ESTATE PLANNING

Who Should Fill Your Shoes? Considerations for Choosing Fiduciaries

2023

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What Estate Planning Documents Should Every Person Have?

- Durable Power of Attorney (“DPOA”)
- Will or Revocable Living Trust (“RLT”)
- Health Care Directive*
- Directive Regarding Disposition of Remains*

*These are sometimes included in a DPOA

Who should I name as my Fiduciary in my Estate Plan?

- What is a Fiduciary?
  - A person or organization that acts on behalf of someone else (the "Principal"). A Fiduciary puts the needs/interests of the Principal ahead of the Fiduciary's own interests. They owe duties to the Principal.
  - Examples: (a) Personal Representative/Executor of a Will; (b) Trustee of a Trust; (c) Agent/Attorney-in-Fact under DPOA.
- Who can serve as a Fiduciary?
  - A family member, a friend, an independent professional fiduciary, an attorney, a bank or trust company.

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Who should I name as my Fiduciary?

- Is this person someone that you like and who communicates clearly?
- Are they responsible?
- Where is this person located?
- Do you trust this person to act in your best interest?
- How old is this person?
- Is this person assertive and can they handle the pressure?
- Is the person willing and able to act?
- What are this person’s strengths and weaknesses?

Who should I name as my Fiduciary?

- Friend or Family Member: Least expensive option. Entitled to hourly compensation generally in the range of $25-$50/hour.
- Independent Professional Fiduciary: An individual or small company that serves as a fiduciary for an hourly fee, and sometimes a percentage of the assets managed, or minimum flat fee. The hourly rates vary widely based on the tasks required, and some have staff members who charge for tasks at a lower rate.
- Attorney/CPA: An attorney/CPA will charge their hourly rate to be a fiduciary. The attorney will also be assisted by paralegal(s) or other staff that charge at lower hourly rates.
- Banks and Trust Companies: Usually charge a percentage of assets under management, generally around 1-2% for trustee services.

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Durable Power of Attorney

This document takes effect immediately for **health care** purposes and either immediately or upon incapacity for **financial** purposes. A Durable Power of Attorney is **only effective during your life** and loses its effectiveness upon your death.

The Durable Power of Attorney allows your Agent to **handle your finances and work with your health care providers on your behalf while you are still alive but are, for some reason, unable to** take care of these things yourself.

Durable Power of Attorney

Immediately Effective: This Power of Attorney shall become **effective upon its execution by me** and shall remain effective until revoked in writing by me or by my legal guardian.

Effective Upon Incapacity: This Power of Attorney shall **only become effective upon my incapacity** and shall continue in effect until (a) a court of competent jurisdiction adjudges that I am no longer incapacitated at law, (b) one licensed physician certifies that the incapacity has abated, or (c) the Affidavit of Detention is revoked.

Durable Power of Attorney

Requirements for a validly executed DPOA:

- Signed
- Dated
- Acknowledged before a notary OR
- Attested by two or more competent witnesses
- In the presence of Principal and at Principal's request or direction

Health Care Directive

Make health care decisions in advance: (a) Terminal Illness, (b) Permanent Unconscious Condition.

- Continue all life support measures indefinitely.
- Remove all life support measures.
- Can make different decisions about artificial nutrition and hydration.

Health Care Directive

Requirements for a validly executed HCD:

- Signed
- Dated
- Attested by two or more competent witnesses
- In the presence of Principal and at Principal's request or direction
- Witness are not: (i) an attending physician of the Principal; (ii) an employee of such physician; (iii) an employee of a health facility in which the Principal is a patient; (iv) a person who has a claim against any portion of the estate of the Principal upon the Principal 's death; (v) related to the Principal.

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Disposition of Remains

- Burial
- Cremation (fire or liquid a.k.a. aquamation)
- Composting
- Donation to Science or Body Farm
- Anatomical Gift: WA has an Organ Donation Registry. If you have a ♥ on your driver's license, you joined the Registry, and you may have agreed to donate organs, eyes, and tissue for transplant and research.
- Your estate will cover the expense, but these expenses are usually incurred prior to opening probate; therefore, prepayment can be helpful.

Disposition of Remains

Requirements for a validly executed Disposition of Remains:

- Signed
- Dated
- Attested by a competent witness
- In the presence of Principal and at Principal's request or direction

Will

This document is not effective until your death. You can change it at any time during your lifetime.
It basically **provides a road map for distribution of your probate assets at death**. It appoints someone (an Executor/Personal Representative) to gather all of your assets at death and distribute them according to your wishes expressed in your Will.

A Will is filed with the court after death and a probate may be opened wherein the court formally appoints the Executor/Personal Representative named in your Will to distribute your probate assets according to the terms of your Will.

Will

Requirements for a validly executed will:

- Writing
- Signed
  - (1) By Testator
  - (2) By two or more competent witnesses
- In the presence of the Testator

What is Probate?

Probate is a court-supervised process of settling a dead person's (Decedent's) estate, basically settling debts and transferring assets.

Court gives the Personal Representative/Executor the power to settle the estate by issuing that person **Letters Testamentary**, which show the rest of the world that the Personal Representative/Executor has the power to deal with the Decedent's estate.

If Decedent dies without a Will, they died intestate, and the Court gives the Administrator the power to settle the estate by issuing that person **Letters of Administration**.

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Probate Cont.

Executor/Personal Representative/Administrator must:

- Gather all the Decedent's probate assets;
- Notify and pay the Decedent's creditors;
- File tax returns and pay any taxes due; and
- Distribute Decedent's assets according to the terms of the Decedent's Will.

Non-Probate Assets

- Assets titled as joint tenancy with rights of survivorship
- Property held in trust
- Life insurance policies
- Transfer on death or pay on death accounts
- Property subject to a community property agreement

Non-Probate Assets are included in your estate for estate tax purposes. Titling assets this way is a method to avoid probate. Even if you don't have any probate assets, you may have a taxable estate.

Revocable Living Trust “RLT”

This document is active during your lifetime and governs distribution of your assets at your death. Like a Will, it is completely revocable during your life, and you **can change it any time.**

It is essentially an entity that holds title to your assets while you are living. Then, at your death, all the assets held in the Trust will be distributed according to the terms of the Trust agreement. **If properly funded during life, probate proceedings may not be necessary at death.** It is a Will substitute.

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RLT - Trust Administration

Trustee must:

- Gather all the Decedent's assets (currently in the RLT or transferred during probate);
- Notify and pay the Decedent's creditors;
- File tax returns and pay any taxes due; and
- Distribute Decedent's assets according to the terms of the Decedent's RLT.

What happens if you don’t have an Estate Plan?

Washington Creates a Plan for you! But it may not be what you want.

- Fundamental reason for DPOA - personal autonomy. Choose the individual to make your decisions if you cannot. Avoid court removal of your personal rights (guardianship/ conservatorship).
    - Guardian (makes personal care / living decisions)
    - Conservator (makes financial decision)
- If you die without making a Will (die intestate), then WA law determines who can serve as your Personal Representative/Executor, and how your estate will be distributed.

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What happens if you don't have an Estate Plan?

Administrator of Intestate Estate

- The following, in order, are entitled to administer a single person's estate: (1) child or children; (2) parents; (3) siblings; (4) grandchildren; (5) nephews/nieces.
- If none of those people are able or willing to serve, then state law will continue to try to find someone to serve in this role. Eventually, even a decedent's creditors could serve in this role if no one else steps up!

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What happens if you don’t have an Estate Plan?

Distribution of Intestate Estate:

- If the decedent was single, then their estate will be distributed in the following order: (1) their descendants (children, grandchildren, etc.), (2) their parents, (3) their siblings, (4) their nieces and nephews or further downstream from there.
- If none of these people are living, then in the following order: (1) their grandparents, (2) their aunts and uncles, (3) their 1st cousins or further downstream from there.
- Basically, going up and then down the family tree to find someone to inherit.

What About Estate Taxes?

A one-time transfer tax due if the Decedent's assets reach certain threshold levels.

- Washington State Estate Tax Exemption $2,193,000
- Federal Estate Tax Exemption $12,920,000
- If estate exceeds Fed Exemption – do you pay both WA and Fed Taxes? Any credit for WA taxes?

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Federal Estate Tax

For Taxable Estates in This Range	You'll Pay This Base Amount of Tax	Plus This Rate on the Excess Above the Lower End of the Range
$0 to $10,000	$0	18%
$10,000 to $20,000	$1,800	20%
$20,000 to $40,000	$3,800	22%
$40,000 to $60,000	$8,200	24%
$60,000 to $80,000	$13,000	26%
$80,000 to $100,000	$18,200	28%
$100,000 to $150,000	$23,800	30%
$150,000 to $250,000	$38,800	32%
$250,000 to $500,000	$70,800	34%
$500,000 to $750,000	$155,800	37%
$750,000 to $1 million	$248,300	39%
$1 million and up	$345,800	40%

Washington Estate Tax

Table W - Computation of Washington estate tax

For dates of death 01/01/14 and after

Note: The Washington taxable estate is the amount after all allowable deductions, including the applicable exclusion amount.

If Washington taxable estate is at least...	But less than...	The amount of tax equals: Initial tax amount...	Plus tax rate %...	Of Washington taxable estate value greater than...
$0	$1,000,000	$0	10.00%	$0
$1,000,000	$2,000,000	$100,000	14.00%	$1,000,000
$2,000,000	$3,000,000	$240,000	15.00%	$2,000,000
$3,000,000	$4,000,000	$390,000	16.00%	$3,000,000
$4,000,000	$6,000,000	$550,000	18.00%	$4,000,000
$6,000,000	$7,000,000	$910,000	19.00%	$6,000,000
$7,000,000	$9,000,000	$1,100,000	19.50%	$7,000,000
$9,000,000		$1,490,000	20.00%	$9,000,000

How do Estate Planners Minimize Taxes?

Estate planners often create irrevocable trusts to minimize estate taxes:

- Upon death (in a Will or RLT) we create a ***Testamentary Trust*** for descendants or other individuals and allocate Decedent's tax exemptions to the Testamentary Trusts.
- During life, we create Irrevocable Trusts designed to either reduce Decedent's taxable estate or freeze Decedent's estate.

Trusts for Descendants or other Relatives

Main reasons to create a Trust for someone:

1. Tax Planning
2. Creditor Protection
3. Control
4. When we don’t trust the beneficiary and want someone else to manage the assets

Trust Provisions:

- Term of the Trust (for the beneficiary’s lifetime, or termination at a specific age)
- Distribution provisions:
  - Health, Education, Maintenance, and Support (“HEMS” or “MESH” Ascertainable Standard)
  - Discretionary or mandatory income distributions
  - Additional distributions made by independent Trustee for purchase of a secondary residence, the purchase of investment real estate, to be invested in a business that the beneficiary is or will become personally actively involved, or for the purpose of reducing the trust’s income tax liability.

Trusts for Descendants or other Relatives

Trusts seem restrictive, how do we give the beneficiary back some power and control?

- Allow the beneficiary to become Co-Trustee or sole Trustee at a certain age
- Grant the beneficiary a power of appointment to control the disposition of the Trust upon their death
  - This can be very broad → to any individual or charitable organization
  - This can be limited→ only to descendants

Which States Have an Estate Tax?

- Washington
- Oregon
- Minnesota
- Iowa
- Nebraska
- Kentucky
- New York
- Hawaii
- Massachusetts
- New Jersey
- Vermont
- Maryland
- District of Columbia
- Illinois
- Pennsylvania
- Rhode Island
- Maine

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Tax Issues To Note

Consider the following when contemplating gifts during life vs. bequest upon death:

- Income Tax Basis Adjustment
- Valuation Date
- Proposed Tax Law Changes

Income Tax Basis Adjustment

If an asset is gifted during life, the beneficiary ("Donee") receives the asset with the Donor's basis ("Carryover Basis").

Upon death, the Decedent's property receives a tax "**Basis Adjustment**" (either a step-up or a step-down in basis) to the FMV as determined on the date of the Decedent's death.

The Basis Adjustment of the Decedent's assets will be used to determine the amount of gain or loss recognized by the Estate or by a beneficiary of the Estate when the asset is later sold or exchanged in a taxable event.

Valuation Date

Assets will be valued either as of:

- The Decedent’s date of death (“DOD”), or
- The alternative valuation date (“AVD”).

The AVD is six months following the Decedent’s DOD. The AVD can only be used if it would result in a savings in federal estate taxes.

If elected, the AVD must be used in valuing all of the assets of the gross estate of the Decedent. Cannot pick and choose the assets to be valued as of the DOD or as of the AVD.

Can be a conflict between wanting to minimize taxes by selecting AVD, but wanting to get a greater basis with DOD value.

Proposed Tax Law Changes

Biden Administration wanted to change tax laws as follows:

- Repeal the Basis Adjustment provisions of the Internal Revenue Code, so the Estate and its beneficiaries would take the Decedent's basis in the assets ("Carry-Over Basis" not Stepped-Up Basis);
- Taxation of capital gains at the ordinary income tax rate;
- Increase the maximum federal gift, estate, and GST tax rates from 40% to 45%;
- Reduce the federal estate tax exemption to $3,500,000 or change it back to $5,000,000 indexed for inflation earlier than the end of 2025; and
- Reduce the federal gift tax exemption to $1,000,000.

Federal Gift Tax

- What is a gift tax?
- Is there a gift tax in Washington?
- What is subject to the federal gift tax?
- What about the $17,000 annual exclusion?
- What is the annual exclusion for married couples?
- Are there any deductions?
- What about medical and educational expenses?
- What is a death bed gift?
- Are gifts of all assets created equal?

What is an ILIT?

Many individuals own life insurance policies on their own lives for the benefit of their spouse, children, or other individual beneficiaries. The death benefit on a life insurance policy of a deceased person is includable in their estate for estate tax purposes.

Because the individual who owns the policy on their own life does not need the asset during life, certain life insurance policies can be a great asset for the insured to gift during their life. One way to do this is to gift or sell the policy to an Irrevocable Life Insurance Trust ("ILIT") for the benefit of the insured's spouse, children, etc.

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What is a QPRT?

If an individual is considering transferring a residence to a beneficiary during life, a Qualified Personal Residence Trust ("QPRT") or "House Trust" may be a good option.

With this tool, the individual transfers the residence to the QPRT and retains the right to live in the house for a term of years. The donor is basically making a gift of their remainder interest in the residence, which is a fractional interest in the FMV of the residence and ultimately allows the individual to transfer the residence out of their estate for estate tax purposes with a discounted estate tax exemption reduction.

What is a GRAT?

If an individual wants to freeze their estate rather than reduce it, a GRAT may be a good option.

A GRAT is an estate freezing technique. It allows the donor to gift assets, but still benefit from them.

The Grantor transfers assets to a GRAT and retains the right to receive a fixed annuity for a term. At the end of the term, the remainder beneficiaries receive the remaining trust principal and income.

During the Trust term, the Grantor pays the Trust income taxes.

What is a zeroed-out GRAT?

Gift taxes are generally due when the Trust is created; however, this may be avoided by creating a “zeroed-out” GRAT.

When creating a zeroed-out GRAT, the donor makes a contribution to the GRAT and the annuity is fixed to return the entire contribution to the donor. In this scenario, there is no gift tax liability.

Why do this if everything is just going to come right back to you? When you have an asset that you expect to rapidly increase in value in the future.

Generally, better to create a GRAT when interest rates a low.

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Charitable Lead Trusts

A **Charitable Lead Trust** ("CLT") is established for the benefit of a charity for the life of the donor or for a term of up to 20 years. The charity receives a regular income stream (annuity or unitrust) during the trust term. At the expiration of the trust term or at the donor's death the remaining trust assets pass to Donor's remainder beneficiaries.

CLAT – pays the charitable beneficiary an annuity equal to a specified dollar amount or a specified percentage of the initial trust value.

CLUT – pays the charitable beneficiary a specified percentage of the value of the trust as determined annually.

- Donor receives an income tax deduction, when CLT is established.
- Donor is deemed to make a gift to the noncharitable beneficiaries.
- Donor pays the income tax on income accruing to the CLT during its term.
- Assets in CLT are excluded from Donor's gross estate for estate tax purposes.

Charitable Remainder Trusts

A **Charitable Remainder Trust** (“CRT”) is established for the benefit of the donor for life or for a term of up to 20 years. The donor receives a regular income stream (annuity or unitrust) during the trust term. At the expiration of the trust term, or at the donor’s death, the remaining trust assets pass to a charity.

CRAT – pays the donor an annuity equal to a specified dollar amount or a specified percentage of the initial trust value.

CRUT – pays the donor a specified percentage of the value of the trust as determined annually.

- Donor receives an income tax deduction equal to the value of the remainder interest that ultimately will pass to charity.
- Assets transferred to a CRT are excluded from Donor’s gross estate for estate tax purposes.

Qualified Domestic Trust ("QDOT")

The unlimited marital deduction is only allowed when the Surviving Spouse is a US citizen. If the Surviving Spouse not a US citizen, a Trust for the Surviving Spouse must have certain additional provisions that allow it to qualify as a QDOT in order to defer estate taxes:

- At least one Trustee must be an US citizen or a domestic corporation.
- If QDOT value exceeds $2M, at least one Trustee must be a US bank, the Trustee must post a bond with the IRS equal to 65% of the FMV of the property transferred to the Trust, or the Trustee must give the IRS with a letter of credit of 65% of the FMV of the property transferred to the Trust.
- No distribution (other than income) can be made unless the Trustee has the right to withhold from the distribution the tax on distributions under IRC 2056A .

QDOTs are not exempt from estate tax, they are a means to defer tax.

Family LLC

A family LLC is generally an entity that is established and funded by the parents with a large asset that is difficult to divide and/or value (real property).

There will be restrictions on how/when a members can transfer their interest in the LLC. These types of restrictions create **a lack of marketability**.

There will also be restrictions on how decisions are made (usually majority vote). So, if a person has a minority interest in the family LLC, they **lack control of the LLC**.

The value of the Family LLC is usually discounted for **(1) a lack of marketability, and (2) a lack of control (minority interest)**. Those discounts combined with the valuation fluctuation of the underlying asset, can significantly reduce the taxable value of the Family LLC interest that is being transferred to the next generation.

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