THE BASICS OF ESTATE PLANNING

Webinar: May 28, 2020

A. Essential Estate Planning Documents

1. Durable Power of Attorney

A Durable Power of Attorney ("DPOA") designates a third party to take action and make decisions on the maker's behalf. Before launching into the details, there are some basic terms to understand. The maker of a DPOA is called the "Principal" and the person granted the authority to act on the Principal's behalf is called the "Attorney in Fact" or "Agent."

There are several key characteristics to a DPOA.

First, from an estate planning perspective, it is critical that the power of attorney is "durable," as it ensures that the authority granted under the DPOA is not terminated by the Principal's incapacity. There are several reasons outside of estate planning why a person might execute a power of attorney where it would be desired that the Attorney in Fact's authority would terminate if the Principal became incapacitated. In estate planning, however, ensuring that the Attorney in Fact can continue to act on behalf of the Principal if the Principal becomes incapacitated is one of the main purposes of creating a DPOA.

Second, on a similar note, a DPOA can be effective either immediately or only upon the incapacity of the Principal. If the DPOA is effective immediately, the Attorney in Fact can act on behalf of the Principal immediately (i.e., open a bank account in the Principal's name), regardless of whether the Principal retains capacity to take such actions on his or her own behalf. Conversely, if the DPOA is only effective upon incapacity, the Attorney in Fact must get proof from a doctor or the Principal's attending physician that the Principal is incapacitated before taking any action on the Principal's behalf.

There are pros and cons to either option for when the DPOA becomes effective. If the DPOA is only effective upon incapacity, it ensures that the Principal retains control to make decisions and take actions regarding his or her affairs. However, in instances where it would be beneficial for the Attorney in Fact to take power, it could be difficult to the prove the Principal is incapacitated if her or she is suffering from a "slow" onset disease (i.e., dementia). A DPOA only effective upon incapacity may also present an issue if a quick decision needs to be made and no doctor is available to declare the Principal incapacitated. On the other hand, if the DPOA is effective immediately, the Principal gives up a measure of control over their own affairs while he or she is still able to manage them, but the issue of when the Attorney in Fact is allowed to act on the Principal's behalf is avoided.

DPOAs deal with two main areas of decision making: (1) asset management (financial affairs), and (2) health care decisions. A Principal can make a joint DPOA that contains provisions relating to asset management and health care decisions, or two separate DPOAs, one for each area of

decision making. One main reason for making two separate DPOAs is if the Principal wants to designate different Attorneys in Fact for making asset management decisions than for making health care decisions. Additionally, there is a level of retained privacy by making two separate DPOAs, where the Principal's medical team is not given access to who is designated to make financial decisions for the Principal, and vice versa for the Principal's financial team.

Within these two overarching areas of coverage, there are several specific powers a Principal may grant or withhold from his or her Attorney in Fact. These powers include, but are not limited to: dealing with real property, accessing bank accounts, buying and selling stock, enforcing contracts, filing tax returns, making gifts, consenting to medical procedures or treatment, the administration of drugs, and consenting to the withdrawal of life-sustaining care or services. Due to living our lives increasingly online in the digital age, it is important to ensure that an Attorney in Fact also has the specific power to access and manage digital assets and records.

2. Health Care Directive (Living Will)

A Health Care Directive states your wishes regarding the administration, withholding, or withdrawal of life-sustaining treatment if you are in a terminal or permanent unconscious condition. Under the law, every person has the right to refuse or request the withdrawal of medical treatment; a Health Care Directive memorializes those wishes so that they may be enforced by a third party if you are unable to do so for yourself.

This form is closely related to a DPOA for Health Care as it would fall to the Health Care Attorney in Fact to enforce the wishes as stated in the Health Care Directive.

It is recommended that a copy of the executed Health Care Directive be given to your primary care physician to keep in your file, so that it may be easily accessed if and when needed.

3. Last Will and Testament

A Last Will and Testament ("Will") is a document directing the disposition of property at the Testator's death. The Testator is the maker of the Will. In essence, a Will is simply a statement of wishes of how the Testator wants his or her property divvied up at death. A Will is not operative until the Testator dies, i.e., the terms of the Will have no legal effect while the Testator is living. Even after death, a Will conveys no legal rights to any of the Testator's property until it is "proven." A Will is proven in a process called "probate" (discussed below). Once a Will is proven, it only governs the disposition of probate assets. Any assets owned by the Testator outside of probate will not be governed by the Will, but by some other document or agreement (discussed below).

There are several key characteristics of Wills.

First, a Will identifies the Testator's family and beneficiaries. If a Testator wishes to specifically exclude any relative from inheriting his or her property, that will also be included in the Will. If the Testator has minor children, the Testator may also nominate a guardian or guardians in the Will for such children.

A Will also designates an Executor of the probate assets ("estate"). In Washington, the Executor is called the Personal Representative ("PR"). The PR is in charge of administering the Testator's estate: locating all of the assets, paying off outstanding debts, filing final tax returns, filing estate tax returns (if applicable), and making final distributions to beneficiaries.

As stated above, the main function of a Will is the disposition of property. The Testator may give property outright to a beneficiary or may place the property in trust. If the property is put in trust, the Will contains the terms that govern the trust: how long will the assets remain in trust, for what purposes can distributions be made from the trust, who will administer the trust (the "Trustee"), and who will get the trust assets if the beneficiary dies before the trust terminates.

On a related topic, Wills also contain important tax planning provisions. Federally and in Washington, there is an estate tax imposed on assets passing at death over a certain amount. Wills usually contain provisions to minimize the imposition of estate taxes, and also how such taxes will be paid if the estate is subject to estate tax.

4. Revocable Living Trust

A Revocable Living Trust ("RLT") is a type of trust used in place of a Will in order to direct the disposition of assets at death. The creator of a trust is called the "Grantor" or "Settlor," and the administrator of a trust is called the "Trustee." As the name implies, an RLT is revocable, meaning the Settlor can change or terminate the RLT at any time. Before discussing RLTs, we will provide the basics of trust for context.

A trust is two distinct things: (1) a fiduciary relationship; and (2) a governing agreement. The "trust" is a fiduciary relationship created when the Settlor gives the Trustee the right to hold and administer assets for the benefit of the beneficiaries. The "trust agreement" is the document that sets forth the terms of the fiduciary relationship.

An RLT is a type of trust that "lives" with the Settlor. The Settlor transfers all of his or her assets to the RLT and names himself or herself as Trustee of the RLT. The RLT contains provisions for the administration of the assets during the Settlor's lifetime, and also for the distribution of the assets at the Settlor's death. There are several pros and cons of using an RLT, rather than a Will, as the main tool for the disposition of assets at death.

On the positive side, an RLT provides for the centralized management of the Settlor's assets during life. If the Settlor acting as Trustee becomes incapacitated, the named successor Trustee can immediately step in and continue the administration of the assets. This negates the need for a DPOA, and also, if the Settlor has kept good records, allows for a more seamless transition of management. An RLT can also provide a degree of privacy during life, and at death. If the Settlor names a third party to serve as Trustee, the Settlor removes his or her name from the ownership of the asset, without losing control of that asset, Additionally, there is more privacy regarding the distribution of assets at death, as assets held by the RLT avoid probate, meaning there is no court involvement in the distribution of assets to the beneficiaries. Avoiding probate can also make the administration and distribution of assets at the Settlor's death speedier and more efficient.

On the negative side, an RLT only governs the distribution of assets that it holds. If the Settlor failed to transfer all of his or her assets to the RLT, probate may still be required to deal with those assets. As such, an RLT is never used as a stand-alone but is always accompanied by a Will, just in case. Additionally, an RLT requires more administration during the Settlor's lifetime to ensure all assets are properly titled, and any disposition or acquisition during life is properly structured to and from the RLT. The initial creation and funding of an RLT can also be more costly than making a Will.

B. The Probate Process

The term "probate" refers to a judicial process by which a Will is proved valid by the court and accepted as a legal instrument that can be enforced by the executor. In probating a Will, an executor is given legal authority to act on behalf of the decedent's estate, or "probate" assets. The probate process also allows for the appointment of an executor where no Will exists.

1. Who Is Entitled to Act as Personal Representative or Administrator?

Those individuals or professional fiduciaries who are named in a decedent's Will are, in order, entitled to petition the court to be appointed as personal representative. If a named individual has died or declines to act, the next appointee in line may petition to be appointed. If a decedent was married at the time of his or her death, a surviving spouse, even if not named in the Will, is entitled to serve as the personal representative of the decedent's community property.

In Washington, in the absence of a Will naming an personal representative, the following people have the authority to petition to be appointed as the administrator of a decedent's estate: (1) surviving spouse or state registered domestic partner; (2) next of kin in the following order: children, parents, siblings, grandchildren, nephews, or nieces; (3) a fiduciary such as a trustee that controlled substantially of the decedent's assets at death; (4) a beneficiary; (5) the director of revenue or secretary of the department of social and health services; and (6) a principal creditor.

If a Will existed at death, the legally appointed fiduciary is the personal representative. Where no Will existed, the fiduciary is referred to as the administrator. In either case, the appointed legal representative must swear an oath, and is prevented from acting as personal representative or administrator if they are a minor, if they are of unsound mind, or have committed a felony or a misdemeanor involving moral turpitude (e.g., fraud).

2. When Is Probate Required?

In Washington, probate is required if the decedent owned: (1) $100,000 or more in personal property (i.e., cash, securities, cars, personal belongings, etc.) in his or her name; or (2) owned any real property (real estate) in his or her name.

If the amount of personal property owned by the decedent falls below $100,000 and no real estate was owned, there is a non-judicial process for claiming those assets using a "small estate

affidavit". This process still relies on an understanding of the decedent's heirs and who is entitled to claim the property.

3. Proving the Will

The Will, if any, is submitted to the superior court with pleadings and testimony regarding its validity. In Washington, a will is valid if it is attested to by two competent witnesses. When the Will is submitted to the court, testimony (either written or oral) must be provided by the witnesses regarding the execution of the Will, including the identity and competency of the testator at the time the Will was signed. This is generally done by an affidavit signed by the witnesses, either at the time the Will was signed or upon the death of the testator (the former being much easier than the latter, as it could be years later that the testator actually dies).

4. Where Does The Probate Get Opened?

All superior courts in the State of Washington have the authority to hear probate matters, both for decedents who died in state (whether or not they were Washington residents) and for decedents that died out of state but had property in Washington. It is not necessary to open a probate in the county where the decedent died; rather, the probate can be filed in any superior court in any county in the state. Specifically, probate matters are handled in Ex Parte court, which is a subsection of the superior court that deals with particular subject matters, such as probate and family law.

5. Letters Testamentary and Non-Intervention Powers

If the court admits the Will as valid, or acknowledges the fact there is no will, the petitioner is then appointed as the personal representative, or administrator, respectively, of the decedent's estate. This is done by court order, which then directs the court clerk, upon the filing of the individual's oath, to provide the appointee with Letters Testamentary. This document provides the legal authority for the personal representative to act on behalf of the decedent's estate, and to manage the assets (and are called Letters of Administration for an intestate estate). Anyone holding assets belonging to the decedent will generally require a certified copy of the Letters to show that the PR or administrator has authority to take control of such assets on behalf of the estate.

Under Washington law, a personal representative may be granted "non-intervention powers," either by the testator or by the court. Probate can sometimes be a time-consuming and expensive process because all actions of the personal representative must be overseen and approved by the court. Non-intervention powers allow for the personal representative to administer the estate without court intervention until the end, when a record and accounting of the personal representative's actions is filed and the personal representative is thereafter discharged.

C. <u>How Assets Are Distributed in the Absence of a Will</u>

The distribution of assets at death is usually governed by the property owner's Will. There are circumstances where a Will does not control the distribution of assets at death (e.g., beneficiary

designations) (discussed more below). Outside of those situations, what happens when the property owner ("decedent") dies without a Will?

A person that dies without a Will is said to have died "intestate," and the laws of intestacy govern the distribution of his or her assets at death. In such a situation, the distribution of the decedent's assets is governed by state law. The laws of the state where the property is located, usually the state where the decedent resided at death, will control the distribution of each specific asset. In Washington, the intestacy laws are contained in RCW 11.04.015. The following discussion will be limited to Washington law.

Washington's intestacy law first deals with the portion distributable to the decedent's surviving spouse. If there is a surviving spouse, he or she will receive all of the decedent's share of the community property. The division of the decedent's separate property depends on the decedent's other surviving family members. If the decedent is survived by children or more remote descendants, the surviving spouse will receive one-half of the decedent's separate property. If the decedent does not have any surviving children or more remote issue but is survived by a parent or a child or more remote issue of a parent (e.g., sibling, niece, nephew, etc.), the surviving spouse will receive three-fourths of the decedent's separate property. If the decedent is not survived by any children or more remote descendants, parents, or children or more remote descendants of a parent, then all of the decedent's separate property will be distributed to the surviving spouse.

After making distributions to the surviving spouse, if any, the remaining property, or all if there is no surviving spouse, is distributed in the following order of priority. First, to the decedent's children or more remote descendants. The division of the shares distributable to the decedent's children or more remote descendants is governed by the rule of "representation."

The rule of representation requires the state to identify the family line of each child of the decedent, and then the member or members of each family line in the closest degree of kinship to the decedent. If, for example, the decedent had three children, A, B, and C, who all survived the decedent, each of A, B, and C would receive a one-third share of the property as each them is the member of their family line in the closest degree of kinship to the decedent. How would the shares be distributed, however, if A was still living, B was deceased with two children, D and E, and E was deceased with three children, X, Y, and Z, and C was deceased with no living children or more remote descendants? In such a situation, the first inquiry is which of the decedent's children are still living or are deceased with descendants still living: A (still living) and B (deceased, with living descendants). Thus, the decedent's remaining property will first be distributed into two equal shares. The share for C lapses (fails), and is redistributed equally to the share for A and B's family lines. The share set aside for A is distributed to him or her. B's share must be further divided by the rule of representation. B had two children, one of which is still living (D) and one of which is deceased with living descendants (E), thus B's share is divided into two equal shares. One share is distributed to D. The other share is distributed in equal shares to E's children X, Y, and Z.

If the decedent does not have any surviving children or more remote descendants, the remaining property is distributed to his or her parent or parents. If neither of the decedent's parents are living, the remaining property is distributed to the other children or more remote descendants of the decedent's parents, with shares determined by the rule of representation. If none of the other children or more remote descendants of the decedent's parents are living, the remaining property is distributed to the decedent's grandparents. If both maternal and paternal grandparents survive, one-half is distributed to the surviving maternal grandparent or grandparents, and one-half is distributed to the surviving paternal grandparent or grandparents. If none of the decedent's grandparents are living, the property will be distributed to the children or more remote descendants of the decedent's grandparents, with one-half being distributed to the descendants of the maternal grandparents and one-half distributed to the descendants of the paternal grandparents. The division of the shares among the descendants of each grandparent group is governed by the rule of representation.

If the decedent is not survived by a spouse, nor children or more remote descendants, nor parents or children or more remote descendants of parents, nor grandparents or children or more remote descendants of the grandparents, the decedent's property escheats to the state. In this situation, the decedent is deemed not to have any heirs, and any property subject to the state's laws passes to the state. In practice, in Washington, the Department of Revenue is given authority to deal with the property, which it will normally sell with the proceeds being placed into the common school fund.

D. Non-Probate Assets

These assets are increasingly common and generally form a significant part of individuals' estates and their net worth. Non-probate refers to the fact that these assets pass outside of the probate process and are not subject to the personal representative's control or disposition according to the terms of the decedent's Will or Trust.

Common examples of non-probate assets include:

- Retirement plans, such as 401(k)s, IRAs (traditional and Roth), 403(b)s, and others
- Life insurance
- Annuities
- Trusts
- Transfer on death accounts or deeds
- Assets titled as joint tenants with right of survivorship

1. Beneficiary Designations

Assets with a beneficiary designation will pass immediately on the death of the owner to the primary beneficiary listed on file with the financial institution or plan administrator. If the primary beneficiary predeceased the owner, the asset will pass to the contingent beneficiary, if any.

Where no beneficiary has been named, the contract or agreement that governs the asset will generally have a default beneficiary, such as a surviving spouse or the decedent's estate. In cases where the estate is named or ends up as the beneficiary through default, the asset become a probate asset subject to the control of the personal representative.

Not naming a beneficiary or failing to update a beneficiary can have significant and unintended consequences. For example, a divorce does not automatically remove an ex-spouse as the beneficiary of a non-probate asset; that particular beneficiary designation must be updated to avoid a situation where the ex-spouse inherits the entire asset if he or she survives the decedent. Many retirement plans require the consent of a spouse in order to name a non-spouse beneficiary as the primary beneficiary.

2. Non-Probate Asset by Reason of Title

An asset can also transfer outside of the probate process by the way the asset is titled. For example, some accounts may be considered by a married couple to be jointly owned as community property, when the account is in fact titled as "joint tenants with right of survivorship." If community property, upon one spouse's death, each owns one-half of the asset; the decedent may choose to dispose of his or her one-half as he or she sees fit. In contrast, if in fact a JTWROS account, upon the death of one of the owners, the entire account immediately vests in the survivor and is not subject to the terms of the decedent's Will. This is also true for accounts or deeds to real property that are "transfer on death."

These titling schemes can be useful estate planning tools, particularly if the goal is to avoid a probate proceeding altogether. However, they must be carefully examined to ensure there no unintended consequences. In addition, titling assets in this manner can prevent some types of more sophisticated estate planning techniques surrounding estate taxes that are beyond the scope of this presentation.

3. *Non-Probate Assets and Estate Administration*

Although the personal representative may not have any legal authority to manage or dispose of these non-probate assets, the personal representative must account for their existence and include them in any calculation of the decedent's overall estate. These assets, although they pass outside the probate process, are included the decedent's estate for purposes of calculating estate tax liability. In addition, any non-probate assets can be held liable for their pro-rata shares of the estate administration expenses and any taxes.

E. <u>Guardianship of Minor Children</u>

In a situation where all legal guardians are deceased or incapacitated (whether that is both parents, or one parents with all parental rights), a new guardian must be appointed and approved by the court to care for a minor child. Washington law provides that this may be done by will or by durable power of attorney, with any conflict between the two being resolved in favor of the

most recently executed document. Individuals nominated by will or durable power of attorney must nevertheless be confirmed by the court as appropriate guardians.

There are two types of guardian for a minor child, which roles may be undertaken by the same person or by different people. The first is the guardian of the person, who is responsible for making all personal decisions related to the care of a minor child: where the child lives and goes to school, ensuring the child receives appropriate medical care, and with whom the child socializes. The second is the guardian of the estate, who is responsible for managing any assets of the child (for example, if the child's parents are deceased, any money that the child inherited). A guardian of the estate may not be necessary in circumstances where parents set up a trust for their children under their testamentary documentary. In that case, the trustee would act in the same capacity as a guardian of the estate.