Morgan Stanley

Necessary Considerations and Documents of Estate Planning

Document Review

Certain estate planning documents are critical and should be in place for all individuals in order to dispose of assets on death, enable medical or financial decision-making in case of incapacity and to protect and provide for beneficiaries – in short, to allow the individual to retain control of his or her person and property and avoid time-consuming court proceedings. When an individual dies without a Last Will and Testament (a “Will”), also known as intestacy, his or her estate will be disposed of pursuant to state laws that may not follow his or her wishes. When a person becomes incapable of managing his or her affairs, a court proceeding is generally necessary to appoint someone to care for the person and/or his or her property. These proceedings can be time-consuming, expensive and intrusive. The essential documents to retain control and avoid time-consuming court proceedings generally include a Will, a Revocable Trust, a Health Care Proxy, a Living Will and a Power of Attorney, all of which are addressed below.

Control of Assets Upon Death

WILL

A Will is an instrument which disposes of your property at death in accordance with your wishes. A Will takes effect only on your death and until that time may be revoked or changed (by Codicil or a later Will). Property passing by Will is called “probate property” and generally includes all property you owned individually or as tenant in common and your share of any community property. Probate is the judicial process of proving a Will is valid. Probate makes a Will a public document.

Wealth and Estate Planning Strategists
Family Office Resources

Testamentary Trust

A testamentary trust is created upon your death under your Will. By using a testamentary trust, you transfer property to a trustee who is under a fiduciary duty to manage, invest and administer the property for the benefit of designated beneficiaries.

Revocable Trust

A revocable trust, also known as a living or inter vivos trust, is a private document created during your lifetime. A revocable trust is a trust that you may amend or revoke. You continue to own the assets in the revocable trust for income tax purposes and the assets will be included in your gross estate for estate tax purposes. On your death, a revocable trust becomes irrevocable. Trust property is disposed of according to the terms of the trust and the trust provisions effectively act as a Will substitute. Moreover, assets already in the trust at the time of death avoid the probate process. In contrast to a Will, the trust assets also avoid publication because a trust is a private document. From an investment perspective, revocable trusts can seamlessly, and without the delays associated with a probate proceeding, transfer control over the trust assets to the successor trustee (typically when the settlor is incapacitated or deceased), which can be particularly useful when an individual owns a concentrated and volatile equity position.

Personal Effects

- Are there any items of special significance that you want to give to anyone in particular?
- Assuming your personal property goes to the survivor of you and your spouse, how do you want the property disposed of on the survivor's death? Do you want it to pass to children? Do you want it to pass equally, or as they may agree, or another way (e.g. as the executor decides)?

Examples of Trust Structures

Depending on the size of your estate, it may make sense to have assets equivalent to the maximum amount that may pass free of estate tax ($11.58 million in 2020) "bypass" the surviving spouse and paid to a trust. The trust assets would not flow directly to the surviving spouse, but this structure also would not necessarily deprive the surviving spouse of use of the trust assets. Generally speaking, you may:

- Make a gift of the amount outright or in trust to beneficiaries other than your spouse (e.g., your children or other individuals).
- Create a trust that benefits your spouse or your spouse and descendants, giving the trustee the discretion to distribute income and principal of the trust to any permitted beneficiary.
- Give your spouse the option of either taking the assets or "disclaiming" them into a separate trust.
  - Generally speaking, each spouse should consider owning assets individually equal to the protected amount ($11.58 million in 2020) to take full advantage of the estate tax exemption. This enables each spouse to take maximum advantage of estate tax exemption and allows for growth outside of the estate. However, under recent legislation, if a spouse is not able to fully utilize the estate tax exemption because the spouse dies without sufficient assets to fully utilize the available estate tax exemption, the surviving spouse can elect to apply any unused estate tax exemption amount belonging to the deceased spouse to the surviving spouse's estate.

Another consideration is whether the balance of your estate should flow directly to your surviving spouse or whether you want the balance to be held in trust for your surviving spouse's benefit. Use of a marital trust, also known as a "QTIP" trust, allows you to control the disposition of the property held in the QTIP upon the death of the surviving spouse. In order for a QTIP trust to qualify for the marital deduction (which is effectively a deferral of the estate tax until the surviving spouse's death), the surviving spouse must receive all income from the QTIP at least annually. The surviving spouse's access to principal may be as liberal or restrictive as you may desire.

- In the case of a non-US citizen spouse, a QTIP trust cannot be used. However, a substitute marital trust, referred to as a "QDOT" or qualified domestic trust, can be used to obtain the marital deduction.

Consider also whether you wish to grant to your spouse a power of appointment over trust assets. With respect to the "bypass" trust and QTIP trust, the surviving spouse can be given the right to appoint trust property to or among individuals (outright or in further trust) on the surviving spouse's death. Note, however, that this power may not apply to assets that the surviving spouse disclaims.

Gifts to Children

Generally, children or other descendants inherit assets upon the death of the surviving spouse. Do you want property to pass to them outright or in trust?

Although outright distributions give your children flexibility, it also exposes your children to the claims of potential creditors. To the extent assets remain in trust, the trust may provide protection from creditor claims against your children and can provide a means for controlling how and when the assets are distributed to your children. You may desire to consider the following as examples of your potential choices:

- Full discretion to the trustee (other than any child who is a beneficiary of the trust) over how income and principal are distributed to your children over your child's lifetime or until the child reaches a stated age.
- Mandatory distributions of income each year after each of your children reach a stated age combined with giving the trustee discretion over how principal is distributed (for "health, education, maintenance and support," to start a business," "to purchase a residence," "for emergencies").
- Mandatory distributions of principal at stated ages (e.g., one-third when the beneficiary reaches age 30, one-half when the beneficiary reaches age 35 and the balance when the beneficiary reaches age 40).
- Upon the beneficiary's death, property may pass to the beneficiary's children or as the beneficiary appoints among the beneficiary's descendants.

Contingent Beneficiaries

If no descendants survive you or the surviving spouse, who do you want to inherit your property? For example, you could provide that one-half of the amount should be payable to each of your and your spouse's siblings, as a group; and one-half to each of your and your spouse's parents, or if deceased, then to other particular individuals. Should you be charitably inclined, you may also provide bequests to charities.

- Preparation suggestion: Specify names and relationships to you of your family members and any other potential beneficiaries.

Fiduciaries

You may begin to consider who you want to appoint as fiduciaries:

- Executor of your estate. The executor gathers the assets of your estate, pays expenses and then distributes assets to your beneficiaries outright or to the trustee of any trusts you have established under your Will. Generally, it is a temporary role, but it is also a very important role.

- Trustee of any trusts. You should keep in mind that a beneficiary generally should not be sole trustee of a trust for his / her benefit.
- Guardians of any minor children. It should be noted that the court can always review the appointment to determine if it is in the best interests of the child(ren).
  - Preparation suggestion: Gather names, addresses and telephone numbers of each individual you may wish to name as a fiduciary.

Management of Assets During a Period of Incapacity

Revocable Trust and Power of Attorney

If you have created a revocable trust and later become incapacitated, the terms of the trust, rather than a court-appointed person, govern the disposition of the trust's property. You would generally serve as the sole trustee of your revocable trust and then, upon your incapacity, the successor trustee will take control of the trust assets, and not a court-appointed guardian or an agent named in your Power of Attorney.

- Begin to think about whom you would want to name as successor trustee in such case (to avoid expensive, drawn-out court proceedings). Consider an alternate successor trustee as well in case your first choice trustee is unavailable or does not wish to act.
- Preparation suggestion: Gather names, addresses and telephone numbers of each individual you wish to name as a successor trustee.

A Power of Attorney is an instrument by which you (the principal) appoint another person (the agent) to act on your behalf with respect to any or all of your property. Although not as robust as a revocable trust, a Power of Attorney can also facilitate the transfer of authority over your assets to a fiduciary. Unlike a revocable trust, though, a Power of Attorney terminates at your death.

- A Power of Attorney can be "durable," which means that the power of attorney does not terminate once one becomes incapacitated or disabled.
- A Power of Attorney can also be effective immediately upon execution or, if you are reluctant to grant immediate powers, it can "spring" into effect at a specified future time or upon the occurrence of a specified event such as your incapacity or disability.

Mechanism for Making Health Care Decisions During a Period of Incapacity

Health Care Proxy & Health Care Directive / Living Will

A Health Care Proxy is an instrument by which you (the principal) grant another individual (the agent) the authority to make health care decisions in advance of an accident or the onset of illness. The agent can be any individual, such as a spouse, a trusted friend or family member. The Health Care Proxy becomes effective only if you become incapable of making your own health care decisions, including decisions with respect to the withholding or withdrawal of life-sustaining medical treatment and artificial nutrition and hydration.

A Health Care Directive, also known as a Living Will, is an instrument by which you express your intent or preferences with respect to health care matters, including the withholding or withdrawal of life-sustaining medical treatment and artificial nutrition and hydration. A Health Care Directive / Living Will often includes broad language intended to cover unanticipated situations or new treatments. Under the Health Insurance Portability and Accountability Act

(HIPAA), a privacy waiver may be required to enable physicians and hospitals to share medical information with your health care agent in an emergency. This waiver may be a separate instrument but it is often included in the Health Care Directive.

If you have executed a Health Care Proxy and a Health Care Directive / Living Will, the health care agent must act in accordance with your wishes. The Health Care Directive / Living Will generally serves as specific evidence of those wishes.

- Begin to think about whom you would want to make medical decisions on your behalf in such case (to avoid placing medical care providers in control). Consider alternate agents in case your first choice agent is unavailable or unwilling to act.
- Preparation suggestion: Gather names, addresses and telephone numbers of each individual you wish to name as agent.

Summary

An estate plan commonly employs all of the above tools. A revocable trust can govern the management and disposition of property on death or during incapacity. Wills and Powers of Attorney are necessary to deal with assets not transferred to such a trust. For health care matters, you can empower an agent with a Health Care Proxy to make health care decisions on your behalf and a Health Care Directive / Living Will can serve as a guide to the health care agent.

Important Disclosure

Morgan Stanley Smith Barney LLC does not accept appointments nor will it act as a trustee but it will provide access to trust services through an appropriate third-party corporate trustee.

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