# INSIGHT ON ESTATE PLANNING

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# Revocable trusts offer benefits, but beware of their drawbacks

There's a good chance that your estate plan includes a revocable trust — sometimes known as a "living trust." This type of trust can help your estate avoid probate, guard your privacy and provide protection in the event you're incapacitated. But that's not to say revocable trusts are without drawbacks.

## What is a revocable trust?

A revocable trust's basic premise is relatively simple. As the grantor, you establish a trust, transfer assets to it (essentially funding it) and name a trustee to handle administrative matters. You can name yourself as trustee or choose a professional to handle the job. Regardless of who you choose, be sure to name a successor trustee who can take over the reins when required.

If you designate yourself as the trust's initial beneficiary, you're entitled to receive income from the trust for your lifetime. You should also designate secondary beneficiaries, such as your spouse and children, who are entitled to receive the remaining assets after the trust terminates.

Notably, you still retain some measure of control over the trust during your lifetime. For instance, you may be able to revise certain terms, change beneficiaries or terminate the trust entirely. Thus, the typical living trust is "revocable." The trust becomes irrevocable upon your death.

## What are the pros?

For many people, the main reason for using a revocable trust — and sometimes the only one that really matters — is that the trust's assets avoid probate. Probate is the process of settling an estate and passing the legal title of ownership of assets to heirs specified in a will. Depending on applicable state law, probate can be costly and time consuming. The process is also open to the public, which can be a major detriment if you treasure your privacy.

However, assets passing through a revocable trust aren't subject to probate. Therefore, you don't have the same concerns with respect to that property. This gives you control over deciding "who gets what" in the family without all the trappings of a will. And, along with the flexibility, it keeps your personal arrangements away from prying eyes.

Furthermore, a revocable trust can sidestep restrictive rules relating to guardianships and conservatorships, an often-overlooked benefit. If the trust is properly structured, beneficiaries will have access to assets without interference from a judge in the event you're incapacitated. Otherwise, a guardianship or conservatorship can drag on longer than the usual probate process.

In addition, a revocable trust may be useful in separating assets for residents of a community property state. It can protect assets acquired before a marriage.

### What are the cons?

A revocable trust can cost you time and money. Assuming you're not proficient enough to handle the details on your own, you'll have to pay a professional to establish the trust. Plus, you'll incur additional fees if, for instance, you have a professional trustee. In fact, a revocable trust may cost more than a will initially, though as long as it works the way it's intended it's generally less expensive in the end.

It can, however, take some work to get the trust up and running. For instance, you may have to contact various financial institutions, insurance companies and transfer agents to facilitate ownership changes in accounts. You may also have to update beneficiaries, issue new stock certificates, revise business interests, sign and record real estate deeds, and retitle cars and other property.

Unfortunately, revocable trusts don't offer much protection from creditors. Because you retain ownership rights in the trust property, the assets are exposed to creditor claims, unlike an irrevocable trust. (See "What's the difference between revocable and irrevocable trusts?" at right).

## What's the difference between revocable and irrevocable trusts?

There's a basic distinction between revocable and irrevocable trusts. With a revocable trust, you retain the right to revise the trust's terms, including removing or adding beneficiaries and restricting management of the trust assets. This provides you with flexibility even though the assets have been transferred to the trust.

An irrevocable trust has the opposite effect. The trust's terms cannot be changed after the trust has been drafted. However, the assets you transfer to an irrevocable trust are protected from creditors and removed from your taxable estate. Thus, unlike revocable trusts, irrevocable trusts offer tax benefits. Consider the differences and weigh your options.

Finally, despite a common misconception, revocable living trusts don't provide any direct tax benefits. The assets are included in your taxable estate and dispositions of trust property can result in tax liability. You must report the income tax that's due, including capital gains on sales of assets, on your personal tax return.

### Weighing the benefits

You can't rely on a revocable trust to solve all your estate planning problems. Nor should it be viewed as a one-step alternative to having a will. Nevertheless, the pros discussed above may outweigh the cons — and often do — for your personal situation. Practical advice: Consult with your estate planning advisor to determine if a revocable trust is right for your plan. •

# Long-term care expenses can destroy your estate plan: Plan accordingly

Estate planning is about much more than reducing taxes; it's about ensuring your loved ones are provided for after you're gone and that your assets are passed on according to your wishes. However, few events can upend your estate plan as the way unanticipated long-term care (LTC) expenses can.

LTC expenses generally aren't covered by traditional health insurance policies, Social Security or Medicare. Thus, to preserve as much wealth as possible to pass on to your family, it's critical to form a plan to fund any LTC expenses.

## Paying out-of-pocket

If your nest egg is large enough, it may be possible to pay for LTC expenses out-of-pocket as (or if) they're incurred. An advantage of this approach is that you'll avoid the high cost of LTC insurance premiums. In addition, if you're fortunate enough to avoid the need for LTC, you'll enjoy a savings windfall that you can use for yourself or your family. The risk, of course, is that your LTC expenses will be significantly larger than anticipated, eroding the funds available to your heirs.

Any type of asset or investment can be used to self-fund LTC expenses, including savings accounts, pension or other retirement funds, stocks, bonds, mutual funds, or annuities. Another option is to tap the equity in your home by selling it, taking out a home equity loan or line of credit, or obtaining a reverse mortgage.

Two vehicles that are particularly effective for funding LTC expenses are Roth IRAs and Health Savings Accounts (HSAs). Roth IRAs aren't subject to minimum distribution requirements, so you can let the funds grow tax-free until they're needed. And an HSA, coupled with a high-deductible health insurance plan, allows you to invest pretax dollars that can be withdrawn tax-free to pay for qualified unreimbursed medical expenses, including LTC. Unused funds may be carried over from year to year, making an HSA a powerful savings vehicle.

## Buying LTC insurance

LTC insurance policies — which are expensive — cover LTC services that traditional health insurance policies typically don't cover. Determining when to purchase such a policy can be a challenge. The younger you are, the lower the premiums, but you'll be paying for insurance coverage during a time that you're not likely to need it.

Although the right time for you depends on your health, family medical history and other factors, many people purchase these policies in their early to mid-60s. Keep in mind that once you reach your mid-70s, LTC coverage may no longer be available to you.

In evaluating LTC insurance, be sure to find out whether your employer offers a less costly group LTC policy.

Be sure to also consider hybrid insurance policies. They combine LTC coverage with traditional life insurance. Often, these take the form of a permanent life insurance policy with an LTC rider that provides for tax-free accelerated

death benefits in the event of certain diagnoses or medical conditions.

These policies can have advantages over stand-alone LTC policies, such as less stringent underwriting requirements and guaranteed premiums that won't increase over time. The downside, of course, is that to the extent you use the LTC benefits, the death benefit available to your heirs will be reduced.

### Understanding available tax benefits

Be aware that there are tax benefits available that can help offset some LTC expenses. If you self-fund the cost of your LTC, your out-of-pocket expenses generally will be deductible as medical expenses, but only if you itemize deductions on your tax return. Medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income (AGI).

If you purchase LTC insurance, any benefits you receive will not be taxable. In addition, if the policy is "tax qualified," you'll be entitled to deduct a portion of your premiums.

A tax-qualified policy is one that's guaranteed renewable and noncancelable regardless of health, doesn't condition eligibility on prior hospitalization and doesn't exclude coverage based on a diagnosis of Alzheimer's disease or dementia. The policy must also meet certain other requirements.

Keep in mind that LTC premiums are treated as medical expenses, which are deductible only to the extent they total more than 7.5% of your AGI and only if you itemize. Also, be aware that tax-qualified policies may have higher premiums and stricter eligibility requirements than nonqualified policies, so weigh the advantages of tax deductibility against the potential disadvantages of a qualified policy.

### Turn to your advisor

While no one wants to contemplate the need for LTC, it's good to know that there are several potential strategies for funding the associated expenses. Your advisor can help you find which option is best for you and your family. •

# Charitably inclined?

## Consider pairing a donor-advised fund with your estate plan

If charitable giving is high on your objectives list for your estate plan, one option to consider is using a donor-advised fund (DAF). Indeed, DAFs have been steadily growing in popularity in recent years.

According to the *2023 Donor-Advised Fund Report*, the value of DAF grants made to qualified charitable organizations increased 9% in 2023, to $52.16 billion. The number of accounts increased 2.9%, approaching 2 million. What's the main attraction? Among

other things, a DAF can give you greater control over your charitable endeavors than direct donations.

## ABCs of DAFs

A DAF generally requires an initial contribution of at least $5,000. It's typically managed by a financial institution or an independent sponsoring organization, which in return charges an administrative fee based on a percentage of the deposit.

You instruct the DAF how to distribute contributions to the charities of your choice. While deciding which charities to support, your contributions are invested and potentially grow within the account. Then, the charitable organizations you choose are vetted to ensure that they're qualified to accept DAF funds. Finally, the checks are cut and distributed to the charities.

Normally, contributions to a DAF are made in cash or cash-equivalents. However, depending on the fund, you might also be able to contribute property, such as securities or even real estate in some cases.

## DAF benefits

For starters, using a DAF is relatively easy. With all the administrative work and logistics handled for you, you simply make contributions to the fund. It may be possible to transfer securities directly from your bank account.

The contributions you make to the DAF generally are tax deductible. Therefore, if you itemize deductions on your tax return instead of taking the standard deduction, the gifts can offset your current income tax liability. Contributions can be deducted in the tax year in which you make them, rather than waiting until the fund distributes them.

*Normally, contributions to a DAF are made in cash or cash-equivalents.*

For monetary contributions, you can write off the full amount, up to 60% of your adjusted gross income (AGI) in 2024. Any excess is carried over for five years. For a gift of appreciated property, the donation is equal to the property's fair market value if you've owned the asset for longer than one year, up to 30% of AGI. Any excess is carried over for five years. Otherwise, the deduction for property is limited to your adjusted basis (often your initial cost).

If you prefer, distributions can be made to charities on an anonymous basis. Alternatively, you can name the fund after your family. In either event, DAFs may be created through your will, providing a lasting legacy.

## DAF drawbacks

Even so, DAFs have their drawbacks. Despite some misconceptions, you don't have control over how the charities use the money after it's disbursed from the DAF.

Also, you can't personally benefit from your DAF. For instance, you can't direct that the money should be used to buy tickets to a local fundraiser you want to support. Lastly, detractors have complained about the administrative fees.

### The choice is yours

Does a DAF make sense for your situation? If you're charitably inclined, a DAF may be the right choice. Rely on your estate planning advisor to provide the guidance you need. •

## ESTATE PLANNING PITFALL

# You've failed to properly amend your will

Suppose you want to make a change to your will. It could be something relatively minor, such as a beneficiary is getting married and will be changing her last name. Or your daughter graduated from college and you want to name her as a successor executor.

In these circumstances, do you have to completely rewrite your will? Not usually. For these "quick fixes" you can ask your attorney to draft and execute a codicil. A codicil is a legal document that's typically short — it can even be one or two paragraphs long — spelling out the changes. But be careful to observe all your state's laws about amending a will.

You may have heard stories about codicils being written on the back of an envelope or have seen this happen on TV or in the movies. And it's true that a codicil doesn't have to be written on an attorney's stationery to be legally binding. But there's more.

Notably, a codicil must be signed and witnessed as required under the appropriate state law. Most important, the codicil should refer to the original will and the date of its creation. Without this reference, it can be confusing as to whether the codicil is binding.

Although a codicil may be stored with a will, and it's probably most convenient to do so, it's not required. However, it shouldn't be stapled or attached to the will in any way. This is a separate document that stands on its own.

In a worst-case scenario, a family member may challenge a codicil after you're gone. Thus, it's important to comply with all the rules.

What if you want to make major revisions to your will, such as changes in beneficiaries or the disposition of assets? In that case, a codicil won't suffice. Consult with your attorney and draft a new will.

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