The ESTATE PLANNER

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ESTATE PLANNING RED FLAG

You've designated the wrong beneficiary for your life insurance policy

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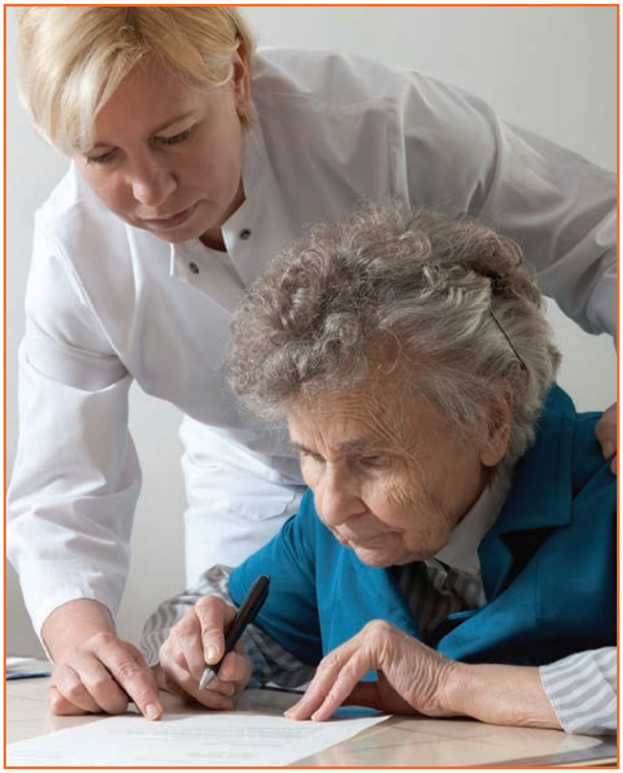
Powers of attorney: Springing vs. nonspringing

Estate planning typically focuses on what happens to your children and your assets when you die. But it's equally important (some might say *more* important) to have a plan for making critical financial and medical decisions if you're unable to make those decisions yourself.

A crucial component of this plan is the power of attorney (POA). A POA appoints a trusted representative to make medical or financial decisions on your behalf in the event an accident or illness renders you unconscious or mentally incapacitated. Without it, your loved ones would have to petition a court for guardianship or conservatorship, a costly process that can delay urgent decisions.

A question that people often struggle with is whether a POA should be springing — that is, effective when certain conditions are met — or nonspringing; that is, effective immediately.



How POAs work

A POA is a document under which you, as "principal," authorize a representative to be your "agent" or "attorney-in-fact," to act on your behalf. Typically, separate POAs are executed for health care and property.

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A POA for health care authorizes your agent — often, a spouse, child or other family member — to make medical decisions on your behalf or consent to or discontinue medical treatment when you're unable to do so. Depending on the state you live in, the document may also be known as a medical power of attorney or health care proxy. Be aware that a POA for health care is distinguishable from a "living will." (See "Make your wishes known with a living will"on page 3.)

A POA for property appoints an agent to manage your investments, pay your bills, file tax returns, continue your practice of making annual charitable and family gifts, and otherwise handle your finances, subject to limitations you establish.

To spring or not to spring

Generally, POAs come in two forms: *nonspringing*, or "durable" — that is, effective immediately — and *springing*; that is, effective on the occurrence of specified conditions. Typically, springing powers take effect when the principal becomes mentally incapacitated, comatose, or otherwise unable to act for himself or herself.

Nonspringing POAs offer several advantages:

- Because they're effective immediately, they allow your agent to act on your behalf for your convenience, not just when you're incapacitated. For example, if you sign a durable POA for property, you might ask your agent to conduct a business or real estate transaction in your place while you're traveling abroad.
- They avoid the need for a determination that you've become incapacitated, which can result in delays, disputes or even litigation. This allows your agents to act quickly in an emergency, making critical medical decisions or handling urgent financial matters without having to wait, for example, for one or more treating physicians to examine you and certify that you're incapacitated.
- They're helpful for elderly principals, who may need assistance in handling their affairs even though they're of sound mind and haven't become incapacitated.

A potential disadvantage to a nonspringing POA — and the main reason some people opt for a springing POA — is the concern that your agent may be tempted to abuse his or her authority or commit fraud. But consider this: If you don't trust your agent enough to give him or her a POA that takes effect immediately, how does delaying its effect until you're deemed incapacitated solve the problem? Arguably, the risk of fraud or abuse is even greater at that time because you're unable to protect yourself.

Given the advantages of a nonspringing POA, and the potential delays associated with a springing POA, it's usually preferable to use a nonspringing POA and to make sure the person you name as agent is someone you trust unconditionally. If you're still uncomfortable handing over a POA that takes effect immediately, consider signing a nonspringing POA but have your attorney or other trusted advisor hold it and deliver it to your agent when needed. This approach gives you peace of mind while still enabling your agent to act quickly when immediate action is required.

Get your plan in place

To ensure that your health care and financial wishes are carried out, prepare and sign POAs as soon as possible and make sure your loved ones know where they are and that they're readily accessible when needed. Health care providers and financial institutions may be reluctant to honor POAs that were executed years or decades earlier, so it's a good idea to sign new documents periodically. ✤

Make your wishes known with a living will

A health care power of attorney appoints a surrogate to make medical decisions on your behalf if you're unable to do so. A living will, also known as an advance medical directive or health care directive, allows you to express your preferences for the use of life-sustaining medical procedures. For example, it might spell out the circumstances under which health care providers should use or withhold CPR, artificial feeding and breathing, surgery, invasive diagnostic tests, or pain medication.

Many people use both documents: a living will to guide health care professionals in making medical decisions in life-or-death situations, and a health care POA that authorizes a surrogate to make any necessary judgment calls.

Watch out for GST taxes

The generation-skipping transfer (GST) tax is one of the harshest in the Internal Revenue Code. It's a flat 40% tax on asset transfers to "skip persons" — that is, your grandchildren, other family members who are more than one generation below you, or nonfamily members who are more than 37½ years younger than you. It's *in addition to* gift and estate taxes, so it can take a significant bite out of your hard-earned wealth.

Fortunately, the estate tax law provides a generous GST tax exemption — currently, $5.43 million (same as the unified gift and estate tax exemption). Careful planning is required, however, to make the most of the exemption. In some cases, in order for an exemption to apply, you must allocate it to particular assets via an affirmative election on a timely filed gift tax return. In other cases, the exemption is allocated automatically (unless you opt out), which can lead to unwanted results if you prefer to allocate your exemption elsewhere.

To avoid costly mistakes, it's a good idea to review each transfer for potential GST tax liability and take steps to ensure that your exemption is allocated in the most advantageous manner.

Taxable transfers

The GST tax applies to direct gifts to a skip person, as well as to two types of transfers involving trusts:

Taxable terminations. Trust assets pass to your grandchildren when your child dies and the trust terminates.

Taxable distributions. Trust income or principal is distributed to a skip person.

GST tax doesn't apply to direct gifts that are covered by the annual gift tax exclusion (currently, $14,000 per recipient; $28,000 for "split" gifts by married couples).

Automatic allocation tax traps

The automatic allocation rules are intended to protect you against inadvertent loss of GST tax exemptions. So, for example, if you make a direct gift in excess of the annual gift tax exclusion to a grandchild or other skip person, your unused GST tax exemption is automatically applied to the gift, without the need to make an allocation on a gift tax return.

The exemption is also allocated automatically to "GST trusts." The rules are complex, but in general a trust is considered a GST trust if there's a possibility it will benefit your grandchildren or other skip persons in the future.

In many cases, the automatic allocation rules work well, ensuring that the GST tax exemption is used where it's needed most. But in some cases the rules lead to unintended — and potentially costly — results. Here are two examples:

Example 1. You set up a trust primarily for the benefit of your children, although your grandchildren are named as contingent beneficiaries. This may be enough to trigger the automatic allocation rules, even if the possibility that your grandchildren will receive any trust assets is remote. Depending on the size of your estate, you may be better off opting out of automatic allocation and directing your exemption to gifts that are more likely to trigger GST taxes.

Example 2. You set up a trust for the benefit of your daughter during her lifetime, with the remainder passing to your grandson. You assume that the trust is a GST trust and that your exemption will automatically be allocated to it. To minimize gift taxes, however, the trust grants your daughter certain withdrawal rights that cause it to not qualify as a GST trust. Unless you allocate your exemption to the trust in a timely filed gift tax return, the transfer to your grandson will be subject to GST taxes.

To avoid costly mistakes, review each transfer for potential GST tax liability and take steps to ensure that your exemption is allocated in the most advantageous manner.

Review your plan

If your estate plan includes gifts, either outright or in trust, to your grandchildren or other skip persons, don't assume that the automatic allocation rules will protect you. Talk to your advisor about strategies for minimizing your GST tax liability. ✤

Retirement ahead?

Choosing the right pension plan payout option requires planning

When Roberta visited her estate planning advisor, she was surprised to hear him talking about retirement strategies. The advisor explained to her that a smart estate plan complements a solid retirement plan in that the more wealth Roberta has when she reaches retirement, the more she'll be able to pass on to loved ones. The key is how well Roberta manages her funds before her death. An important decision to consider is choosing the right pension plan payout option.

Weighing the options

Some defined benefit pension plans give retirees a choice between receiving payouts in the form of a lump sum or an annuity. If you have other sources of retirement income, taking a lump-sum distribution allows you to spend the money as you please. Plus, if you manage and invest the funds wisely, you may be able to achieve better returns than those provided by an annuity.

On the other hand, if you're concerned about the risks associated with investing your pension benefits — or you don't want the responsibility — an annuity offers guaranteed income for life. (Bear in mind that guarantees are subject to the claims-paying ability of the issuing company.)

Choosing an annuity

If you choose to receive your pension benefits in the form of an annuity — or if your plan doesn't

offer a lump-sum option — most plans require you to choose between a single-life or joint-life payout. A single-life annuity provides the plan participant with monthly benefits for life. The joint and survivor option provides a smaller monthly benefit, but the payments continue over the joint lifetimes of both spouses.

Deciding between the two monthly options requires some educated guesswork. To determine the option that will provide the greatest overall financial benefit, you'll need to consider several factors — including your and your spouse's actuarial life expectancies.

It's also important to consider your current financial needs — that is, your expenses and other assets and income sources. Even if you expect a joint and survivor annuity to yield the greatest total benefit over time, you may want to consider a single-life annuity if you need additional liquidity in the short term.

Choosing between the single-life and joint and survivor options can be an uncomfortable decision — essentially, you and your spouse are gambling on each other's lives. And if you bet wrong, the losses can be significant. Suppose, for example, that you have the pension plan, you expect your spouse to outlive you by 10 years and you select the joint and survivor option. If your spouse outlives you by 20 years, he or she will receive a windfall. But if your spouse dies before you — or if you exceed your life expectancy — it may turn out that you would have been better off with the larger monthly benefit offered by the single-life option.

And, unfortunately, you can't change your decision retroactively: Once you select one or the other, you're stuck with it.

The single-life option can be a risk as well. You might choose this option, for example, if you and your spouse have comparable life expectancies or if you expect to live longer. Under those circumstances, the higher monthly payment will maximize your overall benefits. But if you die prematurely, the payments will stop.

If you choose to receive your pension benefits in the form of an annuity — or if your plan doesn't offer a lump-sum option — most plans require you to choose between a single-life or joint-life payout.

Providing spouse a continuing income source

If it's important to provide your spouse with a continuing source of current income, consider combining a single-life pension payout with an insurance policy on your life. Here's how it works: You select the single-life option, locking in a higher monthly payment for life. Next, you purchase a life insurance policy, using some of the higher monthly payment to finance the premiums.

If you die before your spouse, the death benefit provides your spouse with a source of income. If your spouse dies first, you can choose a new beneficiary (a child, for example) or simply cancel or cash in the policy.

Keep in mind that the viability of this strategy depends on whether you qualify for affordable life insurance coverage. So it's a good idea to wait until your application is approved and the policy is issued before you elect a pension payout option.

Making a sound decision

Deciding on the best way to receive your pension plan payout may come down to your family's current financial situation and future income needs. Discuss your options with your advisor. ✤

Estate Planning Red Flag

You've designated the wrong beneficiary for your life insurance policy

Life insurance can be a powerful financial and estate planning tool, but its benefits can be reduced or even eliminated if you designate the wrong beneficiary or fail to change beneficiaries when your circumstances change. Here are some common pitfalls to avoid:

Naming your estate as beneficiary. Doing so subjects life insurance proceeds to unnecessary state inheritance taxes (in many states), exposes the proceeds to your estate's creditors and ensures that the proceeds will go through probate, which may delay payment to your loved ones.

Naming minor children as beneficiaries. Insurance companies won't pay life insurance proceeds directly to minors, which means a court-appointed guardian (who, if you're divorced, could be your former spouse) will manage the funds until your minor-age children reach the age of majority. A better approach is to designate a trust as beneficiary. This allows you to determine who will manage the funds and how they'll be distributed to your children.

Naming your former spouse as beneficiary. It's unlikely that you'd do this intentionally. But if you get divorced and neglect to designate a new beneficiary, this could be the result (even if you've updated your will or trust).

For many people, the best strategy is to establish an irrevocable life insurance trust (ILIT) to purchase and own a life insurance policy, and to designate the ILIT as the policy's beneficiary.

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Carlin Comments
"When Children are Children but Neither Heirs nor Descendants"
By Angela G. Carlin

At common law, when a beneficiary of a will died before the testator, the bequest to the beneficiary lapsed, and the property bequeathed was distributed either as a part of the residue or, if the beneficiary was to receive a part of the residue, as if the decedent died without a will. Revised Code ("RC") 2107.52 (the anti-lapse statute) limited the application of the common law rule by preventing lapsing of bequests (gifts of personal property) or devises (gifts of real property) made to relatives who were dead at the time the will was executed or who died thereafter, but who left issue surviving the testator. The anti-lapse statute applied only to wills.

Although the word "relatives" has a common meaning which includes all persons who are in any way related by consanguinity, the general rule in Ohio, however, is that when used in a will, the word is presumed to be used in a restricted sense meaning relatives or relations who would take the estate as if the testator had no will, in the absence of a contrary intent in the will. The phrase "relative of the testator" included only a consanguineous relationship to the testator and not one of mere affinity, such as a sister-in-law.

Senate Bill 117, effective March 22, 2012, replaced in total the prior version of the anti-lapse statute, and simultaneously added a new statute RC 5808.19 extending identical anti-lapse provisions to trusts. Under new RC 2107.52, unless a contrary intent appears in a will, if a beneficiary fails to survive the testator and is a grandparent, a descendant of a grandparent, or a stepchild of either the testator or the donor of a power of appointment exercised by the testator's will, either of the following applies: (1) if the gift is not in the form of a class gift, and the deceased beneficiary leaves surviving descendants, a substitute gift is created in such surviving descendants; or (2) if the gift is in the form of a class gift, other than a gift to "issue," "descendants," "heirs of the body," "heirs," "next of kin," "relatives," or "family" or a class described by similar language, a substitute gift is created in the surviving descendants of any deceased beneficiary. Each surviving descendant of a deceased beneficiary takes the share to which the deceased beneficiary would have taken had the deceased beneficiary survived the testator. The Ohio Legislature used the term "substitute gift" for the very first time in such amendment to RC 2107.52.

An unanticipated result occurred in the recent case *Castillo v. Ott*, 2015-Ohio-905, that the appellate court in Lucas County applying the new version of the anti-lapse statute affirmed the Probate Court decision (2014 ADV 000470) that the decedent-testator's grandchildren were not entitled to their predeceased father's share under their grandfather's will.

The grandfather's will provided for a gift to be distributed to his "children, share and share alike, absolutely and in fee simple." The testator was survived by the children of the testator's predeceased son, and three surviving children of the testator. The attorney for the testator's estate notified the testator's grandchildren in March 2014 that they would receive no estate distribution under the will because their father's share lapsed upon his death. The grandchildren filed a complaint that they were entitled to their father's one-quarter share under the anti-lapse statute. The executor-son filed a Motion to Dismiss the Complaint under Civil Rule 12(B)(6) which the trial court interpreted as a Motion for Summary Judgment, arguing that the anti-lapse statute was inapplicable because the gift in the will was in the form of a residuary class gift similar in language to the class gifts described in clause (b) of the statute.

The trial court granted the executor-son's Motion to Dismiss, since testator's devise to his "children" was not entitled to the statutory anti-lapse protections under RC 2107.52(B)(2)(b), when such share lapsed upon the predeceased son's death since the class described by "children" is similar in import to the other examples set forth in the new law. Although the statute does not include the word "children," the appellate court analogized that Black's Law Dictionary defines "issue" as "lineal descendants" or "offspring." Further, "descendant" is defined as "one who follows in the bloodline of an ancestor, such as "children" and "grandchildren." Consequently, the appellate court affirmed the trial court decision, that a gift to one's "children" is not entitled to the anti-lapse protections under RC 2107.52(B)(2)(b). While the appellate court recognized the confusion wrought by the Ohio Legislature's omission of the word "children" in describing the class gifts which were not entitled to the anti-lapse protections of the revised statute, the court ruled it need not look beyond the plain language used in such statute.

If you have any questions about this topic, please contact your Weston Hurd lawyer.