

# Wills & Trusts

U.S. Navy / Joshua Adam Muzzo



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**I**n our many years of serving as estate planning attorneys in Hampton Roads, Va., we have had the pleasure of helping hundreds of military families with their estate planning needs. Military families are unique and they require an estate plan that specifically addresses their special circumstances. It has been our experience that the Revocable Living Trust, as the foundation of a comprehensive estate plan, best serves the needs of military families. I will share with you the reasons why this is oftentimes the case.

## Wills vs. Trusts

Almost all military families will visit the J.A.G. office for help with their estate planning needs and most often the estate plan provided to them is a will-based plan. These estate plans basically state that all of a decedent's wealth passes outright to his or her spouse and then, upon his or her spouse's death (or if his or her spouse predeceases him or her) the wealth passes to the children. Simple wills are fully legal and valid tools to transfer wealth and, in many situations, they are quite sufficient to do so. However, they are limited in what they are able to accomplish and many families decide they need more than a simple will to accomplish their own objectives.

A Revocable Living Trust (an "RLT") has some aspects that are like a will-based plan. Both wills and RLTs have been used for hundreds of years, both name the persons who will receive the person's wealth and handle the person's affairs at death, and

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both are easy to amend during life. But it is here where the similarities end.

Unlike the creator of a will, the creator of a Revocable Living Trust (the “trustmaker”) names a trustee who is authorized to manage the trust assets on behalf of the beneficiaries while the person is alive. Most trustmakers will name themselves as trustee, thus remaining in complete control of their assets, and they will also be the lifetime beneficiaries of the RLT. However, because a trustee has been named to hold assets of the trust, the trustmaker is able to transfer the trustmaker’s assets into the name of the trust. This is known as “funding” the trust, and it is the essential factor that allows the trust to accomplish its objectives. Let me explain this more fully.

Most clients own the majority of their assets in two ways (1) in joint tenancy with rights of survivorship and (2) in their own individual name with a death beneficiary named (as with life insurance and retirement accounts). These assets have their own built-in estate plans. At death, they will pass to the joint owner or beneficiary outright by operation of law. A will will not control these assets. Accordingly, if passing assets outright to a spouse or beneficiary does not meet a client’s goals, then the client must switch to an estate plan that coordinates ownership and beneficiaries more appropriately.

Changing the title of a bank account, brokerage account or home held in joint tenancy with right of survivorship into the name of a trustmaker and naming the RLT as beneficiary of a client’s life insurance and retirement accounts, forces the assets to pass through the trustmaker’s estate plan. Remember, assets transfer by the way they are owned, and a properly crafted estate plan must control the assets if the estate plan is to work. This coordination of assets with the estate planning document (RLT) is what makes an RLT special and ensures that the assets will transfer properly.

### Estate Taxes

A prime example of how improper ownership of assets interferes with an estate plan is in the area of estate taxation. The estate tax is one of the most egregious taxes the

I.R.S. imposes on citizens, with tax rates approaching 50 percent of a taxable estate. Everything a person owns (homes, land, bank and brokerage accounts, retirement accounts, annuities, personal property, etc.) is subject to estate taxes at death. Even the face value (death benefit) of all life insurance owned by a decedent is included in the person’s taxable estate.

The good news is that every U.S. citizen has a lifetime exemption, whereby they can pass a certain amount of assets to anyone at death or during life estate tax free. These exemptions are currently \$2 million, but under the current law, they are set to return to \$1 million in 2011. If the fair market value of all of your assets is more than the current lifetime exemption, federal estate taxes must be paid on the excess within nine months after the date of death.

Married couples have a unique tax break available to them when it comes to estate tax planning. In fact, Uncle Sam has already done some estate planning for married couples. It is called the unlimited marital deduction. When the first spouse dies, he or she can leave an unlimited amount of wealth to the surviving spouse estate tax free. When the second spouse dies, the estate is entitled to an exemption of \$2 million. So, how much goes to the beneficiaries tax free? \$2 million. Uncle Sam didn’t tell you, however, that the first spouse could also have claimed a \$2 million exemption. If the couple does no estate tax planning prior to the death and merely passes the couple’s assets outright to the surviving spouse at the death of the first spouse, the first spouse’s exemption is lost forever—never to be claimed by the children. If the exemptions are worth \$1 million, the tax loss to the family would approach \$500,000.

If you are married, a properly designed RLT with tax planning provisions (sometimes called the A-B sub-trusts) will allow each spouse to use his/her exemption, give the surviving spouse complete control over all of the assets while alive and pass on to the children up to \$2



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million Estate Tax free (in 2011-currently \$4 million). But this will not be accomplished if the assets pass outright to spouse by joint tenancy with rights of survivorship or through beneficiary designation. This is why the funding of the RLT is so important and why simple wills oftentimes do not work.

### **Probate**

An additional expense and hassle imposed on all will-based estate plans is the probate process. Probate is a state

court-based procedure which is used to validate a will and oversee the estate administration process. It is completely separate from the Estate Tax, which is imposed by the I.R.S. and state taxation authorities. In limited circumstances, this court-based supervision is appropriate. However, we have found that most military families desire to keep their financial affairs quite private and find that avoiding this oftentimes time-consuming and expensive court process to be preferable. Property that is placed in an RLT during a trustmak-

er's lifetime does not pass through the probate process at death. This also makes an RLT much more difficult to attack by disgruntled beneficiaries, than a will is.

### **Unintentional Disinheritance of Children**

We have found that military families are incredibly "closely knit" and the primary focus of most military couples is their children. Unfortunately, many couples are not being informed of a potential threat to their estate planning objectives: unintentional disinheritance of their children. If Tom and Anne hold their assets as joint tenants with rights of survivorship or own assets that pass to spouse by beneficiary designation, upon the death of Tom, Anne will receive those assets outright. If Anne should subsequently marry Doug, there is a substantial risk that Anne will co-mingle the assets with Doug. Then, if Anne predeceases Doug, Doug will automatically receive the co-mingled assets, and Tom and Anne's children will be disinherited. Furthermore, there is a risk that Doug could convince Anne to change Tom and Anne's original estate plan to provide for Doug and/or his children, thereby intentionally disinheriting Tom and Anne's children of some or all of the assets.

This problem is especially severe with blended families. Clients who are in second marriages with children of former marriages need to insure that assets pass appropriately to all of the children at the death of the surviving spouse. However, if assets pass outright to the surviving spouse, there is a good chance that the children of the first spouse to die will be disinherited.

A properly drafted and funded RLT with remarriage protection provisions will insure that both clients' estate planning objectives are achieved. Because the RLT provides irrevocable protections at the death of the first spouse, the trustmakers can insure that the surviving spouse will neither co-mingle the assets with a new spouse nor be able to modify the original estate plan (to the extent they desire to do so).

### **Protecting Your Legacy**

One significant advantage of the RLT is the ability to keep assets in the trust after the trustmaker's death for the benefit of the beneficiaries of the trust. Assets left in sub-trusts for the death beneficiaries are not technically owned by the beneficiaries and assets that are not owned by the beneficiaries may be harder for them to lose. Military couples oftentimes appoint a co-trustee to


serve with their children over their sub-trusts to protect against unwise spending and investing. These sub-trusts also may protect the inherited assets from the children's failed marriages, lawsuits, creditors and other non-family members. Finally, a properly drafted RLT may include special provisions that will protect the government benefits of any special needs children or elder parents upon the trustmaker's death. Accordingly, leaving assets in further trust for beneficiaries is oftentimes preferable to passing assets outright to them, regardless of their age.

### **Disability**

Planning for disability is of great concern to military families. One of the great shortcomings of a will-based plan is that a will only comes into effect when the will maker dies. A properly drafted and funded RLT provides comprehensive disability planning provisions whereby if two doctors certify that the trustmaker is disabled, specifically named disability trustees will step up to manage the trust assets. This will ensure that the trustmaker will not have to go through a guardianship proceeding, what we like to call a "living probate." A proper estate plan must also include a health care power of attorney, whereby a person designates the appropriate person(s) to make medical decisions for the person, and a Living Will, which states a person's wishes in regards to the use of life support procedures to keep a person alive in a terminal condition.

### **Portability**

Portability is one thing military families truly need out of their estate plans. Fortunately, the RLT is an agreement and is thus governed by contract law. As with all agreements, the trust agreement makers may move to any other state and have their agreement made in another state honored. Accordingly, trustmakers may move to any other state without the need to amend the RLT.

As military lives have become more complicated over the years, there is a need to use an estate plan that will provide the flexibility, portability and protection that will-based plans oftentimes do not provide. A Revocable Living Trust is the perfect tool to provide this service to those who have served their country so well for so many years. 

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