Foundations of Estate Planning – What Your Clients Need to Know

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A.

B. WHY DO YOUR CLIENTS NEED AN ESTATE PLAN?

1. Appointment of Guardians for Minor Children

If the client has minor children, an estate plan is the only way to specify who is to serve as the personal guardian for the children in the unfortunate circumstance that the children are orphaned before they have reached the age of 18. If the client is a single parent, establishing a guardian is particularly important. The client may have particular reasons why he or she would prefer that a specific person or persons should serve as the personal guardians. An estate plan that prepares for the unfortunate situation of both parents dying can accommodate the client's wishes as to who will be the personal guardian of the children. This also avoids conflict between the families of the deceased parents.

2. Asset Distribution

Perhaps the most obvious reason an estate plan is necessary is to delineate how the client would like his or her assets to be distributed. By having an estate plan, clients can specify exactly who gets which assets or what portion of their estate is distributed to which individual or charity. Every client likely will have different wishes on how much his or her estate should go to the spouse and children, if any. The client may also wish that portions of his or her assets go to other family members, such as an elderly parent or a niece, nephew, or grandchild. Perhaps the client would like a portion of their assets to transfer to the community church or to some other charitable or non-profit organization that holds a special meaning to the client. An estate plan can accommodate all of these varying wishes. In addition, when direction is given as to asset distribution, it makes probate a smoother process. Moreover, having an estate plan limits the cost of transferring assets to beneficiaries.

3. Health Care Instructions

The need for an estate plan that includes health care instructions is more essential than ever. Unless the client has been living in a cave for the past several years, he or she likely recalls the ugly litigation involving the health care of Terry Schiavo. Although death is inevitable, the manner in which it will occur cannot be anticipated. As the Terry Schiavo case illustrated, problems arise as to what sorts and how much health care should be administered when an individual becomes incapacitated and unable to make or communicate his or her wishes to health care providers. By creating an estate plan, an individual can provide specific instructions on what types of health care, and how much care, should be administered to them, and allows that individual to designate someone to authorize those decisions.

4. Management of Personal Business Affairs

The disability or death of the client does not have to mean that the operation of the client's business necessarily will be thrown into disruption. Just as an estate plan can facilitate a seamless transition of the client's personal affairs, an estate plan can also provide for an orderly succession and continuation of the clients business affairs, by spelling out what will happen to the client's interest in the business upon his or her incapacity or upon passing.

5. Estate and Income Tax Issues

An essential concern of the client will likely be minimizing the tax implications of the transfer of the client's assets upon death. In addition to the client's estate, itself, being subjected to taxes, the beneficiaries may be taxed on the assets transferred to them as income. A well-conceived estate plan can limit exposure to estate and income taxes as much as is allowed by law, thus saving more of the estate for the beneficiaries.

6. Probate Issues

In some circumstances, an estate plan can avoid the necessity of putting the client's family through the hassles of probate, which can be quite lengthy. In all other circumstances, having an estate plan can often prevent the probate process from becoming a long, drawn out, tangled web of confusion. Probate is only avoided in cases where a revocable trust is established, not in cases where the client just has a will.

Having an estate plan relieves the family, already burdened with having to deal with the loss and plan the funeral, from having to figure out how to distribute the assets. Furthermore, avoiding the costs of probate preserves more of the client's assets for his or her beneficiaries.

C. WHAT HAPPENS IF YOUR CLIENTS DO NOT HAVE AN ESTATE PLAN?

1. Intestate Probate

Even though the client may not have made plans for how the client's assets would be distributed upon his or her death, those assets must nevertheless be distributed upon the client's death. Because the client never expressed his or her wishes – either through a will, trust, or some other method, such as through insurance, pension benefits, or titling the assets under some form of joint ownership – the client will effectively be leaving to the state's intestacy laws the decision of how and to whom the client's assets should be distributed.

Essentially, the law will make certain assumptions about how the client likely would have wanted his or her assets to be distributed. These assumptions might not comport with what the client would actually have wanted. For example, the law of intestacy generally favors "blood" relations over "marital" ones. Thus, the law of intestacy might end up transferring assets to the client's children, contrary to what the client may have wished because, for example, the client's

children are already well-off and the client would have preferred to distribute more of his or her assets to a "favorite nephew" who needs the assets more than the children.

2. Heirship Issues

If your client dies without a will or other valid estate plan in place, they are said to die intestate. The decedent's estate will then be divided according to the state's laws of intestate succession. The state will only recognize the decedent's relatives as potential beneficiaries of his or her estate – no friends, unmarried domestic partners or charities will be recognized. The state will divide the property among the decedent's surviving relatives according to a formula that is established by statute. If the decedent does not have any relatives, the estate will then go to the state.

Therefore, if a client dies without a will, they are taking the risking that their desired beneficiaries may not be the actual recipients of the estate.

3. No Guardians for Children

If your client dies without a valid will in effect and leaves behind minor children with no guardian in place, the parent has no choice as to the physical custody of the children or the management of the children's assets. There may be arguments on either side of the children's biological families as to who would be the best physical guardian of the children. In addition to custody issues, the state will appoint a conservator to manage the orphaned children's assets until they reach the age of majority.

There are several concerns with having a court-appointed conservator handle an orphaned child's finances. First, the assets will only be held by the court until the child reaches the age of majority, which is just 18 in Minnesota. Many parents would prefer that their children not receive a substantial amount of money until they reach a more mature age, or that the money be

released only for certain expenses, such as education. Second, the child's assets will likely end up being held in a standard savings account where it will not earn much interest. A more experienced financial planner would probably be able to better invest the child's assets. In addition, as with any amount of funds held for another, theft is a common concern. Choosing someone known to the family to be conservator is often a much better route.

The solution to these concerns: encourage your clients to think carefully about whom they would want to entrust their children to, speak to the person about it, and then name a guardian and an alternative guardian for minor children.

D. BASIC ESTATE PLAN

1. Will

A will is a testamentary document that provides for the transfer of property that is not effective until the death of the person executing the will, called a testator or testatrix. Different states require differing formats of wills. For instance, some states will accept a handwritten will, called a holographic will. In Minnesota, such a will is only acceptable is it is witnessed and signed by at least two other people.

The requirements for a valid will in Minnesota are:

(1) The testator must be of the age of majority, which is 18 in Minnesota and most states.

(2) The testator must be of sound mind and memory, which means that he or she must have the testamentary capacity to understand the full nature of the document he or she is signing.

(3) The will must be in writing, signed by the testator, and witnessed and signed by at least two other people.

A will that is validly executed according to the above requirements will remain in effect until it is revoked or superseded by a new will. Individual provisions of the will can be changed at any time by a codicil. A will is also the only way an individual may appoint a guardian for his/her minor children in the event of both parents being terminated. It is also suggested that the signatures of the testator/testatrix be separately notarized, making the will a "self-proved" will. This eliminates the need to locate the witnesses to testify at the passing of the testator/testatrix.

2. Health Care Directive

A health care directive generally serves two purposes. First, a health care directive designates an agent to make health care decisions for the client in the event that the client becomes incapacitated and is either unable to make those decisions, or is unable to communicate those decisions. Second, a well-drafted health care directive specifies the client's requests, preferences, and instructions regarding what sorts of care and treatment should be administered in the event the client is incapacitated in a way that he/she is unable to make or communicate those decisions.

Appointing an agent affords the advantage of the agent being able to consider the circumstances of the situation for the client, and make decisions for the client which were most likely not contemplated at the time of the drafting of the directive. The advantage of expressing desires for specific types of medical treatment and desires to not undergo specific types of medical treatment is that the client can be assured that, in the event that the agent also becomes incapacitated and unable to make the decisions, the client's wishes will still be accessible in the written directive. Certainly, if the client prefers the approach of appointing an agent, it would be good advice to recommend that the client back-up that approach with a directive giving written

instructions for specific types of situations. The client can also give instruction as to religious beliefs to be followed and desired funeral arrangements as well.

3. Power of Attorney

A power of attorney is a document that allows an individual to appoint another or an organization to handle his/her individual financial and/or business affairs if he/she is unavailable or unable to do so. A person who is a competent adult may, as principal, designate another person or an authorized corporation as the person's attorney-in-fact by a written power of attorney. Minnesota law governs the creation of a power of attorney, specifically[1]. A power of attorney terminates at the time of death of the principal or at the time the principal becomes legally incapacitated, if the power of attorney does not specifically provide for the continuation of the power in the event of incapacity thus constituting a *durable power of attorney*. The power of attorney is validly executed when it is dated and signed by the principal and, in the case of a signature on behalf of the principal, by another, or by a mark, acknowledged by a notary public.

a. General Power of Attorney

An attorney-in-fact under a general power of attorney may act on behalf of the individual in a variety of different situations. There is a basic statutory short form power of attorney form that allows the attorney in fact to handle all or some of the following powers: real property transactions; tangible personal property transactions; bond, share, and commodity transactions; banking transactions; business operating transactions; insurance transactions; beneficiary transactions; gift transactions; fiduciary transactions; claims and litigation; family maintenance; benefits from military service; and records, reports, and statements. Minn. Stat. § 523.23. The client may choose to craft a custom durable power of attorney, which, in addition to the powers listed in the previous sentence, allows the attorney-in-fact the ability to take on duties, including

but not limited to creating and or funding trusts, handling employee benefits, and expressing preferences in the instance of need for a guardian or conservator for the principal. A custom general durable power of attorney can also be created to be effective only upon the principal becoming incapacitated. The term "incapacitated" needs to be clearly defined in this instance. This would be called a "springing power of attorney."

b. Limited Power of Attorney

An attorney-in-fact under a limited power of attorney is authorized to act on behalf of the individual only in specific situations.

c. Utility of a Power of Attorney

A power of attorney is a useful tool for increasing the efficiency of estate settlement, particularly so with a general power of appointment.

Tax Matters: The completion of Internal Revenue Service Form 2848 authorizes an attorney to deal directly with the Internal Revenue Service with regard to a decedent's tax matters. With this document, an attorney can perform any and all acts that the client can.

[1] Minn. Stat. § 523.01.