosing an attorney-in-fact to make healthcare decisions for you, you should consider how well the person knows you and whether he or she is likely to understand and follow through with your wishes for medical treatment, or the withholding of treatment. If you name a family member, consider the dynamics of the family. For example, if one of several children is named as the attorney-in-fact, it may place that child in a very difficult position when making healthcare decisions if the other children do not agree.

A healthcare power of attorney can provide your attorney-in-fact with broad authority to make any healthcare decisions for you without further direction. It can also provide very specific directions and guidelines as to the type and extent of treatments you want to receive or avoid.

As with the financial power of attorney, you can designate the person you named as healthcare attorney-in-fact as your choice for guardian of the person, should one be appointed. Also similar to the financial power of attorney, there is no requirement that a healthcare durable power of attorney be notarized, although medical providers or institutions may be more likely to accept a document that has been notarized. After you sign your healthcare power of attorney, you should let your attorney-in-fact know where you keep the original document, and it is a good idea to provide a copy to your medical providers and to any hospital or medical care facility to which you are admitted.

4.4 Healthcare Directive and POLST

In addition to the healthcare power of attorney, you can execute a ***healthcare directive*** (sometimes referred to as a "living will"). A healthcare directive is a statutory form that directs your medical provider to withhold or withdraw life-sustaining treatment (including artificial nutrition and hydration) if you are diagnosed to be in a terminal or permanent unconscious condition. Healthcare directives are of limited use because they provide no direction other than with respect to terminal and permanent unconscious conditions, they assume that you want only one course of treatment (withdrawal of treatment), and they do not give anyone authority to enforce your wishes if your medical provider does not follow them. It is generally advisable to appoint a trusted individual under a healthcare power of attorney to work with your medical providers rather than relying on a healthcare directive.

You can also work with your physician and sign a Physician's Orders for Life Sustaining Treatment (**POLST**) form. This form is intended to be a short summary of treatment preferences translated into physician's orders for first responders, and describes a patient's directions with respect to resuscitation, medical intervention, antibiotics, and artificially administered fluids and nutrition. To obtain a POLST form, contact the Washington State Medical Association at (206) 441-9762 or (800) 552-0612, or go to https://www.wsma.org/POLST.

Chapter 5
Taxes

As a general rule, anytime you give an asset away, whether during your lifetime or on your death, the gift is potentially subject to estate or gift tax. There is both a federal and a Washington State estate tax, a federal gift tax (but no Washington State gift tax), and a federal generation-skipping transfer tax. Many lifetime gifts transfer free of gift tax, and many estates pass free of any estate tax. However, if you have a taxable estate (see Sections 5.1 and 5.2), proper estate planning can help you to minimize – or even eliminate – the gift and estate tax cost to your estate.

5.1 Federal Estate Tax

The estate tax is a tax on all assets that you own at the time of your death. Every asset in which you hold an interest is included in your taxable estate, including your home, retirement plans, life insurance policies, IRAs, joint tenancy accounts, brokerage accounts, stocks, bonds, tangible personal property, etc. (see Section 5.3 regarding the interplay with the federal gift tax).

As a general rule, only estates valued at more than the federal estate tax exemption amount pay federal estate tax. The federal estate tax exemption amount was set at $5 million beginning in 2011, and is indexed for inflation (for example, the inflation-adjusted exemption for 2014 was $5.34 million). The federal estate tax exemption amount is essentially reduced for any lifetime taxable gifts. If you are married, special planning is needed to assure that both you and your spouse can fully use your federal estate tax exemption amount. To the extent that the value of an estate exceeds the decedent's estate tax exemption amount, the excess is taxed at a flat rate (40 percent in 2014).

In general, two types of gifts escape federal estate tax:

- *Gifts to Spouse.* Gifts to your spouse pass free of estate tax, no matter how large the amount, under the unlimited marital deduction, so long as your spouse is a U.S. citizen.

- *Gifts to Charities.* Gifts to qualified charities also pass free of estate tax, no matter how large the amount, under the unlimited charitable deduction.

5.2 Washington State Estate Tax

Washington also taxes the value of your assets at death. The Washington estate tax applies to all real and tangible personal property located in Washington as well as to intangible assets owned by Washington residents. As a general rule, only estates valued at more than the Washington estate tax exemption amount pay Washington estate tax. The Washington estate tax exemption amount was set at $2 million beginning in 2006, and is indexed for inflation (for example, the inflation-adjusted exemption for 2014 was $2.012 million).

If you are married, special planning is needed to ensure that both you and your spouse can fully use your Washington estate tax exemption amount. To the extent that the value of an estate exceeds the Washington estate tax exemption amount, the excess is taxed at graduated rates of 10 percent to 20 percent.

5.3 Federal Gift Tax

In addition to the estate tax, there is also a federal gift tax on gifts made during your lifetime, as opposed to gifts made on your death. Under current federal gift tax law, you only pay gift tax beginning when the aggregate value of your lifetime taxable gifts exceeds the federal gift tax exemption; however, you might need to file a gift tax return even when no tax is due. The federal gift tax exemption amount is identical to the federal estate tax exemption amount and also annually adjusts for inflation ($5.34 million in 2014). The federal gift tax rate is also the same as the federal estate tax rate (40 percent in 2014). As noted above, there is no Washington gift tax.

The federal gift and federal estate taxes are “unified,” which means that you can gift the federal estate/gift tax exemption amounts, in aggregate during your lifetime and at death, free of gift and estate tax. For example, if the federal estate/gift tax exemption amounts were $5 million each and you give away $4 million during your lifetime, you would only have $1 million of your exemption remaining at your death, and any of your estate that exceeded $1 million on your death would trigger federal estate tax.

As with the estate tax, certain types of lifetime gifts generally escape federal gift tax even if you have already used all of your gift tax exemption:

- *Gifts to Spouse.* Gifts to your spouse pass free of gift tax, no matter how large the amount, as long as your spouse is a U.S. citizen.

- *Gifts to Charities.* Gifts to qualified charities also pass free of gift tax, no matter how large the amount (note that gift tax is a separate system from income tax, and the gift tax deduction for charitable gifts works differently than the income tax deduction for charitable gifts).

- *Annual Exclusion Gifts*. Every year, you can give the "annual exclusion" amount ($14,000 in 2014) to each of any number of people without paying any gift tax (the annual exclusion amount is also indexed for inflation). This is a non-taxable gift because it does not consume any of your gift tax exemption amount.

- *Exclusion for Qualifying Medical Expenses*. You can also pay certain medical expenses on behalf of another person and not have the payment counted as a taxable gift. The medical expenses are limited to certain qualifying expenses and you must pay the expenses directly to the medical provider (you cannot give the money to the patient and have the patient pay the healthcare provider). There is no dollar limit for this exclusion and it does not count against your gift tax exemption amount.

- *Exclusion for Qualifying Education Expenses*. Similar to the qualified medical expenses, you can pay certain educational expenses on behalf of another person and not have the payment count as a taxable gift. The educational expenses are limited to certain qualifying expenses and you must pay the expenses directly to the provider of the educational services (you cannot give the student the money and have the student pay the school). There also is no limit on this exclusion and it does not count against your gift tax exemption amount.

See Chapter 6 for a discussion on gifting strategies.

5.4 Generation-Skipping Transfer Tax

In addition to federal gift and estate taxes, there is also a federal generation-skipping transfer tax that taxes gifts to anyone who is two or more generational levels below you (such as grandchildren, great-grandchildren, great-nephews, great-nieces, etc. – collectively referred to as "grandchildren" in this section).

As a general rule, only gifts to grandchildren in excess of the generation-skipping transfer tax exemption amount pay federal generation-skipping transfer tax. The generation-skipping transfer tax exemption amount was set at $5 million beginning in 2011, and is indexed for inflation (the inflation-adjusted exemption for 2014 was $5.34 million). The generation-skipping transfer tax exemption amount is essentially reduced for any lifetime taxable gifts to grandchildren. With proper planning married couples can shield twice the federal generation-skipping transfer amount. To the extent that gifts to grandchildren exceed the generation-skipping transfer tax exemption amount, the excess is taxed at a flat rate (40 percent in 2014). The generation-skipping transfer tax applies in addition to the gift and estate tax and its nuances are extremely complex.

5.5 Income Tax Considerations

As noted above, the income tax is a totally different tax regiment from the gift and estate tax. Gifts made during your lifetime and at death have ancillary income tax consequences that you should be aware of and discuss with your accountant and attorney. You do not pay income tax on the value of gifts that you receive, and if you make a gift, you cannot deduct the gift on your income tax return except in the case of gifts to qualified charities.

For purposes of capital gains tax, if you make a gift during your lifetime, your tax basis in the asset transfers to the recipient of the gift (your tax basis is generally the amount you originally paid for the asset). If you give that same asset on your death, the recipient’s tax basis is the fair market value of the asset on the day of your death.

Estates and trusts are separate taxpayers and are generally required to file separate income tax returns. In addition, if a person dies, his or her estate must file a final personal income tax return on that person’s behalf. It is a good idea to consult with tax professionals about these filings.

Chapter 6
Preserving Wealth –
Planning to Minimize Estate and Gift Taxes

If the value of your estate exceeds or is likely in the future to exceed the Washington or federal estate tax exemptions (see Chapter 5), there are several steps you can take to mitigate or minimize the estate tax impact. Depending on the value of your estate, your goals, and your beneficiaries, the steps can be relatively simple or quite complex. This chapter provides a very basic overview, and your estate planning professional can help you to determine what strategies are available and would work best for you.

6.1 Planning for Married Couples

If you give your estate to your spouse on your death and your spouse is a U.S. citizen – no matter how large your estate – there will be no Washington or federal estate tax due because of the unlimited marital deductions (see Chapter 5). However, if your combined estates are in excess of the Washington estate exemption (approximately $2 million), an outright gift to your spouse on your death will trigger Washington estate tax on your spouse's death. That tax could easily be mitigated and perhaps entirely avoided with some advanced planning.

Example. Assume that a couple's combined estate is worth $3 million ($1.5 million each), the Washington estate tax exemption is $2 million, and the husband dies leaving all his estate outright to his wife. There is no estate tax on the husband's death because his $1.5 million estate passes to his wife under the unlimited marital deduction. The wife then has a $3 million estate, and if that is the value of her estate on her death, it will need to pay approximately $100,000 in Washington estate tax.

Now assume the same facts, except that the couple did some advanced planning and established a trust for the wife under the husband's will (often referred to as a bypass or credit trust). On the husband's death, his $1.5 million goes into the trust, which can be designed so that the wife is the trustee and can generally use trust funds as provided by the trust – usually for her health, support, and maintenance. The wife then owns the other $1.5 million directly, and if that is the value on the date of her death, her estate would pay no Washington estate tax. Simply planning in advance with the trust saved the estate $100,000.

6.2 Planning with Lifetime Gifts

If you have assets in excess of what you think you will need to take care of yourself for the rest of your life, you may wish to implement a gifting program during your lifetime. One benefit of lifetime gifts is that all of the subsequent appreciation on the gifted assets is removed from your taxable estate. In addition, the value of the gift escapes Washington estate tax entirely (because the federal gift and estate taxes are "unified" (see Section 5.3), lifetime taxable gifts are included in the calculation of federal estate tax). One downside of lifetime gifts is that the gift recipient receives your basis in the gifted asset. Before making lifetime gifts, you will want to make sure you will never need the gifted assets and be comfortable that you will no longer control them.

Lifetime gifts can be as simple as a $100 birthday check to a child or as complex as highly structured trusts and entities employing various tax planning strategies. This chapter is designed to provide a very basic overview of gift planning. Your estate planning professional can help you evaluate the options in light of your estate planning goals and provide you with planning strategies.

Non-Taxable Gifts. There are three types of gifts that do not count against your gift tax exclusion amount, do not trigger any gift tax, and generally do not require that you even file a gift tax return to report the gift. These are annual exclusion gifts, gifts to pay qualifying educational expenses, and gifts to pay qualifying medical expenses (see Section 5.3).

With a little planning, you can remove substantial value from your taxable estate by taking full advantage of these non-taxable gifts. For example, assume that the annual exclusion amount is $14,000. If you are married and have three children and six grandchildren, you and your spouse together could make tax-free gifts of $28,000 to each child and grandchild every year, thus removing $252,000 from your and your spouse's combined estates. The number of annual exclusion gifts you give each year is not limited, but you can only give one annual exclusion gift to each person during the year. The annual exclusion renews every year, so you can give another round of annual exclusion gifts in each of the following years. In addition, each year you also could pay your grandchildren's private school or college tuition and pay their qualifying medical expenses, no matter how much they are, all as additional tax-free gifts. By making these types of gifts each year, you can remove substantial value from your taxable estate, and still preserve your full gift and estate tax exemptions.

Taxable Gifts. Gifts in excess of these tax-free gifts (referred to as "taxable gifts") use part of your gift tax exemption and require that you file a gift tax return, but you will not owe any gift tax until you have made aggregate taxable gifts during your lifetime in excess of your federal gift tax exemption amount. For example, assume that the annual exclusion amount is $14,000, that the federal gift tax exemption amount is $5 million, and that you have never made any taxable gifts. If you give $14,000 to Tim and $25,000 to Bob, the $14,000 gift to Tim falls under the annual exclusion as a non-taxable gift. Of the $25,000 gift to Bob, $14,000 also falls under the annual exclusion, and the remaining $11,000 counts against your $5 million gift tax exemption (leaving you with $4.989 million of remaining gift tax exemption for future gifts).

When making taxable gifts, you may want to consider gifting strategies that allow you to leverage your gift tax exemption so that you maximize its use. Common strategies include gifting interests in closely held businesses or gifts of life insurance policies. Gifts that delay the beneficiaries' use of the gifted assets also leverage your gift tax exemption and often have the additional benefit of allowing you to retain some limited use of the gifted asset. Your estate planner can explain how trusts such as a qualified personal residence trust, grantor retained annuity trust, and grantor retained unitrust may work to your advantage. You might consider selling assets to your children to remove the subsequent appreciation from your estate. Your estate planner may suggest that you do that through a simple cash sale or may suggest a more complex arrangement such as an installment sale to an intentionally defective grantor trust.

You might also consider leveraging your generation-skipping transfer tax exemption by making gifts to trusts that extend through several generations of your family. With proper allocation of your generation-skipping transfer tax exemption, these types of gifts can escape estate tax at your children's generational level, and perhaps beyond.

Note that these gifting strategies can be quite complex and they require careful structuring and consideration of your goals and needs. Also, as mentioned in Section 5.5, your income tax basis in assets gifted during your lifetime transfers to the recipient, and the assets do not receive a step-up in basis on your death.

Charitable Gifts. Another way to reduce the amount of your estate during your life or to reduce your taxable estate at your death is through gifts to charitable organizations. Lifetime gifts to a "qualified charity" allow you an income tax charitable deduction if you itemize deductions, and a gift tax charitable deduction. Charitable gifts on death to a “qualified charity” provide an estate tax charitable deduction.

Charitable gifts can be as simple as an outright cash gift to a charity with no strings attached. There are also planning opportunities for structured gifts that divide interests between individuals and qualified charities. Your estate planner can explain the advantages and disadvantages to you of split charitable gifts using charitable remainder trusts, charitable lead trusts, and charitable gift annuities. Depending on your circumstances, it may be particularly advantageous to you to gift assets such as appreciated marketable securities, real estate, life insurance, retirement plans, works of art, or closely held stock. You can make your gift to a particular charity or you can create a donor advised fund or private foundation that you use as a tool for you and/or your children to make charitable gifts through the years.

Chapter 7
Planning for Closely Held Businesses

If you own an interest in a closely held business, you should carefully consider the following:

- What happens to the business interest when you die, become disabled, or retire?
  - Who can step in to take over your role in the business?
  - How can key employees be induced to stay in the business and run it profitably?
  - If you earn compensation for your work in the business and your family is dependent on that compensation, how can you replace that for them?
  - Would your death, disability, or retirement create a liquidity event for the business, and if so, how can that be met?
  - Will the beneficiaries of your estate want to sell the business if you die? If so, who are the likely purchasers and how would they pay the purchase price?
  - Have you signed general guarantees for the business, and if so, how would your death, disability, or retirement impact your obligations under the guarantees?
- What is the realistic value of the business? If you own less than all of the business, what is the value of your interest in the business?
- If the business is owned by other people in addition to you:
  - If one of the other owners dies or becomes disabled, who can step in to take over his or her role in the business?
  - Are there key employees who might leave if the other owner were not there?
  - What happens to the other owner's interest in the business if he or she dies? Do their spouses or children become your new business partners? Do you have any right to buy out their interest, and if so, how is the price determined?
  - How can you ensure continuing adequate working capital for the business if one of the other owners attempts to withdraw and take with them their portion of the capital?

These and other concerns are often best dealt with at the time the business is formed. Basic agreements can be made to control the disposition of a business interest and define how the disposition will be handled in the event of an owner’s death, retirement, disability, or divorce (commonly called “buy-sell agreements,” “shareholders agreements,” or “business continuation agreements”). These agreements can set the price and the terms of the buy-out. Consideration is given to how to fund the buy-out, which may involve some life insurance or other sources of cash.

Planning for the payment of the estate tax is also important, as the business can be very valuable but very illiquid. Depending on the circumstances, there may be some relief provisions under the tax laws, such as special valuation rules, deductions, or tax deferral provisions. It is best to consider the impact of the owners’ demise long before the event occurs so that the family members are not left scrambling to pay the tax.

As the business grows (and hopefully prospers), the plan should be periodically reviewed and refined, as necessary, to meet the changing circumstances of the business and its owners.

Planning for a business at one’s death is a complicated process best addressed in advance and with the assistance of a qualified estate planner.

Chapter 8
Trusts and Trustees

Trusts are commonly used in estate planning and provide a flexible tool to manage assets on behalf of someone. A parent may create a trust to hold the inheritance of a minor child or to guard against a spendthrift child. A grandparent may create a trust to be used to fund college expenses for all the grandchildren. People also set up revocable living trusts to hold their assets for their benefit while they are living, possibly avoiding the need for a guardian or attorney-in-fact if the person becomes incapacitated. The revocable living trust later acts as a will substitute upon the person's death (see Section 2.5(2)).

8.1 What Is a Trust?

Put simply, a trust occurs when Person A hands property to Person B and asks that Person B hold the property for the benefit of Person C. It is a legal relationship among a grantor (Person A), a trustee (Person B), and one or more beneficiaries (Person C). The ***grantor*** is the person who creates the trust by transferring legal title (ownership) of specific assets to the trustee. The ***trustee*** is then the legal owner of the property and has the duty to manage the trust property for the benefit of the beneficiaries and to distribute the property to the beneficiaries in accordance with the grantor's directions. The ***beneficiaries*** are entitled to the benefits of the trust and are usually individuals, but they can be other legal entities, such as a charitable institution or even pets.

A trust is formally created using a written trust agreement. The agreement may be a standalone document or it may be incorporated as part of a will. A trust can be revocable or irrevocable, depending on your goals. A typical revocable living trust is wholly revocable during the grantor's lifetime, but any new trusts established under it on the grantor's death are generally irrevocable.

You can create a trust that is effective immediately or only effective upon your death. For example, you may want to establish a trust to help pay for a grandchild's education now, with the expectation that it will remain in effect after your death. Alternatively, you may want to create the grandchild's trust under your will so that it is funded from your estate and only comes into effect after you are deceased.

You can establish a trust for the benefit of yourself and others. If you created a typical revocable living trust, you would be the grantor, and during your lifetime, you would also be the trustee and beneficiary. On your death, the revocable living trust agreement may establish one or more new trusts for your spouse, children, or others. You would be the grantor of the new trusts; your spouse, children, or others would be the beneficiaries; and you would designate someone as trustee. The new trusts could continue for years after your death, and possibly through several generations of your descendants.

Almost any type of property can be transferred to a trust, including tangible personal property, stocks, bonds, real estate, contracts, life insurance policies, proceeds from limited partnership interests, and bank accounts. The trustee is charged with managing and investing the trust assets.

8.2 Who Can Be a Trustee?

A trustee can be an individual (such as a friend or relative) or a corporation if it is authorized to conduct a trust business in Washington. Such corporations may be banks, independent trust companies, qualifying non-profit corporations, or law firms that are professional service corporations. More than one person can be named to act as trustee, in which case the co-trustees normally must act by majority vote. Frequently, an individual and a corporation will be named together as co-trustees.

8.3 When Should You Use a Trust?

Deciding on how or whether to use a trust should begin by thoughtfully considering your goals. You have extreme flexibility in deciding on the trust terms, and you typically create a trust to address a particular need. You may put assets in a trust for the benefit of someone else, such as creating a trust to manage assets for a minor child or to protect a child's inheritance from an aggressive spouse or creditors. Trusts are commonly used for tax planning, such as spousal trusts to capture a deceased spouse's estate tax exemption (see Section 6.1) or to protect assets for your children if your spouse remarries after your death. Trusts are frequently used to make gifts that need to comply with particular provisions of the tax code, such as qualified personal residence trusts, grantor retained annuity trusts, and grantor retained unitrusts. You may use a trust to split interests between beneficiaries in a managed fashion such as pot trusts to manage assets on behalf of several children or charitable lead or charitable remainder trusts (see Section 6.2).

You may create a trust to hold title to your own assets for your benefit during your lifetime. In addition to the revocable living trust that serves as a will substitute, you may want to hold your assets in a trust for privacy purposes so that a nosey person searching through public records would not easily be able to identify what you owned. You may want to use such a trust to designate a professional trustee to manage your assets to relieve yourself of the burden of management and recordkeeping. If you are worried about a future dementia, you may put your assets in a trust so that someone you trust is in place to manage them on your behalf if that should become necessary. If you are about to marry and have not signed a prenuptial agreement, you may put your assets in a trust to clearly segregate them as your separate property and keep them distinct from assets acquired during the marriage.

Trusts provide endless planning opportunities, but you need to make sure that they are drafted to fully carry out your intent in establishing the trust and so that you fully understand all the implications for yourself, the trustee, and the beneficiaries.

GLOSSARY

Administrator. Person appointed by the court to administer an estate if there is no will or if the persons named as executors under the will are unable or unwilling to serve. In this Guide, the administrator is referred to as the "personal representative."

Attorney-in-Fact. Person designated to handle financial affairs or healthcare decisions under a power of attorney.

Beneficiaries. Persons entitled to property or benefits of a trust or estate.

Charitable Gift Annuity. A method of charitable giving that involves a contract between a donor and a charity (as opposed to a trust) under which the charity agrees to pay a fixed amount annually for life to one or two individuals (the annuitant(s)) in return for an irrevocable gift consisting of the transfer of cash or other assets. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Charitable Lead Trust. An irrevocable trust that pays a fixed amount or a percentage of the value of trust assets to one or more charities for a set term. At the end of the term, the remaining assets generally go to one or more individuals. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Charitable Remainder Trust. An irrevocable trust that pays a fixed amount or percentage of the value of the trust assets to one or more individuals for a set term. At the end of the term, the remaining assets go to one or more charities. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Community Property. The presumptive rules for how spouses in Washington hold property. Property acquired during the marriage is deemed to be community property unless it was acquired using separate property funds or received as a gift or inheritance. Property that a spouse owned before the marriage and any property received by gift or inheritance is generally considered to be the spouse's separate property, as is all the income and appreciation on that property. Those presumptions can be altered by the actions of the spouses or an agreement between the spouses, such as a prenuptial, a postnuptial, or a community property agreement.

Community Property Agreement. See three-prong community property agreement.

Decedent. A person who has died.

Durable Power of Attorney. Same as a financial power of attorney, used to designate a person (the “attorney-in-fact”) to handle the maker’s financial affairs under certain circumstances, such as if the maker becomes incapacitated.

Estate. A person’s estate consists of all assets he or she owns as well as any property in which he or she holds an interest.

Executor. The person named under a will to administer the estate. In this Guide, the executor is referred to as the “personal representative.”

Fiduciary. The person appointed to hold or administer property on behalf of another person. It includes a personal representative, executor, administrator, attorney-in-fact, trustee, and guardian.

Financial Power of Attorney. Same as a durable power of attorney for financial affairs, used to designate a person (the “attorney-in-fact”) to handle the maker’s financial affairs under certain circumstances, such as if the maker becomes incapacitated.

Grantor. The person who creates the trust by transferring legal title (ownership) of specific assets to a trustee.

Grantor Retained Annuity Trust. An irrevocable trust that pays a fixed amount to the grantor for a set term. At the end of the term, the remaining assets generally go to one or more of the grantor’s family members. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Grantor Retained Unitrust. An irrevocable trust that pays a fixed percentage of the value of the trust assets to the grantor for a set term. At the end of the term, the remaining assets generally go to one or more of the grantor’s family members. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Guardian for Minor. The person appointed by the court to manage a minor child's personal and/or financial affairs.

Guardian of the Estate. The person appointed by the court to administer a person's financial affairs.

Guardian of the Person. The person appointed by the court to manage a person's personal affairs.

Healthcare Directive. A document that provides instructions to medical professionals regarding life-sustaining treatments if the maker cannot provide those instructions (also called a "living will").

Healthcare Power of Attorney. A document that designates a person (the "attorney-in-fact") to make healthcare decisions for the maker if he or she cannot make those decisions.

Intentionally Defective Grantor Trust. An irrevocable trust in which the grantor makes a completed gift to other individuals but purposely retains specific powers or interests that cause all the income of the trust to be taxed to the grantor rather than the trust. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Intestate. A person is "intestate" if he or she dies without making a will.

Joint Tenancy with Rights of Survivorship. A form of co-ownership in which, upon the death of one of the joint tenants, the property automatically passes to the surviving joint tenant(s).

Living Will. Same as a healthcare directive (not to be confused with a living trust).

Non-Probate Assets. Specific assets that pass other than under a will, such as retirement plans, IRAs, life insurance, payable-on-death or transfer-on-death accounts, joint tenancy accounts, or property held in trust. It also includes assets that pass under a will substitute such as a revocable living trust or community property agreement.

Personal Representative. The person appointed by the court to administer an estate after a person dies. As used in this Guide, the term "personal representative" refers to both executors and administrators.

POLST (Physician's Orders for Life Sustaining Treatment). A form entered into with a healthcare provider that serves as a short summary of treatment preferences.

Pot Trust. A single share trust administered for the benefit of several beneficiaries.

Probate. The legal process whereby a decedent's debts and taxes are settled and paid and the decedent's property is transferred to the intended beneficiaries. The probate process is based in the courts; however, unlike most states, Washington courts generally have little direct involvement in probate matters. Compared to other states, Washington has a relatively simple and streamlined probate procedure in which a personal representative of a solvent estate generally administers the estate without involvement with the court, other than to open and close the estate.

Qualified Personal Residence Trust. An irrevocable trust to which the grantor transfers a residence but retains the right to use the residence rent-free for a specified term. At the end of the term, the residence is transferred to other individuals or a new trust. If structured properly, it may provide gift, estate, or income tax benefits for the donor.

Registered Domestic Partner. A person who enters into a registered domestic partnership within the State of Washington. Both same-sex and opposite-sex couples can register as domestic partners, but at least one of the couple must be age 62 or older. Registered domestic partners generally have the same rights and interests as married couples under Washington law, and because registered domestic partnerships are somewhat limited by definition, references to a spouse or married couple in this Guide are also intended to include registered domestic partners.

Revocable Living Trust. A will substitute that can provide instructions as to who will receive property held in the trust following the grantor's death, and how debts and taxes will be paid. It cannot provide who will serve as guardian for minor children. A revocable living trust is only effective for assets that have been transferred to it.

Solvent. An estate is solvent if the value of the assets exceeds its liabilities.

Spouse. The person to whom the other spouse is legally married. Washington recognizes both opposite-sex and same-sex marriages.

Tangible Personal Property. Tangible assets that are held for personal use or enjoyment, such as furniture, jewelry, china, books, clothing, works of art, cars, and airplanes. It does not include cash, stock, bonds, or real estate.

Three-Prong Community Property Agreement. A contract between spouses by which they designate all their current and future property as community property and specify that all community property transfers to the survivor on the first death.

Trust. A legal relationship in which one person (the grantor), transfers property to another person (the trustee) to hold for the benefit of a third person (the beneficiary).

Trustee. The person who administers a trust. The trustee manages and invests assets held in the trust and makes distributions to the trust beneficiaries in accordance with the terms of the trust.

Unitrust. A payment based on a fixed percentage of the net fair market value of trust assets, with such value generally determined annually.

Will. A document that provides instructions as to who will receive a person's property upon his or her death, how they will receive it, how debts and taxes will be paid, who will administer the estate, and who will serve as guardian for minor children. It must be executed with certain formalities to be effective and does not become effective until the death of the maker.

Will Substitute. A revocable living trust or a community property agreement.

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