Trust & Estate Planning Fundamentals

RCB BANK

Trust

Why you need an Estate Plan

An estate plan allows you to direct how and to whom your property will be distributed after your death. If you own property of any type – homes, cars, bank accounts, investments, collectibles, etc. – then you need an estate plan. If you have no estate plan, your property may be distributed according to state intestacy laws without regard to your wishes or your family's needs.

What is Probate?

Probate is the legal process of administering the estate of a deceased person, resolving all claims and distributing the deceased person's property. A probate court decides the legal validity of the deceased person's will and grants its approval for the Executor/Personal Representative to distribute the assets as directed by the will. If an Executor/Personal Representative has not been named, the probate court will appoint an administrator to perform the same functions. With few exceptions (as in some cases involving minors), probate court documents are public records and the administration of the will may be viewed by any interested party.

Why you need a Will.

A will is a legal document that allows you to direct how your estate will be administered and distributed after death. If you die without a will, a state court will choose an administrator for your estate and, if needed, a guardian for your minor children. The court's choice may or may not be the individuals you would have selected. The court-appointed administrator will distribute your property according to the state's intestacy laws, regardless of any desires you may have expressed during your lifetime. Your children, grandchildren or other heirs who are minors at the time of your death may automatically receive their shares of your estate outright when they reach legal age, whether or not they are experienced enough to manage their inheritance wisely.

It is important to note that certain assets avoid probate, including 401(k)'s, IRA's, Payable-On-Death accounts, insurance policies, etc. because they already have named beneficiaries, and these beneficiaries have precedence over any conflicting instructions in a will or a trust.

Family dynamics and tax laws change continually, so you should review your will regularly to make sure it is still meeting your needs. Once your will is written, you may change, revoke and/or replace it at any time for any reason.

Carefully select your Executor/ Personal Representative

Choosing your Executor/PR

You can name almost anyone you wish as your EX/PR. Just make sure they're up to the task. People who have never served as an EX/PR frequently don't know what they are getting into when they agree to serve – and subsequently find themselves overwhelmed by the duties required of them.

When you write your will, you'll need to name an Executor or Personal Representative (EX/PR). The terms vary state-by-state. This person will administer your estate and distribute your assets to your beneficiaries, as directed by your will.

The EX/PR has numerous duties. They include:

- Presenting the will to the probate court for approval;
- Collecting and providing safekeeping of the estate's assets;
- Notifying creditors and paying all valid debts;
- Collecting anything that is due to the estate;
- Filing claims for retirement, Social Security and veteran's benefits;
- Managing the estate's assets;
- Selling assets to pay estate expenses or legacies;
- Keeping detailed records of all estate transactions;
- Distributing assets to beneficiaries;
- Filing the decedent's final income tax return;
- Filing the state death tax return;
- Filing the federal estate tax return.

Powers of Attorney for Finances & Health Care

Because a will does not become effective until death, it does not provide for a situation in which a person becomes ill or incapacitated. Therefore, everyone should at least consider having a power of attorney for finances and a power of attorney for health care.

A *power of attorney for finances* gives the appointed person the right to conduct broad financial and legal affairs. If the power is a durable power of attorney, it becomes effective when signed and continues to be effective in the event the individual should ever become incapacitated, although it can be modified or revoked so long as the grantor has the mental capacity to do so. (A limited power of attorney, on the other hand, is more restrictive in nature and covers only certain events or circumstances.)

A *power of attorney for health care* gives the appointed person the authority to make health care decisions for the grantor up to and including terminating care and life support. The grantor can typically modify or restrict the powers of the agent to make end-of-life decisions.

Federal Transfer Taxes

Transfer taxes are a key consideration in estate planning. There are three types of federal transfer taxes: estate taxes, gift taxes and generation-skipping taxes.

1. The Estate Tax is a tax on the transfer of property at death. The amount of estate tax depends on the total net value of the property transferred. There are several important deductions that are available to reduce or eliminate the estate tax. The most important are the *unlimited marital deduction* (which allows a person to leave an unlimited amount of assets to his/her spouse, provided the spouse is a U.S. citizen) and the *charitable deduction* (which protects from estate taxes all assets left to qualified charities).

Federal law provides an exemption amount from estate tax that varies from year-to-year, but which is generally large enough to totally protect most estates from the federal estate tax.

2. The Gift Tax is a tax on the transfer of property during a person's lifetime. Several types of gifts are protected from gift taxes, including gifts to spouses who are U.S. citizens, tuition or medical expenses paid directly by an individual on behalf of another person, gifts to political organizations within certain limits and gifts to charities.

In addition to these gifts, an individual may make an annual tax-free gift (the amount varies year-by-year) to as many people as he/she chooses. Under current law, using any of the exemption on lifetime gifts results in a corresponding deduction in the exemption available at death.

3. The Generation-Skipping Tax is a tax on the transfer of property to descendants two or more generations away. Generation-skipping transfers are subject to tax whether outright or in trust. The underlying premise of this tax is that a transfer tax should be imposed at each generational level.

What is a Trust

A trust is simply a legal arrangement that holds assets for the benefit of another.

There are three parties to a trust arrangement:

1. ***Grantor:*** the person who creates and funds the trust;

2. ***Beneficiary:*** the person who receives the benefit from the trust (such as the income from an investment portfolio or the right to use a home);

3. ***Trustee:*** the person or entity who holds legal title to the trust property, administers the trust and has an absolute duty to serve in the best interests of the beneficiary.

There are basically two types of trusts: *revocable* and *irrevocable*. A revocable trust is one in which you can change the terms and the property at any time. An irrevocable trust, on the other hand, cannot be changed or ended except by its original terms.

Trusts

■ *There's a long-held perception that trusts are strictly for the wealthy. However, most trust arrangements can be very straight-forward and are extremely effective.*

Trusts are not just for the wealthy

■ *Trusts can be extremely effective estate planning tools. Whether you're seeking investment expertise during your lifetime, planning for incapacity or looking to control how your assets are distributed after your death, trusts can help you accomplish your objectives.*

Funding a Trust

You can put almost any kind of asset into a trust. The assets you choose to fund the trust will depend largely upon your goals. For example, if you want the trust to grow in value or to produce income, you might fund it with liquid assets such as stocks and bonds. If you want the trust to create a fund that can be used to pay estate taxes or provide for your family after your death, you might fund it with a life insurance policy. Or, if your goal is to avoid probate when you die, you could fund the trust with virtually all of your assets, both liquid and non-liquid.

Advantages & Disadvantages of a Trust?

Potential advantages:

- Trusts may be used to minimize estate taxes for married individuals with substantial assets;
- Trusts can provide management assistance for your heirs (which can be particularly important for minors, for adults who have difficulty managing money or for incapacitated adults who may need support, maintenance, and/or education).
- Properly funded trusts can avoid many of the costs of probate (e.g., attorney fees, documents filing fees, etc.). Also, unlike the probate process, a trust is private and does not become a part of the public record.
- Trusts can minimize income taxes by allowing the shifting of income among beneficiaries;
- Trusts can ensure that assets go to your intended beneficiaries. For example, if you have children from a previous marriage, you can make sure that they, as well as a current spouse, are provided for.
- Contingent trusts for minors (which take effect in the event that both parents die) may be used to avoid the costs of having a court-appointed guardian manage your children's assets;
- Properly structured irrevocable life insurance trusts can provide liquidity for estate settlement needs while removing the policy proceeds from estate taxation at the death of the insured.

Potential disadvantages:

- There are costs associated with setting up and maintaining a trust. Such costs can include attorney fees, trustee fees and filing fees;
- Depending on the type of trust you choose, you may give up some control over the trust assets. (This is the case with many irrevocable trusts);
- Maintaining the trust and complying with recording and notice requirements can be time-consuming;
- Income generated by trust assets that are not distributed to trust beneficiaries may be taxed at a higher income tax rate than your individual rate.

Basic Types of Trusts

- **A Revocable Living Trust is the most basic of all trust arrangements.** The Revocable Living Trust has three primary purposes. (1) It can *provide for the management of assets*. The trustee can manage the assets in the trust or arrange for another individual or professional trustee to manage the assets. (2) It *protects against incapacity*. If an individual, as trustee, can no longer handle his/her financial affairs, a successor trustee can step in to manage the trust property. (3) It *avoids probate*. Unlike property that passes via a will, property that passes by a RLT is not subject to probate.

- **A Credit Shelter (Bypass) Trust is typically used by a married couple to minimize federal estate taxes.** Under this arrangement, an individual bequests an amount to the Credit Shelter (Bypass) Trust up to but not exceeding the federal estate tax exemption. The remainder of the estate is passed to the surviving spouse tax-free under the unlimited marital deduction guidelines. This results in a transfer of all assets from the first to the second spouse totally free of estate taxes.

- **Charitable Trusts are used to leave assets to qualified charities.** There are two basic types: In a *Charitable Lead Trust,* an income stream is paid to a qualified charity for a given period of time. At the end of that period, the remainder of the principle is given back to the donor or the donor's heirs. In a *Charitable Remainder Trust*, the donor or the donor's heirs receive the income stream first, and the charity receives the remainder after the trust terminates. This can be particularly effective when the donated property consists of highly-appreciated assets, since the trustee can sell the appreciated property without capital gains liability and reinvest into a more well-diversified investment portfolio.

- **Irrevocable Life Insurance Trusts can remove the value of insurance proceeds from an individual's taxable estate, help pay estate costs and provide heirs with cash.** To remove the policy value from the estate, the owner must surrender all ownership rights, which means he/she can no longer borrow against it or change beneficiaries. In return, the trustee can use the proceeds from the policy to pay estate costs and provide beneficiaries with tax-free income.

Choosing your Trustee

Choosing your trustee is one of the most important decisions you can make relating to your trust. A trustee is responsible for managing and investing the trust assets, making distributions to the beneficiaries, preparing and filing tax returns, responding to questions and requests from the beneficiaries and maintaining full and accurate trust records. A trustee has the highest standard of care that exists under American law – and is held accountable for each and every decision made.

You may decide to appoint your spouse, a relative or a friend as your trustee. The individual selected should be able to make careful, objective decisions in the best interests of the beneficiaries without allowing personal bias to cloud his/her judgment. An individual trustee should also be someone who has business sense, can manage investments and be willing to devote the time necessary to fulfill the role.

You may instead decide to appoint a corporate trustee - like a bank with trust powers or a trust company. Corporate trustees have specialized fiduciary training in the field of trust administration and investment management. Typically, separate teams of specialists are involved in the administration of the trust and the management of the trust assets.

We can help

■ **We can help you and your advisors develop the right plan. Come by and let us address your questions regarding trusts and estate plans.**

RCB BANK

Trust

www.RCBbank.com/*Trust*

Investment products are not insured by FDIC or any government agency, Not a bank guarantee, Not a deposit, Subject to risk and may lose value. For more information about RCB Bank Trust, visit us online at www.RCBbank.com/Trust.