

# YOUR ESTATE PLAN: IS A TRUST RIGHT FOR YOU?

You take care of your family and work hard for the things you've acquired. You take the necessary steps to ensure your family's taken care of. Why wouldn't you put in the same effort to care for your loved ones after death?

Estate planning isn't the first thing you wake up in the morning thinking about. Often it requires us to discuss uncomfortable questions and make tough decisions. A better way to view estate planning is as a way to provide for your loved ones even after your death—an objective well worth the effort.

But there are many people who haven't taken the appropriate steps to ensure their wishes are documented properly in an estate plan should something happen to them. Whether you're just getting started or want to ensure your estate plan has the right pieces, this guide will help you understand your options and take the next important steps.

## IN THIS GUIDE, YOU WILL LEARN ABOUT:

- ▶ Common obstacles to estate planning and how to overcome them.
- ▶ The most important questions to consider when estate planning.
- ▶ The key documents everyone should have in a plan and when they need to be updated.
- ▶ Trusts: the various types and the goals they each address.



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An estate plan is all about getting the right things to the right people at the right time.

## COMMON OBSTACLES TO ESTATE PLANNING

First let's take a look at the three most common reasons people avoid planning.

### DIFFICULTY:

You have to think about your own mortality, consider who should receive your assets and identify the people who will care for your children and handle your assets after your death.

Although difficult, the results will likely be more preferable than if you had passed without a plan in place. Without a properly documented plan, state statutes decide who receives your assets, and the court will name the individual(s) who will care for your children and manage your assets.

### EXPENSE:

While there certainly is expense to having an estate plan created (you'll need to work with an attorney), the cost is typically less than the additional expenses your estate would pay in the event you died without any planning. The cost for a basic will can be as low as \$300, going up to about \$1,500. A more comprehensive estate plan that includes a trust ranges from \$1,500 to \$3,000, depending on the complexity.

Alternatively, court and attorney fees can take about 5 percent of an estate's value when there is no estate plan. For a \$300,000 estate (house, investments, etc.), fees could reach \$15,000.

### CONFUSION:

There are countless state and federal laws that come into play and a number of documents that might be necessary. Additionally, beyond just signing documents, there is often additional planning, such as retitling assets, that may be necessary.

The benefit of working with an estate planning attorney and a financial professional is that they can help you decide on the best course of action for your needs and determine what should be done. In most cases, they can also help implement your plan.

When things are hectic, taking time out to think about your wishes for after your death and meet with an attorney to put your plan in place may not be at the top of your list of things to do. But the old saying "It's never too late until it's too late" couldn't be more true for an estate plan.

It's too expensive.

Who's going to take care of our kids?

Who will manage our assets for us?

Which documents do we really need?

We'll do it soon, just not today.



## WHERE TO START

The first thing to know is that whether rich or poor, everyone has an estate. It's made up of "real property" and "personal property." Real property basically refers to real estate: primary residence(s), vacation property, rental property or any land. Personal property is typically defined as any property that is not real estate: vehicles, investments, financial accounts, furniture, jewelry, etc.

An American family with an average income of \$100,000/year may have accumulated assets such as cars, a house, retirement accounts, life insurance and education funds by the time they reach 35-40. And those closer to retirement may have even more reason to ensure their estate plan is in place, as they have accumulated wealth and vacation homes or have a larger family to consider.

When you are ready to begin thinking about your estate plan, you first need to consider these five questions:

Spend more time planning for your estate than your next vacation.



1. **Whom do you want to receive assets?** You can leave your assets to anyone over the age of 18. Minors cannot receive assets. When determining who should receive your assets, think about how much and when. A benefit of estate planning is that you can be specific about how your assets are distributed, even when you are no longer here.
2. **Who should administer your estate (such as managing and distributing assets)?** This person will need to sell your assets, if necessary, and/or distribute them per your written instruction.
3. **Who should care for minor children, and how do you want your children raised?** For parents, this is often the hardest question to answer. A few things to keep in mind: The person caring for your child(ren) does not need to be the same person managing your assets, and you can specify the type of life you want your child to have.
4. **Who should provide any needed continued management of assets for those you want to provide for?** When created properly, an estate plan can provide you control over the assets you've worked so hard to acquire even after you are gone. You will want to think about who will properly manage money and other assets in ways consistent with your directions.
5. **What is your plan in the event of incapacity?** Having a plan in place should you become ill and unable to make financial or health decisions for yourself is a critical aspect of estate planning—and is often overlooked. Without the proper documents in place and people named, the court will need to step in and name a guardian who can then make financial and medical decisions for you.

Once you've thought through these initial questions, you will be ready to start putting your estate plan in order.

## BASIC ESTATE PLANNING DOCUMENTS

There are three basic documents all individuals should have in their estate plan.

### 1. DURABLE POWER OF ATTORNEY FOR FINANCES:

This is a legal document that can allow you to name someone to manage your property and financial and legal affairs in the event of incapacity.

### 2. DURABLE POWER OF ATTORNEY FOR HEALTH CARE:

A health care power of attorney is a legal document that allows you to name someone else to make health care decisions if you are unable to do so.

### 3. HEALTH CARE DIRECTIVE (LIVING WILL):

Unlike a power of attorney, a living will does not name anyone to act on your behalf. Rather, it is a directive from you to your physician indicating your wishes regarding treatment in certain limited medical situations.

Once you have accumulated assets, gotten married or added children to your family, the following documents should also be considered.

#### WILL:

A will allows you to tell the courts how you want your property distributed after your death. It also allows you to name a guardian for minor children and provide directives for your funeral. However, a will becomes active only after you die; it does not account for needs if you become incapacitated. It also needs to be filed with the courts, which makes it a public document that anyone can access.

#### TRUST:

A trust is a legal document that describes how property will be managed by someone for the benefit of a third party. Unlike wills, a trust can be used during a time of incapacity, and it also can exist well beyond. It also provides control over your assets following your death in a way that a will cannot guarantee. There is often confusion about whether a trust and a will are both needed. There are benefits to both documents (as noted in the table below), and in many cases, people have both in place for their estate plan.

BENEFITS OF TRUSTS	WILL	TRUST
Identifies guardianship for minors after death	Yes	No
Allows for control of asset distribution at death	Yes	Yes
Allows control of assets and directives during incapacity	No	Yes
Avoids probate and courts (including property in other states)	No	Yes
Manages assets for minor / special-needs children	No	Yes
Can reduce estate taxes	No	Yes
Ensures privacy	No	Yes

Each state has its own estate laws; work with an estate planning attorney in your area to ensure you have the proper documents in place to meet your needs.

## UNDERSTANDING PROBATE

When someone dies, his or her will is submitted for probate, the legal process in which it is reviewed by a local court to determine whether it is valid and authentic. Probate makes sure creditors are paid and that assets are distributed to the correct beneficiaries as determined by your will. If you die without a will in place, you are considered to have died intestate, and the distribution of your assets will be based on your state's intestacy laws.

Probate expenses can range from hundreds to thousands of dollars depending on the value and complexity of the estate and whether a will was in place. Expenses can typically reach 5 percent of the estate's value. But, the bigger issues identified with probate are the lack of privacy (your will becomes a public court document) and the delay in administering your estate. The probate process itself can take months or years.

There are a few ways to avoid probate.

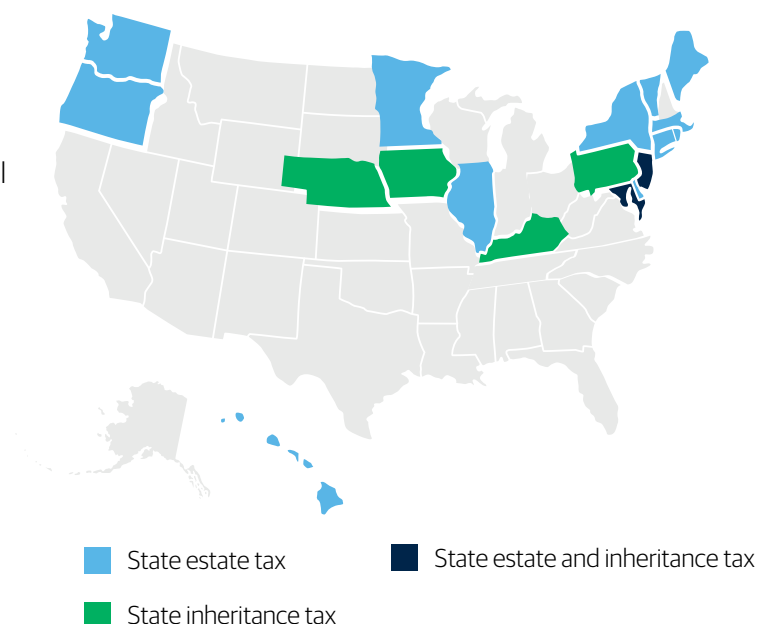
- **Designate beneficiaries whenever possible.** Assets that have a beneficiary designation (such as life insurance, retirement accounts, etc.) will pass to the named beneficiary (as long as the decedent's estate isn't named as beneficiary) without probate.
- **Title assets properly.** Assets that are co-owned with a right of survivorship (typically those titled as joint tenancy or tenancy by the entirety) will pass automatically to the surviving co-owner without probate (for example, a home owned by a married couple with a right of survivorship).
- **Utilize a trust.** Trusts avoid probate for assets that are transferred to the trust before death; for assets that allow for a beneficiary designation, the trust can be named as beneficiary, or an individual can be a direct beneficiary.
- **Include a pour-over will.** Having a pour-over will can account for any assets that are missed and were not transferred to the trust by specifying that assets are to be transferred to the trust at death.

## TAXES

Estate and inheritance taxes can be confusing. Although the federal estate tax exemption for 2016 is \$5.45M per individual (\$10.9M for married couples), you could be subject to state-level estate or inheritance taxes, many of which have much lower exemptions.

- A recent article noted that there are 19 states and the District of Columbia that impose state-level estate taxes; some tax estates at \$1M or less.<sup>1</sup> Iowa currently allows no exemption to its inheritance tax.

If you may be impacted by estate taxes, there are trust strategies that can help you avoid excessive taxes.



## IS A TRUST RIGHT FOR YOU?

Deciding whether or not a trust is right for you and your estate plan is typically part of a conversation with an estate planning attorney. The attorney will begin by asking you what your goals are for your estate. Based on your needs, he or she will determine if a trust is right for you. A trust may be the right estate planning tool for you if you:

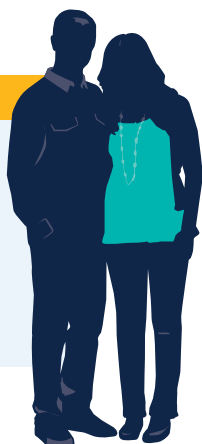
- Are concerned about the management of your assets if you become incapacitated.
- Want to protect your assets against mismanagement by beneficiaries or from creditors (including ex-spouses) of beneficiaries.
- Want to provide for minor children.
- Are married to a non-U.S. citizen.
- Want to provide for a family member with special needs.
- Are part of a blended/modern family (divorced/remarried/same-sex marriage).
- Want to avoid probate and maintain privacy.
- Want to reduce estate taxes (state or federal).
- Desire to have control of your assets both during your life and after you're gone.

It's a common misconception that trusts are only for the wealthy, but as you can see from the list above, that is not true. Many people can benefit from some form of trust in their estate plan. While there are many different types of trusts that serve many different objectives, all trusts involve at least three parties: the grantor, the trustee and the beneficiary.

## KEY ROLES

### Grantor:

Establishes the trust and funds it.



### Trustee/Co-trustee:

Responsible for administering the trust and managing the assets; can be an individual or a corporation.



### Beneficiary:

The person(s) the trust names to receive assets, such as net income or property.



### PROS AND CONS OF USING A CORPORATE TRUSTEE

PROS	CONS
Experience with record keeping, tax returns	May lack knowledge of specific family situations and goals
Objective decision making	Charges a fee that may be greater than an individual trustee
Not impacted by death or inability to serve	

## TYPES OF TRUSTS

There are many variations of trusts, and the type of trust you need is based solely on the goals you are looking to achieve.

The first thing to know is that a trust can be either revocable or irrevocable.

### REVOCABLE TRUSTS

(also called a Living Trust or a Revocable Living Trust)

A revocable living trust is created during your lifetime and usually takes effect upon disability or death. It can be changed or revoked any time prior to then; the main benefit is the flexibility it offers. It serves as a “will substitute” in many cases, but most people will still need a will to name guardians for minor children and to make sure all assets pass to the trust at death.

During life, you maintain control of assets you put in the trust (typically the grantor serves as the trustee), and you pay income tax on any income earned by the trust assets. In addition, assets in a revocable trust are included in your taxable estate, as they remain under your control. A revocable trust becomes irrevocable at death.

### IRREVOCABLE TRUSTS

As a general rule, if the goal is to reduce estate taxes, the trust must be irrevocable. An irrevocable trust takes effect immediately and can be changed only in very limited circumstances or by court order. Therefore, it's important for your estate planning attorney to include as much flexibility as possible when the trust is created.

A key feature of irrevocable trusts is that the assets belong to the trust, so they are not included in your gross estate for the determination of estate taxes because they are no longer owned by the grantor.

Beyond revocable and irrevocable, trusts can also be designed to meet certain needs. Below are the most common goal-specific trusts.

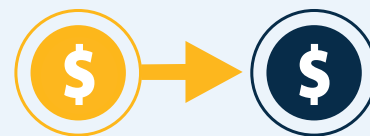
### CREDIT SHELTER TRUSTS

The purpose of the credit shelter trust is to receive assets from your estate after your death; these assets will be sheltered from the estate tax.<sup>2</sup> Typically, this type of trust is structured so that upon death, the assets (up to the amount of the federal estate tax exemption amount, \$5.45M for 2016) are transferred to the trust for the benefit of the trust beneficiaries. This allows the assets passing to the trust to escape estate tax in your estate and your spouse's estate.

For many couples, a credit shelter trust is no longer necessary for federal estate tax purposes, because of “portability.” Under portability, a deceased spouse's unused\* exemption can be used by the surviving spouse. Some couples might still need a credit shelter for other non-tax reasons, such as to remove an appreciating asset from the estate, seek creditor protection or provide greater control over the ultimate disposition of the assets.

#### FUNDING A TRUST

After you create a trust, you must “fund” it if your goal is to avoid probate. This means transferring your assets to the trust—such as re-deeding your house in the trust's name or naming the trust as your life insurance beneficiary.



\* Note that an estate tax return must be filed in order to elect portability and use this benefit.

## SPECIAL-NEEDS TRUST

A key consideration in estate planning is how an inheritance would affect the beneficiary's ability to qualify for Medicaid or other publicly funded disability programs. A special-needs trust can allow distributions for needs not covered by government assistance—things that improve a person's quality of life, such as vacations and entertainment. It is important that a special-needs trust be created by a local attorney with expertise in your state's law.

## QUALIFIED TERMINABLE INTEREST PROPERTY (QTIP) TRUSTS

A QTIP trust helps address the needs of blended families. It allows you to provide for your surviving spouse while controlling how the trust's assets are distributed after he or she passes. For example, you and your spouse both have children from previous relationships; you can leave assets to a QTIP trust to provide for your spouse, and upon his or her death, the assets could then pass to your children.

## IRREVOCABLE LIFE INSURANCE TRUST (ILIT)

An ILIT is a trust funded by one or more insurance policies. Even though a life insurance death benefit is not subject to income tax, it is considered part of your estate for estate tax purposes if you own the policy at death. An insurance policy death benefit could use a large portion of both your federal and state estate tax exemption if the policy is owned personally.

An alternative is to establish an ILIT and name a trustee (you can't be the trustee, but your spouse or children could). Once established, you give the trust a cash gift used to purchase the life insurance policy with the trust as the owner and beneficiary. Upon your death, the trust receives the death benefit—free of income and estate taxes—and then makes distributions according to the terms of the trust.

### CAN YOU GIVE AN EXISTING POLICY TO AN ILIT?

If you have an existing policy, you can give the policy to an ILIT but must survive for three years to avoid estate tax on the death benefit. It may be possible to avoid the three-year rule; if this is important to you, discuss your options with your estate planning attorney.

## THE ROLE OF LIFE INSURANCE IN AN ESTATE PLAN

Life insurance policies are an excellent resource to handle the immediate financial needs that can be created upon death.

Life insurance can provide financial support for the following needs:

- Financial support for a surviving spouse
- Income for child, family members and those with special needs
- Liquidity to pay estate taxes
- Funding business buy-sell liquidation agreements
- Provide financially for a charity or community organization





## KEEP THE GOAL IN MIND

Confused yet? Instead of trying to wrap your head around this, focus on your goals and work with a financial professional and estate planning attorney to help you decide how best to achieve them. A financial professional can recommend an estate planning attorney who will be right for your situation; he or she can also work with the attorney on how assets such as life insurance, annuities and investments can impact your estate.

GOAL	TRUST	BENEFITS
Manage the distribution of your assets either at death or disability	Revocable living trust	<ul style="list-style-type: none"> <li>Assets held by trust are not subject to probate</li> <li>Generally takes effect upon death or disability of grantor</li> <li>Provides privacy as to donor's assets and wishes</li> </ul>
Control and manage assets for minor children	Living or testamentary trust	<ul style="list-style-type: none"> <li>Control over principal and income of the trust and when it is distributed</li> </ul>
Control assets for beneficiaries who: <ul style="list-style-type: none"> <li>Are unable to manage assets themselves</li> <li>May face creditor claims</li> <li>May be divorcing a spouse</li> </ul>	Living or testamentary trust with spendthrift provisions	<ul style="list-style-type: none"> <li>Protection from creditors of beneficiary may be available (sometimes including divorcing spouses)</li> </ul>
Provide for a loved one with special needs	Special-needs trust	<ul style="list-style-type: none"> <li>Can provide for needs beyond support only</li> <li>Generally designed to avoid disqualifying beneficiary from government programs</li> </ul>
Provide for non-citizen surviving spouse	Qualified domestic trust	<ul style="list-style-type: none"> <li>Allows deferral of estate tax that would otherwise be payable at the death of the first spouse</li> </ul>
Reduce the value of your taxable estate while also managing the assets for others	Irrevocable trust	<ul style="list-style-type: none"> <li>Assets are no longer owned by the individual and are not part of the estate</li> </ul>
Provide for blended families	QTIP Trust	<ul style="list-style-type: none"> <li>Provides for surviving spouse but also for children</li> <li>Allows you to maintain control over assets</li> </ul>

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## SUMMARY

The process of estate planning can seem daunting, but it's essential to protect your family and the things you work so hard for. And you don't have to do it alone. By partnering with a financial professional and an estate planning attorney, you get the proper guidance to focus on the strategies that are right for you and your situation.

Once you're ready to meet with an attorney, you'll want to bring the following:

- ✓ Answers to the five questions on page 3
- ✓ A list of goals you wish to accomplish
- ✓ A complete list of assets (and statement of accounts), including your life insurance policies, home, vacation home, any other real estate, any bank accounts, retirement accounts, investment accounts, stocks, annuities, any income generators, etc.
- ✓ Copy of your most recent income tax return
- ✓ Any divorce agreements or prenuptial agreements
- ✓ Any business agreements
- ✓ Any current estate planning documents
- ✓ The list of people (and their contact information) whom you expect to name in your estate plan (guardians, beneficiaries, etc.)

When you complete your estate plan, don't just set it on a shelf and forget it. Estate planning attorneys typically do not reach out to you on a regular basis to review your documents; they expect you to come to them for updates.

To keep current, use your annual reviews with your financial advisor to identify financial changes or life events (marriage, children, divorce, etc.) that could impact your plan. Don't let fear, confusion or inconvenience keep you from one of the most important things you can do for yourself and your family.



<sup>1</sup> Where Not to Die in 2016, Forbes, October 2015

<sup>2</sup> Northwestern Mutual's "Estate Planning in Depth"

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