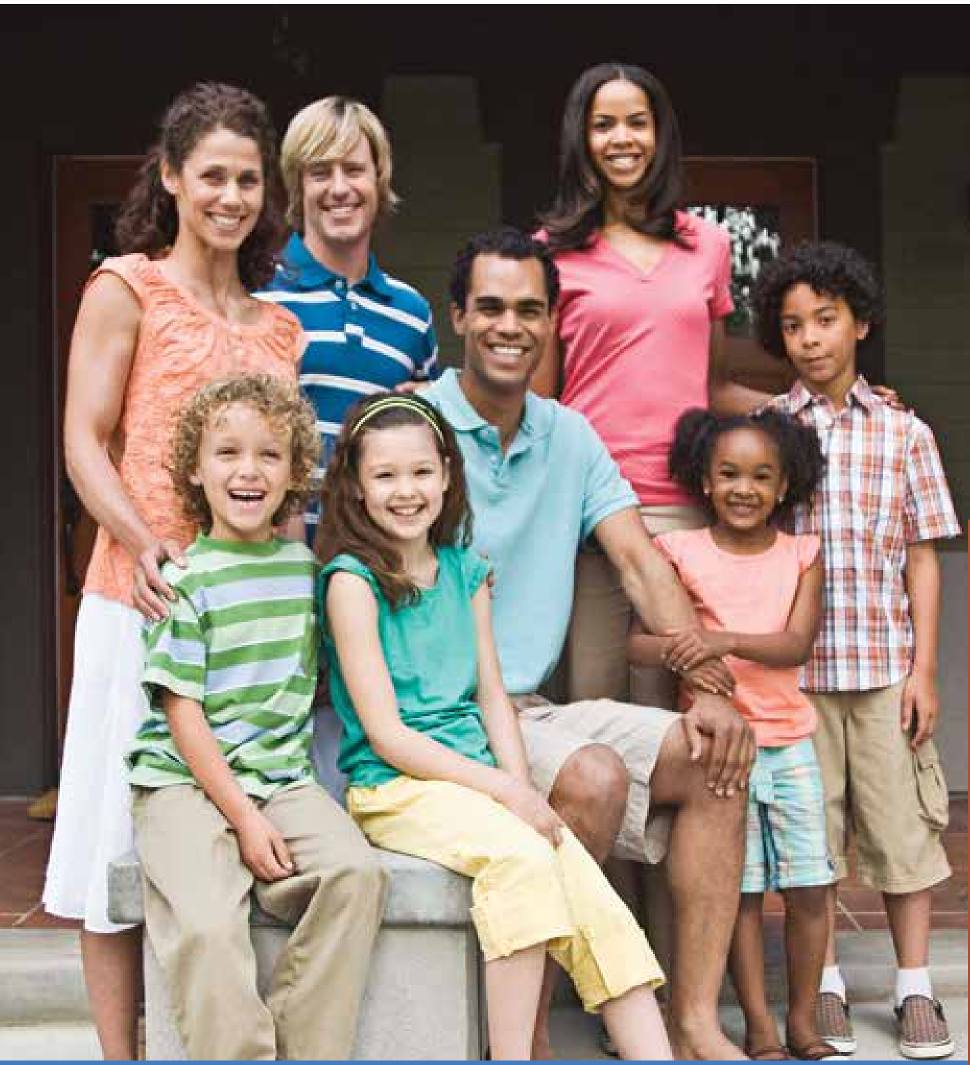
INSIGHT ON ESTATE PLANNING



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You're donating high-basis stock to charity

YEAR END 2016

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6 estate planning techniques for blended families

A "blended family" is more than just a staple of TV sitcoms. Today, it's not unusual for a household to include children and even grandchildren from prior marriages, as well as adopted family members or same-sex couples. These various family arrangements can create estate planning complications that could lead to challenges in the courts after your death.

Fortunately, you can reduce the chances of family squabbles by using estate planning techniques designed to preserve wealth for your heirs in the manner you want, with a minimum of estate tax erosion, if any. Here are six prime-time examples.

1. Will. A will is the foundation of most estate plans. Your will generally determines who gets what, when, where and how. It may be combined with "inter vivos trusts" established during your lifetime or be used to create testamentary trusts, or both. While you can include a few tweaks for your blended family through a codicil to the will, if the intended changes are substantive — such as removing an ex-spouse and adding a new spouse — you should meet with your estate planning advisor to have a new will prepared.

2. Living trust. The problem with a will is that it has to pass through probate. In some states, this can be a costly and time-consuming process. Alternatively, you might transfer assets to a living trust and designate members of your blended family as beneficiaries. Unlike a will, these assets are exempt from probate. With a revocable living trust, the

most common version, you retain the right to change beneficiaries and distribution amounts. Typically, a living trust is viewed as a supplement to — not a replacement for — a basic will.

3. Prenuptial agreement. Generally, a "prenup" executed before marriage defines which assets are characterized as the separate property of one spouse or community property of both spouses upon divorce or death. As such, prenuptial agreements are often used to preserve wealth for the children of a first marriage before an individual enters into a second union. It may also include other directives, such as estate tax elections, that would occur if the marriage dissolved. Be sure to investigate state law concerning the validity of your prenup.

4. Durable power of attorney. As the name implies, this document authorizes another person to legally act on your behalf in the event you're incapacitated or otherwise unable to conduct your own affairs. Be aware

Update plan and policy beneficiaries

Don't be cavalier when you fill out the paperwork for qualified retirement plans, traditional and Roth IRAs, and life insurance policies. Absent any proactive changes, your choices are effectively written into stone. Be aware that the designations for beneficiaries generally trump conflicting provisions of your will. Therefore, if you name an ex-spouse as the primary beneficiary, he or she may be entitled to benefits — even if a revised will names a new spouse as the beneficiary of your estate.

Remember to designate both primary and secondary beneficiaries. If the primary beneficiary dies before you do, the benefits will automatically go to the secondary beneficiary. This can avoid potential hassles later on.

Finally, if you're part of a blended family, review your current beneficiary designations. Depending on your situation, you might reallocate the percentages going to children or grandchildren from a first marriage to accommodate offspring from a second marriage and even decide to include stepchildren and stepgrandchildren as beneficiaries.

that the power may be "broad" or "limited" (for example, restricted to selling or managing personal property such as a home). Because some discretion is involved, it's important for an individual heading up a blended family to choose the attorney-in-fact wisely. This document may be coordinated with health care directives and/or a living will.

5. Marital trust. This type of a trust can be customized to meet the needs of blended families. It can provide income for the surviving spouse and preserve the principal for the deceased spouse's designated beneficiaries, who may be the children of prior relationships. If certain tax elections are made, estate tax that is due at the first death can be postponed until the death of the surviving spouse.

6. Irrevocable life insurance trust (ILIT). Life insurance is often used to provide needed benefits should the main breadwinner suddenly pass away. However, if you retain any "incidents of ownership" in a life insurance policy, such as the right to change beneficiaries, the proceeds will be included in your taxable estate. This result can be avoided by transferring the policy to an ILIT. The trustee, who may be a professional or family member, will follow the directives spelled out by the ILIT.

While you can include a few tweaks for your blended family through a codicil to the will, if the intended changes are substantive you should meet with your estate planning advisor to have a new will prepared.

These are just six estate planning strategies that could prove helpful for blended families. You might use others, or variations on these themes, for your personal situation. Consult with your estate planning advisor before year end to develop a comprehensive plan. •

If it's broken, fix it!

Trusts that no longer achieve their objective can be repaired

When was the last time you reviewed your estate plan? If you answered, "Not in the past few years," it could be out of date. What with changing life circumstances and new tax laws, not to mention potential mistakes made when the plan was first drafted, the trusts used in your estate plan may be "broken." The good news is that there are tools to fix them.

Why trusts "break"

Changing life circumstances are the primary reason a trust may cease to achieve your estate planning objectives. A trust that worked just fine when it was established may no longer achieve its original goals if your family circumstances change. If you divorce, for example, a trust for the benefit of your spouse may no longer be desirable. If your children grow up to be financially independent, they may prefer that you leave your wealth to *their* children. Or perhaps you prefer not to share your wealth with a beneficiary who has developed a drug or alcohol problem or has proven to be financially reckless.

Changes in the estate tax laws may also be a cause. Many trusts were created when gift, estate and generation-skipping transfer (GST) tax exemption amounts were relatively low. Today, however, the exemptions have risen to $5.45 million (in 2016), so trusts designed to minimize gift, estate and GST taxes may no longer be necessary. And with transfer taxes out of the picture, the higher income taxes often associated with these trusts — previously overshadowed by transfer tax concerns — become a more important factor.

Potential errors in your estate plan can wreak havoc on your estate planning objectives. Typical mistakes include naming the wrong beneficiary, omitting a critical clause from the trust document and including a clause that's inconsistent with your intent. These are just a few examples of how you might end up with a trust that fails to achieve your estate planning objectives.

Tools for the fix

If you have one or more trusts in need of repair, you may have several remedies at your disposal, depending on applicable law in the state where you live and, if different, in the state where the trust is located. Potential remedies include:

Reformation. The Uniform Trust Code (UTC), adopted in more than half the states, provides several remedies for broken trusts. Non-UTC states may provide similar remedies. Reformation allows you to ask a court to rewrite a trust's terms to conform with the grantor's intent. This remedy is available if the trust's original terms were based on a legal or factual mistake.

Modification. This remedy may be available, also through court proceedings, if unanticipated circumstances require changes in order to achieve the trust's purposes. Some states permit modification — even if it's inconsistent with the trust's purposes — with the consent of the grantor and all beneficiaries.

Division/consolidation. The UTC also permits a trustee to divide a trust into two or more trusts, or to consolidate two or more trusts, under certain circumstances. For example, if a trust is only partially exempt from GST taxes, it might be appropriate to divide it into two trusts — one fully exempt and one nonexempt — and use the exempt trust to benefit grandchildren or for other generation-skipping gifts.

Relocation. In some cases, it may be possible to fix a broken trust by changing its situs — that is, by moving it to a jurisdiction where the laws are more favorable. The UTC may allow a trustee to relocate a trust to an appropriate jurisdiction if doing so would be in the beneficiaries' best interests.

Decanting. Many states have decanting laws, which allow a trustee, according to his or her distribution powers, to "pour" funds from one trust into another with different terms and even in a different location. Depending on your circumstances and applicable state law, decanting may allow a trustee to correct errors, take advantage of new tax laws or another state's asset protection laws, add or eliminate beneficiaries, extend the trust term, and make other changes, often without court approval.

Federal tax consequences

One risk associated with making changes to a trust — particularly those designed to take advantage of tax benefits — is uncertainty over how the IRS will view these changes. For one thing, state court rulings aren't necessarily binding on the IRS, so the agency may reach its own conclusions about whether a reformation or modification of a trust is effective for federal tax purposes and whether it should apply retroactively.

The importance of specifics

If after reviewing your estate plan you believe your trusts are no longer working as you intended, meet with your estate planning advisor to discuss the appropriate fix. The techniques to modify trusts are complex, and tax law varies depending on your state of residency, so getting the specifics right is important. •

Preparing for a new year

Take time now for a quick estate plan review

Hopefully, you've already made certain estate planning provisions this year to protect the interests of your heirs and minimize potential estate tax liability. But that doesn't mean you're completely in the clear. You can't just fill out the paperwork, lock up the documents in a file cabinet or store them electronically, and forget about it. Consider your estate plan to be a "work in progress."

Reflect life-changing events

Notably, your circumstances could be affected by certain life events that should be reflected in your estate plan. And the plan should be reviewed periodically anyway to ensure that

it still meets your main objectives and is up to date. Although you can examine the plan whenever you choose, the end of the year and the start of a new year is often an opportune time for individuals to take stock of their situations.

What sort of life events might require you to update or modify estate planning documents? The following list isn't all-inclusive by any means, but it can give you a good idea of when changes may be required:

- Your marriage, divorce or remarriage,
- The birth or adoption of a child, grandchild or great-grandchild,
- The death of a spouse or another family member,
- The illness or disability of you, your spouse or another family member,
- When a child or grandchild reaches the age of majority,
- When a child or grandchild has education funding needs,
- The death of the person named as guardian for minor children in your will, your personal representative or trustee of trust,
- Changes in long-term care insurance coverage,
- Taking out a large loan or incurring other debt,
- Sizable changes in the value of assets you own,
- Sale or purchase of a principal residence or second home,
- Significant promotion at work or change in job circumstances,
- Your retirement or retirement of your spouse,
- Receipt of a large gift or inheritance,
- Sale of a business interest, or
- Changes in federal or state income tax or estate tax laws.

As part of your estate plan review, examine the critical components — including the key legal documents incorporated within the plan. A quick perusal might take only 15 minutes or even less.

If you have any minor children, your will should designate a guardian to care for them should you die prematurely, as well as make certain other provisions, such as creating trusts to benefit your children until they reach the age of majority, or perhaps even longer.

Your durable power of attorney authorizes someone to handle your financial affairs decisions if you're disabled or otherwise unable to act. Likewise, a medical durable power of attorney authorizes someone to handle your medical decision making if you're disabled or unable to act. Typically, these powers of attorney are coordinated with a living will and other health care directives. The powers of attorney expire upon your death. A living will spells out your wishes concerning life-sustaining measures in the event of a terminal illness. It says what means should be used, withheld or withdrawn.

Although a letter of instruction isn't legally binding, it can be incredibly useful. The letter may provide an inventory and location of assets; account numbers for securities, retirement plans and IRAs and insurance policies; and a list of professional contacts that can help your heirs after your death. It may also be used to state personal preferences (for example, specifics for funeral arrangements).

Prepare for a new year

Don't put off your estate plan review any longer. Identify the items that should be changed and arrange to have the necessary adjustments made when 2017 arrives. Your estate planning advisor can help. •

ESTATE PLANNING PITFALL

You're donating high-basis stock to charity

As the end of the year fast approaches, you may be thinking about making gifts to qualified charitable organizations as a way to reduce your potential estate and income tax liability while supporting a worthy cause. If you're considering a stock donation, be careful about gifting the "right kind" of stock and not the "wrong kind."

When contributing stock that you've owned for longer than one year, your tax deduction is determined by the stock's fair market value. As a result, if you donate stock with a low basis that you've held for a long time, the appreciation in value remains untaxed forever. Conversely, if you donate stock owned for one year or less (considered a short-term capital gain) you must use your basis — which generally is your initial cost — as the amount of the contribution.

Therefore, all other things being equal, it's smart to donate low-basis long-term stock and hold onto high-basis stock, especially if it's a short-term holding. Suppose, for example, that you bought Stock A years ago for $5,000 and it's now worth $15,000. Also, you

acquired Stock B earlier this year for $10,000 and its current value is $10,500. If you donate Stock B before year end, your deduction is limited to $10,000 (your basis in the stock). However, if you gift Stock A instead, you may deduct $15,000 and never pay tax on the $10,000 in appreciation.

Of course, taxes are only one part of the equation. Nevertheless, efficient use of available tax deductions should be considered.

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Saving for College: GET or 529

The end of the year often means gift-giving, and many families consider saving for a child's future college education. A variety of savings tools are available to save for minors: traditional options include a basic Uniform Transfers to Minors "UTMA" account or creating a trust for the benefit of one or more children or grandchildren, with provisions tailored to encourage educational pursuits. For several years, Washington residents have been able to purchase 529 Plans through other states, or participate in the Guaranteed Education Tuition "GET" Program. The GET program provides the ability to pre-pay towards a college education in any state by purchasing units that can be used to pay for future tuition at public or private colleges and universities. The price of GET units has historically been based on the highest tuition charged at the "priciest" Washington public university. GET unit prices generally increased year to year based on actual increases to tuition and were designed to purchase tuition at today's rate that could be redeemed in the future, when presumably tuition would be higher.

In 2015, the Washington legislature passed the College Affordability Program, which generally lowered tuition at state colleges, tied future tuition increases to average wage growth, and called for Washington to create its own 529 College Savings Plan. Because the College Affordability Program affects assumptions about tuition increases that the GET Program is based on, the GET Program suspended creation of new accounts and most unit purchases for two years to review the Program for feasibility. In September 2016, it was announced that the GET Program will stay open and begin accepting new accounts and unit purchases in 2017.

There are some key differences between GET and 529 accounts: a GET account owner does not choose particular investments; rather, units are purchased at a set price and can be redeemed in the future towards college tuition. A 529 account allows selection of particular investments, which might include mutual funds invested in stocks or bonds, or a combination thereof. A 529 account allows its owner to create a more tailored portfolio of investments suited to a particular risk tolerance and investment style.

Both GET and 529 accounts offer tax-deferred growth to encourage saving for college. Generally, both types of accounts are not taxed on income earned or increases in account value year to year, and withdrawals for qualified education expenses are also generally income tax free to the student beneficiary.

Since a new Washington-specific 529 Plan is forthcoming, current GET account holders may choose to withdraw existing GET funds without program penalties through September 1, 2017, or until 60 days after a new 529 college savings plan opens (whichever is later). Account holders should be aware, however, that federal taxes and penalties may still apply to any account gains if refunds are not deposited into another qualified 529 Plan within 60 days of withdrawal. Be sure to work with your investment advisor to select a college savings option.