INSIGHT ON ESTATE PLANNING

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Don't count out the bypass trust

To paraphrase Mark Twain, the reported demise of the bypass trust may be greatly exaggerated. In fact, this estate planning technique is still a viable option for many individuals and may actually stage a "revival" in future years.

Reasons for the change

For decades, a bypass trust was a staple of estate plans of wealthier families. But two key factors have effectively reduced the use of such trusts in recent years: the increased gift and estate tax exemption and the "portability" provision.

As its name implies, a bypass trust (sometimes called a credit shelter trust) is designed to allow assets to bypass your spouse's estate before others, typically children and grandchildren, inherit the property. Because the trust effectively uses the full estate tax exemption for each spouse, it may enable a married couple to transfer millions of dollars without paying any federal estate tax.

In the usual setup involving a married couple, each spouse includes a provision in his or her will establishing a trust for the surviving spouse's benefit and funds it with the equivalent of the deceased spouse's basic exemption amount. Then, when the surviving spouse dies, the remaining assets go to the designated beneficiaries. If the trust is structured properly, this arrangement may avoid estate tax by using the estate tax exemptions of both spouses.

But here's the rub: the exemption amount has been significantly boosted since near the turn of the century (see "Evolution of the gift and estate tax exemption" below). Currently, it's set at $10 million through the end of 2025, indexed annually for inflation. The exemption amount for 2022 is $12.06 million (up from $11.7 million in 2021).

Furthermore, estate tax planning has been enhanced by the portability provision initially created in 2010 and subsequently made permanent. Under this provision, any portion of an exemption not used by the first spouse to die becomes available to the surviving spouse's estate. In other words, a couple now

Evolution of the gift and estate tax exemption

Before the enactment of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) in 2001, the estate tax exemption was a relatively modest $675,000. But then EGTRRA pushed the exemption up over $1 million.

The exemption gradually increased to $3.5 million in 2009 before the estate tax was repealed for one year (2010). After 2010, the exemption was increased to $5 million, subject to inflation indexing. Finally, the Tax Cuts and Jobs Act doubled the exemption amount to $10 million, with inflation indexing, for 2018 through 2025. Currently, it's scheduled to revert to $5 million (again indexed for inflation) in 2026 — unless Congress takes action.

can transfer double the exemption amount — without estate taxes — no matter who the non-spousal beneficiaries are.

As a result, the estate tax benefits of using a bypass trust have been curtailed, yet bypass trusts are hardly obsolete. There are still several potential reasons to include a bypass trust within your overall estate plan.

Benefits of a bypass trust

For starters, assets that are owned individually by a surviving spouse generally become "fair game" for creditors. This can be especially bothersome to family members if a significant amount of assets is siphoned off to help pay the debts of someone who marries the surviving spouse. However, a bypass trust can protect the assets from the clutches of creditors.

Although the children may be named as the successor beneficiaries in the respective wills of a married couple, that could change, especially if a surviving spouse eventually remarries. There's no guarantee that the children of the initial marriage will receive their fair share of an inheritance on the death of the surviving spouse. With a bypass trust, you can arrange for the assets to pass to your children and grandchildren, regardless of any future marriages by a surviving spouse.

In addition, remarriage isn't the only financial concern of a married couple. Assets can be diluted through reckless spending by the younger generation or financial interests might be assigned to others. By including a spendthrift provision in a bypass trust, you can guard against these potential dangers, while still allowing the beneficiaries to use assets in a reasonable manner.

Also, note that a bypass trust can provide flexibility by granting a power of appointment to a surviving spouse. Doing so can give this person legal authority to use trust assets for health care, education or other costs. As opposed to a broad general power of appointment, a limited power may permit the beneficiary to allocate only their share of the trust among classes of potential recipients.

The right trust?

A bypass trust remains a valuable tool in your estate planning toolbox. Bear in mind that the gift and estate tax exemption is scheduled to revert to $5 million in 2026 (indexed for inflation). The reduced amount may not be sufficient for your family's estate planning needs. A bypass trust may become even more important as a complement to other techniques. Discuss with your estate planning advisor whether a bypass trust is right for your estate plan. •

COVID-19 and estate planning

Estate planning is possible in a socially distanced environment

In light of the ongoing COVID-19 pandemic, are you leery about visiting your advisor's office to attend to estate planning documents? You're not alone. But how do you plan your estate and execute critical documents if you're uncomfortable with face-to-face meetings or are required to self-quarantine? The good news is that you have options.

Meeting remotely vs. in-person

It can be argued that estate planning is more important now than ever before. Fortunately, many estate planning activities may be doable from the safety of your own home.

Bear in mind that there are definite advantages to meeting with your advisor in person to talk about creating or updating your estate plan. But these discussions can be conducted in video conferences or phone calls, and document drafts can be transmitted and reviewed via email, secure online portals or even traditional "snail mail."

Signing documents

Traditionally, estate planning documents are executed in an attorney's office in the presence of witnesses and a notary public. In-office document signings may still be possible with appropriate precautions, such as wearing masks and practicing social distancing. But there are other options that allow you to avoid traveling to an attorney's office and that minimize the number of people involved. The options available depend in part on the type of document being signed.

In most states, a typewritten will (as well as a modification or codicil to an existing will) must be signed in the physical presence of at least two witnesses. Typically, those witnesses must be disinterested — that is, they don't stand to inherit or otherwise benefit under the will. But some states permit family members or other interested parties to serve as witnesses.

In those states, it may be possible to conduct a will signing at home (with instructions from your attorney) and have members of your household witness it. If disinterested witnesses are required, you might have friends or neighbors observe the signing from a safe distance (in your backyard, for example). In some states a will can be valid without witnesses, if "clear and convincing" evidence is provided

in court, after the will-maker's death, to prove its validity.

What about notarization? In some states wills are notarized as a best practice, but in most states it's not required. However, wills are often accompanied by a self-proving affidavit, which must be notarized. A self-proving affidavit is a sworn statement, signed by the will-maker and witnesses, that affirms the will's validity. It's not required, but it can streamline the probate process. One strategy for avoiding the presence of a notary (assuming online notarization isn't an option in your state) is to sign the will without a notary and then arrange for the parties to sign a self-proving affidavit in front of a notary when it's safer to do so.

Another option in some states is a "holographic," or handwritten, will, which generally doesn't require witnesses or notarization.

In many states, you can sign a trust document without witnesses or notarization, and it may even be possible to sign it electronically. One potential strategy for avoiding traditional will-signing requirements is to sign a holographic "pour over" will that transfers all assets to a revocable trust, which can accomplish many of the same objectives as a traditional will.

Using powers of attorney and health care directives

Finally, depending on your state, it may be possible to sign a valid durable power of attorney (for financial or legal matters) without witnesses or notarization. This isn't advisable, however, since notarization usually confers presumptive validity, making it more likely that the document will be accepted by financial institutions or other third parties.

Health care powers of attorney or advance directives generally must be signed in front of witnesses. However, typically they're not required to be notarized.

Exploring your options

In a time of social distancing, it may be tempting to explore one of the many do-it-yourself (DIY) tools for creating an estate plan. Software or online tools that automate the creation of wills, trusts and other documents have a certain appeal, but they also present some significant risks.

Before you turn to DIY estate planning tools, talk to your estate planning advisor. They may have options available to you so that you can feel safe while attending to your estate plan. •

Create an eldercare plan for an elderly loved one

No one would expect you to operate a business without developing a business plan. Typically, you would review the plan annually and modify it to accommodate your needs. Yet many people don't follow similar practices for approaching the end of life. In other words, they don't have an eldercare plan in place.

Your family may be facing these challenges as an elderly family member — perhaps your parent or an in-law — is experiencing difficulties caring for themselves. Don't be caught without a plan that addresses key issues and includes contingencies.

Call a family meeting

If you haven't already done so, convene a family meeting. Be sure to invite all of the adult children of the elderly relative and their spouses. Of course, the "invitation list" will depend on the size of the family and other dynamics.

Be forewarned that some family members might not agree with the need for a meeting. Furthermore, it likely won't be easy to find time to meet due to busy schedules and other commitments. Plus, location may be a factor, with many families spread out around the country and maybe even abroad. Nevertheless, it's important to bring as many participants into the loop as possible.

Fortunately, technology can provide additional flexibility. If everyone can't meet in person, a teleconference may be sufficient — or at least better than nothing.

Should you have a professional advisor attend the meeting? That may depend on the nature of relationships and whether you want to formalize some decisions. Also, don't overlook or ignore a third-party caretaker (such as a nurse or aide) who might be able to contribute valuable insights.

Finally, consider whether to include the elderly relative. This, of course, can be a delicate decision. Determine what's best for your family's particular situation.

Discuss the details

A family meeting enables you to share information and allows others to air their concerns. In some cases, one or more siblings may feel that they're being asked to do too much caretaking, while others might profess to want to do more. In any event, remember that there's no "perfect" solution.

Naturally, you'll want to discuss matters relating to your loved one's health care. This could result in a decision to have the person move to an assisted living facility or to upgrade current living arrangements. Or you might keep the person at home and use live-in care if the situation warrants. Or family members may volunteer to assume the role of caregiver and have the elderly person reside with them.

Don't overlook a third-party caretaker (such as a nurse or aide) who might be able to contribute valuable insights.

These decisions are often wrought with emotion as well as requiring an analysis of personal preferences, priorities and costs. That's why you can't expect to finalize everything in a single meeting. It'll likely take time to arrive at consensus.

Consider the legal documents that may further the plan, such as a power of attorney (POA), living will and other health care directives and use of trusts. In addition, the elderly relative's will may have to be revised. Some of the main objectives may be preservation of assets and minimizing federal and state tax liabilities.

Generally, one family member — perhaps it's you — will be chosen to handle your loved one's financial affairs. This person can usually write checks and draw on the elderly relative's bank and retirement accounts through a POA.

Communicate clearly

As always, communication is critical. Things may be especially stressful in families where relations haven't always been harmonious, but you must reach some conclusions for the collective good of your loved one. Of course, conflicts may arise at the meeting, so expect some compromises. Try to honor prior agreements, when possible. It's recommended that one person take notes and then distribute a summary via email.

Finally, try to remain flexible, especially if the situation changes (as it frequently does). Develop a "Plan B" if an assisted living facility or other living arrangement doesn't work out or the elderly person's condition suddenly worsens. •

ESTATE PLANNING PITFALL

You're using the wrong type of living trust

You may have already recognized the benefits of using a living trust. Typically, this trust type makes sense if you're looking to preserve assets for other family members without dire tax consequences or to avoid probate. But should you use a "revocable" or "irrevocable" living trust? The answer can make a big difference. Significantly, if you choose the wrong type of trust, it can defeat your main intentions.

As the name implies, a revocable trust allows the creator of the trust to modify it in the future. This means, for example, that you can remove, add or otherwise change beneficiaries or revise the trust terms due to changing circumstances.

In contrast, with an irrevocable trust, you don't have the ability to make such modifications. Except for extraordinary situations, the trust terms are set in stone. So, you can't remove a beneficiary or add another one later.

At first glance, a revocable trust seems preferable, but there are several potential disadvantages to consider. Notably, assets aren't shielded from creditors the way they're protected in an irrevocable trust. The trust assets may have to be liquidated to pay off certain claims. In addition, revocable trust assets are included in the taxable estate of the person who created the trust. This could result in sizeable federal or state estate tax liability — or both.

On the other hand, if structured properly, the assets in an irrevocable living trust generally are removed from the creator's taxable estate. This is often one of the main reasons for choosing an irrevocable trust.

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No Contest Clauses and Challenge Proof Planning

Every family seems to think they have more problems than the next, and while they all can't be right, it really is common for complicated family dynamics to give rise to estate planning concerns. Often, clients are worried about future challenges to an estate plan after their death. Whether it is siblings that don't get along, a relative who is being disinherited, or, as is sometimes the case, a relative who just likes to stir up trouble, there is often reason think about what can and should be done to prevent any future challenges to a will or trust.

Many clients will insist that their will or trust include a "no contest" clause. Sometimes also called an *in terrorem* clause, this is a provision that states that any person who brings a challenge to the will or trust will either be completely disinherited or only receive a nominal sum. The goal is to dissuade any challenges and ensure that the plan, as drafted, is put into effect. These clauses may be limited in scope, for instance to allow good faith legal actions to *interpret* rather than *object* to a provision of the will or trust. While it is not necessarily a bad idea to include a no contest clause, clients should be aware that they are not nearly the effective solution many expect. Many states have held no contest clauses to be unenforceable altogether, and although that is not the case in Washington, Washington courts have significantly limited their enforceability. In Washington, if a contest is brought in good faith and with probable cause, a no contest clause will not be enforced. Crucially, if a contestant initiates a contest on the advice of their attorney after fully and fairly disclosing all material facts, he or she is deemed to have acted in good faith and with probable cause. All it really takes to get around a no contest clause is to find an attorney who is willing to fight. With that said, the mere appearance of a no contest clause in your estate planning document may be enough to dissuade a would-be challenger.

So, what is a savvy, yet concerned, client to do? The first step is to get estate planning documents in place, ensuring that all the proper formalities are met in executing them. If a decedent has no estate planning in place or it is found to be invalid, the "laws of intestacy" determine who will serve as personal representative and where assets will pass. Not only does this lead to undesirable results, it invites litigation.

Documents must be executed while a testator has "testamentary capacity." It is best practice to avoid executing documents when there is any question about capacity. Once capacity has diminished, any large changes to an estate plan should be avoided to the extent possible.

One of the most important, if not the most important, things a person can do to prevent a future challenge is talk openly with family and potential beneficiaries about his or her estate plan. Consistently, the motivation for a will contest comes from expectations not being met. If a child is surprised when their sibling gets more than they do, and they don't have any explanation, they may begin to think it is a result of foul play.

If the idea of discussing the subject with family makes a client uncomfortable, an alternative is to draft a letter separate from the will or trust explaining the thought process that went into the decision. After death, the letter can be shown to the would be contestant to explain away their concerns and dissuade them from bringing a contest. Such a letter may also serve as valuable evidence in the contest itself.

If you would like to get your estate planning in order, we at Stokes Lawrence would be happy to assist. Please contact a member of the Stokes Lawrence Estate Planning Group at (509) 853-3000 in Yakima or (206) 626-6000 in Seattle.