A Primer on Wills

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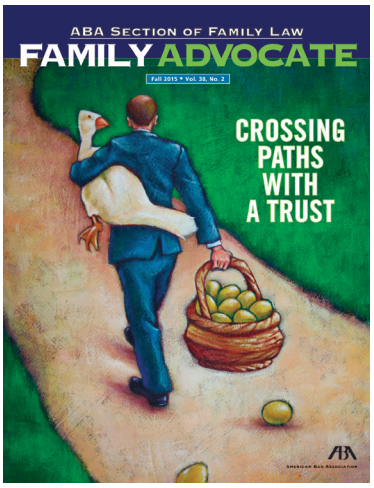

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Following are some basic definitions and explanations of concepts and terms commonly used in planning and drafting wills as part of a client's complete estate plan.

Will Basics

A "will" is a written instrument in which an individual, also called the testator, directs the disposition of his or her property, appoints one or more people to administer its terms, specifies how final debts and taxes should be paid, and sets out additional instructions to be followed after death.

It is important to note that a will does not dispose of all of a person's property, since ownership of some property may pass automatically to other people at death. Such property, as described below, is not subject to the probate process—and should not be included in a will.

- **Joint Ownership:** Where an individual owns property jointly with one or more others, it will usually pass automatically to the joint owners upon the decedent's death. While the specific wording varies depending on state law, the title to such property must usually specify that it is held in "joint tenancy with right of survivorship," or for married couples, "tenancy by the entirety" or "community property with right of survivorship."

- **Payable on Death Designations:** For some types of property, an individual may specify that a new owner take it directly when he or she dies rather than designate ownership in a will or other document. Property that commonly passes this way is in retirement accounts. In some states, individuals also can register their vehicles with a "transfer on death" designation, allowing them to pass directly to the individual named.

- **Trust Property:** Property that a person puts in a living trust or some other trust arrangement also passes according to the trust terms rather than being included in a will.

  Money and other property that passes according to the terms of a will are called "probate assets." "Non-probate assets" are those not subject to the will or the probate process.

Dispositive Provisions

The manner by which a testator may dispose of property under a will varies greatly. For example, a gift or bequest of property may be made "outright," or "in trust," or a combination. In addition, the nature of the bequest may be specific or general, and conditional or unconditional.

- **Outright Gift:** A simple example of an outright gift is:

  "I give and bequeath the sum of $1,000 to John Jones."

  Such a gift is unconditional, unencumbered by trust; when the testator dies, John Jones would receive the sum of $1,000, assuming sufficient funds are in the probate estate to pay the gift.

- **In Trust:** In contrast to the outright gift, a gift in trust disposes of property by giving legal title to the property to a trustee and the equitable title to a named beneficiary. The trustee, or principal, holds the property—which can be tangible, intangible, real, personal, or mixed—according to the testator's directions, and may pay the interest or principal to the beneficiary as a will directs.

  An example of a simple gift in trust is:

  I give and bequeath to my Trustee the sum of $10,000.

  My Trustee shall pay the income to my son, Jim, until he is 21 years old; when my son reaches the age of 21, my Trustee shall pay the principal of the Trust to my son.

  Here, the trustee is made the owner of a $10,000 sum until the testator's son reaches age 21. Until that time, the trustee is obligated to pay the son all income derived from trust property, however, the principal of $10,000 is only delivered to the beneficiary when he reaches the age specified. (Details as to how the trustee may invest the principal are covered in the section on "Fiduciary Provisions," below).

- **Conditional Gifts:** Whether a gift is made outright or in trust, it also may be "conditional." Examples of conditional provisions include:

  - *I give and bequeath to my daughter, Joan, if she is married at the time of my death, 1,000 shares of my AT&T stock.*
  - I give and bequeath to my son, John, the sum of $10,000, provided my estate, for tax purposes, exceeds $100,000.

  In the first example, Joan doesn't get the stock if she is single when her father, the testator, dies. In the second, if the testator's estate contains only $99,000 when he dies, his son John would not receive any part of the $10,000 gift.

- **Specific Bequests:** Specific bequests are gifts of definitely ascertainable property, such as a particular piece of jewelry, a specific antique, enumerated stock certificates and bonds, or a certain parcel of real property. Unless the will specifies otherwise, this class of gifts, pursuant to law, is the last to be applied to the debts of the decedent or taxes of the estate. However, where the decedent no longer owns the specific property at death, or the item is not described sufficiently, then the gift is "adeemed" or lost, and no substitution is made for it.

- **Demonstrative Bequests:** The "demonstrative" legacy is a bequest of a certain sum or security, payable out of a particular fund or account—for example, a bequest of $1,000 payable out of the proceeds of a specific bond and mortgage. If the fund designated is not sufficient to cover the bequest, it may be paid from the general assets of the estate.

- **General Bequests:** This type of bequest is exemplified by a gift of a fractional portion of the testator's estate, or a general class of property in the estate. For example:

  - *I give to my friend Alice one-half of my estate.*
  - *I give my personal belongings to my son, Rafi.*

  The subject of the gift is not particularized in the same manner as the specific bequests discussed above. Where assets of an estate are insufficient to pay the decedent's debts and the estate taxes, the law requires that the general gifts be

applied first to pay such obligations, and where such payments are necessary, the gifts are adeemed to the extent they are reduced. The law further differentiates between personal and real property. General bequests of personal property are adeemed before devises of real property.

- **Marital Bequests:** For federal tax purposes, all bequests made to a surviving spouse are deductible from the testator's adjusted gross estate. For example, if a testator's gross estate is $6,530,000 after deducting administrative and funeral expenses of $100,000, the adjusted gross estate would be $6,430,000. If the testator made a $3,000,000 bequest to a surviving spouse, then the taxable estate would be reduced to $3,430,000.

  The "marital deduction" is one of the most important devices for estate and tax planning. It includes property passing through the will as well as property passing outside it. For a bequest to qualify for the marital deduction, it must meet the technical requirements of the estate tax statutes, however. The marital bequests may be made either outright or in trust. If made via trust, the trust must be drafted to provide that the principal, upon the death of the surviving spouse, may be freely conveyed by the surviving spouse. In most cases, where the estate exceeds the federal exemption amount—$5.43 million in 2015—a qualifying marital bequest is almost an automatic requirement to reduce estate taxes. However, in certain instances where the surviving spouse's estate is equal to or greater than the testator's estate, the marital bequest should be reduced to avoid "double taxes" upon the death of the surviving spouse.

- **Unified Credit or Federal Exemption:** A unified credit offsets gift and estate taxes. An estate tax is imposed on a decedent's estate based on the value of the estate assets, including life insurance. In 2015, the federal exemption amount is $5,430,000, and the lifetime gift amount is the same. The maximum estate tax rate is currently 40%. In addition, about 15 states impose their own estate tax, although most exempt estates up to $1 million. Reducing estate taxes is an imperative part of estate planning for some clients.

- **Residuary Bequests:** The residuary disposition is the remainder of a testator's estate not disposed of elsewhere, either by specific or general bequests. Usually, this provision is the last of the dispositive clauses and is intended to include all property not otherwise disposed of as well as conditional gifts that fail to take effect and legacies that are renounced. The residuary bequest may be made outright or in trust, and in some wills, the residuary bequest is in the form of an extended trust arrangement for survivors.

Fiduciary Provisions

"Fiduciary" is a general term for a person named as an executor, trustee, or guardian in a will or other estate planning document. Fiduciaries may be individuals or banks, one person, or several. Every testator must name an executor, and if the will contains any trust provisions, a trustee. Guardians may be nominated where the testator leaves minor children or those with disabilities, but a court must approve the nomination. In addition to naming the initial fiduciaries, the testator also should name alternates in case the first choice is unable or unwilling to serve.

- **Executor or Personal Representative:** The executor or personal representative is responsible for collecting the estate assets and distributing them as the will directs. Additional duties include filing the will with the local probate or surrogate court, filing federal and state estate tax returns and income tax returns, filing a final

accounting, and settling claims against the estate. The duties may last from several months to several years, depending on the complexity of the estate.

- **Trustee:** A trustee, who has legal title to property in a trust, also has the obligation of investing or distributing it as the will or trust document directs. The trustee must periodically account for trust assets and pay over or apply the interest or profits earned or trust balance to those specified. Oftentimes, a trustee is given discretionary powers by the testator. For example, a gift in trust made to a minor may direct the trustee to pay only the income earned by the trust principal until the minor reaches his state's age of majority, unless the trustee believes it to be in the best interests of that minor to make the payouts differently.

- **Guardian:** A guardian is the person named to take custody of the decedent's minor children, to manage property for the minors, or both. While it is usually best to name one person as guardian of both the person and property, different people are sometimes named. Also, though the person named to take custody in a will is usually given serious consideration, there still must be a court hearing to finalize the choice and ensure the person named is qualified to act. Where the decedent leaves a surviving spouse, that spouse will automatically become the legal guardian unless there are issues of incompetency or other unusual circumstances. It also is a good idea to appoint alternates if the first choice can't act. Extreme care must be taken in naming a guardian, since he or she will act in place of the deceased parent. Some factors to consider are whether the guardian is an appropriate age, has similar views to the testator on education, will be physically able to cope with the duties—and most important: will agree to serve beforehand.

- **Bond:** The law provides that unless the testator makes a contrary provision in the will, each of the fiduciaries named must file a bond and maintain that bond until the court releases them from responsibility. Most wills specify that fiduciaries shall serve without bond, especially where fiduciaries are related or have close personal ties with the testator.

- **Commissions:** Fiduciaries are entitled to receive certain fees and commissions for performing their duties. Statutes specifically provide the method by which such fees and commissions are to be computed. Generally, they are set at a small percentage of the value of the estate, although family members often opt to waive them, and most states provide that the commission received must be "reasonable" for the amount of work involved. Some testators also opt to make a gift under the will in lieu of the statutory commission.

- **Powers:** The manner in which fiduciaries may deal with the assets of the estate and trust principal is set forth in the "powers clause" of a will. The testator may give the fiduciaries very limited powers or empower them to invest in all kinds of securities, to operate the testator's business, and even to handle the assets in their own discretion—and to invade the trust or sprinkle the trust income among named beneficiaries. All fiduciaries are required by law to act in a "prudent and reasonable" manner, however, and to handle the assets for the benefit of the named beneficiaries rather than for self-enrichment.

Declaratory & Explanatory Provisions

In addition to providing directions for how property should be distributed and how debts and taxes should be paid, some wills contain additional directions.

- **Explanatory Provisions:** Such provisions are intended to avoid attempts to contest wills. Examples include suggestions to trustees about when and how the trust principal may be invaded, or explanations for why a particular person—such as a sibling or child—was omitted from the will.

- **Survivorship Clause:** The laws of many states specify that if a testator and beneficiary die at the same time, or under circumstances where it is impossible to ascertain which of them survived the other, the testator will be deemed to have survived the other person. Alternatively, a will may provide that if a beneficiary does not survive the testator for a specific period, then the bequest will pass to another person or organization.

- **Tax Apportionment:** To preserve specific gifts, and to avoid reducing the marital and charitable deductions, some wills specify that estate taxes will not be allocated against them. To the same effect, administration expenses may be allocated among the various assets.

- **Business Continuation:** A will may include declaratory and instructional advice to the fiduciary regarding continuing or winding up a testator's business or carrying out a buy-sell agreement. The testator may also recommend that the executor consult with certain people concerning the sale of a business interest or employ certain people to continue the business.

- **Non-hypothecation:** This refers to will provisions that restrict beneficiaries from selling, assigning, or pledging their interests in the will. The clause serves as a form of insurance that the beneficiary will not squander or dispose of the testator's gift before receiving it, or in the case of a trust, will not discount her interest in the trust principal in advance.

- **In Terrorem Clause:** This provision, more simply called a "no-contest clause," is used in situations where the testator may reasonably expect a beneficiary to contest the will. The provision provides that any person who asserts any other claim against the will, or contests it, shall forfeit all property and interest the will might have bestowed on him or her.

Miscellaneous Definitions

Certain words of art are frequently used in connection with wills. Several of the most common are defined briefly below.

- **Attestation:** The clause in which the witnesses signify they have seen the testator sign the will. Any person who is named to take property in the will should not act as a witness.

- **Bequest:** A gift of personal property.

- **Codicil:** An amendment to a will. A codicil must be executed in the same manner as the original will, and upon the death of a testator, the original will and all codicils are probated together; each must be proved.

- **Corpus:** Synonymous with "principal" when referring to a trust.

- **Crummey Power:** A power held by a beneficiary of a trust to withdraw a representative share from the principal of a trust. This enables the grantor or settlor of the trust to take a corresponding amount of the gift tax annual exclusion.

- **Descendant:** The term describes the issue of a deceased person; it does not apply to children of a living parent.
- **Devise:** A gift of real property.
- **Intestacy:** Defines the situation in which a person dies without making a will, or makes a will that cannot be probated. The assets of such person would be distributed according to the laws of "intestate succession" in the state where he or she lives.
- **Issue:** A person's child or children. Under most state laws, adopted children are included in the definition of "child."
- **Marital Right:** The surviving spouse of a decedent is statutorily entitled to a specific share of a decedent's estate, the amount depending upon the other survivors of the decedent. If the testator does not make sufficient provisions in the will or the nonprobate assets received by the surviving spouse are less than the minimum amount prescribed by statute, then he or she may opt to make an "election against the will" and be entitled to the minimum statutory amount instead of the amount specified in the will.
- **Per Capita:** A system distribution among heirs meaning "by right of number." For example, assume a testator made a gift of $100,000 to two children, a daughter and son, per capita. Also assume that during his lifetime, the son had four children of his own and the daughter had one child, and both the son and daughter predeceased the testator. Under the per capita system, each of the five grandchildren would receive $20,000—that is, $100,000 divided by 5.
- **Per Stirpes:** A system of distribution among heirs, meaning "by right of representation." In the "per capita" example above, the son's four children would each receive $12,500 and the daughter's child would be entitled to $50,000.
- **Sibling:** Brothers and sisters descended from the same parent. Half-brothers and half-sisters of a testator are entitled to share in a testamentary gift to be divided among "brothers" and "sisters."
- **Spouse:** A gift made to a spouse is, by definition, a gift to one who occupies that relationship. Divorce will terminate the bequest unless a will specifies to the contrary.
- **Testamentary:** Arising from or relating to a will. For example, all trusts created under the will are called "testamentary trusts" as differentiated from other types of trusts that may be created during a lifetime. **FA**

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